CHAPTER I

INDIAN BANKING INDUSTRY: AN OVERVIEW

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CHAPTER I

INDIAN BANKING INDUSTRY: AN OVERVIEW

1.1 Introduction

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 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, Non-Performing asset (NPA) 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 case 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.

It has been observed that those banks that are more 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), Rangarajan and Mampilly (1972) and Subramanyam (1993) amongst others. But none of these studies relate to measuring the efficiency of the Indian banks. Late nineties witnessed few studies carried out to evaluate the efficiency of the banks in the Indian context.

Many research studies have studied the impact of deregulation on the efficiency of the banks and financial institutions. In some countries the impact of the deregulation has been favourable: Australia (Sturm and Williams, 2004), Taiwan (Shyu, 1998), Korea (Gilbert and Wilson, 1998), Norway (Berg et al., 1992), Turkey (Zaim, 1995), Portugal (Canhoto and Dermine, 2003), Thailand (Leightner and Lovell, 1998) whereas in others there has been no significant change or unfavourable change, for example, Spain (Grifell-Tatje and Lovell, 1996). Thus, it may be observed that deregulation literature from the rest of the world provides no conclusive findings to suggest Indian policy makers to foresee the impact of deregulation in India. Hence this study will provide some fresh insights with respect to the Indian environment.

This chapter is divided into three sections and the presentation of the chapter is as follows: Section 1.2 is the introductory section giving an overview of the
current study; Section 1.2 presents a discussion on commercial banks and Section 1.3 discusses the focus of the current study.

1.2 Commercial banks in India

The Indian Banking industry is governed by "The Banking Regulation Act, 1949". The act has formulated the definition of ‘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 demand or otherwise, and withdrawable by cheque, draft, order or otherwise.

The Indian Banking industry can be broadly classified into two major categories, scheduled banks 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)\(^5\). 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 Origin and pre reform years

In India, the modern banking system started with 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 came into existence in the mid of the nineteenth century. These were set up by the East India Company. These were namely, The Bank of Bengal (1809), The Bank of Bombay (1840) and Bank of Madura (1843). These banks were independent establishments and were designated as
Presidency banks. In 1920 a new bank “Imperial Bank of India” was established which was the amalgam of these three banks.

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 the parliament. Earlier it was constituted as a shareholders bank in India. Since 1st 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 Corporates. 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 Survey (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 the 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 major banks were nationalized. The first phase of financial reforms resulted in the nationalization of 14 major banks in the 1969 and resulted in change of focus from class banking to mass banking. The objective of this
move towards nationalization was to serve better the needs of development of the
economy in agreement with national objectives and priorities. For most of the part of
twentieth century, the financial system was merely considered as a mobiliser of funds.
The next major change took place in 1980 when six more commercial banks were
nationalized. Since then the number of the scheduled commercial 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.

Pre reform status

In the pre reform era, the public sector banks were the most important source of financial
intermediation between the provider of funds and the 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 the
local areas. They were unable to expand over broader regions. To a great extent, there
were major restrictions to the entry of new banks and difficulties for the banks to exit.
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.

1.2.2 Post reform period

In 1992, the first phase of reforms was initiated as a result of the recommendations of a
committee on the Financial System, known as Narsimham Committee I. The purpose of
these reforms was to make the Indian banking system more productive and efficient.
This phase saw the beginning of the implementation of prudential norms comprising asset
classification and income recognition and provisioning, capital adequacy ratios and the
liberalization of the banking operating environment. In the second phase of reforms in
1998, there was a further reinforcement of the prudential norms, based on the Narsimham Committee II, which made the banking business environment more competitive.

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 (PSBs) 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 decision 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 and forex markets has improved the 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).

1.2.3 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 (20 in number)
   Regional Rural Banks sponsored by Public sector Banks

2. PRIVATE SECTOR BANKS
   Old Generation Private Banks
   New Generation Private 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.

1.2.4 Current scenario

Global ranking of the Indian banks

India has 20 banks which are rated amongst the top 1000 banks globally according to The Banker 2004, of which only six found place amongst the top 500. There are over 200 from USA, over 100 from Japan, over 80 from Germany, over 40 from Spain and around 40 from the U.K. Most of the banks that appear in the top 1000 are large or mid sized and are from the developed nations than from the developing economies. China has 16 banks which could make top this list of which 14 appear amongst the top 500.

An important aspect of the banking industry in India is the growth of newly licensed private sector banks, many of which have attained the best international practices in term of technology and sophistication. In many cases the performance of these banks have surpassed the performance of even the foreign owned banks operating in India.

