## CHAPTER - 1
### INDIAN BANKING: INTRODUCTION, HISTORY & DEVELOPMENT

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1.1 Introduction:

Finance is the life blood of trade, commerce and industry. Now a days, banking sector acts as the back-bone of modern business. Development of any country mainly depends upon the banking system. In the present-day world in the developed and developing money economies the vital processes of production and consumption are significantly affected by the aggregate money supply consisting of the currency, demand and time deposits with banks. The banking sector is the lifeline of any modern economy. Banks are one of the oldest financial intermediaries in the financial system. Long back the well-known nineteenth century economist David Ricardo had stated that a bank was a dealer or transactor in money. But so is also the money-lender. The development of commercial banks has taken place under different banking systems in different countries. A commercial bank is a dealer in money assets that are largely derived from its deposits. They are the heart of our financial structure, since they have the ability, in co-operation with the Reserve Bank of India, to add to the money supply of the nation and thus create additional purchasing power. Banks Lending, Investing and related activities facilitate the economic processes of production, distribution and consumption.

1.2 The Origin of the Word “Bank”:

There is no unanimity amongst economists about the origin of the word ‘banking’. The word ‘bank’ is itself derived from the Greek word ‘banque’, i.e., a bench. The German word ‘banc’ means a joint stock firm. In olden days, European money lenders or money changers used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging. In modern times, commercial banking occupies quite an important place in the framework of every economy because of the continuing challenge it presents to those who are responsible for managing the affairs of nation’s banks and to those who observe and study their performance. The character of banking has kept on meandering though time and the working of the commercial banks reflects the changing character of the credit mechanism which is itself the outcome of the economic changes taking place in the economic system. Consequently, the working of commercial banks must be flexible to
enable them to face new economic problems and policy issues in order to play their useful role in the economy.

1.3 Meaning and Definition:

1.3.1 Meaning of Bank:

Bank means financial institution dealing in money. It accepts deposits and lends money. Banking operations are performed by banker; bank plays an important role in modern economic activities. Expansion of credit in economic activities is widely performed by banks.

A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it.

1.3.2 Definitions:

Banking as “the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdraw able, by cheque, draft, order or otherwise.”

A bank is “an establishment for custody of money which it pays out on customer’s order”.

- Oxford Dictionary

→ Section 5(1) (b) of the Banking Regulation Act.

Banking company is “any company which transacts the business of banking in India”.

→ Selection 5(1) (c)

The essential characteristics of the banking business as defined in Selection (5) (b) of the Banking Regulation Act are as follows:

- Acceptance of deposits from the public.
- For the purpose of lending or investment.
- Repayable on demand or otherwise, and
- Withdrawable by means of an instrument whether a cheque or otherwise.
1.4 Characteristics / Features of a Bank :

1.4.1 Dealing in Money :

Bank is a financial institution which deals with other people’s money i.e. money given by depositors.

1.4.2 Individual / Firm / Company :

A bank may be a person, firm or a company. A banking company means a company which is in the business of banking.

1.4.3 Acceptance of Deposit :

A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.

1.4.4 Giving Advances :

A bank lends out money in the form of loans to those who require it for different purpose.

1.4.5 Payment and Withdrawal :

A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts. It also brings bank money in circulation. This money is in the form of cheques, drafts, etc.

1.4.6 Agency and Utility Services :

A bank provides various banking facilities to its customers. They include general utility services and agency services.

1.4.7 Profit and Service Orientation :

A bank is a profit seeking institution having service oriented approach.

1.4.8 Ever Increasing Function :

Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.
1.4.9 Connecting Link:

A bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who have surplus money and give the same to those who are in need of money.

1.4.10 Banking Business:

A bank’s main activity should be to do business of banking which should not be subsidiary to any other business.

1.4.11 Name Identity:

A bank should always add the word “bank” to its name to enable people to know that it is dealing in money.

