CHAPTER I

BANKING INDUSTRY: A GENESIS

- Introduction
- Commercial Banks in India
- Contour of Reforms
- Focus of Current Study
CHAPTER I

BANKING INDUSTRY: A GENESIS

1.1 Introduction

The institutional framework for the mobilization of financial resources has been one well developed feature of the Indian economic system over the past several decades. The financial system is essentially aimed at mobilizing financial savings and intermediating between the suppliers of savings and those in demand of resources.

It is only the efficiency of the financial system which determines whether the full potential of resources has been mobilized at any particular stage of economic development. An efficient financial system facilitates mobilization of the full potential of resources, promotes productive investment and thereby generates high economic growth.

The institutions falling within the framework of the financial system are, in general, the following: (a) Commercial Banks (b) Development Finance Institutions (c) Cooperative Banks (d) Mutual Funds (e) Venture Capital Funds (f) Non-Banking Financial Intermediaries, (g) Rural banks, (h) Development Banks for industry, external trade, housing, etc. and (i) Social security institutions such as insurance companies, pension and provident funds. In addition to the above institutions, India has a well-established capital market with suitable regulatory and monitoring capacity. Different varieties of financial instruments for money and capital markets have also evolved over time to make the capital market system one of the most important institutions for overall resource generation.

Before the onset of the reform process, Indian banking was operating in a relatively regulated and protected environment. The banking system’s branch network grew at a
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fast pace in the beginning of 1990s, but it was felt that the efficiency of the financial system was not to be measured only by quantitative growth in terms of branch expansion and growth in deposits and advances or merely by fulfillment of social obligations of development. “The financial strength and operational efficiency of the Indian banks and financial institutions which were working in a highly protected and regulated environment were not measuring up to international standards” (RBI, 1999). It was realized the Indian banking system was operating far away from the global benchmarks.

The financial sector reforms undertaken in the early 90s of the twentieth century paved way for remarkable changes in the functioning of the Indian banking business. “Every aspect of the functioning of the banking industry, be it profitability, Net Non-Performing Asset (NNPA), management, customer service, risk management, human resource development, etc. has to undergo the process of transformation to align with the international best practices” (Muniappan, 2003).

With the entry of private sector banks and liberal branching policy for the foreign banks, the public sector banks have to face more competition. The reforms have been taking place in a phased manner since the year 1992. “As a consequence of the transitional developments that are taking place, the dividing lines between financial products, types of financial institutions and their geographical location have become less relevant than in the past. At the same time, the growing size of financial activity relative to overall economic activity in a closely integrated world has implied that disruptions in financial markets or infrastructure in any economy can cause contagion, which can spread rapidly and have far greater adverse economic ramifications than was the cause earlier” (Report on Trends and Progress of Banking in India 2001-02). Thus it is imperative to assess the functioning of the Indian commercial banks in the new dynamic environment.
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It has been observed that those banks that are efficient will perform better in the long term. Though many research studies have been conducted in the West on the efficiency of the banks, few empirical studies have been done in the emerging economies. Research studies have been carried out to evaluate the performance of the Indian banks examining related issues by Tyagarajan (1975)\(^4\), Rangarajan and Mampilly (1972)\(^5\) and Subramanyam (1993)\(^6\) amongst others. But none of these studies relate to measuring the performance with reference to organizational culture.

This chapter is divided into three sections and the presentation of chapter is as follows: Section 1.1 is the introductory section giving an overview of the present scenario in banking industry; Section 1.2 presents a discussion on Commercial Banks in India, evolution of banking and nationalization of Indian banks; Section 1.3 presents the contour of reforms and Section 1.4 discusses the prospects of banking industry in India.

### 1.2 Commercial Banks in India

In India, as early as the Vedic period, banking, in the most crude form, existed. The books of Manu contains references regarding deposits, pledges policy of loans and rates of interest.

The Indian banking industry is governed by “Reserve Bank of India Act, 1935” and “The Banking Regulation act, 1949”. The Act has formulated the definition of

The ‘banking’ in Section 5 (1) (b) which reads as under:

5b) “banking” means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on

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\(^3\) Report on Trends and Progress of Banking in India 2001-02
\(^4\) Tyagarajan (1975)
\(^5\) Rangarajan and Mampilly (1972)
\(^6\) Subramanyam (1993)
demand or otherwise and with drawable by cheque, draft, order or otherwise.”

The Indian Banking Industry can be broadly classified into two major categories – Scheduled and Non-Scheduled Banks. Scheduled Banks consist of commercial banks and the co-operative banks. “The commercial banks are those banks that besides their other functions, finance commerce, industry and agriculture. Most of their advances are repayable on demand or at short notice” (Rao, 1993) In terms of ownership, commercial banks can be further grouped into nationalized banks, the State Bank of India and its group banks, Regional rural banks and Private sector banks (the old/new domestic and foreign).