Share of bank assets in the aggregate financial sector assets

In India the share of banking assets in total financial sector assets is around 75 per cent, as of March 2004. It is generally observed that in developing economies the proportion of banking assets as proportion of assets in the overall financial sector is over 80 percent whereas in developed economies it is much lower. Similarly, deposits
still hold a prominent proportion in total liabilities in emerging economies as compared to the developed economies.

**Internationalization of banking operations**

In several European counties (Austria, Ireland, Spain, Germany and Nordic countries), there has been a significant increase in the foreign controlled banking assets as proportion of total domestic banking assets, though smaller increases have been found in some cases (U.K. and Switzerland). Even in several Latin American economies the increase has been substantial, though it has been modest in several Asian economies. The foreign banks in India which at present are allowed to function as branches enjoy considerable freedom at par with the domestic banks in comparison to most of the developing countries. The profitability of these foreign banks is found to be higher from Indian operations as compared to that of domestic banks and also their own operations in other developing countries. India is quite liberal in granting the licenses to these banks for opening up new branches in India.

**Share of state – owned banks**

The government owned banks are allowed to diversify ownership by inducting private share capital through public offerings rather than by strategic sales and still absorb the overhang problems. Many other emerging economies followed a path of privatization of their public sector banking industry after a process of absorption of the overhang problems by the government. This has facilitated less burden on the government, better market discipline, increase transparency and improve efficiency as reflected by the banks’ share prices.

**Challenges facing the Indian Banking Industry**

a) **Competition and Consolidation**
The banking environment has become more competitive following the deregulation in interest rates, greater functional autonomy in the domain of credit, and entry of new private banks. Though the majority of the banking business is still dominated by the public sector banks, foreign banks have shown an increasing trend in the trend in the market share. Recent developments suggest freedom for greater Foreign Direct investment (FDI) in private sector banks and awarding freedom to foreign banks to either operate as branches of their parent banks or to set up subsidiaries as per recent announcement made in Union Budget for 2002-03. Thus, there are clear indications to the Public Sector Banks (PSBs) that to survive in this competitive era they have to be better performers as compared to what they have been for years.

b) NPA management

A big issue, key to the stability of the banking sector, is the level of non-performing assets (NPAs). One of the major hindrances of the competitive efficiency of the banks is to be saddled with poor quality assets. A good reflector of the quality of assets is the quantum of NPAs in relation to the total loan portfolio. “A major drag on financial sector reforms in India is the slow progress in the management of non-performing assets (NPA). Although net NPAs have undergone a steady decline since 1992-93, they are still high by the international standard of about 2 per cent” (Jalan, 2002). For year 2004, the net NPL ratio for the Indian scheduled commercial banks is at 2.9 per cent.

There have been consistent efforts by banks, in view of steps taken by RBI and the Government of India, to reduce the level of NPAs. “The level of non-performing assets (NPAs) continues to be high by international standards, preempting funds for provisioning and eating into the performance and profitability of financial intermediaries. The response to the debt recovery and asset restructuring initiatives undertaken as part of financial sector reforms has also been slow” (Jalan, 2002).

Few of the recent measures taken are:
a) The Securitization and Reconstruction of financial assets and enforcement of Security Interest law (2002):

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 enhanced the power to lenders. Soon after the law was passed, defaulters turned up to settle their dues with banks. In ICICI's case, 10 out of 24 defaulters wished to settle with the bank for their dues.

This Act has certain bottlenecks as well. Banks cannot sell the assets they have seized till the case is cleared. The value of the collateral underlying these loans is far lower. That is too, as on date. As the time passes, the collateral further loses its value. In Korea, disposal in 6 months earned the banks 26 cents for every dollar worth of asset. In Taiwan, banks sold after 2-3 years - they got only 10-12 cents for each dollar. Further, the bank officials fear prosecution by Central Bureau of Investigation (CBI) and the like, if settlement is done at a discount. Banks hold another view that it might be easier to recover loan when the unit is still working.

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 mechanism 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 to strengthen their loan appraisal systems and pay more emphasis to the monitoring and follow up mechanism of the loans.

c) Capital Adequacy

Banks are required to have a substantial amount of capital which would be a requisite as a cushion against the shocks and losses. Capital adequacy has got a greater importance ever since the Asian crisis took place in late nineties. The draft of the new Capital Accord, proposed to be implemented in 2006 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 Basle 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 make suitable provisions thus impacting the capital base of the banks. The banks have been expected to maintain a CAR of 11%. Most of the banks have been able to maintain the capital adequacy of more than 11% over the last few years. However few banks need to still come up to this level!