1.5 A History of Banking:
1.5.1 Early Beginning:

The origin of banking in India is very old and is traceable in ancient times. Information recorded in scriptures and ancient texts reveals that indigenous banking existed in India in very ancient times. Money-lending, which is one of the principle functions of a modern bank, existed in the Vedic period and there is repeated mention of RNA or debt in the Vedic literature. In his well-known work entitled History of Civilization in Ancient India, R. C. Dutt refers to the existence of lending and usury during the Vedic period. There is a reference in Ramayana, a sacred book of Hindu that among the people of Ayodhya who accompanied Ram’s younger brother Bharat to the jungle to urge Ram to return to Ayodhya was also a ‘Vridhipjivi’, i.e., a member of the money lending community.

During the Ramayana and Mahabharata era, banking which was a side business during the Vedic Period became a full-time business activity for the people. During the Smriti Period, which followed the Vedic Period and the Epic age, banking business was carried on by the members of the vaishya community and Manu, the great law giver of the time, speaks of the earning through interest as principle business of vaishyas. According to B. K. Bhargava the banker in the Smriti Period performed most of the functions which modern banks perform. He accepted deposits from the public, granted loans against pledges and personal security, granted simple open loans, acted as bailey for his customers, subscribed to public loans by granting loans to kings, acted as treasurer and banker to the state and managed the currency of the country.
During Buddhist Period, the banking business was decentralized and became a matter of free volition. Consequently, Brahmans and Kshatriyas, who were not permitted to take to banking as their profession except under very exceptionally rare circumstances during the Smriti period, also took to the lucrative business of banking. During this period, further refinements were made in the banking business. Money changing came into vogue and state regulation of the business became more systematic; bills of exchange came also in wide use. During this period, bankers or the sheathes as they were called became influential people in the community life throughout the kingdom and they were often the royal/treasurers.

1.5.2 Muslim and British Period:

During the Muslim period, indigenous banking, which by the time of the Buddhist period was a fairly well developed business, received a great setback as the Muslim rulers believed in the Quranic injunctions according to which the raking of byaj or interest was a great sin (haraam). The other equally important factor adversely affecting the development of banking in the country during the Muslim period was the greatly unsettled political situation in the country. Virtually unending wars and royal succession feuds between the claimants for the royal throne greatly hampered the development of trade and commerce on which the development of banking and money-lending depended. Only a limited rehabilitation of indigenous banking business was made possible during the secular and settled reign of Emperor Akbar who gave the much-needed political stability to the country.

During Jahangir’s reign, private banking further developed and it is recorded that there were many enterprising bankers functioning in the country at this time. During Shah Jahan’s reign banking prospered without interruption and large banking houses were established at important trading centers in the country. This happy state of affairs, however, proved short-lived.

During Fanatic Aurangzeb’s reign, banking, which had somewhat revived during the reigns of his great-grandfather, grandfather and father, again suffered a great setback. A staunch practitioner of the Quranic injunctions, Aurangzeb adopted a negative approach toward money-lending and banking. Even so, some of the sagacious indigenous bankers were very influential in the country’s life and the “Jagat
Seth’s of the 17th and 18th centuries, for their power and influence are comparable with any private banking houses in any other country; and indeed they seem to have fulfilled many of the functions of a central bank essentially a modern institution.”

The seventeenth century witnessed the coming into India of the English traders and the indigenous bankers being in conversant with the language and trade practices of the former could not take advantage of the English merchants. The English traders established their own agency houses at the port towns of Bombay, Calcutta and Madras. These agency houses, apart from engaging in trade and commerce also carried on the banking business. Time was thus set for the decline of the wake of the downfall of the Mogul Empire affected their business adversely. The unification of the currency in 1835 gave a further severe blow to the indigenous bankers as it deprived them of the profitable business of money-changing. The British agency houses which combined banking business with their trading activities were the forerunners of the modern joint stock banks established on the European lines.