1.2.1 Present Structure
At present the banking system can be classified in the following categories:

1. PUBLIC SECTOR BANKS
   Reserve Bank of India
   State Bank of India and its 7 Associate Banks
   Nationalized Banks
   Regional Rural Banks sponsored by Public Sector Banks

2. PRIVATE SECTOR BANKS
   Old Generation Banks
   New Generation Banks
   Foreign Banks in India
   Scheduled Co-operative Banks
   Non-Scheduled Banks

3. CO-OPERATIVE SECTOR BANKS
   State Co-operative Banks
   Central Co-operative Banks
   Primary Agriculture Credit Societies
   Land Development Banks
   Urban Co-operative Banks
   State Land Development Banks
4. DEVELOPMENT BANKS
Industrial Finance Corporation of India (IFCI)
Industrial Development Bank of India (IDBI)
Industrial Investment Bank of India (IIBI)
Small Industries Development Bank of India (SIDBI)
National Bank for Agriculture & Rural Development (NABARD)
Export-Import Bank of India
SCICI Ltd.

Figure 1.1: Scheduled Banking Structure in India (as on March 31, 2002)

Almost 80% of the businesses are still controlled by Public Sector Banks (PSBs). PSBs still dominate the commercial banking system. Shares of the leading PSBs are already listed on the stock exchanges. The RBI has given licenses to new private sector banks as part of the liberalization process. The RBI has also been granting licenses to industrial houses. Many banks are successfully running in the retail and
consumer segments but are yet to deliver services to industrial finance, retail trade, small business and agricultural finance.

The PSBs will play an important role in the industry due to its number of branches and foreign banks face the constraint of limited number of branches. Hence, in order to achieve an efficient banking system, the onus is on the Government and the respective leadership to encourage the PSBs to be run on professional lines.

Table 1.1 Summary Profile of the Banking Industry From 1990-91 to 2004-05

<table>
<thead>
<tr>
<th>YEAR/BANK GROUP</th>
<th>1990-91</th>
<th>1995-96</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PSB</td>
<td>PVT.</td>
<td>FOR.</td>
</tr>
<tr>
<td>1. No. of Banks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Listed</td>
<td>28</td>
<td>25</td>
<td>23</td>
</tr>
<tr>
<td>(b) Non-listed</td>
<td>None</td>
<td>None</td>
<td>NA</td>
</tr>
<tr>
<td>2. Share (in per cent) of</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Assets</td>
<td>91.4</td>
<td>3.7</td>
<td>4.9</td>
</tr>
<tr>
<td>(b) Deposites</td>
<td>92.0</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>© Credit</td>
<td>93.0</td>
<td>4.0</td>
<td>3.0</td>
</tr>
<tr>
<td>(d) Income</td>
<td>89.4</td>
<td>3.3</td>
<td>7.3</td>
</tr>
<tr>
<td>(e) Expenses</td>
<td>90.0</td>
<td>3.3</td>
<td>6.8</td>
</tr>
<tr>
<td>(F) Profit</td>
<td>68.5</td>
<td>4.1</td>
<td>27.4</td>
</tr>
<tr>
<td>3. Memo Bank asset/GDP (per cent)</td>
<td>56.3</td>
<td>50.4</td>
<td>80.4</td>
</tr>
</tbody>
</table>

PSB : Public Sector Banks; For : Foreign NA : Not applicable : Listed : Banks listed on recognised stock exchange
Figures in bracket under Private pertain to de novo private banks
Source : Reserve Bank of India

1.2.2 Origin and Pre-reform Era

In India, the modern banking system started with the set up of the first joint bank, the General Bank of India in the year 1786. Soon after, Bank of Hindustan and Bengal Bank were established. Another three banks were set up by the East India Company in

Introduction
the nineteenth century namely- The Bank of Bengal (1809), The Bank of Bombay (1840) and Bank of Madura (1843). These were independent banks, designated as Presidency banks. In 1920 a new bank “Imperial Bank of India” was established which was the amalgam of these three banks.

The genesis of Indian Banking can be clearly segregated into three distinct phases.

**PHASE – I**

1786 - First Bank, General Bank of India formed.
1809 - Bank of Bengal formed.
1813 - Slowly came the bank of Princely states, i.e. Patiala, Trivancore, Bikaner & Jaipur.
1920 - Bank of Bengal, Bank of Madras and Bank of Bombay were amalgamated to form Imperial Bank of India.
1935 - Reserve Bank of India formed

**Characteristics:**

**Slow Growth:** This phase basically saw a slow growth in terms of both the depositors as well as the creditors. The people largely relied on the indigenous bankers and co-operatives for placing their money and for all credit purpose.

**Periodic Failures:** Due to the lack of proper check on the system, the banking system was very risky and prone to failure and there were numerous cases of failures of banks resulting in depositors’ loss.