The new Basle accord is however more extensive and complex than the 1998 accord. It is more risk sensitive and it contains a number of options for measuring both credit and operational risks. The new accord would be implemented in member jurisdictions in 2006. “The adoption of the New Basel Capital Adequacy Framework, relating to assigning capital on a consolidated basis, use of external credit assessments as a means for 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)\(^\text{18}\). Thus, banks have to gear themselves to be ready for the new framework.

d) Risk Management systems

Banks have been faced with various kinds of risk both financial and non financial risks in wake of financial sector deregulation. Thus, the banks need to have sophisticated risk handling techniques like Value at Risk (VaR), Duration and simulation adopting internal model based approaches. Though with the present internal systems, it might appear to be difficult for all the banks to go in for such models, at least the top banks can have the credit risk modeling techniques in place. RBI has been concerned with this issue for some time and thus has recently issued the guidelines on credit and market risks. 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 is likely to give a clear focus on the risk measurement and risk management at the instructional level. Banks that can adopt the risk management techniques will be ahead of their competing peers.

e) 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. Thus, in view of thrust on risk management systems, the role of regulatory and supervisory bodies becomes very important. “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)\(^7\).

Thus, the financial sector supervision in future 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 external audit would be replaced by risk based audit system.

1.3 Focus of Current study

Post independence, as India promoted and focused on planned economic growth, it felt a need for a strong and efficient financial system to meet the diversified requirements of credit and development. To accomplish this objective it adhered to a mixed pattern of economic development and established a financial system to support such development. It was successful in taking banking to the masses and making the banking system a potent vehicle for furthering public policy. The banking system witnessed rapid growth in the post nationalization year of 1969 for two decades. The public sector banks had 90 percent share in entire banking business by 1990’s. 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 financial strength and operational efficiency of the Indian banks and financial institutions was not up to the international standards. It was felt that the bank environment was least competitive and the 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 programme of structured economic reforms was 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 entry private sector and the foreign banks in India to increase competition in 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 and deposits and advances has led to an increased competition not only amongst the public sector banks but also from the private and the foreign owned counterparts. The corporate have an access to low cost funds both via the debt and the 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 and asset classification and provisioning norms.

Further, there has been always a notion on the differential performance of banks across different ownerships. It is generally felt that the ownership should be affecting the efficiency of the respective bank as the incentives for managers to efficiently allocate resources might differ under different ownership arrangements. If owners do not have the incentive or if they lack the required capability and skills to monitor the activity of management, then it might increase the agency problems and subsequent costs are thought to increase. In particular it is felt that foreign-owned banks will be relatively more efficient as compared to government owned and Indian private banks as their corporate governance is of international standards. Also, it is expected that the public sector banks are relatively inefficient due to complacency and seniority.
(rather than performance) based promotions, poor governance and connected lending. Private sector banks are generally placed higher than public sector banks in these regards. Thus it will be of great importance to study how banks are performing across the different ownership structures in a competitive arena following continuous efforts on the part of the regulators to strengthen the ongoing phase of reforms.

Thus this study will study the impact of deregulation of the Indian banking sector in terms of identifying those banks which are doing well in the competition created by deregulation. “Policy makers are interested in the adoption of operating practices and market equilibria consistent with maximum productive efficiency” (Resti, 1997). It will help the decision makers to evaluate that how are the banks performing in increased competitive pressures following deregulation. A pertinent issue of deregulation is its impact upon the efficiency of the financial system, as a key objective of deregulation is to improve efficiency” (Berger and Humphrey, 1997). Luo (2003) also propounds that overall technical efficiency of the profitability performance can predict the likelihood of bank failure. This will also be helpful in taking decisions on closure of non-performing banks or branches or merging them with more efficient banks. That is, whether the banks which are not performing well should be merged with more efficient banks or whether they should exit. The policy makers can assess how the public sector banks are performing relative to their private sector and foreign counterparts. Knowledge of efficient banks is equally important for consumers as efficient banks tend to have lower service charges, better loan and deposit rates and quality services to offer.