The first joint stock bank established in the country was the Bank of Hindustan founded in 1770 by the famous English agency house of masers Alexander and Co. This bank failed in 1832 with the coming to grief of the firm of Alexander and Co. The Bengal Bank and the General Bank of India were established in 1785. The Bank of Bengal, the first of the three Presidency Banks, was established in Calcutta in 1806 under the name of the Bank of Calcutta. It was renamed in 1809 on the grant of the charter as the Bank of Bengal. The two other presidency Banks, namely, the Bank of Bombay and the Bank of Madras were established in 1840 and 1843 respectively. The share capital of the Bank of Bombay was Rs.50 lakhs while that of the Bank of Madras was Rs.30 lakhs with the government subscribing Rs.3 lakhs to the share capital of each bank. Like the Bank of Bengal, these banks were also empowered to issue notes. After the paper currency Act of 1862 the right of note issue was taken away from entire three presidency Banks. The capital of the Bank of Bombay was subsequently raised to Rs.2.09 Crores. The Bank of Bombay was carried on the speculative activities in cotton following the American Civil war and it suffered heavy losses culminating in its final winding up in 1868. To replace this bank, a new bank of the same name was constituted under the Indian Companies Act of 1866. The Presidency Banks Act of 1876 placed certain restrictions on the functioning of these banks were forbidden from negotiating foreign bills; they were also forbidden from giving advances for a period exceeding six months.
In 1898 some witnesses who tendered their evidences before the Fowler currency committee favored the establishment of a central bank in the country but the Government was apathetical to the suggestion. The Presidency Banks, which were anxious to maintain their individuality, were also not in favor of a single bank by amalgamating the three presidency Banks. The Chamberlain commission in 1913 suggested the appointment of a committee to examine the whole issue. The banking crisis of 1913-1917, however, brought to the fore the serious deficiencies of the existing banking system in the country showing the need for effective coordination requiring the establishment of a central bank.

After repeated efforts the three Presidency Banks were fused into a single bank under the name of the Imperial Bank of India in 1921. At the time of the amalgamation the three Presidency Banks had a total of 70 branches, total paid-up capital of Rs. 3.5 crores. The Imperial Bank of India eventually became the State Bank of India.

The sudden boom of investment in the 1900s, led to the emergence of leading joint stock banks such as,

1895 The Punjab National Bank
1906 The Bank of India
1906 The Indian Bank
1909 The bank of Baroda
1911 Central Bank of India
1919 The Union Bank of India

The major function of these banks was to finance foreign trade while domestic trade was largely handled by the Multani Shroffs and moneylenders.

Between 1941 and 1945, the number of banks rapidly increased from 473 to 737 but these banks suffered from certain limitations such as inadequate capital structure and unsound methods of operation and management. To overcome these limitations, the government, in consultation with the RBI, enacted the Banking Companies Act in 1949. Through elimination and mergers, the number of banking institutes was reduced.
1.6 Development of Banks:

The Indian banking sector as it stands today is mature in supply, product range and reach, with banks having clean, strong and transparent balance sheets. The major growth drivers are increase in retail credit demand, proliferation of ATMs and debit-cards, decreasing NPAs due to securitization, improved macroeconomic conditions, diversification, interest rate spreads, and regulatory and policy changes (e.g. amendments to the Banking Regulation Act.)

January 1, 1949: The Reserve bank of India is nationalized by an act of Parliament.

September 4, 1951: The government announces its plan to seek developmental loans from the World Bank.

July 1, 1955: The State Bank of India comes into existence, taking over the Imperial Bank operations.

1956: Life Insurance Companies are nationalized and brought under government management.

July 3, 1964: IDBI is set up.

June 6, 1966: Rupee is devalued by 36.5 percent to Rs. 7.50 from Rs. 4.76 to dollar.


1973: The Foreign Exchange Regulation Act comes into effect.

January 11, 1978: Currency notes in denomination of Rs. 1,000, Rs. 5,000 and Rs. 10,000 are withdrawn from circulation.


November 19, 1986: The government of India launcher Indira Vikas Patra.

1987: To mobilize resource for meeting drought-related-expenditure the government of India introduces 9 percent relief bonds.

April 1988: National housing Bank is set up with a share capital of Rs. 100 crores entirely subscribed by RBI.
July 1 and 3, 1991: The RBI had to devalue the rupee in a two-step downward adjustment of 17.38 per cent.

July 3, 1991: The bank rate, which was dominant since July 1981, is hiked from 10 per cent to 11 per cent and further to 12 per cent on October 8, 1991.

November 1991: M. Narasimham committee on reforming the financial system presents its report. Among other things it suggests phased reduction of SLR to 25 percent in three years and CRR to 10 per cent in four years.

April 1992: RBI introduces risk assets-ratio-system for banks as a capital adequacy measure.

March 1, 1992: Dual exchange rate system is instituted under liberalized exchange rate management enabling orderly transition from a managed floating regime to a market determined one.


January 1993: Guidelines for setting up private sector banks are issued.

March 1993: Rupee is made convertible on the trade account, starting the process of convertibility.

September 1993: New bank of India is merged into PNB.

March 1994: With the receipt of a license, UTI bank becomes the first private sector bank to start operating.

June 13, 1994: RBI issues guidelines on prudential norms. Banks to achieve minimum capital adequacy ratio of 6 per cent on their risk weighted assets and off-balance sheet exposures by March 31, 1995 and 8 percent by March 1996.

July 15, 1994: With the amendment to the Banking Companies (Acquisition and Transition of Undertakings) Act 1970, nationalized banks are allowed to strengthen their capital base by tapping the capital market for public constitution to their capital up to 49 percent.

August 1994: Second step towards fall convertibility is taken by making the rupee convertible on the current account.

October 1994: Oriental bank of Commerce becomes the first nationalized bank to access the capital market to raise Rs. 387.24 crores.
October 1, 1995:  Banks are allowed to fix own interest rated on domestic term deposits with maturity of two years.

July 1996:  The insurance Regulatory Authority is set up to privatize the insurance sector.

May 9, 1997:  RBI issues new norms for non-banking finance companies to improve their financial health and viability; they are required to apply for registration with RBI by July 8, 1997

December 7, 1997:  RBI constitutes a working group under chairmanship of S. H. Khan to examine the harmonization of the role and operations of development finance institutions and banks.

April 24, 1998:  The Khan Committee on the Harmonization of the role and deportations of development finance institute owns and Banks submits recommendations suggesting a gradual move towards universal banking

August 9, 2000:  Banks having a minimum net worth of Rs.500 corer and satisfying other criteria in regard to capital adequacy are allowed to enter the insurance business through a joint venture.

November 10, 2000:  Guidelines for bank financing of equities and investment in shares is issued banks are allowed to invest up to 5 percent of its total outstanding domestic credit in capital market.

January 3, 2000:  Revised guidelines for licensing of new banks in the private sector are issued.

March 15, 2001:  GOI reduces the interest rate payable on relief bonds issued under the 9 percent, 1999 Scheme to 8.5 percent.

April 19, 2001:  Banks permitted to formulate fixed deposit scheme specifically for senior citizens offering higher and fixed rate of interest.

April 28, 2001:  RBI clarifies approach to Universal banking for term leading and refinancing instructions.
1.7 Specific Structure of Bank in India:

Scheduled commercial banks are those included in the second schedule of the Reserve Bank of India Act, 1934. In terms of ownership and function, commercial banks can be classified into four categories: Public sector banks, private sector banks, foreign banks in India, and regional rural banks. These are 165 scheduled commercial banks –26 public sector banks, 21 in the private sector and 36 foreign banks and 82 Regional Rural Bank.

Chart: 1.1 Banking Structure in India (As on 31 October 2006)

1.7.1 Banking Regulator:

The Reserve Bank of India is the central banking and monetary authority of India as the regulator and supervisor of commercial banks.

1.7.2 Scheduled Banks in India:

Scheduled banks comprise scheduled commercial bank and scheduled co-operative banks. Scheduled commercial banks form the bedrock of the Indian financial system, currently accounting for more than three-fourths of all financial institutions’ assets. SCBs are present throughout India, and their branches, having grown more than four-fold in the last 40 years now number more than 80,500 across the country.
1.7.3 Public Sector Banks:

Public sector banks are banks in which the government has a major holding. These can be classified into two groups:

(i) The state bank of India and its associates and
(ii) Nationalized banks.

