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CHAPTER ONE
INTRODUCTION

1. OVERVIEW OF INDIA
An Economic History of India from 1947-2011

India economy, the third largest economy in the world, in terms of purchasing power, is going to touch new heights in coming years. As predicted by Goldman Sachs, the Global Investment Bank, by 2035 India would be the third largest economy of the world just after US and China. It will grow to 60% of size of the US economy. This booming economy of today has to pass through many phases before it can achieve the current milestone of 9% GDP.

The history of Indian economy can be broadly divided into three phases: Pre-Colonial, Colonial and Post Colonial.

Pre Colonial: The economic history of India since Indus Valley Civilization to 1700 AD can be categorized under this phase. During Indus Valley Civilization Indian economy was very well developed. It had very good trade relations with other parts of world [editor's note: India developed the way most other nations did: by peaceful settlement, wars and invasions], which is evident from the coins of various civilizations found at the site of Indus valley.

Before the advent of East India Company, each village in India was a self sufficient entity. Each village was economically independent as all the economic needs were fulfilled within the village.

Then Came the Phase of Colonization. The arrival of East India Company in India ruined the Indian economy. There was a two-way depletion of resources. British used to buy raw materials from India at cheaper rates and finished goods were sold at higher than normal price in Indian markets. During this phase India’s share of world income declined from 22.3% in 1700 AD to 3.8% in 1952.
After India got independence from this colonial rule in 1947, the process of rebuilding the economy started. For this various policies and schemes were formulated.

**India’s GDP Growth Rate**

The Gross Domestic Product (GDP) in India expanded at an annual rate of 8.60% in the last quarter of 1998. According to the World Bank, India’s Gross Domestic Product is worth 1296 billion dollars or 2.09% of the world economy. India’s diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, and a multitude of services. Services are the major source of economic growth, accounting for more than half of India’s output with less than one third of its labor force. The economy has posted an average growth rate of more than 7% in the decade since 1997, reducing poverty by about 10% points.¹

**India’s Growth Since 1980**

The rate of growth improved in the 1980s. From Financial Year 1980 to Financial Year 1989, the economy grew at an annual rate of 5.5%, or 3.3% on a per capita basis. Industry grew at an annual rate of 6.6% and agriculture at a rate of 3.6%. A high rate of investment was a major factor in improved economic growth. Investment went from about 19% of Gross Domestic Product (GDP) in the early 1970s to nearly 25% in the early 1980s. India, however, required a higher rate of investment to attain comparable economic growth than did most other low-income developing countries, indicating a lower rate of return on investments. Part of the adverse Indian experience was explained by investment in large, long-gestating, capital-intensive projects, such as electric power, irrigation, and infrastructure. However, delayed completions, cost overruns, and under-use of capacity were contributing factors.

Private savings financed most of India’s investment, but by the mid-1980s further growth in private savings was difficult because they were already at quite a high level. As a result, during the late 1980s India relied increasingly on borrowing from foreign sources. This trend led to a balance of payments crisis in 1990; in order to receive new loans, the government had no choice but to agree to further measures of economic liberalization. This commitment to economic reform was reaffirmed by the government that came to power in June 1991.²
India’s primary sector, including agriculture, forestry, fishing, mining, and quarrying, accounted for 32.8% of Gross Domestic Product (GDP) in Financial Year 1991. The size of the agricultural sector and its vulnerability to the vagaries of the monsoon gave rise to relatively large fluctuations in the sector’s contribution to Gross Domestic Product (GDP) from one year to another.

In Financial Year 1991, the contribution to Gross Domestic Product (GDP) of industry, including manufacturing, construction, and utilities, was 27.4%; services, including trade, transportation, communications, real estate and finance, and public-sector services and private-sector services, contributed 39.8%. The steady increase in the proportion of services in the national economy reflects increased market-determined processes, such as the spread of rural banking, and government activities, such as defense spending. Despite a sometimes disappointing rate of growth, the Indian economy was transformed between 1947 and the early 1990s. The number of kilowatt-hours of electricity generated, for example, increased more than fiftyfold. Steel production rose from 1.5 million tons a year to 14.7 million tons a year. The country produced space satellites and nuclear-power plants, and its scientists and engineers produced an atomic explosive device. Life expectancy increased from twenty-seven years to fifty-nine years. Although the population increased by 485 million between 1951 and 1991, the availability of food grains per capita rose from 395 grams per day in Financial Year 1950 to 466 grams in Financial Year 1992.³

However, considerable dualism remains in the Indian economy. Officials and economists make an important distinction between the formal and informal sectors of the economy. The informal, or unorganized, economy is largely rural and encompasses farming, fishing, forestry, and cottage industries. It also includes petty vendors and some small-scale mechanized industry in both rural and urban areas. The bulk of the population is employed in the informal economy, which contributes more than 50% of Gross Domestic Product (GDP). The formal economy consists of large units in the modern sector for which statistical data are relatively good. The modern sector includes large-scale manufacturing and mining, major financial and commercial businesses, and such public-sector enterprises as railroads, telecommunications, utilities, and government itself.
The greatest disappointment of economic development is the failure to reduce more substantially India’s widespread poverty. Studies have suggested that income distribution changed little between independence and the early 1990s, although it is possible that the poorer half of the population improved its position slightly. Official estimates of the proportion of the population that lives below the poverty line tend to vary sharply from year to year because adverse economic conditions, especially rise in food prices, are capable of lowering the standard of living of many families who normally live just above the subsistence level. The Indian government’s poverty line is based on an income sufficient to ensure access to minimum nutritional standards, and even most persons above the poverty line have low levels of consumption compared with most of the world countries.

Estimates in the late 1970s put the number of people who lived in poverty at 300 million, or nearly 50% of the population at the time. Poverty was reduced during the 1980s, and in Financial Year 1989 it was estimated that about 26% of the population, or 220 million people, lived below the poverty line. Slower economic growth and higher inflation in Financial Year 1990 and Financial Year 1991 reversed this trend. In Financial Year 1991, it was estimated that 332 million people, or 38% of the population, lived below the poverty line.4

Farmers and other rural residents make up the large majority of India’s poor. Some own very small amounts of land while others are field hands, seminomadic shepherds, or migrant workers. The urban poor include many construction workers and petty vendors. The bulk of the poor work, but low productivity and intermittent employment keep incomes low. Poverty is most prevalent in the states of Orissa, Bihar, Uttar Pradesh, and Madhya Pradesh, and least prevalent in Haryana, Punjab, Himachal Pradesh, and Jammu and Kashmir.

By the early 1990s, economic changes led to the growth in the number of Indians with significant economic resources. About 10 million Indians are considered upper class, and roughly 300 million are part of the rapidly increasing middle class. Typical middle-class occupations include owning a small business or being a corporate executive, lawyer, physician, white-collar worker, or land-owning farmer. In the 1980s, the growth of the middle class was reflected in the increased consumption of
consumer durables, such as televisions, refrigerators, motorcycles, and automobiles. In the early 1990s, domestic and foreign businesses hoped to take advantage of India’s economic liberalization to increase the range of consumer products offered to this market.\(^5\)

Housing and the ancillary utilities of sewer and water systems lag considerably behind the population’s needs. India’s cities have large shantytowns built of scrap or readily available natural materials erected on whatever space is available, including sidewalks. Such dwellings lack piped water, sewerage, and electricity. The government has attempted to build housing facilities and utilities for urban development, but the efforts have fallen far short of demand. Administrative controls and other aspects of government policy have discouraged many private investors from constructing housing units.

**Liberalization in the Early 1990s**

Increased borrowing from foreign sources in the late 1980s, which helped fuel economic growth, led to pressure on the balance of payments. The problem came to a head in August 1990 when Iraq invaded Kuwait, and the price of oil soon doubled. In addition, many Indian workers resident in Persian Gulf states either lost their jobs or returned home out of fear for their safety, thus reducing the flow of remittances. The direct economic impact of the Persian Gulf conflict was exacerbated by domestic social and political developments. In the early 1990s, there was violence over two domestic issues: the reservation of a proportion of public-sector jobs for members of Scheduled Castes and the Hindu-Muslim conflict at Ayodhya.\(^6\)

The central government fell in November 1990 and was succeeded by a minority government. The cumulative impact of these events shook international confidence in India’s economic viability, and the country found it increasingly difficult to borrow internationally. As a result, India made various agreements with the International Monetary Fund and other organizations that included commitments to speed up liberalization.
In the early 1990s, considerable progress was made in loosening government regulations, especially in the area of foreign trade. Many restrictions on private companies were lifted, and new areas were opened to private capital. However, India remains one of the world’s most tightly regulated major economies. Many powerful vested interests, including private firms that have benefited from protectionism, labor unions, and much of the bureaucracy, oppose liberalization. There is also considerable concern that liberalization will reinforce class and regional economic disparities.