The deregulation literature from the rest of the world provides no conclusive findings to suggest Indian policy makers to foresee the impact of deregulation in India. Hence this study will provide some fresh insights with respect to the Indian environment.
1.3.1 Objectives

The objectives of this study are as under:

1. It aims to find out how has the efficiency of the banks operating in the Indian environment changed over the study period. The study not only highlights the trend of the banks as a group but also measures the efficiency of the banks under different ownership structures as groups. Thus the efficiency will also be estimated for three ownership structures: public sector, private sector and foreign banks over the study period.

2. The study will attempt to establish a relationship between the efficiency and the percentage of non-performing loans existing in the commercial banks operating in India.

3. Efficiency estimates drawn using different combinations of inputs and outputs are compared for checking the robustness of the efficiency estimates. Two different approaches will be followed: “Revenue focus”, indicating how well are the managers managing the income and expenses and ii) “Business focus”. indicating how successful are the banks in generating business and capturing the market share. Subsequently, the efficiency estimates will be compared with different assumptions of scale: constant returns to scale and variable returns to scale.

1.3.2 Methodology

A non-parametric approach, Data Envelopment Analysis (DEA), will be used to determine the efficiency of the commercial banks operating in India. Using DEA, the relative efficiency scores of various Decision-Making Units (DMUs) in the particular sample can be calculated. The DMUs could be the banks or branches of banks. In this study, the DMUs are the commercial banks operating in India.
The DEA model separates the efficient DMUs in the sample from the non-efficient ones. The most efficient unit in the sample is designated as fully efficient firm and given a score of 1 or in terms of percentage as 100%. The DEA estimate compares each of the banks or branches in that sample with the one that is the best practice observation/DMU in the sample.

1.3.3 Data collection

The study incorporates all the commercial banks that were operating in India during the period 1997-2001 in the sample. Thus this study has tried to incorporate the population of the banks operating in India. The sample comprises commercial banks across the three ownership structures that operate in India: Public sector banks, private sector banks and the foreign owned banks.

The data has been collected from secondary sources. The data used is based on financial information published in the annual reports of the banks and RBI publications.

1.3.4 Chapter scheme

Being introductory in nature, Chapter I deals with the introduction, the background of the commercial banks operating in India, their present structure and the current environment in which they are operating. Thereafter, it gives an overview of objectives of the study, the methodology, data collection methods and the limitations associated with the study.

Chapter II present the survey of existing literature in the area of evaluation of efficiency of the banks. This chapter has been divided broadly in two sections: i) International context, where the review highlights the international studies; ii) Indian
context, in which the studies carried out on the Indian banking system have been reviewed.

The theory and conceptual framework of this study are laid out in Chapter III. This chapter gives explanations on concepts used in this study: Concept of efficiency. Efficiency measurement tools: Non-parametric methods and Parametric methods, and a detailed discussion on the tool used in this study: Data Envelopment Analysis followed by elaboration of types of DEA models.

Chapter IV presents the methodology adopted in this study. It explains the concept of efficiency of the banking sector and states the objectives of the study. It highlights the choice of the DEA model over the parametric methods. Subsequently, it carries elaborate discussions on the constant debate on defining as to what should constitute the inputs and outputs in case of the banking sector. Finally, the chapter concludes with sampling and data collection for this study.

Chapter V and VI discusses the results and analysis for the study carried out while Chapter VII puts forth conclusions arising from the study, recommendations for banks management and policy makers and directions for future research.

1.3.5 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 certain limitations.

The study has been analyzed only through the quantitative analysis of the financial information available. The qualitative aspects having bearing on efficiency of the Indian banking system have been ignored.

This study uses a quantitative model named Data envelopment analysis to determine the efficient banks across the sample. This model has some inherent limitations. The
model gives results which are sample specific. Also, the efficiency scores are defined in relative terms rather than absolute terms.

Though there has been an attempt to cover all the banks which were operating during the study period, few had to be dropped due to unavailability of data. The significance tests have not been conducted to generalize the finding of the study for the entire commercial banking sector of India as the model used in the study is of non-parametric nature. Thus, the findings of the present study should be used considering the various limitations cited in this section.

In this chapter, an overview of the Indian banking sector is given. It reflects on how the modern banking system has evolved ever since its origination in the eighteenth century to the present twentieth century. It discusses the current structure and the environment in which the present banking system operates. It puts forth the challenges facing the Indian banks today. In light of these challenges, it discusses the need to evaluate the efficiency of the banks operating in India. Thus, a brief discussion is done on the focus of the study highlighting the objectives, methodology, data collection, chapter scheme and limitations. The following chapter will review the existing literature on the efficiency of the banks both in the global and Indian context.
References:


