CHAPTER: I
INTRODUCTION

1.1 INTRODUCTION

1.1 STATEMENT OF THE PROBLEM

As late as 1991-92, the profitability was a forbidden word. The banks were established to fulfill social objectives and their performance was rated from their ‘task fulfillment’ initiatives rather than from their commercial successes. Lending to priority sectors, opening up of rural branches, achievements in the implementation of the Government sponsored schemes and generally toeing the line in adherence to the policies and programmes of the Government were the parameters considered for judging the performance of a bank. No one gave thought to the actual state of the affairs in many banks, which was dismal with huge unrealizable debts, many unviable branches, inert staff, an unsustainable manpower and very ineffective customer service.

The increasing scope of bank activities, the range of services offered by banks, the continuous technological change, impact of globalization and liberalization, entry of both domestic and foreign government controlled and regulated environment, all have redefined the business of banking. The business of banks has transformed from the traditional banking to the societal and developmental banking, from brick or mortal banking to ‘anywhere and anytime banking’. The process of integration of domestic and international banking that began in 1991 has thrown domestic commercial banks of India to the competitive environment. The banking sector, which constitutes the core of the financial sector, plays a critical role in transmitting monetary impulses to the entire economic growth. Its efficiency and development therefore, are vital for enhancing growth and improving the chances of price stability.

In the context of developing economy, some economic institutions would deserve a sustained study and analysis. Undoubtedly, a developed banking system holds the key as well as serves as a barometer of economic health. The development
of an economy depends on how efficiently its financial sector performs and banks constitute a major part of this financial sector.

1.2 INDIAN BANKING IN BRIEF

Banks play a positive role in the process of economic development of a country; they are the repositories of the community's savings and the purveyor of credit. Indian banking has boosted the economic development during the last more than six decades in an effective way. It has shown remarkable responsiveness to the needs of the planned economy. It has brought about a considerable progress in the efforts in respect of deposit mobilization and has taken a number of measures in the recent past for accelerating the pace of growth of deposits. Under the lead bank scheme in each district a lead bank undertakes the responsibility of ensuring the geographical spread of bank branches all over the country. The underlying rationale was to see no part of the country remained unbanked and everybody should have access to the banking facilities. The commercial viability of the branch was never an issue. The commercial banks have opened a number of branches in urban, semi-urban and rural areas and introduced a number of attractive schemes and free services to the customers to attract more deposits. The tremendous expansion of the bank branches especially in the rural areas coupled with a drastic reduction in population served per bank branch, and an increase in deposits and credit per office demonstrated that since nationalisation the banks are playing a catalytic role in the development of every nook and corner of the country. The percentage of rural branches to total branches has gone up significantly from 22.2% in June 1969 to 58.5% in March 1991. The semi-urban and rural overage when taken together accounted for 76.9% in March 1991 against 62.2% in June 1969. Since nationalisation there has been a spectacular rise in the volume of deposits that was Rs. 4666 crore in Jun 1969 rose to Rs. 219539 crore in March 1991 amounting to almost 42 times’ increase. The deposits in the rural areas increase both in absolute and relative term from 3.1% (Rs. 145 crores) in June 1969 to 15.1% (Rs. 33166 crores) in March 1991. Since nationalisation the credit deployment has increased in absolute terms; however, there has been a significant change in the direction of flow of credit. The share of rural areas credit has increased from just 1.5% (Rs. 54 crores) in June 1969 to 14.7% (Rs. 19688 crores) in March 1991.
The banks have to perform their intermediary function in the way that the transaction cost is kept to the minimum. Till seventies the banks were operating under the shield of government protection. But with the liberalisation of Indian economy, there was increase in number of new financial market players. Now the banks have to earn high spread to cover their high operating cost. On the other hand, the tremendous growth in information technology has increased the competitive environment by promoting growth of non-bank financial companies. They have started attracting the bank clientele by better and improved services.

The change in interest rate policy has also facilitated the competitive environment. The banks have been given freedom to decide the prices of their products. To compete with the non–banking finance companies the banks have started looking for the fee based business. In this way, the banks have been forced to pay much attention on productivity so that their transaction cost remained at the minimum. In order to improve their productivity, the banks have to look at their organizational structure, human resource development, customer satisfaction, automation and computerization, non-fund business etc. The Reserve Bank of India constituted a committee in April 1990 to examine the question of cost control, operational efficiency and bank profitability. The committee, in its report made a number of recommendations on these aspects. It is of the view that the banks should exercise maximum economy in their operations so as to keep overheads and establishment expenses to the minimum and undertake continual review of the costs of various activities so that effective measures could be taken to bring down the costs wherever possible.

1.2 MEANING AND NATURE OF BANK

Despite unanimity about the significant roles of the bank in the economic development, opinions are divided regarding the exact meaning.

1.2.1 Dictionary Meaning of “Bank”

The oxford dictionary defines a bank as an establishment for the custody of the money which it pays out on a customer order. It has emphasized the deposit taking and payment making functions of a bank to the total exclusion of its money creation role. Hence, this meaning is not very precise of the exact nature of a bank.
1.2.2 Legal Meaning of “Bank”

The Banking Companies Act 1949 has defined a bank as one who, for the purpose of lending or investments accepts deposits of money from public, repayable on demand or otherwise. This definition suffers from the same limitation as the dictionary meaning.

1.2.3. Etymological Meaning of “Bank”

The word bank can be traced to the Italian word ‘banco’, and the French word ‘banque’ meaning bench and chest respectively. These words sum up the two basic functions that commercial banks perform. The word ‘banco’ suggest a table, a counter or a place transacting business. With reference to a bank, these benches consist of a tellers’ window, a loan officer’s desk, a bank manager’s cabin desk and so on. These benches provide the customers a medium to approach the bank for conducting the banking transactions. Chest is a place where valuables are kept; it denotes the safe keeping function. A modern bank’s chest is its portfolio of earning assets. These are the life blood of a bank. Viewed thus two basic functions of commercial banks consist of:

(a) furnishing a place for transacting business in money, and

(b) Providing safe keeping functions.

1.2.4. Bank as a Departmental Store of Finance

The concept of bank may be defined in the sense of a departmental store of finance. The nature of financial services provided by the bank is dependent on the size of the assets. Large bank can afford to provide more, though not necessarily better financial services. Some of these financial services are acceptance of deposits, collection of cheques, loans and advances, certificates of deposits, credit cards, trust services, foreign exchange transactions.

1.2.5. Commercial Bank

A commercial bank is a financial intermediary which accepts deposits of money from the public and lends them with a view to make profits. A post office may accept deposits but it cannot be called a bank as it does not perform the
otheressentialfunction i.e. of lending money. Similarly, some other institutions like Unit Trust of India may be licensing to others but since they do not accept chequable deposits, they cannot be termed as banks. They are Non-banking financial institutions

Lester V. Chandler, the great Economist and a monetary Expert has found fault with the very term ‘commercial bank’. He considers that the term is not adequately descriptive of the true nature of banking as may be evident from the followings:

(i) The term ‘commercial bank’ fails to size up the true scope of bank’s activities. In the initial stages, the banks confined their activities to lending to merchants and traders for short periods. With the passage of time, there has been a tremendous increase in the volume and variety of their activities. Now-a-days they not only finance trade and industry, but also lend to customers and government besides undertaking long-term investment.

(ii) The term does not highlight bank’s unique role as a creator of deposit money. Unmistakably, it is the banks alone that have the power to create money.

(iii) The term fails to signify that banks perform a variety of roles and lending is just one of them.

However, Chandler failed to suggest a suitable word as could incorporate the unique characteristics indicated by him.

1.3. FUNCTIONS OF A BANK

Since banking involves dealing directly with money, the government in most countries regulates this sector rather stringently. In India, the regulation traditionally had been very strict and in the opinion of certain quarters, is responsible for the condition of the banks, where NPAs are of a very high order. The process of financial reforms which started in 1991 has cleared the cobwebs somewhat but a lot remains to be done. The multiplicity of policy and regulations under which a Bank has to work makes its operations even more complicated.

The Banking Regulations Act of India,1949 defines banking as “accepting for the purpose of lending or investment of deposits of money from the public, repayable
on demand or otherwise and withdrawal by cheques draft, order or otherwise”. Following are the functions essentially performed by banks:

1.3.1. Accepting Deposits

It is one of the two major activities of a bank. Banks are also called custodians of public money. Basically, the money is accepted as deposit for safekeeping. But since the banks use this money to earn interest from people who need money, banks share a part of this interest with the depositors. However, accepting deposits and keeping track of the money involves a lot of book-keeping and other operations. The Bank needs to maintain the followings to provide this service:

(i) An effective branch network to reach the targeted customer base.
(ii) A system of intra-branch accounting with separate account for each
(iii) A system of reconciliation at the end of the day
(iv) Availability of adequate funds at each branch
(v) Trained staff for effective customer service
(vi) Infra structural inputs like space, stationary, comfortable environment etc.

1.3.2. Lending Money to the Public

Lending money is one of the two major activities of any bank. In a way, the Bank acts as an intermediary between the people who have the money to lend and those who need the money to carry out business transactions. This activity places its own requirements on the resources of the bank. For effective functioning of this, a bank must possess

(i) Sufficient deposit
(ii) Skills to appraise the potential borrowers and the activity.
(iii) Legal skills for documentation
(iv) Legal skills for recovery of its dues through the courts
(v) Skills to follow up and monitor the end use of money lent by it.
(vi) An effective credit delivery system
(vii) Review of credit portfolio
1.3.3. Transfer of Money

Apart from accepting and lending money, banks also carry out on behalf of their customers the act of transfer of money—both domestic and foreign—from one place to another. This activity is known as “remittance business”. Banks issue Demand Drafts for transferring the money. Banks also have the facility of quick transfer of money known as Telegraphic Transfer/RTGS. To deliver this service, a bank has to maintain the followings:

(i) Effective branch network or correspondent relationships
(ii) A system of inter branch reconciliation with the correspondents
(iii) A system of reconciliation with the correspondent
(iv) Availability of funds at all the centres

1.3.4. Trustee Business

Banks also act as trustees for various business purposes. For example, whenever a company wishes to issue secured debentures, it has to obtain a financial intermediary as trustee who takes charge of the security for the debenture and looks the interests of the debenture holders. Such entity necessarily has to have expertise in financial matters and also be of sufficient standing in the market/society to generate confidence in the minds of potential subscribers to the debenture. While Banks are the natural choice for the customers, banks possess the following to be effective and retain that.

(i) A track record of sufficient length
(ii) Facilities for safekeeping
(iii) Legal skills to take necessary steps for the trusteeship

1.3.5. Safe-keeping

Bankers are in the business of providing security to the money and valuables of the general public. While security of money is taken care of through offering various types of deposit schemes, security of valuables is provided through making secured space available to general public for keeping these valuables. These spaces are available in the shape of lockers. The lockers are small compartments with dual
locking facility built into strong cupboards. These are stored in the bank’s strong
room and are fully secured. Lockers can neither be opened by the hirer nor by the
bank individually. Both must come together and use their respective keys to open the
locker. To make this facility available to its customers the bank provides

(i) Physical structures to house the lockers
(ii) Locker cabinets
(iii) Security arrangements
(iv) Record of access to lockers

1.3.6. Government Business

Earlier, the government business used to be exclusively carried out by the
government treasuries where all types of transactions took place. However, now
Banks act on behalf of the government to accept its tax and non-tax receipts. Most of
the government disbursements like pension payments and tax refunds also take place
through banks. While the banks carry out this business for a fee to be paid by the
government, providing this service require a lot of effort.

1.4 ROLE OF BANKS

Banks are the life blood of a modern economy. Their role comes into
prominence when on the one hand, they help in mobilizing the nations’ saving and on
the other, and they channelize these savings into high investment priorities.

The operations of banks record the economic pulse of a country. The banks set
the tempo of aggregate economic activity in an economy. Besides performing
traditional functions like deposit mobilization and advances, banks perform various
developmental functions. In developing countries like ours, commercial banks help in
accelerating the pace of capital formation by generating the savings of masses through
widely spread network of branches. Their function of credit also stimulates the
economic growth. Banks guide the flow of community resources towards productive
channels.

The banking system’s contribution for the industrialization of Indian economy
is very significant. It has worked in close connection with the term lending institutions
such as the industrial credit investment corporation of India. This helped in successful implementation of the scheme for rehabilitation of sick industrial units, although the profitability of banks declined.

Banks provide resources to government for creating infrastructure facilities which are necessary for the development of both industry and agriculture. Banks provide two types of employment to society:

(i) Direct employment in banks, and
(ii) Indirect employment by financing various project schemes.
(iii) Banks also contribute in improving country’s balance of payment position by promoting exports and encouraging inward foreign remittances. This enables the country to meet its increasingly higher development needs.
(iv) Banks also help in the fulfillment of social objectives. The commercial banks are required to finance destinations specified by the Government. These areas are termed as priority sector. Banks, thus, help in promoting economic growth with social justice.

All these functions can be performed more efficiently if the banks are productivity conscious.

1.4.1 Role of Commercial Banks

Commercial banks play an important role in the development process of the developing economies. By offering attractive saving schemes and ensuring safety of deposits, commercial banks encourage willingness to save among the people. By reaching out to people in rural areas they help convert idle savings into effective ones. Commercial banks improve the allocation of resources by lending money to priority sectors of the economy. These banks provide a meeting ground for the savers as well as the investors.

1.5. REVIEW OF EXISTING LITERATURE

Banking research in India is not very old. The credit for starting banking research in India goes to the RBI when it established the Economic department in the
year 1945. Then in the fifties, the RBI established the Division of Banking Research. But banking research work gained momentum only after the annual conference of the PSBs’ Economists in seventies. Over the past two decades, substantial research by financial economists in Government and Academia from all over the world has gone into evaluating the efficiency of financial institutions including commercial banks, highlighting the importance and greater frequency of this research in recent years. In what follows is presented a brief review of some of these studies published during the period 1990-2011:

1. A.A. Reddy (2006) examined total factor productivity scale and technical efficiency changes in regional rural banks by using DEA and Malmquist index from 192 banks for the period 1996 to 2002. He found that the technical efficiency of rural banks is higher in service provision than in the parent public sector banks. The efficiency of rural banks is higher in economically and socially developed regions as well as in low banking density regions. Rural banks show significant economies of scale in terms of assets and number of branches under each bank. Total factor productivity growth of rural banks was higher in profitability than service provision during the liberalisation period. Banks located in economically developed as well as low banking density regions exhibited significantly higher productivity growth. Overall there was a convergence of efficiency of rural banks during the study period. There is no influence of parent PSBs on the efficiency and productivity growth of rural banks. The decomposition of productivity into technical change growth and technical progress indicated that technical efficiency change contributed more to productivity growth than technical progress in both rural and parent PSBs, however, comparatively contribution of technical progress is higher for rural banks than parent PSBs.

2. Ahmed (2009) concluded that Indian banking has huge quantum of NPAs and the effective management of NPAs is essential to speed up the growth of profitability of public sector banks.

3. Ajit (1997) in his paper examined the issue of para banking activities and suggested that banks should be allowed to undertake these activities, and use capital on the basis of experiences of other countries like U S A.
4. Amandeep (1993) in her work evaluated the economic performance of banks, and profits and profitability of nationalised banks. The study analysed the factors/variables that influence the profitability of banks and suggested that in order to improve the banks’ profitability, the banks need to focus attention on the management of spread, burden, establishment expenses, other income and deposit composition. The study observed that priority sector lending and rural banking do not have an adverse effect on the bank profitability to a significant extent. Hence, advances to the priority sector and opening of rural branches may be extended in the larger interests of the society.

5. Antony and M (2007) has made an attempt to design a model for pricing loans in the backdrop of Basel 2nd guidelines. Accordingly, interest rate for a loan is to be fixed as a sum of percentage costs, percentage risk premium and percentage of economic value added. The risk premium is the computation of the expected loss premium and unexpected loss premium depends on the value of profitability of default and loss given default and their values have to be arrived at based on past data. Expected loss is completed as the product of profitability of default and loss given default. Unexpected loss is computed as the product of weighted average cost of capital and economic capital required for the loan. To compute economic capital the IRB risk weight models of Basel 2nd are used.

6. Banmali (2001) suggested a dispassionate and unprejudiced approach to weed out NPAs. A broad based and multi-pronged attack to the problem is necessary involving all staff members right from grass root level to the controlling points.


8. Berger (1995) has shown the relationship between the capital and earnings of banks. It was shown in the study that there is strong and significant positive relationship between capital-asset ratio and returns on equity.

9. Bhatia (2007) found that the amount of NPAs has been on a continuous increase and had reached an alarming 6% in 2006 which was much higher than the 4% benchmark of Citi Financial.
10. Bhaumik and Piesse (2004) used bank-level data from India, for six years (1995-96 to 2000-01), and showed that while foreign banks have high credit-deposit ratios, the domestic banks experienced much greater improvements in technical efficiency in the context of credit. The most significant improvements in technical efficiency were registered by the domestic banks. They also found that there was weak evidence that foreign banks may be bullish only with respect to blue chip borrowers. Together with recent literature on the Indian banking system, these results emphasized the dominance of competition rather than changes in ownership-mix as a policy objective for banks in an emerging market economy.

11. Boovendran K. (1993) examined how the transition phase from a high CLR/SLR regime to a lower one can be used to simplify the laws related to the maintenance of CRR/SLR. The study also suggested that the liberalisation of the economy would be more meaningful if the complex rules and regulations are simplified.

12. The Chartered Financial Analyst (1997) conducted a study to evaluate performance of 90 commercial banks for the year 1997 by taking parameters of productivity, profitability and operational ratios. The banks were ranked on the basis of actual values for each parameter. The scores were then weighed by the weight allocated to that parameter. Then the weight scores of each parameter were added up to determine the score for each group of ratios. The key parameters considered were: net worth, net profits, total deposits, total advances, total borrowings, total investments and total working funds. The operational ratios were credit/deposit ratio, unsecured advances/total advances, total debt/net worth, Operating expenses to total expenses, operating expenses/working funds, net profit/working funds, and net profit/net worth. The productivity ratios considered were: Operating expenses per branch, net profits per branch, advances per branch, and employees per branch. The results showed that in case of overall ranking, The State Bank of India stood at rank NO. 1 followed by the Bank of Baroda, and Bank of India which were at Number 2 and 3 ranks respectively. Among the private sector banks, the Vysas Bank stood first with overall rank 18, the Federal Bank at No 2 with the overall rank of 28 and the Bank of Rajasthan was at 3rd position with overall rank of
31. The citi Bank was at top position among the foreign banks with the overall ranking of 7 followed by ANZ Grindlays and the Hongkong Bank. The State Bank of Saurashtra appeared at the last position with the overall rank of 41 among PSBs. If PSBs were gigantic, the private sector banks were fleet footed and foreign banks were technology savvy.

13. C. HariVithalRao (1999) highlighted the importance of recovery of NPAs in the study ‘NPA Recovery Made Easy’ and stated that unless the banks curb the NPA menace with an iron hand, the banking industry itself will become the biggest NPA.

14. Das (1997) examined the efficiency of PSBs since nationalisation by using longitudinal data. The data considered were related to the years 1969, 1970, 1984, 1990, and 1996. The two outputs considered were: the spread and commission, the exchange and brokerage. The two inputs were: deposits and the loanable funds. A non-parametric approach was used to calculate the overall, technical, allocative, pure technical and scale efficiency. The State Bank Group was more efficient than the nationalised banks. The main source of inefficiency was technical in nature rather than allocative. Inefficiency in PSBs was due to wasting or underutilization of resources. The PSBs improved their allocative efficiency significantly in the post nationalisation era. He found that the PSBs in 1996 had scope of producing 1.3 times as much output from the same inputs. He concluded that the deregulation was not the only change required to affect the efficiency of a bank. There are many other factors in the economy which influence and shape the performance of a bank favorably or unfavorably depending on the bank’s risk exposure.

15. Das (2002) analysed the level of risk and productivity of public sector banks and observed interrelationship of the fact that the productivity, capital base and risk taking attitude to be jointly determined and reinforced.

16. Das, Ray and Nag (2005) used Data Envelopment Analysis to measure labour use efficiency of individual branches of a large public sector bank with several thousand branches across India. They found considerable variation in the average levels of efficiency across the four metropolitan regions considered in this study. In this context, they introduced the concept of area or spatial
efficiency for each region relative to the nation as a whole. Their findings suggested that the policies, procedures, and incentives handed down from the corporate level cannot fully neutralize the influence of the local work culture in the different regions. Most of the potential reduction in labour cost appears to be coming from possible downsizing the clerical and subordinate staff. Their analysis identified branches that operate at very low levels of efficiency and may be gainfully merged with other branches wherever possible.

17. Goiporia (1992) made a general review of the profitability of banks and maintained that for adequate flow, the following priorities will have to be observed by the banks (a) lending operations have to be directed to areas which would maximize profitability and growth (b) non-find based operation should be promoted and (c) charging fees for bank services should be determined after taking into consideration the cost and benefit of services offered.

18. Gupta (2004) observed that amongst the seven parameters, NPAs are the most important variable that affects the performance of any financial corporation.

19. Hartough(1994) studied the implications of bankers action plan for profitable small business portfolio. He suggested that considering customer’s payment history and market condition etc., bank should make advance to most attractive and growth potential units.

20. Hugar (1998) analyzing first phase of reforms found that with the introduction of reform packages, banks have improved their profitability, stated cleaning their balance sheets, improved the NPA position, but they are yet to give more focus on rationalizing cost structure.

21. Jain Alokkumar (1993) in his work studied various aspects of bank marketing and suggested the areas where weaker and undeveloped sections needed support. He focused on the specific expectations on various types of banking customers and highlighted specific points for banker-customer relationship. He also pointed out that disparities in branch expansion and credit deployment should be reduced.
22. Jones, Williams, Thorat & Thorat (2004) argued that discussions on banking reforms to reduce financial exclusion have referred little to possible attitudinal constraints, on the part of staff at both branch and institutional levels, inhibiting the provision of financial services to the poor. For this purpose, behavior and attitude of rural bank branch managers, including personal background, professional background and workplace has been examined for the time period of May 2001 to April 2002 using both quantitative and qualitative analysis. They concluded that bank reforms to address human resource management, the work environment, intermediate bank management and organization, and the client interface are much more required than financial reforms.

23. Joshi P. N. & Khan S. H. (2000) highlighted the various reasons of NPAs in banking in the article ‘NPAs: How do we tackle them’ and suggested various strategies for reducing NPAs such as revamping of organisation and management, overhauling of legal reforms and establishment of ARCs.

24. KalyanDebnath (1994) conducted a study on ‘Managing Non-Performing Assets: A Professional approach for better Asset Management’. The banks need to coin a new slogan- “Manage Credit or Perish”.


26. Kohli, (2001), emphasised on the importance of technology and issues emerging from this technology. According to him technology is emerging as a key driver of business in the financial services industry. The advancement the financial industry and banking on the net is fat catching on. As e-commerce gets transformed into m-commerce with the increasing use of technologies like WAP, banking business is in for a major overhaul.

27. Kulkarni R. V. (2000) conducted a study ‘changing Face of Banking from Brick and Mortar Banking to E-Banking and discussed various aspects such as manual banking to computerized banking, stage of automation in nationalised banks, new PSIBs and FBs.
28. Misra (2004) examined whether allocative efficiency of the Indian Banking system has improved after the introduction of financial sector reforms in the early 1990s. He studied Allocative efficiency of twenty three States of India for two periods 1981-92 and 1993-2001; broadly corresponding to the pre financial sector reforms and the post reforms periods, respectively. He carried analysis under panel co integration framework which revealed that overall allocative efficiency of the banking system had almost doubled in the post reform period. This suggested that reforms are successful in improving allocative efficiency of the banking system in India. He also estimated Allocative efficiency at the State and sectoral level to get a deeper insight. The allocative efficiency of Banks’ funds deployed in the services sector had improved in the agriculture and deteriorated in industry during the post reform period for the majority of the States. He found improvement in the overall allocative efficiency in the post reform period for the majority of the States. Further, the improved allocative efficiency was more marked for the services sector than for industry across the States.

29. Murty (1996) analyzed various factors which can helpful to improve the profitability of public sector banks. The study examines the impact of monetary policy and market interest rates on the banks’ profitability and also suggests various measures to improve the profitability of the public sector banks in India.

30. Murty, (2001) the author analyzed the significance of banking sector in the insurance sector. On the eve of banks entry into insurance business, this made an attempt to trace the historical background of Indian banks to private investment, banks’ eagerness to enter insurance business and how private banks are for exploiting the new business opportunities. According to the author there are many issues to be sorted out before banks take up insurance business. The new entrants are likely to give a stiff competition through their customized activities and usage of technology to reach the customer with minimal resistance from any quarter.

31. Naidu and Nair (2002) attempted empirically the technical efficacy of scheduled commercial bank groups has declined during the post reform era which has indicated a severe competition among the bank groups.
32. Naik (2006) indicated that the Government of India has to set the asset reconstruction companies to manage NPAs to face the challenges before the banking sector and give various management techniques like analysis of NPAs by sector, prevention of slippages, early warning signals and legal remedies etc. to cure NPAs problem.

33. Nair (2000) the technological advancements achieved very recently in the field of computerization have unfolded many areas of innovations in our living styles. The world of banking is fast shedding its ancient image and entering from brick and mortar model to click model. The virtual banking is rising in a total revolution in the banking transactions. The author realized that those banking and financial services providers who switch over to the electronic environment in the quickest possible time frame alone will be able to survive. The introduction of Cyber Law is also expected to boost the E-commerce and E-banking further in the days to come. And the writing on the wall rather on the net is clear for the Indian Banking Industry. E-banking has come to stay.

34. The Narasimham Committee (1991) also expressed concern about the declining trends in bank profitability. The committee observed that one of the major elements constructing the operational flexibility of banks and depressing banks income earnings has been the system of directed investments in terms of minimum statutory liquidity ratio. The system of directed credit programmers towards agriculture, small scale industry and self- employed persons was also observed to have depressed banks potential income. This led to a deterioration in the quality of loan portfolio, a large increase in overdoes and consequent erosion of profitability.

35. Patel K.V. & Kaveri V. S. (1998), conducted a study “Non-Performing Advances in Priority Sector” and highlighted the magnitude, implications of NPAs and factors responsible for accounts becoming NPA in priority sector.

36. Rangarajan (1991) pointed out that improving the quality of loan assets is the true test of improving the efficiency of the banking system.

37. Rajender and Suresh (2007) an assessment on the cause and consequences of NPAs of the commercial banks was done.
38. Ram Mohan and Ray (2004) attempted a comparison between PSBs and their private sector counterparts based on measures of efficiency and productivity that use quantities of outputs and inputs. They employed three measures: Tornquist total factor productivity growth, Malmquist efficiency and revenue maximization efficiency for the period 1992-2000, comparing PSBs with domestic private and foreign banks. Out of a total of six comparisons they had made, there are no differences in three cases, PSBs do better in two, and foreign banks in one. In other words, PSBs were seen to be at a disadvantage in only one out of six comparisons. It is difficult, therefore, to sustain the proposition that efficiency and productivity have been lower in public sector banks relative to their peers in the private sector.


40. Rao Ramchandra B (1994) conducted a ‘Review of three Similar Sized Nationalised Banks’ and concluded that all the banks have added sizable funds of their deposits, but the rise in deposits exceeding two years have not been substantial. As regards advances, these banks have gone slow due to non-fulfillment of capital adequacy norms OBC with smaller capital base has maximized its income, whereas PNB and DB though bigger than OBC in capital base have been poor in funds management.

41. Ravi (2004) emphasised on branch rationalization policy of banks for bringing down loss making branches. He also suggested that continuous emphasis should be given on reducing the deposit costs and burden, manpower re-deployment of loss making branches.

42. Reddy (2002) stresses the importance of a sound understanding of the macroeconomic variables and systemic issues pertaining to banks and the economy for solving the NPA Problem along with the criticality of a strong legal framework and legislative framework.

43. Rehman (2009) found that the volume of idle fund is in increasing trend that leads to increase in the NPA level.
44. Robert M. Adams, Lars HendrikRollerb, Robin C. Sickles (2000) have taken loans and deposits as inputs only to show the performance of the banks. Market concentration in banking is typically measured in terms of total deposits. Market concentration affects the performance of banks.

45. Roy (2001) articulated that customer loyalty management programme should be an important part of the relationship marketing exercise undertaken at the bank branches.

46. Sarkar and Das (1997) compared performance of public, private and foreign banks for the year 1994-95 by using measures of profitability, productivity and financial management. They find PSBs comparing poorly with the other two categories. However, they caution that no firm inference can be derived from a comparison done for a single year.

47. Satyamurty (1994) clarified the concepts of profits, profitability and productivity applicable to the banking industry. It is organized by the bank managements that the pressure on the profitability is more due to the factors beyond their control. He suggested the technique of ratio analysis to evaluate the profit and profitability performance of banks. He opined the endeavors should be made to improve the spread performance through better finds management.

48. Saxena (2000) analyzed the importance of IT in the banking sector. According to him, the future promises to be even more exciting, interesting and challenging. The Internet has enabled us to talk to each customer as an individual, with different needs and requirements. This IT affects the productivity and profitability of the banks.

49. SHAPIRO (2000) studied the effects of cyberspace are evolving in ways that threaten privacy and other constitutional rights. It is eroding the liberty. The character of cyberspace is still up for grabs and different user environments yield widely different experiences. The character of cyberspace is still up for grabs and different user environments yield widely different experiences. The nature of cyberspace may flip instead of promoting free and open exchange. It may end up controlling our lives in ways we have never imagined.
50. Shenoy (2001) dealt issues relating to the Indian banking and has stressed on proper asset liability management and credit monitoring system.