The balance of payments crisis of 1990 and subsequent policy changes led to a temporary decline in the Gross Domestic Product (GDP) growth rate, which fell from 6.9% in Financial Year 1989 to 4.9% in Financial Year 1990 to 1.1% in Financial Year 1991. In March 1995, the estimated growth rate for Financial Year 1994 was 5.3%. Inflation peaked at 17% in Financial Year 1991, fell to 9.5% in Financial Year 1993, and then accelerated again, reaching 11% in late Financial Year 1994. This increase was attributed to a sharp increase in prices and a shortfall in such critical sectors as sugar, cotton, and oilseeds. Many analysts agree that the poor suffer most from the increased inflation rate and reduced growth rate.7

The Economic History of Indian Economy [from 1951-1996]

The Economic System of India

Before the last decade, the 1990’s, India was probably on the short list of almost every economist outside India of the countries with the worst economic systems. India had and probably still has a parasitical class of politicians and bureaucrats that micromanage the economy in the interests of their class. They hypocritically aver that they are doing what they are doing in the interest of the people of India. There has been some official allegiance to socialism with a goal of achieving it through Stalinist central planning. The fact that the result has been some horrible mixture of state capitalism and moribund corporatism is usually attributed to incompetence and ineptitude on the part of the bureaucracy. The Indian American economist Jagdish Baghwati of Columbia University remarked that he agreed with the view that “India’s
misfortune was to have brilliant economists: an affliction that the Far Eastern super-
performers were spared.” The policies implemented by the Government of India
before the last decade were brilliant only in maintaining the power and influence of
the bureaucrats. Judged with respect to an promoting the welfare of the Indian
people those policies were ridiculously bad, to the point of stupidity.  

The bureaucracy has been rather competent in generating excuses for the failure of
their policies. One of those excesses has been that there is a Hindu rate of growth
that is significantly lower than the rate of growth that other countries could achieve.
What the bureaucrats dare not say is that in maintaining a pool of economic rents the
bureaucrats’ policies were an outstanding success.

The disappointing economic progress in India up to 1990 cannot be attributed to any
shortcoming in talent among the Indian people or the impediments resulting from
Indian cultures. Indians out from under the oppression of the bureaucracy of the
Indian Government have succeeded spectacularly in professions and business.
Probably the misguidance of India development can be attributed to India’s First
Prime Minister, Pandit Jawaharlal Nehru. Nehru chose the goal of economic self-
sufficiency with economic development to be achieved by central planning modeled
on that of the Soviet Union. By cutting off imports India gave a protected market to
domestic producers. India got domestic production but it was production of low
quality, obsolete products. The policies stifled economic growth and India, with its
high level of population and poverty, could ill afford low rates of economic growth. 

The Indian Economic Plans had to be financed and this often meant taking resources
away from agriculture and giving them to pet industries that were not viable on there
own. Ultimately this meant starving agriculture to feed inefficient industries the
Government favored. Such a program was not likely to alleviate poverty and so in
1971, under Mrs. Indira Gandhi, the Government tried to eliminate poverty by
promoting small, labor intensive enterprises.
The net effect of the Government programs was to take away resources from agriculture in the countryside to give it to favored businesses in the cities. When the effects on agriculture and the countryside became significant, the plan added programs to help the countryside (labor intensive small businesses) and programs to aid agriculture such as a fertilizer subsidy. These programs to help agriculture and the countryside generally came from resources which the Government took away from agriculture and the countryside. The fertilizer subsidy may have been of greater benefit to the wealthier farmers than to the poorer farmers.\textsuperscript{11}

India’s output did grow but not as much as did that of other countries in the region. The Government of India generally takes credit for growth, but when India’s performance is compared to that of other countries one sees that the Government’s contribution to growth was negative. This shows the magnitude of the shortfall in growth that India’s oppressive system is responsible for. With the top performers achieving a growth rate of industrial production of about 10% while India achieved a growth rate of only at the most about 5%. The cost of the License Raj to India’s growth rate was about 5%, or half the rate of growth.

One of the most wonderful things to happen to the world was the genetic development of high-yielding grain varieties, the Green Revolution. This development probably put an end to famine from natural causes. Between 1970 and 1989 agricultural production in India did grow but the rate of increase was only 2.1% per year whereas over the same per period the annual rates of growth of farm output in Indonesia, Malaysia, the Philippines and Thailand were 3.7%, 4.7%, 3.6% and 4.5%, respectively. Again the cost of the License Raj to growth in India was about half the rate of growth. The cost of the License Raj more importantly is in the slower pace of alleviating poverty.\textsuperscript{12}
India’s Status AT A TIME OF Global Financial Crisis

New Delhi: The main concern for the emerging market economies (including India) may not be the direct exposure to global financial institutions, but more about access to credit and the slowdown, it is causing in America and other European economies.

Rama Prasad Goenka [RPG] Foundation chairman and economist, D.H. Pai Panandikar, says that Indian markets may not be as affected by the subprime crisis as they would be if there was a recession in the United State. He adds that Europe is on the brink of recession, and Germany is already in it. When big countries hit a recession, it is bound to have an effect on the Indian economy. "This will affect our rate of growth," he says. Economists point out that the extent of the effect will be decided by the nature of the United State Of America recession. If it is shallow (and the United State Of America comes out of it quickly), India may not suffer much of an impact. But if it is long and deep, India’s exports will be adversely affected.

As per Standard & Poor's Ratings Services [S&P] India's Principal Economist, D.K. Joshi, “Countries in the western world are net importers. If they slow down, Asian imports will also slow down. And don’t forget the liquidity crunch – India Inc is already having difficulty in raising funds. Market sentiments remain weak as Foreign Institutional Investments pull out money and uncertainty rules. Funding in sectors like real estate are showing signs of drying up altogether. Other Indian companies looking at borrowing outside will also have more difficulty, and the Gross Domestic Product (GDP) growth too is expected to stall. D.K. Joshi says that his company has forecast India to grow by 7.8% this year. "Next year will be slower," he says. Yet there are some bright spots amid this gloomy scenario. Sanjay Pant, IMF India's Representative, says that different countries will benefit or be affected differently. For instance, India is different from some other large emerging market economies in that it is not a net commodity exporter. In turn it will be helped by the decline in prices of commodities. Also its large domestic demand does shield it to some extent from the events outside. Panandikar adds that Information Technology companies may actually benefit as there will be pressure on United State Of America's companies to cut costs. So outsourcing of Indian Information Technology companies may actually increase in the long run.
India’s Foreign Trade and Global Economic Policies

India is quickly emerging as a powerful trade partner in the global economy. What was once an undeveloped, closed-off economy is now becoming a massive economic force in Asia, rivaling all in the region.

The economy of India is twelfth largest in the world (in exchange rates, with a Gross Domestic Product (GDP) of United State $1.089 trillion) and the fourth largest in the world by purchasing power. India has a population of 1,147,995,904, making it the second largest country in the world. In 2006, India’s trade reached 24% of Gross Domestic Product (GDP), which is by no means excessive, but is a huge increase from the 6% it was in 1985. On a global scale, Indian trade represents 1% of the world’s commerce.\textsuperscript{13}

India Maintains Sense of Optimism and Growth

NEW DELHI - While most of the world grapples with a crippling financial crisis and a recession, optimism reigns in much of India as its economy continues to grow. India’s trillion-dollar economy remains a relative bright spot, some say, in part because the country’s bureaucracy and its protectionist policies have kept it insulated from the fallout of the global downturn. “India is not as vulnerable” as other countries, said Rajeev Malik, head of Indian and Southeast Asian economics at Macquarie Capital, who recently wrote a report titled “India: Better Off Than Most Others.” India reported that its economy grew by 5.3% in the quarter ended in December when compared with the previous year. While that was down from the 7.6% growth in the earlier quarter, it was in sharp contrast to the retrenchment in other countries.

Washington, for example, reported that gross domestic product for the end of the year had contracted at an annualized rate of 6.2%, and Japan recently reported that its economy shrank at an annual rate of 12.7%.
Economic development in India.

The economic development in India followed a socialist-inspired policies for most of its independent history, including state-ownership of many sectors; extensive regulation and red tape known as "License Raj"; and isolation from the world economy. India's per capita income increased at only around 1% annualized rate in the three decades after Independence. Since the mid-1980s, India has slowly opened up its markets through economic liberalization. After more fundamental reforms since 1991 and their renewal in the 2000s, India has progressed towards a free market economy.