• The State Bank of India:

The State Bank of India was initially known as the Imperial Bank. The Imperial Bank was formed in 1921 by the amalgamation of three presidency banks the Bank of Bengal, the Bank of Bombay and the Bank of Madras. These Presidency banks were created as a charter to deal in bills of exchange payable in India and were an integral part of the Indian treasury. They were taken over by the Imperial Bank of India as going concerns under a special legislation in 1920. The Imperial Bank acted as the banker to the government until the establishment of the RBI in 1935. Later on, it was authorized to act as the sole agent of the RBI in places where the latter did not have its own branches. The Imperial Bank was nationalized under the State Bank of India Act, 1955. This was passed on 8 May 1955. The State Bank of India came into existence on 1 July 1955. This marked the beginning of the first phase of nationalization of banks. The main objective of nationalization was extending banking facilities on a large scale, particularly in the rural and semi-urban areas. The other objectives for which the bank was established were as follows.

• To promote agricultural finance and to remedy the defects in the system of agricultural finance.
• To help the Reserve Bank in its credit policies.
• To help the government to pursue the board economic policies.

The State Bank of India has seven subsidiaries:

SBI has five associate banks: all use the State Bank of India logo, which is a blue circle, and all use the “State Bank of” name, followed by the regional headquarters’ name:

• The State Bank of Bikaner and Jaipur.
• The State Bank of Hyderabad.
• The State Bank of Indore.
• The State Bank of Mysore.
• The State Bank of Patiala.
• The State Bank of Travancore.

   State Bank of Saurashtra merged with SBI, reducing the number of associate state banks from seven to six in August 13, 2008.

• Nationalized Banks:

   In 1969, fourteen big Indian joint stock banks in the private sector were nationalized. The nationalization was effected by an ordinance which was later replaced by an act of parliament, known as the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. This was the second phase of nationalization on 15 August 1980 – the third phase of nationalization. In all, 28 banks were nationalized from 1955 – 1980. At present, there are 26 nationalized banks; the State Bank of India and its six associates and 19 nationalized banks (New India Bank was merged with Punjab National Bank). The major objective of Nationalization were to widen the branch network of banks particularly in the rural and semi – urban areas which, in turn, would help in greater mobilization of savings and flow of credit to neglected sectors such as agriculture and small-scale industries.

   With the amendment to the Banking Companies Act, public sector banks are now allowed to access the capital market to raise funds. This has led to a dilution of the share holding of the government.

1.7.4 Private Sector banks :

   For over two decades, after the nationalization of 14 larger banks in 1969, no banks were allowed to be set up in the private sector. In the pre-reforms period, there were only 24 banks in the private sector. The Narasimham Committee, in its first report, recommended the freedom of entry into the financial system. It stated that the RBI should permit the establishment of new banks in the private sector provided they conform to the minimum start-up capital and other requirements. The committee also recommended that there should not be any difference in treatment between the public sector and private sector and any restrictions in operation in this regard should be removed. The RBI considered the above recommendations and allowed banks to be set up in the private sector. The banks which have been setup in the 1990s taking into consideration the guidelines of the Narasimham Committee are referred to as new private sector banks.
Today, there are 21 private sector banks in the banking sector 14 old private sector banks and 7 new private sector banks. These new banks reported profits in the very first year of their existence. The public sector banks are facing a stiff competition from the new private sector banks.

1.7.5 Foreign Banks in India:

Foreign banks have their registered and head offices in a foreign country but operate their branches in India. The RBI permits these banks to operate either through branches; or through wholly-owned subsidiaries. The primary activity of most foreign banks in India has been in the corporate segment. However, some of the larger foreign banks have also made consumer financing a significant part of their portfolios. These banks offer products such as automobile finance, home loans, credit cards, household consumer finance etc.

Foreign banks in India are required to adhere to all banking regulations, including priority – sector lending norms as applicable to domestic banks. Some of the existing private sector banks, which showed signs of an eventual default, were merged with state owned banks. It may be noted that two important erstwhile developmental financial institutions viz. Industrial Development Bank of India (IDBI) and Industrial Credit and Investment Corporation of India (ICICI) converted themselves into commercial banks after the new bank licensing policy was announced in July 1993.