51. Singh (1992) carried out a comprehensive study to analyse the trends in the productivity of the Indian banking industry since nationalisation in 1969. The State Bank of India and its subsidiaries along with the banks nationalised in 1969 were considered for analysis. He performed cross sectional inter-temporal analysis on the basis of 17 parameters. The indicators were: deposit per employee, credit per employee, business per employee, establishment expenses per employee, spread per employee, deposit per branch, credit per branch, business per branch, total earnings per branch, total earnings as a percentage of total credit, establishment expenditure as a percentage of total expenditure, establishment expenditure as a percentage of total earnings, volume of business per Rs. 100 of establishment expenses, volume of business per Rs. 100 of total expenditure. The results showed that all the banks under study showed improvement in their productivity except the UCO Bank, which showed decline in productivity from all angles. He suggested that banks should monitor the productivity and its growth on the basis of key indicators identified by him. All banks should create productivity cells which should develop and implement productivity improvement programmes. He also recommended that the information relating to productivity should become part and parcel of the annual reports of the bank.


53. Sudhakar V.K. (1998) conducted a study “Policies and Perspectives of NPA reduction in Banks” and highlighted the dimensions of NPAs, accountability syndrome and critical amount concept.

54. Sukumaran and Shaheena (1991) made an attempt to study management of Spread, burden and profitability by preparing a case study of Palghat District Cooperative Bank. It indicated that the management of spread, burden and profitability within the bank during the reference period was not that much effective, and unless and otherwise the bank take immediate and necessary
steps, the position of the bank may become still worse or even uncontrollable within a short period of time.

55. Taneja& Singh (2004) argued that the efficiency of intermediating (financial Institutions) depends on the width, depth and diversity of the financial system. They measured the efficiency and financial performance of Public Sector Banks since commencement of the opting for the LPG programme. For the purpose of analysis they studied the impact of banking sector reforms mainly on all public sector banks except SBI and its Associate, by data envelopment analysis with intermediation approach. They concluded that the financial sector reforms has taken these banks in better position than pre-nineties as TFP growth in Indian PSBs was mainly driven by frontier effect i.e. Technological Efficiency Change.

56. Taori (2000) dealt with the NPA management in PSBs and stated that surest way of containing NPAs is to prevent their occurrences. He suggested proper risk management; strong and effective credit monitoring, co-operative working relationship between banks and borrowers etc. should be the tenets of NPA management.

57. Tarapore S S (1995), made an analytical review of the “Banks response to Reforms” and suggested that improvement in customer service especially for depositors, simplifying procedures and speed of operations should be the paramount objective of the banks if they are to be relevant in the emerging environment.

58. Tompson (2004) examined the state of the Russian banking sector in 2004 and assesses the most important reform initiatives of the last two years, including deposit insurance legislation, a major reform of the framework for prudential supervision, steps to increase transparency in the sector, and measures to facilitate the development of specific banking activities. He concluded that the Russian authorities’ approach to banking reform is to be commended. The design of the reform strategy reflected an awareness of the need for a ‘good fit’ between its major elements, and the main lines of the reform address some of the principal problems of the sector. The lacuna in the Russian bank reform strategy concerned the future of state-owned banks. Despite a long-standing
official commitment to reducing the role of the state – and of the Bank of Russia in particular – in the ownership of credit institutions, there is still a need for a much more clearly defined policy in this area.

59. Trippe (2004) has measured the efficiency of banks in New Zealand banks’ efficiency is compared with the efficiency of Australian banks. The model took intermediary role of commercial banks where inputs are interest and non-interest expenses (staff expenses) and the output are interest income and other incomes earned from service and agency.

60. Wheelock and Wilson (1999) (6) Simons used non-parametric methods to measure the bank productivity. They estimated Malmquist Productivity Index with the help of Data Envelopment Analysis technique of measuring productivity.

Most of the studies have focused on measuring efficiency of PSBs at different time periods by using the different methodologies except some studies like Das (2005) and Ram Mohan Ray (2004) had taken all the banks.

1.3 OBJECTIVES OF STUDY

1.3.1. Studies Done

Most of the studies have focused on measuring efficiency of PSBs at different time periods by using the different methodologies except some studies like Das (2005) and Ram Mohan Ray (2004) have taken all the banks.

Period of Present Study: 2000-2001 to 2010-2011

1.3.2. Objectives of the present study

(i) Study the Profitability aspect of nationalised banks of India;

(ii) Study the Problem of Non-performing Assets and the Profitability of nationalised banks of India;

(iii) Study the Productivity aspect of nationalised banks of India;

(iv) Offer recommendations and suggestions with respect to improving the operating and general performance of nationalised banks of India.
1.3.3 **Hypothesis**

“Profitability of nationalised banks has not been in the upward trend following the measures of deregulation with clear commercial goals.”

### 1.4 **RESEARCH METHODOLOGY**

Basic data relating to individual banks, the nationalised one and two New Private Sector Banks was collected for the study period. Report on Trend and Progress of Banking in India (Various issues), and Statistical Tables Relating to Banks in India (Various issues) were extensively used.

For the purpose of analysis of data, a number of financial and statistical techniques have been used in this study. The present study is of analytical and exploratory nature. Secondary data is collected from various sources. Basically, the relevant secondary data are drawn from RBI publications. The information is processed and analysed and used to bring about the operating performance on comparative basis for the period 2001-2011. The comparison is drawn by analyzing the Assets and liability management in terms of liquidity, profitability, resources, management of NPAs, deployment of resources and recovery performance. The profitability is an overall indicator of financial performance. The level of efficiency, productivity, and cost effectiveness is reflected through the bank’s profit figure.

In financial analysis, a ratio is used as a benchmark for evaluating the financial position and performance. The absolute accounting figures reported in the financial statements do not provide a meaningful understanding of the financial position and, therefore, the ratio analysis has been used as a major tool for assessing the performance of the nationalised banks. The time series analysis has also been done on the available data. Various statistical techniques such as Descriptive Statistics, Correlation, Regression, ANOVA test, and CRAMEL analysis have been applied.

The tools used were:

(i) **Ratio Analysis**

(ii) **Trend Analysis**

(iii) **Compound Growth Rate**
Indices (FBI as well as CBI)
Pearsonian Coefficient of Correlation
Spearman Coefficient of Correlation
Regression (a) Simple, and (b) Multiple
ANOVA Analysis
Descriptive Statistics
Polystat Software
XL-stat Software
MS-XL (2007 as well as 2010)

In order to make the processed data comparable, Verma committee’s Categorisation of PSBs was made the basis of analysis. For ready reference, the detailed description of the Verma Committee is given hereunder:

Verma Committee Report on Weak Banks was appointed by the RBI in consultation with the Government of India to suggest measures for the revival of weak Public Sector Banks. It identified seven parameters for identification of banks’ strengths and weaknesses covering the aspects of solvency, earning capacity and profitability: Capital Adequacy Ratio 8 %, Coverage Ratio 0.50%, Return on Asset Ratio median level, Net Interest Margin median level, Profit to average working funds median level, Ratio of Cost to Income median level, and Ratio of Staff Cost to Income median level. The 27 PSBs have been evaluated by the Committee on the basis of these parameters for the years 1997-98 and 1998-99 and have been categorised into five following categories:
<table>
<thead>
<tr>
<th>S. No.</th>
<th>Category</th>
<th>State Bank Group</th>
<th>Nationalised Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Compliance with ALL Efficiency Parameters</td>
<td>State Bank of Patiala (1)</td>
<td>Oriental Bank of Commerce (1)</td>
</tr>
<tr>
<td>2</td>
<td>Non-Compliance with ONE or TWO Efficiency Parameters</td>
<td>State Bank of Hyderabad, State Bank of Indore, State Bank of Saurastra (3)</td>
<td>Bank of Baroda, Canara Bank, Panjab National Bank, Corporation Bank (4)</td>
</tr>
<tr>
<td>3</td>
<td>Non-Compliance with THREE or FOUR Efficiency Parameters</td>
<td>State Bank of Bikaner &amp; Jaipur, State Bank of India, State Bank of Mysore, State Bank of Travancore (4)</td>
<td>Andhra Bank, Bank of India, Bank of Maharashtra, Dena Bank, Syndicate Bank (5)</td>
</tr>
<tr>
<td>4</td>
<td>Non-Compliance with FOUR or FIVE Efficiency Parameters</td>
<td></td>
<td>Allahabad Bank, Central Bank, Indian overseas Bank, Punjab &amp; Sind Bank, Union Bank of India, Vijaya Bank (6)</td>
</tr>
<tr>
<td>5</td>
<td>Non-Compliance with More than FIVE Efficiency Parameters</td>
<td></td>
<td>Indian Bank, United Bank, United Commercial Bank (3)</td>
</tr>
<tr>
<td></td>
<td>T O T A L</td>
<td>8</td>
<td>19</td>
</tr>
</tbody>
</table>

1.5 DATA SOURCES

Following were the major source of data for this study:-

1. Statistical Tables Relating to Banks of India for various years published by the Reserve Bank of India

2. Data base on Indian banks published by the Indian Banks Association

3. Various issues of the Report on Trends and Progress of Banking in India published by the Reserve Bank of India

4. Report on Currency and Finance (Various issues)
5. Website of individual banks

6. Website of the Reserve Bank of India

7. Economic Survey of India (Various issues)

The data was collected for the period 2001-2011.

1.6 LIMITATIONS OF THE STUDY

The inferences drawn in the present study are subject to the veracity of data available. Undoubtedly, the published reports show the position of a concern on a specified date which may not prove true for the whole year. But the researcher as an external analyst, with time constraint has to depend upon the reports because it is not possible to compile the data originated at different places and times during the years. Certain conclusions have also been based upon general impressions gathered from persons associated with the banking system.

1.7 ORGANISATION OF THE STUDY

This study has been divided into eight chapters including the present one. Chapter II attempts to put Indian Banking in Historical perspective. It also brings out the theoretical impact of reforms on the working of the Nationalised banks of India. In chapter III Profitability aspect of the nationalised banks has been analysed and discussed. Chapter IV has been designed to do the analytical approach to the Problem of Non-Performing Assets of the nationalised banks. Chapter V discusses the Productivity aspect of nationalised banks. Chapter VI makes a comparative study of selected Nationalised Banks and Private Sector Banks. Chapter VII is designed to do the Asset-Liability Management and CRAMEL Analysis of the banks. Chapter VIII summarises the research study and makes some suggestions based on its findings. It also point out the issues requiring intensive research.