In the late 2000s, India's growth has reached 7.5%, which will double the average income in a decade. Analysts say that if India pushed more fundamental market reforms, it could sustain the rate and even reach the government's 2011 target of 10%. States have large responsibilities over their economies. The annualized 1999-2008 growth rates for Gujarat (9.6%), Haryana (9.1%), or Delhi (8.9%) were significantly higher than for Bihar (5.1%), Uttar Pradesh (4.4%), or Madhya Pradesh (6.5%). India is the eleventh-largest economy in the world and the fourth largest by Purchasing Power Parity adjusted exchange rates (PPP). On per capita basis, it ranks 128th in the world or 118th by Purchasing Power Parity [PPP].

The economic growth has been driven by the expansion of services that have been growing consistently faster than other sectors. It is argued that the pattern of Indian development has been a specific one and that the country may be able to skip the intermediate industrialization-led phase in the transformation of its economic structure. Serious concerns have been raised about the jobless nature of the economic growth.

Although living standards are rising fast, 75.6% of the population still lives on less than US$2 a day (Purchasing Power Parity, around US$0.5 in nominal terms), compared to 73.0% in Sub-Saharan Africa. In terms of occupation, two-thirds of the Indian workforce earn their livelihood directly or indirectly through agriculture in rural villages. As a proportion of Gross Domestic Product [GDP], towns and cities make over two thirds of the Indian economy. Favorable macroeconomic performance has been a necessary but not sufficient condition for the significant reduction of poverty
among the Indian population. The rate of poverty decline has not been higher in the post-reform period (since 1991). The improvements in some other non-economic dimensions of social development have been even less favorable. The most pronounced example is an exceptionally high and persistent level of child malnutrition (46% in 2005–6).

The progress of economic reforms in India is followed closely. The World Bank suggests that the most important priorities are public sector reform, infrastructure, agricultural and rural development, removal of labor regulations, reforms in lagging states, and HIV/AIDS. For 2010, India ranked 133rd in Ease of Doing Business Index, which is setback as compared with China 89th and Brazil 129th. According to Index of Economic Freedom World Ranking an annual survey on economic freedom of the nations, India ranks 124th as compared with China and Russia which ranks 140th and 143rd respectively in 2010.

India is the largest producer in the world of milk, cashew nuts, coconuts, tea, ginger, turmeric and black pepper. It also has the world's largest cattle population (193 million). It is the second largest producer of wheat, rice, sugar, groundnut and inland fish. It is the third largest producer of tobacco. India accounts for 10% of the world fruit production with first rank in the production of banana and sputa.

The required level of investment for the development of marketing, storage and cold storage infrastructure is estimated to be huge. The government has implemented various schemes to raise investment in marketing infrastructure. Among these schemes are Construction of Rural Go-downs, Market Research and Information Network, and Development / Strengthening of Agricultural Marketing Infrastructure, Grading and Standardization.

Main problems in the agricultural sector, as listed by the World Bank, are:

- India's large agricultural subsidies are hampering productivity-enhancing investment.
- Overregulation of agriculture has increased costs, price risks and uncertainty.
- Government interventions in labor, land, and credit markets.
- Inadequate infrastructure and services.
Research and development

The Indian Agricultural Research Institute (IARI), established in 1905, was responsible for the research leading to the "Indian Green Revolution" of the 1970s. The Indian Council of Agricultural Research (ICAR) is the apex body in kundiure and related allied fields, including research and education. The Union Minister of Agriculture is the President of the Indian Council of Agricultural Research (ICAR). The Indian Agricultural Statistics Research Institute develops new techniques for the design of agricultural experiments, analyses data in agriculture, and specializes in statistical techniques for animal and plant breeding. Prof. M.S. Swaminathan is known as "Father of the Green Revolution" and heads the MS Swaminathan Research Foundation. He is known for his advocacy of environmentally sustainable agriculture and sustainable food security.

Services

India is fifteenth in services output. Service industry employs 23% of the work force and is growing quickly, with a growth rate of 7.5% in 1991–2000, up from 4.5% in 1951–80. It has the largest share in the Gross Domestic Product [GDP], accounting for 57% in 2010 up from 20% in 1950. Business services (information technology, information technology enabled services, business process outsourcing) are among the fastest growing sectors contributing to one third of the total output of services in 2000. The growth in the Information Technology sector is attributed to increased specialization and availability of a large pool of low cost, highly skilled, educated and fluent English-speaking workers on the supply side and on the demand side, has increased demand from foreign consumers interested in India's service exports or those looking to outsource their operations. India's Information Technology industry, despite contributing significantly to its balance of payments, accounts for only about 1% of the total Gross Domestic Product or 1/50th of the total services.

The Information Technology Enabled Services - Business Process Outsourcing sector has become a big employment generator especially amongst young college graduates. The number of professionals employed by Information Technology and Information Technology Enabled Services [ITES] sectors is estimated at around 1.3 million as on March 2006. Also, Indian Information Technology [IT]- Information
Technology Enabled Services [ITES] is estimated to have helped create an additional 3 million job opportunities through indirect and induced employment.\textsuperscript{15}

**Banking and finance**

The Reserve Bank Of India [RBI] headquarters in Mumbai Since liberalization, the government has approved significant banking reforms. While some of these relate to nationalized banks (like encouraging mergers, reducing government interference and increasing profitability and competitiveness), other reforms have opened up the banking and insurance sectors to private and foreign players.

Currently, in 2007, banking in India is generally matured in terms of supply, product range and reach—even, though reach in rural India still remains a challenge for the private sector and foreign banks. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies of Asia. The Reserve Bank of India is an autonomous body, with minimal pressure from the government. The stated policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate.

Currently, India has 88 scheduled commercial banks (SCBs) — 28 public sector banks (that is with the Government of India holding a stake), 29 private banks (these do not have government stake; they may be publicly listed and traded on stock exchanges) and 31 foreign banks. They have a combined network of over 53,000 branches and 17,000 Auto Teller Machines [ATMs]. The public sector banks hold over 75% of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively.

Banks over the years, have become a significant aspect of an economy. With the ongoing financial depression, the position of banks have become all the more important in the course of working of the money market and hence the economy of a nation. The banking sector forming a portion of the financial sector primarily works as a financial intermediary generating money supply. From the different macroeconomic
models, banks have been found to be a part of the supply side of the economy. However, over time banks have transformed from merely money generating organizations to a multi tasking entity. In this paper, we shall deal with the role of banks in the context of the world economy as well as the Indian economy. The first section will illustrate the functions of a bank along with its classification. In the second section, we shall discuss the role of a banks as a major component of the service sector rendering to the economy as a whole. In the third section, we would like to empirically validate our hypothesis with a comprehensive data analysis.

The objective of commercial banks like any other organization is profit maximization. This profit generally originates from the interest differential between borrowers and lenders. In the present day, however, the banking operation has extended much beyond simple lending exercise. So there are other different channels of profit ensuing from other investment programmes as well. However, it should be mentioned in this context that the entire deposit held by a bank cannot be given as loans as the Central Bank retains a portion of this money in the form of cash-reserve for unforeseen circumstances.

Banks create money in the economy by making loans. The amount of money that banks can lend is directly affected by the reserve requirement set by the Federal Reserve. The reserve requirement is currently 3% to 10% of a bank’s total deposits. This amount can be held either in cash on hand or in the bank’s reserve account with the Reserve Bank. To see how this affects the economy, think about it like this. When a bank gets a deposit of $100, assuming a reserve requirement of 10%, the bank can then lend out $90. That $90 goes back into the economy, purchasing goods or services, and usually ends up deposited in another bank. That bank can then lend out $81 of that $90 deposit, and that $81 goes into the economy to purchase goods or services and ultimately is deposited into another bank that proceeds to lend out a %age of it. In this way, money grows and flows throughout the community in a much greater amount than physically exists. That $100 makes a much larger ripple in the economy than you may realize!
Other Services Offered by Banks

- Credit Cards
- Personal Loans
- Home and Car Loans
- Mutual Funds
- Business Loans
- Safe Deposit Boxes
- Debit Cards
- Trust Services
- Signature Guarantees
- ...and many other investment services.