**Lesser confidence in Banks:** People had very less confidence in banks mostly because they were seen as an instrument of the rich. The other reason was the faith of the people in the local people who were carrying on the business of lending money albeit at exorbitant rate. Funds were largely given to traders: The funds were mostly available to the traders and there was not much concern for the needs of the farmers and the villagers.
PHASE – II

1949 - Reserve Bank of India nationalized.
1955 - Imperial Bank of India was nationalized to form State Bank of India to act as principal agent of RBI and to handle banking transactions of the Union and State Governments all over the country.
1959 - Banks of seven princely states came to be known as associates of State Bank Of India.
1961 - DICGC formed to extend insurance cover to deposits.
1969 - Fourteen banks were nationalized.
1971 - CGC formed to provide insurance guarantee on loans.
1980 - Seven more banks were nationalized – 80% of banking came under government ownership.

Characteristics:

**Low Bank Failures:** Due to the enactment of the Banking Regulations Act, 1949, the banking system was subjected to stringent regulations resulting in a decline in the systemic failures of the bank.

**Increased Bank Branches:** The number of branches jumped from a mere 8200 in 1969 to 61000 in 1993 due to massive expansion policy.

**Increased Bank Business:** The expansion of the branches even to the rural areas resulted in the surge of banking business and increased bank’s outreach to interior rural areas.

**Poor Quality of Credit:** The problem of poor credit cropped up due to the irrational disbursement of loans.

**Political Interference:** This phase saw a direct interference of the politics in the banking system as the government was directly controlling the banks. The banks were used as a tool to promote their own causes as was the case in the previous with the traders.
**Squeeze on Profitability:** Due to the erratic growth in the number of branches without considering the profit potential; the banks had a squeeze on profitability.

**Low Service/Low Efficiency:** The banks were hardly concerned about the customer service and efficiency.

**PHASE – III (1991 onwards)**
This phase brought the drastic changes in the functioning and management of Indian Banks. There was a shift in strategy from branch expansion to profit orientation: The management was given autonomy and made more accountable. As a result, the focus shifted from merely branch expansion to profitability of the banks.

**Characteristics:**

**Lowered entry barriers:** The norms were relaxed and the entry of foreign banks as well as private banks was made easy. The entry of new generation banks brought dynamic changes in the working of once lethargic banking system of India.

**Deregulation of interest rates:** The second phase largely had a system of regulated interest rates. This was eased in this phase and the bank management was made free to manage its own business with proper risk management.

**Overall lowered regulation (Market Oriented):** The banks started paying more attention to attracting the customers in order to compete in the market and increase profitability.

**Application of Prudential Norms (Basel-I)**

- Classification of Assets
  - Income recognition
  - Capital Adequacy
  - Profitability
  - Strengthening of Bank Balance Sheet

**Unleashing the focus of competition**

- Product differentiation
- Deregulated Interest Rates
- Internationalization of Banking
By independence, the commercial banking system in India was fairly developed. The Reserve Bank of India (RBI) was nationalized in the year 1935 by an Act passed in parliament. Earlier it was constituted as a shareholders bank in India. Since 1\textsuperscript{st} January, 1949, RBI started functioning as the state owned and state managed "Central Bank" of India. The RBI directs the banks for their lending norms and their activities with large Corporate. These restrictions were called as "Consortium guidelines".

The Banking Regulation Act was enacted in 1949 providing a framework for supervision and regulation of the Indian commercial banking. The initial steps towards nationalization were consequence of the report (under the aegis of RBI) by the Committee of Direction of All India Rural Credit Society (1951).

The Committee suggested that there should be one strong integrated state partnered commercial banking institution to stimulate banking development in general and rural credit in particular. In view of this proposal, after Independence, "the Imperial Bank" was nationalized and the State Bank of India Act was passed in 1955 which changed its name to State Bank of India. RBI acquired substantial holding of shares in State Bank of India. Soon after, in 1959, a number of erstwhile banks owned by princely states were made subsidiaries of SBI.

It was felt that in 50s and 60s the banking sector witnessed considerable growth and success in establishing close links between commercial and industry houses. However, it was still felt that the necessary impetus with respect to support to the agriculture and small industries was lacking.

Subsequently, on July 14, 1969 14 banks were nationalized. The first phase of financial reforms resulted in the nationalization of 14 major banks in the 1969 and resulted in the focus from \textit{class banking to mass banking}. \textbf{The specific objectives for nationalization was to} remove control of few large industrial houses over commercial banking in the country, to provide adequate credit to priority sector like agriculture, small industry, exports and so on, to introduce professional management in
commercial banking business of the country, to provide proper incentives and stimuli, so that a new class of entrepreneurship emerge in the country and to make provision for adequate training and reasonable terms and conditions of service for bank employees.

For most of the part of twentieth century, the financial system was merely considered as a mobilizer of funds. The next major change took place in 1980 when six more banks were nationalized. Since then the number of the scheduled banks have increased to four fold and the number of bank branches have increased eight fold. This also resulted in the growth of geographical coverage of banks.

**Overall lowered regulation (Market Oriented):** The banks started paying more attention to attracting the customers in order to compete in the market and increase profitability.

In the pre-reform era, the public sector banks were the most important source of financial intermediation between the provider and user of funds. The thrust was on expanding branch network of these banks, provision of banking services and garnering larger volumes of deposits. The interest rate regime was administered with interest rates fixed both on deposits and lending. The banks were not allowed to determine the interest rates on deposits or loans. The licensing regime and allocative mechanism dominated the delivery of credit. As a result, the private sector banks' operations were confined to local areas. They were unable to expand over broader regions. To a great extent, there were major restrictions to the entry and exit of banks. The environment was least competitive for the government owned banks operating in the country. Majority of the banking business in India was regulated by the Government.

1.3 Policy Guidelines of Reserve Bank Of India (RBI)

Following the nationalization of banks, RBI had introduced the policy guidelines to direct credit to the priority sector consisting of Agriculture, small-scale industry, and
weaker sections. For increasing the amount of priority sector lending, RBI took two steps. (i) to provide liberal finance facilities to the banks and (ii) to introduce credit guarantee scheme as a support measure for bank lending in the priority sector with view to enlarging the flow of credit to the neglected sectors. Public sector banks were advised by the Govt. Of India in 1974 that the priority sector lending should reach a level not less than one third of their outstanding credit by 1979 March. In 1978, RBI instructed the private sector banks also should oblige the norms by the end of 1980. A working group on 20 Point Programme set up by RBI suggested certain changes in priority sector lending. It introduced the concept of weaker section within priority sector.

1.3.1 Establishment of New Institutions And Schemes

In addition to the above measures, govt. established two banks to assist the progressive expansion of rural credit. They are the Regional Rural Banks (RRB) and the National Bank for Agriculture and Rural Development (NABARD). The Regional Rural Banks were established in 1975 with the objective of providing credit and other facilities especially to the small and marginal farmers, artisans and small entrepreneurs in rural area. The NABARD established in 1982 was another set up to promote rural credit in accordance with the recommendations of CRAFICARD, a committee set up by RBI. The basic idea was that this should be a national bank to pay individual attention to all regions of the country requiring credit and other needs related to agriculture and rural development. Secondly, fragmented problem of agricultural and rural development were to be viewed in an integrated and comprehensive way instead of a manner by several financial institutions in an uncoordinated way, which was happening till then. It was felt that if there was a banking institution at the national level the above objective would be achieved.

1.3.2 Lead Bank Scheme

Based on the recommendations of National Credit Council headed by D.R.Gadgil, RBI introduced the Lead Bank scheme in 1969. Under the scheme, each district has
been allotted to a specific public sector bank named as Lead Bank. As per the scheme, each lead bank should co-ordinate the banking and financial activities of the district as a whole. The Lead Bank should identify their district opening of new branches of the commercial banks to meet the credit needs of the district, formulation of District Credit Plan and setting up of a District Consultative Committee etc., are other major duties of Lead Bank. Another major reforms in banking sector was the village adoption schemes in 1975, some commercial banks have taken up the village adoption scheme with the objective to develop the village economy in all the aspects in a phased manner. By 1977 the bank took the responsibility of the development of more than 50000 villages

1.4 Contour of Reforms

The banking crises in Asia, America and elsewhere accentuated the reform process in India. India embarked on a strategy of economic reforms in the wake of a serious balance-of-payments crisis in 1991. The objective of the banking sector reforms was to promote a diversified, efficient and competitive financial system with the ultimate objective of improving the allocative efficiency of resources through operational flexibility, improved financial viability and institutional strengthening.

The objective of the banking sector reforms was to promote a diversified, efficient and competitive financial system with the ultimate objective of improving the allocative efficiency of resources through operational flexibility, improved financial viability and institutional strengthening. The financial system in India by the 1980s was characterized by dominant government ownership of banks and financial institutions, widespread of administered and variegated interest rates, financial repression through forced financing of government fiscal deficits by banks and through monetization. Thus, although a great degree of financial deepening had indeed taken place and financial savings had increased continuously, financial markets were not really functioning. There was little price discovery in terms of the cost of money, i.e., interest rates. The efficiency and productivity enhancing function
of the financial system was severely handicapped. Hence, a widespread financial sector reform effort has been underway since 1991.

Financial repression through statutory pre-emption has been reduced, while stepping up prudential regulations at the same time. Interest rates have been progressively deregulated on both the deposit and lending sides.

1.4.1 **Restoration of the health of the banking system has involved:**

- Restoration of public sector banks' net worth achieved through recapitalisation where needed (total cost less than one per cent of GDP).
- Competition increased through entry of new private sector banks and foreign banks.
- Higher levels and standards of disclosure achieved to enhance market transparency.
- Bank regulation and supervision strengthened towards international best practice.
- Micro prudential measures instituted.
- Supervision process streamlined with combination of on-site and off-site surveillance along with external auditing. Risk based supervision introduced.
- Process of structured and discretionary intervention introduced for problem banks through a prompt corrective action mechanism.
- Ownership of public sector banks has been broadened through dis-investment up to 49 per cent, and banks have been listed.
- Mechanism for greater regulatory coordination instituted for regulation and supervision of financial conglomerates.
- Measures taken to strengthen creditor rights.