STRUCTURE AND FUNCTIONS OF BANKS

1. Central Bank: A central bank, reserve bank, or monetary authority is the entity responsible for the monetary policy of a country or of a group of member states. Its primary responsibility is to maintain the stability of the national currency and money supply, but more active duties include controlling subsidized-loan interest rates, and acting as a lender of last resort to the banking sector during times of financial crisis (private banks often being integral to the national financial system). It may also have supervisory powers, to ensure that banks and other financial institutions do not behave recklessly or fraudulently.

2. Commercial Banks: A commercial Bank performs all kinds of banking functions such as accepting deposits, advancing loans, credit creation & agency functions. They generally advance short term loans to their customers, in some cases they may give medium term loans also. Ordinarily, the industrial banks perform three main functions: Firstly, Acceptance of Long term deposits: Since the industrial bank give long term loans, they cannot accept short term deposits from the public. Secondly, Meeting the credit requirements-of-companies: Firstly the industries require to purchase land to erect buildings and purchase heavy machinery. Secondly the industries require short term loans to buy raw materials & to make payment of wages to workers. Thirdly it does some Other Functions - The industrial
banks tender advice to big industrial firms regarding the sale and purchase of shares and debentures.

3. Agricultural Banks: As the commercial & the industrial Banks are not in a position to meet the credit requirements of agriculture, there arises the need for setting up special types of banks to finance agriculture. Firstly, the farmers require short term loans to buy seeds, fertilizers, ploughs and other inputs. Secondly, the farmers require long term loans to purchase land, to effect permanent improvements on the land to buy equipment & to provide for irrigation works.

4. Foreign Exchange Banks: Their main function is to make international payments through the purchase and sale of exchange bills. As is well known, the exporters of a country prefer to receive the payment for their exports in their own currency. Hence their arises the problem of converting the currency of one country into the currency of another. The foreign exchange banks try to solve this problem. These banks specialize in financing foreign trade. Indigenous Banks: According to the Indian Enquiry Committee, “Indigenous banker is a person or a firm which accepts deposits, transacts business in hundies and advances loans etc”.

INTRODUCTION OF THE STUDY
The evolution of State Bank of India can be traced back to the first decade of the 19th century. It began with the establishment of the Bank of Calcutta in Calcutta, on 2nd June 1806. The bank was redesigned as the Bank of Bengal, three years later, on 2nd January 1809. It was the first ever joint-stock bank of the British India, established under the sponsorship of the Government of Bengal. Subsequently, the Bank of Bombay (established on 15th April 1840) and the Bank of Madras (established on 1st July 1843) followed the Bank of Bengal. These three banks dominated the modern banking scenario in India, until when they were amalgamated to form the Imperial Bank of India, on 27th January 1921.

An important turning point in the history of State Bank of India is the launch of the first Five Year Plan of independent India, in 1951. The Plan aimed at serving the Indian economy in general and the rural sector of the country, in particular. Until the Plan,
the commercial banks of the country, including the Imperial Bank of India, confined their services to the urban sector. Moreover, they were not equipped to respond to the growing needs of the economic revival taking shape in the rural areas of the country. Therefore, in order to serve the economy as a whole and rural sector in particular, the All India Rural Credit Survey Committee recommended the formation of a state-partnered and state-sponsored bank.

The All India Rural Credit Survey Committee proposed the take over of the Imperial Bank of India, and integrating with it, the former state-owned or state-associate banks. Subsequently, an Act was passed in the Parliament of India in May 1955. As a result, the State Bank of India (SBI) was established on 1st July 1955. This resulted in making the State Bank of India more powerful, because as much as a quarter of the resources of the Indian banking system were controlled directly by the State. Later on, the State Bank of India (Subsidiary Banks) Act was passed in 1959. The Act enabled the State Bank of India to make the eight former State-associated banks as its subsidiaries.

The State Bank of India emerged as a pacesetter, with its operations carried out by the 480 offices comprising branches, sub offices and three Local Head Offices, inherited from the Imperial Bank. Instead of serving as mere repositories of the community’s savings and lending to creditworthy parties, the State Bank of India catered to the needs of the customers, by banking purposefully. The bank served the heterogeneous financial needs of the planned economic development.16

**Branches.**

The corporate center of State Bank Of India is located in Mumbai. In order to cater to different functions, there are several other establishments in and outside Mumbai, apart from the corporate center. The bank boasts of having as many as 14 local head offices and 57 Zonal Offices, located at major cities throughout India. It is recorded that State Bank Of India [SBI] has about 10000 branches, well networked to cater to its customers throughout India.
ATM Services
State Bank Of India provides easy access to money to its customers through more than 8500 Auto Teller Machines [ATMs] in India. The Bank also facilitates the free transaction of money at the ATMs of State Bank Group, which includes the ATMs of State Bank of India as well as the Associate Banks – State Bank of Bikaner & Jaipur, State Bank of Hyderabad, State Bank of Indore, etc. You may also transact money through State Bank Of India, Commercial and International Bank Limited by using the State Bank ATM-cum-Debit Card.

2. THEORETICAL FRAME WORK

A commercial bank is a financial intermediary because it remains in between saving makers i.e. House-Hold Sector or General Public and Investors. i.e. Business Sector or Entrepreneurs. Commercial banks contribute to economic development of the country through the process of creating or generating saving, mobilizing saving and channelizing saving; we can explain process of credit creation in the following manner.

Creating or Generating Saving:
Commercial banks encourage people to increase saving by explaining them importance of saving, Banks explain people that they can earn interest on savings, They can spend on social ceremonies like arranging marriages of their children. Saving is also useful as a old age security. This is how commercial banks encourage people to increase saving.

Mobilizing Savings:
If saving among people increases this saving is to be mobilized to the Banks themselves. For this commercial banks will have to offer various attractive schemes by opening branches in various areas, to deposit savings made by people in the commercial banks. This is how commercial banks are mobilizing savings.

Channelizing savings: Once savings made by people are deposited in commercial banks, then commercial banks have to channelize this savings by issuing loans and advances, to the various sectors of the economy. Borrowers of these loans will make investments. This is how investment increases and increase in investment will increase capital formation, increase in capital formation will increase production and
national income. This increase in Production and National Income will turn into Economic Development. This is how commercial banks play an important role in economic development of the country.

The word bank is coined from the original word banca in Latin. Which means “bench” and Bench means money lenders’ table.

History of banking

How banks developed out of Goldsmith Establishments
All these facts are so much taken for granted by every modern banker that he is hardly aware of them. But it was not always so. According to superficial but useful history, commercial banking began with the ancient goldsmiths, who developed the practice of storing people’s gold and valuables for safekeeping. At first such establishment were simply like parcel checkrooms or warehouses. The depositors left their gold for safekeeping, were giving a receipt, later presented that receipt paid a small fee for the safekeeping, and got back their gold.

Quite obviously, however, money is wanted only for what it will buy, not for its own sake. Money has an anonymous quality, making one dollar just a good as another, and one piece of pure gold as good as another. The goldsmiths soon found it more convenient to have to tag the gold belonging to any one individual so as to be able to give to him upon request exactly the same piece of gold that he had left. Instead, the customer was quite willing to accept for a receipt for amount of gold or money of a given value, even though it was not the identical particle of matter that he actually left. This “anonymity” is important. There lies a significant difference between today’s bank and a checkroom or warehouse. If I check my bag at Kennedy Airport and later see someone walking down the street with that same suitcase. I call my lawyer and sue the airlines. If I mark initials on a ten-dollar bill, deposit it in my bank account, and late notice it in the hands of a stranger, I have no grievance against the bank management. They have only agreed to pay me on demand any old $10 But let us return to be goldsmith establishments, which are supposed to typify the first embryonic commercial bank. What would balance sheets of a typical establishment look like? Perhaps like following table. We assume the company has long since dropped its activities as a smith and is principally occupied with storing people’s
money for safekeeping. Over past time, $1 million had been deposited in its vaults, and this whole sum it holds as a cash asset. To balance this asset, there is current deposit liability of the same amount. Actually, such as a business need have no other asset [except the negligible value of its office space and vaults]. But its owners could have – on the side, so to speak – subscribed $50000 of capital to be lent out at interest or to buy securities like stocks or bonds. On the asset side, this is shown under the heading Loans and Investments, it is balanced on the right-hand side by a like sum in the Capital and Retained Earnings account.

At this primitive stage, the bank would be of no particular interest to the economist. These investment and capital Items have nothing to do with the bank’s deposits, if all the bank’s loans and investments should go and become worthless, the loss would fall completely on the stockholders, who have agreed to take that risk in the hope of making a profit. Every depositor could still be assisted off in full out of the 100% cash reserves held by the bank. The bank would still cover its overhead and

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<tr>
<td><strong>First gold smith bank held 100 % cash reserves against demand deposits.</strong></td>
<td></td>
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<tr>
<td>Only 1-to1 creation of deposits out of new reserves was possible at the primitive stage.</td>
<td></td>
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<tr>
<td>There was nothing ‘high-powered’ about reserves in those days.</td>
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<table>
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<th>BALANCE SHEET OF EARLY BANK</th>
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<tr>
<td><strong>ASSETS</strong></td>
<td><strong>LIABILITIES AND NET WORTH</strong></td>
</tr>
<tr>
<td>Cash reserves</td>
<td>Capital and retained earnings</td>
</tr>
<tr>
<td>Loans and Investments</td>
<td>Demand deposit liability</td>
</tr>
<tr>
<td>$1,000,000</td>
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<td><strong>Total</strong></td>
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<td>1,050,000</td>
<td>$1,050,000</td>
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Clerical expenses by making customers pay storage charges. This would presumably vary with the length of time the customer left his money for safekeeping, the average amount of his money requiring safekeeping and the number of times the turnover of his account made a clerk wait on him and keep various records.

Economists could ignore such a bank’s operations. The bank money— the demand deposits created jointly by the bank’s willingness to accept a demand obligation and the customer’s willingness to hold a deposit – would just offset the amount of ordinary money [currency or coin] placed in the bank’s safe and withdrawn from active circulation. The process would be of no more interest than if the public decided to convey some dollar bills into an equivalent amount of dimes. One says that the banking system has a rental effect on spending and prices – not adding or subtracting from total volumes of money or its velocity.

**BANKING AS A BUSINESS**
Banking is a business much like any other business. The commercial bank is a relatively simple business concern. A bank provides certain services to its customers [depositors and borrowers] and in return receives payments from them in one form or another. It tries to earn a profit for its stock owners.

A member bank’s balance sheet shows certain assets, certain liabilities, and certain capital ownership. Except for minor rearrangements, the bank’s published balance sheet looks, on the whole, much like the balance sheet of any other business, and rather simpler than most. The only peculiar feature about the consolidated bank balance sheet shown in the following table is the fact that such a large portion of its liabilities are payable on demand; i.e. These deposits are created and controlled by the central bank.

This fact is intriguing to economists because we choose to call such demand liabilities money; but to the banker it is a familiar condition which has long since been taken for granted. He knows well that, although it would be possible for every depositor suddenly to decide to withdraw all this money from the bank on the same day, the probability of this is quite remote. Each day, as some people withdraw their
money, others normally make deposits tending to cancel the withdrawals. In a growing community, new deposits more than offset the withdrawals from an average bank.

This, however, need not be strictly true at any one moment, in any one day, or in any one week. By chance alone the amount of withdrawals might exceed deposits for some period of time – just as a coin may land with heads, rather than tails, turned up for a consecutive number of tosses. For this reason, the banker would voluntarily keep a little cash- but only a little – handy in his vaults and perhaps as a “reserve deposit” at the nearby Federal Reserve Bank.

Table
Demand deposits are liabilities of banks

Reserves and demand deposits are the two key items of interest to our later economic analysis. Reserves are this large primarily because of legal requirements and not to provide against possible unexpected withdrawals. [source: Federal Reserve Bulletin]

CONSOLIDATED BALANCE SHEET OF ALL MEMBER BANKS,
JANUARY 1, 1972 [in billions of dollars]

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
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<tbody>
<tr>
<td>Reserves $31.3</td>
<td>Capital accounts $37.3</td>
</tr>
<tr>
<td>Loans and discounts 277.7</td>
<td>Demand Deposits 213.4</td>
</tr>
<tr>
<td>U.S. government</td>
<td>Time deposits 212.0</td>
</tr>
<tr>
<td>Securities 47.6</td>
<td>Other liabilities 48.7</td>
</tr>
<tr>
<td></td>
<td>Total</td>
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<td>$511.4</td>
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3. OBJECTIVES OF THE STUDY

The above exposition of our key focus of the statement of the problem leads us to formulate the objectives of the research study. The major essence of this proposed research study is to examine the role and contribution of the State Bank Of India to the Indian Economy and to assess the performance of the State Bank Of India and its efficacy in the economic development of India. This will be analyzed by sector wise performance and project wise analysis at national level. The following are the objectives of the propose research work.

1. To find out whether the State Bank of India has spurred growth and economic development in India.

2. To find out whether the State Bank of India contributes financial assistance to increase aggregate welfare, measured by Human Development Index in India.

3. To find out whether the State Bank of India has improved the infrastructure facilities.

4. To find out whether the State Bank of India has fostered development of the agricultural and industrial sector in India by providing loan and advances.

5. To find out whether the State Bank of India’s financial assistance has positive impact on economic growth when there is sound macroeconomic policy in India.

6. To find out whether the State Bank of India's financial assistance affects the government expenditure.
4. HYPOTHESIS OF THE STUDY

Hypothesis means a non obvious statement that makes an assertion or it can be an underlying proposition or statement that can be supported by argument and evidence. The Hypothesis describes two relationships on the independent and dependant variables. The hypothesis enables the researcher to test relationship of a profound statement. From the above logic the following are the hypothesis of the study:

1. The State Bank of India has spurred growth and economic development in India.

2. The State Bank of India contributes financial assistance to increasing aggregate welfare, measured by Human Development Index [HDI], in India.

3. The State Bank of India has contributed the development of infrastructure like power, irrigation transport and telecommunication in India.

4. The State Bank of India has spurred the development of agriculture and industrial sector by providing loans and advances in India.

5. The State Bank of India’s financial assistance has positive impact on economic growth when there is a sound macro economic policies in India.
5. RESEARCH METHODOLOGY AND DATA COLLECTION

The present study has proceeded through two kinds of analysis: Descriptive and quantitative analysis. Descriptive analysis of various projects financed by the State Bank of India is carried out using secondary data collected from various reports and economic reviews published by the institutions in India and other international institutions such as "Indian Banks’ Association" and Wikipedia, the free encyclopedia. Quantitative analysis is carried out after collection and compilation of the required secondary data by applying statistical and regression models to capture the functional relationship by using Ordinarily Least Squire [OLS] regression in the present study.

This research work being built upon secondary data survey makes us theoretical and historical framework of the State Bank Of India with a major intention of capturing the model of foreign assistance in economic development and the evolving role of the State Bank of India playing development agency. The empirical input enables us to examine the data collected and conclusively say whether the State Bank Of India has performed satisfactorily and its efficacy realized in the economic development in India or not. In our study we will use the Ordinarily least Squire [OLS] to run the regression equation. The regression sample runs from 1990 to 2010. The model tests the long run effectiveness of the state Bank Of India and official development as assistant in the economic development of India. This module period is of 1990-2010.
Data sources and their description

Past studies of effectiveness were mostly based on cross country data. Only few studies used time serried data from individual countries. It is generally believed that single country tune series analysis is more useful, as it can capture country specific features that may not be found in a cross country analysis. The use of secondary data which we have scrutinized through only before being applied for empirical investigation. The data used in our study is based on the State Bank of India, World development Indicator 2010. For this study to be accurate a reliable data has to be collected. Data provided by the national sources differ significantly from those found in international sources such as the "Indian Banks' Association". After a rigorous analysis of our topic of study data from the State Bank of India and Government of India were selected appropriately. The State Bank of India data is more reliable as these are collected directly from the donors who have better recording system in India. Although these data are mostly collected from national sources, the State Bank of India does internal consistency counter checks and supplements the data from the Indian source with their occasional sectors. The variable used are the Gross Domestic Production [GDP] per Capita, Official Development Assistant [ODA] the Reserve Bank Of India Assistance [RBI] Total national population, money supply, inflation, infant mortality and total government expenditure. Interpretation of data will take the form of tables, charts, graphs, diagrams, figures, estimates, %ages, ratios, statistical models like least ordinary squares, means and other for the clarity purposes.
6. CHAPTER DESIGN

The entire research study is divided into eight chapters. Brief outlines of the thesis are as follows.

Chapter One: It is chapter of introduction. This chapter discusses the background of India, background of the study, research methodology, objectives, hypothesis, and scope, limitation of the study and literature review.

Chapter Two: This chapter discusses the origin of the State Bank of India, its establishment membership and its structure so as to understand how the State Bank of India Was formed and what are its objectives.

Chapter Three: This chapter briefly discusses the financial structure and leading policies of the State Bank of India in India.

Chapter Four: State Bank of India is financing for Human development in India.

Chapter Five: State Bank of India is financing for infrastructural development in India.

Chapter Six: State Bank of India is financing in agriculture and industries in India.

Chapter Seven: Empirical assessment of the State Bank of India’s financing in the economic development in India.

Chapter Eight: This chapter contains summary of the study and it also includes findings, conclusions, policy recommendation and suggestion for further research.
7. LITERATURE REVIEW

INTRODUCTION OF LITERATURE REVIEW

The main objective of literature review is to substantiate the rationale of the present research study by providing an overview of empirical analysis to highlight the research trend and offer critique to the research problem. The methodology employed guides the direction of the study, which aims to fill up the lacunae into the existing knowledge and examine the relationship and performance of State Bank Of India in economic development of India. The main objective of this research study is to survey the numerous literatures to enable us to develop the model that is presented in Empirical Analysis.

From the above logic the present research work being an empirical study drawn from a variety of books and journals relating to the broad rubrics of economic development. The main objective of this study is to know the of effectiveness of the Banking sector, commercial Banks and State Bank Of India in economic development in India. Here we have surveyed research papers, published in various journals and reports from both international and national institutions etc.

A. International Level Literature Review

At International Level many studies are made on Commercial Banks. We have surveyed here few studies, they are as follows.

McKinnon (1973)\textsuperscript{17} has stated in his study made for China and India that the proper sequencing of financial sector and capital account liberalization is one of the most important policies in preventing another Asian-type “capital account” crisis. It is now widely accepted that capital account liberalization should follow current account and domestic financial sector liberalization. This sequence issue is even more important for countries such as China and India, which have not yet launched full capital account convertibility and where public-sector banks still remain dominant. In such countries, financial sector liberalization comes against more politically difficult issues than those that have already opened up their capital account to a substantial degree since they have to first restructure predominant public-sector banks.
Ojha (1987)\(^{18}\) in his paper gave a detailed description of the concepts, productivity and profitability of public sector banks and outlined the difficulty of measuring those concepts. He studied these aspects with a number of indicators and outlined that the profitability of the banks has not been improving despite increases in productivity. On an international comparison our public sector banks showed very low level of productivity and profitability. He emphasized that a more comprehensive and multi-dimensional approach has to be adopted to increase productivity and profitability in India.

Beverly L. Milkman [1993]\(^{19}\) This is a study about USA, it is about the shift in economic development responsibility away from the federal level-**United States** in the 1980s, state and local governments have been called upon to join forces with the private sector to plan and finance local development. The Economic Development Administration (EDA) has attempted to help local public and private sector leaders assume this responsibility by sharing information on successful local innovations with substantial private sector involvement. In this article, an EDA project that tested the widespread utility of the Bank Community Development Corporation (Bank CDC) is described for the purpose of acquainting economic development practitioners with an innovative financing tool.

Ross Levine and Sara Zervos [1993]\(^{20}\) have also made study about USA. This paper shows that stock market liquidity and banking development both positively predict growth, capital accumulation, and productivity improvements when entered together in regressions, even after controlling for economic and political factors. The results are consistent with the views that financial markets provide important services for growth in **United States**, and that stock markets provide different services from banks. Considerable debate exists on the relationships between the financial system and economic growth. Historically, economists have focused on banks. Walter Bagehot (1873) and Joseph Schumpeter (1912) emphasize the critical importance of the banking system in economic growth and highlight circumstances when banks can actively spur innovation and future growth by identifying and funding productive investments.
Clarke and Cull (1998)\textsuperscript{21} have demonstrated that Argentina promoted the privatization of public-sector banks in a reasonably developed regulatory and infrastructure environment, and thus privatized banks improved productivity remarkably.

Richard E. Messick [1999]\textsuperscript{22} The study surveys a wide range of current studies on judicial reform and finds some surprising results assessed the importance of sound judicial systems to good governance and economic growth, the World Bank and several other donor organizations have funded judicial reform projects in more than two dozen developing countries and transition economies during the past few years. Yet little is known about the actual effect of judicial reform on economic performance or even about what elements constitute a sound reform project.

Claessens, Demirgüç-Kunt and Huizinga (2000)\textsuperscript{23} authors have made this study of Holland have reported that the number of entrants matters compared with their Holland market share, indicating that foreign banks affect local bank competition upon entry rather than after they have gained a substantial market share. Moreover, these banks may be able to provide a source of new capital for enterprises and thus reduce government restructuring costs, especially when the domestic banking sector is devastated in the aftermath of a crisis. They also found out that foreign banks tend to go for higher interest margins and profitability than domestic banks in developing countries, while the opposite is true in developed countries.

Viverita (1997-2006)\textsuperscript{24} In this study according to author An inclusive merger mechanism became one option for the Indonesian banking industry to response the Asian Financial crisis under its bank consolidation program. This study gives insight into the effectiveness of economic policy reforms in the Indonesian banking industry. This study examines the impacts of merger on commercial bank’s performance in Indonesia during 1997 to 2006. The period was characterized by financial deregulation, the Asian economic crisis, and bank restructuring programs. The traditional financial ratios and non-parametric Data Envelopment Analysis approach is employed to investigate any efficiency gains both in the pre and post merger periods, in order to detect whether bank mergers produce any efficiency gains as well as factors contributed to the performance. The evidence shows that merger created
synergy as indicates by the statistically and significantly increasing the post-merger financial and productive efficiency performances.

James Laurenceson, J. C. H. Chai [2000] This is a study of China’s financial sector. The authors have analyzed State-owned banks remain dominant in China's financial sector despite over two decades of gradual financial liberalization. Their performance is typically evaluated using commercial banking criteria. The standard view is that because state banks have experienced declining profitability and capital adequacy, they have been a drain on past economic development and endanger future growth prospects. However, we argue that state banks have strong development bank characteristics and hence warrant different performance criteria. The analysis in this paper suggests that while their commercial performance may have been poor, the overall impact of State banks on China's economic development appears to have been both positive and sustainable.

B. National Level Literature Review
At National Level also many studies have been made on banking sector. Some of these studies, we have reviewed as under.

S.G. Shah (1979) has evaluated while discussing the profitability of banks, has disfavored the attitude of banks that higher profitability can result from increased spread and that innovations have a team spirit and improvement in the management for improving bank profitability.

Kiran Chopra (1987) in her book entitled Managing Profits, Profitability and Productivity in Public Sector Banking, studied the emerging trends in profits and profitability of some selected public sector banks. She is of the opinion that there is a need to introduce management essentials for the better managements of profits and productivity of public sector banks and recommended proper management of both costs as well as earnings.
Rangarajan (1994) has examined in this study about the credit position for the poor in India and how the poor can help themselves. A number of programmes have been designed specifically to enlarge the flow of credit to the poor through programmes like Integrated Rural Development Program (IRDP), Differential Rate of Interest, Self Employment Programmes for urban poor. Despite these efforts, the desired effects have not been achieved. The cumbersome lending procedure, inadequate supervision and the apathy of bank staff have been resulted in delayed and untimely credit, which had further led to large scale mis-utilization of loans and default of credit. Non governmental organizations (NGOs) and Self-Help Groups can play an important role in rural credit. Non governmental organizations (NGOs) can act as catalysts which facilitate project formulations by bank and their effective implementation, thus becoming efficient channels during disbursal of credit to the rural poor.

Joshi and Little (1996) In this study state that Prior to the Reforms, India’s financial sector had long been characterized as highly regulated and financially repressed. The prevalence of reserve requirements, interest rate controls, and allocation of financial resources to priority sectors increased the degree of financial repression and adversely affected the country’s financial resource mobilization and allocation. After Independence in 1947, the government took the view that loans extended by colonial banks were biased toward working capital for trade and large firms. Moreover, it was perceived that banks should be utilized to assist India’s planned development strategy by mobilizing financial resources to strategically important sectors.

Sarkar and Bhaumik (1998) have concluded in their analysis that foreign banks, despite the superior quality of services they offer, have not been a competitive threat in Delhi, West Bengal and Maharashatra, where their presence is the greatest. This shows that competition has emerged only at the fringe, since the entry of new banks have been at the lower end. Domestic private banks have gained some market share in these regions, but the impact on public-sector banks was small and gained at the expense of foreign banks. In Uttar Pradesh, Madhya Pradesh, Bihar, Orissa, Gujarat and Punjab, public-sector banks have been predominant before and since the reforms, thus no apparent impact from new entries was observed. In Tamil nadu,
Kerala, Andhra Pradesh, Karnataka, Jammu and Kashmir and Rajasthan, private domestic banks have been more concentrated than in other regions and have experienced an increase in market shares at the expense of public-sector banks. But the presence of foreign banks was small.

**Meenakshi Malhotra (1999)** in her study, “Banking Sector Reforms – Experience of Public Sector Banks,” has analyzed the performance of Public Sector Banks as a result of banking sector reforms. Her study is divided into two parts. In the first part, a brief review of banking reforms has been made. The major reforms being deregulation of lending/deposit rates deregulation of entry, revamping of branch licensing policy, measures to improve the financial health, measure to improve the operating efficiency and reserve pre-emption. In the second part, she has discussed the impact of banking sector reforms on Public Sector Banks, after dividing the reform period of 1992-98 into two phases.

Phase I pertaining to the period 1992-93 to 1995-96 and phase II pertaining to thereafter. The profitability of the banks became negative from 0.28% in 1991-92 to -0.99% in 1992-93 and further 1.15% in 1993-95. The situation started improving in 1994-95 but the negative trend continued again in 1995-96 (-0.07%), however, the profitability has improved during 1996-97 and 1997-98. It was concluded by her that the positive effect of reforms had been felt by the banks so far as their profitability performance was concerned.

**Rohit Rao (1999)** in his detailed study regarding banks has concluded that public sector banks remained in the comfort of a controlled economy up to liberalization in India. But with the economy opening up, there has been a change in mind set. Now there is a change in paradigm in Indian banking. He is of the opinion that as the economy wilted, the Indian banking industry in 1997-98 managed to emerge pretty much unscathed. The year 1997-98 marked the sixth year of financial sector reforms in which public sector banks continued to clean up their balance sheets as well as strengthen their capital base. It was reflected in reduced Non Performing Assets[NPAs] and improved Capital Adequacy Ratio [CAR], the operating profits of Public Sector Banks [PSBs] increased by 15.5%. He says that after liberalization, banking is no more a cushy job; now Public Sector Banks [PSBs] have to evolve
clearly define goals and strategy, not only to grow the business but to sustain it. He is of the opinion that various Public Sector Banks [PSBs] suffered on account of Asian flu which dragged down the rupee. According to him now only way to increase or even maintain profitability is to increase volumes. Despite improved profitability (1997-98), the Public Sector Banks [PSBs] that are listed are quoting much below their issue price. The level of Non Performing Assets [NPAs] of Public Sector Banks [PSBs] that dominate the market is unsatisfactory with international standards. Out of 27 Public Sector Banks [PSBs], ten had Non Performing Assets [NPAs] in double digits.

**Allen and Gale (2000)** have mentioned in their study that the second unique feature of India’s banking sector is that the Reserve Bank of India has permitted commercial banks to engage in diverse activities such as securities related transactions (for example, underwriting, dealing and brokerage), foreign exchange transactions and leasing activities. The 1991 reforms lowered the Cash Reserve Ratio [CRR] and Statutory Liquid Ratio [SLR], enabling banks to diversify their activities. Diversification of banks’ activities can be justified for at least five reasons. First, entry deregulation and the resulting intensified competition may leave banks with no choice but to engage in risk-taking activities in the fight for their market share or profit margins. As a result, risk-taking would reduce the value of banks’ future earnings and associated incentives to avoid bankruptcy.

**Reddy (2000)** has noted that the Indian financial sector today is significantly different from what it used to be a few decades back, in the 1970s and 1980s. The Indian financial system of the pre-reform period essentially catered to the needs of planned development in a mixed-economy framework where the Government sector had a predominant role in economic activity. Fiscal activism to kick start economic growth took the form of large developmental expenditures by the public sector, much of it to finance long-gestation projects requiring long-term finance.

**CRISIL [Credit Rating Information System of India Ltd] Study (2002)** In this study concluded that lower operating expenses improved the profitability of banks, contrary to the popular perception that only trading profits helped the banking sector shore up their bottom lines. The reduction in operating expenses became possible
the rough large scale Voluntary Retirement Services [VRS] implemented by Public Sector Banks [PSBs]. As this reduction in operating expenses seems sustainable, a brighter future for the banking sector in India is expected. The study concluded that the banking sector is now reaping the benefits of rationalization of employee costs, and undertaking various other cost reduction initiatives. The study pointed out that banks ability to repeat and sustain such initiatives would be a deciding factor in maintaining their productivity and profitability in the years to come.

C. Literature Review On Commercial Banks

Some specific studies on Commercial Banks are as follows.

S.K. Varghese (1983)\textsuperscript{36} in his study, “Profits and profitability of Indian Commercial Banks in 1970s” has stated that profit and profitability indicators computed from the banks published balance sheets and profit and loss account do not reflect the true financial feature of banks. He has analyzed the profits and profitability of groups of Indian commercial banks 1970-79 by using operating results, operating margins, growth yield on assets and spread related ratios. According to him, during that period Statutory Liquid Ratio and Cash Reserve Ratio requirements of Indian and foreign bank groups were the same. The large yield differential between them gives a clue regarding the declining profitability of Indian banks. While discussing the employee’s productivity, he has used five proxy indicators, giving a broad measure of the trend of productivity in Indian commercial banks.

He held monitory policy measures responsible for the increased in profits and profitability of commercial banks in mid-1970s, GUPTA (1983) has empirically established the fact that for purposes of comparison of profitability levels among different firms within a homogenous industry groups, profitability of sales measure is superior to profitability of asset measure.

V.V. Angadi and V. Johan Devraj (1983)\textsuperscript{37} in their study, “Productivity and profitability of banks in India” aimed at assessing the productivity and profitability of Indian scheduled commercial banks during the period of 1969-80. According to them, the profitability of banks is governed by several factors, some of them endogenous
and some of them exogenous to the system and yet structural. As far as profitability was concerned various changes had their impact on banks' earnings, expenses, and overall profitability during the period under review. A thorough analysis of volume and pattern of expenses has been made. The pattern of aggregate earnings and expenses analyzed above has an impact on the levels of profits made during the period. They concluded that changes in the earnings, expenses, working funds, priority sectors, growth of bank offices, employees, credit deposit ratio, investment deposit ratio, interest rate structure, patterns of deposit etc. During the period under review affected the productivity and profitability of scheduled commercial banks.

**Durgadas Roy (1986)** in his article entitled bank profitability: social role is no barrier, studied that the productivity and profitability of scheduled commercial banks in India and revealed that during 1970-80, profitability and productivity ratios of foreign banks were the highest.

**A.K. Vashisht (1987)** in his thesis entitled, “Performance Appraisal of Commercial Banks in India,” evaluated the performance of public sector banks with regard to six indicators viz., branch, expansion, deposit, credit, priority sector advances, Deposit Rates /advances and net profit, over the period of 1971-83. He has used a composite weighted growth index to rank the banks as excellent, good, fair and poor. In order to improve the performance, he suggested developing marketing strategies for deposit mobilization, profit planning and SWOT [Strength, Weakness, Opportunity and Threat] analysis.

**Desai (1988)** assessed the institutional credit requirement for agriculture production in 2000 A.D. and observed the growth rate of total credit between 1972-73 and 1982-83 was 17 % in nominal terms. The commercial bank’s share has more than doubled from 16.31% in 1972-73 to 35.85% in 1982-83. He estimated short term credit requirement by taking the total value of crop output from the cost of cultivation scheme of government of India for the period from 1974-75 to 1984-85 and found that the growth rate in agriculture advance to be 16.28%.
Ramdass (1989)\textsuperscript{41} in this study has measured the institutional credit flow in Pondicherry and observed that the short term credit advance by the institutions had grown enormously, while the long term credit lagged behind. He suggested the need for institution to come forward to provide long term credit and utilize the saving mobilized in rural areas exclusively for rural investment.

C.R. Kothari (1991)\textsuperscript{42} in his book entitled, Social Banking and Productivity, analyzed the productivity, profitability and social objectives in public sector banks and stressed the need for better profitability in banks to ensure the bank’s role in the development of an economy.

Sanjay Kaushik (1995)\textsuperscript{43} in his thesis entitled, “Social objectives and profitability of Indian banks,” has discussed the effect of social objective/obligations on the profits and profitability of the Indian commercial banking industry. He is of the opinion, that the nationalization of the banks had a more dampening effect on profitability. The profitability of nationalized banks is adversely affected by a lot of factors, including social objectives. So, to know there relative significance, he has used a multivariate approach viz, ratio analysis, per annum growth rates, correlation analysis, regression analysis and factor analysis. He concluded that the social obligation was not a major drag on profitability of banks. He suggested various measures to improve the profitability.

Puhazhendhi and Jayaraman (1999)\textsuperscript{44} in this study are concerned about the growth of agriculture advance during 1990-96, pointed out that despite the phenomenal growth in absolute terms, the proportion of amount outstanding advance to priority sector showed a declining trend from 16.9% in June 1990 to 14.3% in March 1996. The reversal trend was observed in 1996-97 March when the loans for agriculture constituted 16.3% of net bank advances. The share of priority sector lending at all India level whose share had declined from the peak of 42.9%. In 1985 marginally improved to 41.7% in March 1997.
Nair (2000) in his analysis has reviewed recent trends in rural financial intermediaries and commercial banks in India indicated that the commercial banks credit to rural areas during the late 1980’s and early 1990’s has shown a deceleration in growth. The relative proportion of bank credit flowing to priority sector, especially agriculture was fallen below the target of 18% at a national level since the mid 1980’s.

Abate (2000) has made study of the loan and advances to agriculture from all of the financial institutions shown significant compound growth rate over the study period. Compared to the growth in term loan (13.0%), the growth in crop loan (17.2%), which is a major index of agriculture production finance has shown a higher growth rate in Karnataka state during the study period. Similarly, the growth in agricultural advances (12.5%) has shown higher growth rate in direct agricultural advances (10.9%). However the share of agriculture advance and weaker section had shown a declining trend during the study period. The recovery performance of agricultural advances in commercial banks, regional rural banks and co-operative banks has shown a positive trend. Only the recovery performance of primary cooperative agricultural and rural development bank had shown a declining trend. With respect to the problems encountered in Agriculture credit system, misutilization of loan amount by borrower, willful and deliberate default by borrowers and diversion of income generated out of the investment have found prime importance in the order.

D. Literature Review On State Bank of India

Here we have reviewed specific studies on State Bank Of India. We have put these studies as under.

Balishter et. al. (1989) attempted in their study to find the overdue position of farmer borrowers from Bichipuri branch of State Bank of India in Uttar Pradesh in 1985-86. It was observed that 61% of farmers defaulted, with overdoes on advance to crop loans by the bank. Large and medium farmers accounted for 55% of total overdoes. Willful default was found in about 35% cases. Slackness by the banks in insisting on timely repayment of loans, diversion of income for purchasing lands or other property and uncertainty about getting new loan after repayment were the main reasons for willful default.
Rajendran(1993)\textsuperscript{48} in his comparative study of the public sector and private sector banks during the year 1990-91 has chosen three profitability ratios and six balance sheet ratios. He has brought eight scheduled private sector banks, three nationalized banks and the State Bank of India within the purview of his study.

Srinivasan.R.(1997)\textsuperscript{49} Ramani quotes in State Bank of India Report which identified that financial management, lack of planned and organized approach are the major causes of failure. However in his study of 20 units, he finds management failure as the single largest contributing factor. He also found problems with governmental procedures and consequent delays contributing to the malaise. However these and other studies also refer to the problem and importance of marketing function on the need for planning and organizing for marketing.

Prasanta Athma (1997)\textsuperscript{50} in his doctoral dissertation, “Performance of Public Sector Commercial Banks – a Case Study of State Bank of Hyderabad,” has evaluated the performance State Bank of Hyderabad [SBH] by selecting certain parameters like deposit mobilization, analyses of advances, credit deposit ratios, interest spreads, employee productivity, customer services, profit as a %age of working funds etc. One major conclusion drawn by him is that the profits of State Bank of Hyderabad [SBH] showed an increasing trend, indicating a more than a proportionate increase in spread, then in burden. He has stated that there is a gradual increase in the %age of profit on the working funds over the study period showing the efforts made by the bank (1980—94). In increasing the profits by recovering the operating costs fully. According to him, there is a decline in operating costs, responsiveness of the State Bank of Hyderabad [SBH] during the study period which is a clear symptom of cost effectiveness/productivity which has resulted in a profit though many banks were in red signal during the year 1992-93 and 1993-94 due to introduction of banking sector reforms.

S. Venkitaramanan (2006-07)\textsuperscript{51} states in his study that the accounts of the Reserve Bank of India [RBI] for 2006-07 contain an extraordinary item, arising from the sale to Government of India, of shares in State Bank Of India [SBI] held by the Reserve Bank Of India [RBI] as majority owner of State Bank Of India [SBI]. Following the
Securities and Exchange Board of India (SEBI) rules, the value on sale of these shares was determined on the basis of six-month average market price. This brought a hefty gain on sale to the extent of Rs 34,308 crore. Including this, the excess of receipts over expenditure came to Rs 78,348 crore. The distributable surplus, that is, the amount to be transferred to Government of India, is arrived at after making due provision for contingency reserve and asset development reserve, which are allocated as a matter of prudential accounting.

**V.Ramkumar (2007)** In his study the author has stated that the objective of State Bank of India in the present day context is to ensure financial inclusion of the whole population irrespective of areas and sectors. The 'inclusion' phenomenon cannot be confined to few pockets of area and people. The important question is increasing outreach and deepening penetration. There are two ways of doing it: i) through the brick and mortar rural branches, ii) outsourcing all the functions to business correspondent in a particular area, viz., a state or with the help of business facilitators at a local level. Large-scale roll out and rapid scaling up again is not possible without suitable technology intervention which is easy to use, robust, dependable and, at the same time, cost-efficient. State Bank Of India [SBI] answer to financial inclusion is the 'State Bank Of India [SBI] Tiny project', which can in simple terms be defined as a “Bank in a Box”. The entire set up consists of a cell phone which serves as aspects machine, a finger print reader and a tiny printer, all of which can be packed into a 10 inch by 10 inch box. All these work on rechargeable batteries. State Bank of India [SBI] Tiny accounts (no frills accounts) are opened on the smart cards. The smart card is akin to an e-purse and stores information about the customer, the account number, finger prints as well as the balance in the account. The smart card can handle up to 16 accounts including loan accounts. This card is highly secured as it works on the bio-metric validation of the customer.

**Shobana (2009)** has examined in her study that the information of the State Bank of India aims at promoting planned economic development of the country. The development activities of the State Bank Of India [SBI] and its subsidiaries are many fold. Besides opening new branches in non-banking areas State Bank Of India [SBI] and its subsidiaries finance agriculture, the cooperative movement and small scale
industries. By March 1995 the State Bank Of India [SBI] and its associates over 13,800 small scale business units and other small operators. The amount of loans outstanding was Rs.9200 crores. The most spectacular progress has been achieved in the field of rural credit. In March 1995 the loans outstanding to farmers rose to over Rs.7450 crores. The State Bank’s role in financing small units is significant. It has started “Pilot Centers” to experiment with financing schemes. State Bank Of India [SBI] has also introduced Installment Credit Schemes. It is designed to assist the financing equipment or machinery used by small and medium size manufacturing units. To be of special use for small industrial units the State Bank Of India [SBI] has launched Branch Banking. In the first five years of its existence. The State Bank Of India [SBI] opened 416 branches. The State Bank offices have increased from 500 at the end of 1955 to 1570 in 1969. At the end of June 1999, the total number of branches of the State Bank group (State Bank Of India [SBI] and 7 associate banks) came to 13,192. It is noteworthy that nearly two-thirds of these located in rural and semi-urban areas with a population of less than 25000.

**Mr Arun Kumar Agarwal(2010)** has mentioned in his study that State Bank of India (SBI) has signed a pact with Unique Identification Authority of India (UIDAI) to work as a registrar for the Unique Identification registration of residents. It has become the first bank to take up registration work for the Unique Identification Authority of India (UIDAI) project. As a registrar, State Bank of India (SBI) will capture through empanelled enrolment agencies, the biometric characters such as finger prints and send the information to UIDAI.

**Chatterjee, Debojyot (2010)** state in their study that State Bank of India (SBI) is the country’s largest commercial bank. The government-controlled bank—the Indian government maintains a stake of nearly 60% in State Bank of India (SBI) through the central Reserve Bank of India—also operates the world’s largest branch network, with more than 13,500 branch offices throughout India, staffed by nearly 220,000 employees. The State Bank of India (SBI) also presents the Overview Of Indian Economy particularly During our study period i.e. 1990-2010.
**Concluding Remarks**

All these above mentioned studies are on specific aspects and are not well integrated into some system. There are no theoretical and empirical underpinning provided by most of the studies and very little empirical effort is made for examination of structural relationships exhaustively and comprehensively.

Though this is not an exhaustive survey of the literature and findings of empirical work that has gone into this area, we feel that it does provide analytical framework for enabling us to undertake the present study.
8. NOTES AND REFERENCES


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