1.5 **Narasimham Committee Recommendations (First and Second)**

In 1992, a committee was set up by the Government of India, known as Narsimham Committee I to study the financial system and recommend the reforms to be
undertaken to overhaul the system in order to improve profitability and productivity of Indian banks. It was also asked to suggest the prudential norms so that the banks ensure proper checks and avoid untoward incidence of failures resulting in the loss of depositors’ money.

The various recommendations of the Committee are summarized below:

- Removal of restrictions on entry and expansion of private banks and reduction of restrictions on expansions of foreign banks.
- New private banks to have a minimum initial capital of Rs. 1 billion.
- Joint ventures between foreign banks and Indian Banks to be allowed (foreign banks to have not more than 20% stake).
- Credit allocation to be mostly market driven.
- Priority sector lending to be reduced from 40% to 10% and eventually to be phased out.
- SLR & CRR to be gradually reduced.
- Structural changes in Public Sector Banks.
- Improvements in regulatory environment and processes empowerment of banks by giving more autonomy.
- Deregulation of interest rates. Minimum capital to risk weighted assets ratio to be raised to 9%
- Setting up of asset reconstruction funds.

It was only in the early nineties that the private banks entered the Indian financial system and they were allowed to operate under the guidelines prescribed by the RBI. In 1993, the new private sector banks were allowed to enter the Indian banking system. The policies related to licensing of branches of foreign banks and entry of new foreign banks were made more liberal. The new private sector banks and foreign banks were technology driven and penetrated the market quite aggressively. They offered services such as Automated Teller Machines (ATMs), online banking facilities and any branch banking to meet the growing needs of the upwardly mobile consumer class. Thus, the intention of these reforms was to increase competition
amongst banks irrespective of the ownership. To meet the competition, the Public Sector Banks also jumped into the fray. Since then, there have been consistent efforts by the Public Sector Banks to modernize their infrastructure and offer better services to the consumer.

The reforms have given greater freedom to the banks to manage both the pricing and quality of resources. The priority sector lending/directed lending continues, though the focus for these loans too is on commercial or near commercial terms. The mandatory stipulation of market financing of Government borrowing needs has decreased.

The role of RBI has changed from the micro perspective to a macro perspective. Rather than focusing on minute details of functioning of banks, RBI supervises the functioning of banks by giving them a set of general guidelines to be followed and adhered to. The guidelines on credit decisions are set by the board of the individual banks.

The prudential standards have been imposed in a progressive manner to further strengthen the banking system to enable it to face the competitive environment. Though greater freedom is imparted to banks to take decisions on their credit related issues, more focus on capital adequacy and provisions for asset classification, income recognition and provisioning norms and asset liability management have helped to identify and manage risk, thus ensuring financial stability from a long term perspective.

The post reform phase has observed setting up of a suitable institutional, technological and regulatory framework for the expansion of financial markets. "There is now increased volumes and transparency in the primary and secondary market operations. Development of the Government securities, money, forex markets has improved transmission mechanism of monetary policy, facilitated the development of a yield curve and enabled greater integration of markets. The interest
rate channel of monetary policy transmission is acquiring greater importance as compared with the credit channel" (Reddy, 2001)

1.5.1 Reforms Since 1991

- SLR has been reduced from 38.5 per cent to 31.5 per cent and has moved towards the target of 25 per cent.
- The medium-period target of 10 per cent for CRR has already been achieved and it is hoped that it will be further reduced by 3 to 5 per cent of the total deposits as recommended by the Committee.
- A number of private-sector banks have started functioning as a result of the easing of the norms of entry and exit of private-sector banks.
- The nationalized banks have been allowed direct access to the capital market to mobilize funds from the public while the Government would continue to hold 51 per cent of the equity of the banks.
- Interest rates have been rationalized and simplified and considerably deregulated.
- The interest yield on government securities is moving towards market-related rates.
- The branch licensing policy has been extensively liberalized.
- The accounting and prudential norms relating to income recognition and capital adequacy have been stipulated in conformity with international standards.
- A number of debt tribunals have been set up in order to facilitate and expedite the adjudication and recovery of the debts.
- Government has been providing capital to the banking system for its recapitalization by making budgetary provisions for this purpose.
- The Reserve Bank of India has set up a Board for Financial Bank Supervision for strengthening the supervisory function of RBI.
- Capital adequacy ratio now at 9%
- Financial restructuring authority formed to restructure weak banks.
- Risk management system issued in 1993.
Credit to small scale industries now at 15.6% of net bank credit.
Setting up of off site monitoring and surveillance system – required to submit quarterly and half yearly statements on asset quality, capital adequacy, risk exposure.
Implementation of corporate governance.
Use of banks as channels of distribution for insurance and other products.
Restructuring of weak banks – Rs 204461 Cr injected in the weak banks.
Increased exposure to sensitive sectors like capital markets, real estate & commodities.
Banks given freedom to choose segments, products/services and customers.
Introduction of new payment mechanisms like MICR cheques and availment of Society for Worldwide Interbank Telecommunication (SWIFT).
Diversification into non traditional areas like merchant banking, lease finance, project finance, trust and pension management, fee based services, investment banking, housing finance, factoring & forfeiting.
Development of new distribution channels like phone banking, mobile banking.
New banking services such as ATM, EFTPOS, ECS, credit cards, AWB, RTGS
Improvement in accounting standards: disclosure of accounting policies, capital adequacy ratio separately under Tier I, Tier II and Tier III capital, shareholding pattern, % of net NPA to net advances, category wise provisions towards depreciation and NPA, income ratios, business and profit per employee, maturity pattern of deposits and other liabilities as well as asset portfolio.

1.5.2 Specific Issues In Indian Banking Industry

The most important issues for the banking industry are listed below:

- Competition
- Non Performing Assets Management
- High level of concentration of banking business within Public Sector Group.
Introduction of proper debt recovery laws including bankruptcy procedures and insolvency laws.

Dilution of government ownership in PSU banks.

Exit policy for enterprise.

Better internal governance

Risk management

Technology absorption

Rationalization of branches

Optimal manpower planning

Achievement of full market integration

Margin pressures

Internationalization of banking operations.

1.5.3 Few of the recent measures taken are as follows:


Banks can now recover their assets by issuing notices to a defaulter to pay up. Within 60 days, if the defaulter does not pay up, banks can take the permission to take over the assets—a factory, land or machinery—and sell it off. Subsequently, banks can package and sell loans via securitization. Loans can be traded between banks, like bonds or shares. This Act has benefited the banks in a large way. It has empowered the lenders.

b) Corporate Debt Restructuring (CDR)

In spite of their best efforts and intentions, sometimes corporates find themselves in financial difficulty because of factors beyond their control and also due to certain internal reasons. The objective framework of CDR is to ensure timely and transparent mechanism for restructuring the corporate debts of viable entities facing problems, outside the purview of Board of Industrial and Financial Reconstruction (BIFR), Debt
Recovery Tribunal (DRT) and other legal proceedings, for the benefit of all concerned. CDR mechanisms has been successful in countries like U.K., Thailand, Korea etc. However, in India some banks have not joined the CDR mechanism and many of them who have joined have not referred many cases to CDR cell.

The steps taken by the RBI and Government of India will go a long way in controlling the burgeoning of NPAs. At the same time, the banks have strengthened their loan appraisal systems and pay more emphases to the monitoring and follow up mechanism of the loans.

b) Capital Adequacy

Banks are required to have a substantial amount of capital which would be a requisite as a cushion against shocks and losses. Capital Adequacy has got a greater importance ever since the Asian crisis took place in late nineties. The draft of the Capital Accord, predicts higher risk sensitivity of capital ratios, refinement of measures of credit risk including a greater role for external credit rating, flexibility and national discretion rather than a ‘one size fits all’ approach.

A significant contribution has been made by the Basel Accord of 1988. It has played an important role in strengthening the soundness and stability of banks and enhanced the competitive equality among the international banks. There has been a pressure on the banks to maintain CRAR (Capital to Risk Weighted Assets Ratio) of 9%.

The new Basel Accord is more risk sensitive and it contains a number of options for measuring both credit and operational risks. The adoption of the New Basel Capital Adequacy Framework, relating to assigning capital on a consolidated basis, se of external credit assessments as a means of assigning preferential risk weights, sophisticated techniques for estimating economic capital, etc., may need suitable modifications to adequately reflect the institutional realities and macro-economic
factors specific to emerging market economies including India" (Kamesan, 2002)\(^9\)

Thus, banks have to gear themselves to be ready for the new framework.

c) Risk Management Systems

Banks have been facing various kinds of risk both financial and non-financial risks in the wake of financial sector deregulation. Thus, the banks need sophisticated risk handling techniques like VAR (Value at Risk), Duration and Simulation adopting internal model based approaches. Banks are expected to develop an integrated risk management system depending on their size, complexity and their capacity to take risks.

In modern economies, banking will focus a lot on risk management. The triumphant negotiation and implementation of Basel II Accord will give a clear focus on the risk measurement and risk management at the instructional level. Banks that can adopt the Risk Adjusted Returns on Capital (RAROC) based performance measures will increase.

d) Issues in Supervision and Regulation

In India, progressive strengthening of the regulatory and supervisory framework has been a key element of financial sector reforms since their inception. Supervision and Regulation related issues contribute to the long-term financial stability. “Financial sector supervision is expected to become increasingly risk-based and concerned with validating systems rather than setting them. This will entail procedures for sound internal evaluation of risk for banks. As mentioned earlier, banks management will have to develop internal capital assessment processes in accordance with their risk profile and control environment. These internal processes would then be subjected to
review and supervisory intervention if necessary. The emphasis will be on evaluating the quality of risk management and the adequacy of risk containment. In such an environment, credibility assigned by markets to risk disclosures will hold only if they are validated by supervisors. Thus, effective and appropriate supervision is critical for the effectiveness of capital requirements and market discipline (Jalan, 2002).°

The financial sector supervision in future will witness greater risk orientation and concern with validation of systems. The internal risk management systems developed by banks would be subject to review and suitable intervention as and when required. The transaction based internal and external audit would be replaced by risk based audit system.

1.6 Future Landscape of Indian Banking
Liberalization and de-regulation process started in 1991-92 has made a sea change in the banking system. From a totally regulated environment, the banks have gradually moved into a market driven competitive system. Our move towards global benchmarks has been, by and large, calibrated and regulator driven. The pace of changes gained momentum in the last few years. Globalization would gain greater speed in the coming years particularly on account of expected opening up of financial services under WTO. Four trends change the banking industry world over, viz. 1) Consolidation of players through mergers and acquisitions, 2) Globalization of operations, 3) Development of new technology and 4) Universalisation of banking. (Banking Industry Vision Document 2010, IBA Committee 2005). With technology acting as a catalyst, the banking industry will witness changes in the coming years. It entails emergence of an integrated and diversified financial system. The move towards universal banking has already begun. This will gather further momentum bringing non-banking financial institutions also, into an integrated financial system.

The banking system that will evolve will be transparent in its dealings and adopt global best practices in accounting and disclosures driven by the motto of value enhancement for all stakeholders.
1.6.1  Product Innovation And Process Re-Engineering

With increased competition in the banking industry, the net interest margin of banks has come down over the last one decade. Liberalization with globalization will see the spreads narrowing further to 1-1.5% as in the case of banks operating in developed countries. Banks will look for fee-based income to fill the gap in interest income. Product innovations and process re-engineering will be the order of the day. The changes will be motivated by the desire to meet the customer requirements and to reduce the cost and improve the efficiency of service. All banks will therefore go for rejuvenating their costing and pricing to segregate profitable and non-profitable business. Service charges will be decided taking into account the costing and what the traffic can bear. From the earlier revenue = cost + profit equation i.e., customers are charged to cover the costs incurred and the profits expected, most banks have already moved into the profit = revenue - cost equation. This has been reflected in the fact that with cost of services staying nearly equal across banks, the banks with better cost control are able to achieve higher profits whereas the banks with high overheads due to under-utilization of resources, un-remunerative branch network etc., either incurred losses or made profits not commensurate with the capital employed. The new paradigm in the coming years will be cost = revenue - profit.

As banks strive to provide value added services to customers, the market will see the emergence of strong investment and merchant banking entities. Product innovation and creating brand equity for specialized products will decide the market share and volumes. New products on the liabilities side such as forex linked deposits, investment-linked deposits, etc. are likely to be introduced, as investors with varied risk profiles will look for better yields. There will be more and more of tie-ups between banks, corporate clients and their retail outlets to share a common platform to shore up revenue through increased volumes.
1.6.2 Technology In Banking

Technology will bring fundamental shift in the functioning of banks. It would not only help them bring improvements in their internal functioning but also enable them to provide better customer service. Technology will break all boundaries and encourage cross border banking business. Banks would have to undertake extensive Business Process Re-Engineering and tackle issues like a) how best to deliver products and services to customers b) designing an appropriate organizational model to fully capture the benefits of technology and business process changes brought about. c) how to exploit technology for deriving economies of scale and how to create cost efficiencies, and d) how to create a customer - centric operation model.

Entry of ATMs has changed the profile of front offices in bank branches. Customers no longer need to visit branches for their day to day banking transactions like cash deposits, withdrawals, cheque collection, balance enquiry etc. E-banking and Internet banking have opened new avenues in “convenience banking”. Internet banking has also led to reduction in transaction costs for banks to about a tenth of branch banking.

Technology solutions would make flow of information much faster, more accurate and enable quicker analysis of data received. This would make the decision making process faster and more efficient. For the Banks, this would also enable development of appraisal and monitoring tools which would make credit management much more effective. The result would be a definite reduction in transaction costs, the benefits of which would be shared between banks and customers.

Under Basel II accord, capital allocation will be based on the risk inherent in the asset. The implementation of Basel II accord will also strengthen the regulatory review process and, with passage of time, the review process will be more and more sophisticated. Besides regulatory requirements, capital allocation would also be determined by the market forces. External users of financial information will demand
better inputs to make investment decisions. More detailed and more frequent reporting of risk positions to banks' shareholders will be the order of the day. There will be an increase in the growth of consulting services such as data providers, risk advisory bureaus and risk reviewers.

These reviews will be intended to provide comfort to the bank managements and regulators as to the soundness of internal risk management systems.

1.6.3 Human Resource Management

The key to the success of any organization lies in how efficiently the organization manages its' human resources. The principle applies equally and perhaps more aptly to service institutions like banks. The issue is all the more relevant to the public sector banks who are striving hard to keep pace with the technological changes and meet the challenges of globalization.

An equally important issue relevant to HRM is to create a conducive working environment in which the bankers can take commercial decisions judiciously and, at the same time, without fear. This calls for a re-look into the vigilance system as it exists today, and perhaps there is a need to keep the banking industry out of the CVC. The Banks' Boards may be allowed to have their own system of appropriate checks and balances as well as accountability.

1.7 Focus of Current Study

The banking system witnessed rapid growth in the post nationalization year for two decades. The public sector banks had 90 per cent share in the entire banking business by 1990s. By March 1992, the branch network of all the public sector banks together had expanded to a colossal network of 60,646 branches spread across country and held deposits of Rs.1,10,000 crores and advances of Rs.66,760 crores. It was felt that the bank environment was least competitive and banks were functioning in a highly
regulated and protected environment. "Competitive challenges can maintain high efficiency in a large finite system, if there is an arbitrarily small infusion of new high efficiency firms (Sjostrom and Weitzman, 1996)." Hence, from 1992 onwards, India witnessed a phase when a part of a broader program of structured economic reforms set in motion.

The reforms focus on the deregulation of policies, prescription of prudential norms on capital adequacy, income recognition, asset classification and provisioning for impaired assets and opening up the entire private and foreign banks in India to increased competition by the Indian banking system. Competitive challenges perform a "magic trick" by maintaining and even creating efficiency in a system that otherwise would be running down over time (Sjostrom and Weitzman, 1996). Deregulation of interest rates on deposits and advances has led to an increased competition not only amongst the public sector banks but also from the private and foreign counterparts. The corporate have an access to low cost funds both via the debt and equity markets. Thus their dependence on the banks for raising capital is low. Thus, the public sector banks are losing their market share not only to the private counterparts but also to non-banking financial sector. The profitability of the banks is also under pressure due to prudential norms on capital adequacy, asset classification and provisioning norms.

Further, there has always been a notion on the differential performance of banks. The differential performance of public sector banks within the same competitive environment generated the need for the study. Studies have also shown that there is a direct connection between an organization's performance and the nature of culture within that organization (Dennison, 1990). A shared meaning has positive impact because an organization's members work from a common framework of values. Hence, forms a basis for coordinated actions and decision process.

Hence the focus of this study was to see the prevalent culture and thereby the existing values in public sector banks with differential performance. It is assumed that performing banks will have lesser competing values than banks with weak performance.
1.7.1 Objectives

The objectives of this study are as under:

1. It aims to describe the prevalent culture in public sector banks with differential performance. The study not only highlights the role of culture but also compares the performance within and across for a 5 year period. Thus the performance in the years can be gauged by the data analyzed over the study period.
2. The study will attempt to establish that the performing banks have a dominant culture with less competing values. Hence a dominant culture will emerge which facilitate performance.
3. Performance parameters compared will establish the significant role of culture in performance; thereby establishing the need to pay attention to culture as a main source of sustainable competitive advantage.

1.7.2 Methodology

The public sector banks with different Z-score was categorized as strong, average and weak banks. Competing Value Framework (Quinn and Rorbaugh, 1983)\(^\text{13}\) has been made use of to assess the organizational culture and thereby the underlying values through the Organizational Culture Instrument (OCAI) instrument (Cameron and Quinn, 1999)\(^\text{14}\).

1.7.3 Data Collection

The study incorporates all the commercial banks that were operating during the period 1997 - 2006 in India. The sample comprises of public sector banks. The financial data used for comparison is collected from secondary sources i.e., financial information published in the Annual Reports of Banks and RBI publications.
1.7.4 Chapter Scheme

Being introductory in nature, Chapter I deals with the introduction, the genesis of banking, its present structure and the current environment in which the banks are operating. Thereafter, it gives an overview of objectives of the study, the methodology, data collection and the limitations associated with the study.

Chapter II presents a brief profile of the banks covered in the study.

The conceptual framework of organizational culture and organizational performance has been presented in Chapter III and chapter IV respectively.

Chapter V presents the existing literature in the area of relationship between organizational culture and performance. This chapter has been divided broadly in two sections: (i) Perspectives of values and culture (ii) Review of literature in international and Indian context with respect to impact of culture on performance.

Chapter VI presents the methodology adopted in this study. It mentions the objectives of this study, research hypothesis formulated and explains the sampling frame of the study. Finally, the chapter concludes with sampling and data collection for this study.

Chapter VII and Chapter VIII presents the analysis and conclusions and recommendations respectively.

Limitations

Taking into account the coverage and the objectives of this study both in terms of time span and the number of banks, the study is not free from limitations. This is explained at the end of the study.
References