In addition, a foreign institution could also invest up to 74% in domestic private bank, in which up to 49% can be via portfolio investment. At the end of June 2009, there were 32 foreign banks with 293 branches operating in India. Besides, 43 foreign banks were operating in India through representative offices. Under the World Trade Organization (WTO) agreement RBI allows a minimum 12 branches’ of all foreign banks to be opened in a year.

1.7.6 Regional Rural Banks:

A new category of scheduled banks came into existence in 1975 when 6 regional rural banks (RRBs) came into existence under the Regional Rural Banks Ordinance, 1975. This ordinance was promulgated by the Government of India on 26 September 1975. The ordinance was subsequently replaced by the Regional Rural Banks Act, 1976.
Although cooperative and commercial banks achieved a high reach and disbursement of credit, there existed a vast gap in the area of rural credit. In order to fill up this gap, a new setup of banks, namely, RRBs was established. The number of RRBs rose from six in 1975 to 196 in 2001. These 196 RRBs operate in 500 districts with a network of 14,313 branches excluding satellite branches and extension counters. The branch network comprises six metropolitan, 348 urban, 1875 semi-urban and 12,084 rural branches. RRBs branch network forms nearly 37 per cent of the total rural branch network of all scheduled commercial banks.

1.7.7 Co-operative Banks:

Co-operative banks cater to the financing needs of agriculture, retail trade, small industry and self-employed businessmen in urban, semi-urban and rural areas of India. A distinctive feature of the co-operative credit structure in India is its heterogeneity. The structure differs across urban and rural areas, across states and loan maturities. Urban areas are served by urban co-operative banks (UCBs), whose operations are either limited to one state or stretch across states. The rural co-operative banks comprise state co-operative banks, district central co-operative banks, SCARDBs and PCARDBs.

The Co-operative banking sector is the oldest segment of the Indian banking system. The network of UCBs in India consisted of 1721 banks as at end-March 2009, while the number of rural co-operative banks was 1119 as at end-March 2008. Owing to their widespread geographical penetration, co-operative banks have the potential to become an important instrument for large-scale financial inclusion, provided they are financially strengthened. The RBI and the National Agriculture and Rural Development Bank (NABARD) have taken a number of measures in recent years to improve financial soundness of co-operative banks.
The Banking industry plays a dynamic role in the economic development of a country. The growth story of an economy depends on the robustness of its banking industry. Banks act as the store as well as the powerhouse of the country’s wealth. They accept deposits from individuals and corporate and lends to the businesses. They use the deposits collected for productive purposes which help in the capital formation in the country.

1.8 Recent Trend on Banking Reforms:

The banking sector reforms are aimed at enhancing the productivity, efficiency and competitiveness of the banking industry. The financial sector reforms seem to achieve:

- Improvement in the financial health;
- Improvement in the competitive capabilities;
- Improving financial infrastructure relating to supervision, audit, technology and legal framework;
- Suitable modifications in the policy framework, etc.
Ballabh J. (2001) analyzed challenges in the post-banking sector reforms. With globalization and changes in technology financial markets, world over, have become closely integrated. For the survival of the banks they should adopt new policies/strategies according to the changing environment.

Passah P.M. (2002) analyzed the Indian financial system comprising the commercial banks, the financial institutions and the capital markets. He concluded that Indian banking has undergone a very rapid transformation in the past three decades. There is a sea change in the Indian banking sector in the post-financial sector reforms.

Shveeta and Satish Verma, (2002), they analyzed the profitability behavior of SBI group, other nationalized and foreign banks in India. They empirically estimated factors influencing the profitability of banks. They concluded that priority sector advances (in case of PSBs) and spread and burden (for all categories of banks) were the major and significant that influent the profitability of banks.

Singh, R (2003), analyzed profitability management of banks under the deregulated environment with some financial parameters of the major four bank groups i.e. public sector banks, old private sector banks, new private sector banks and foreign banks, profitability has declined in the deregulated environment. He emphasized to make the banking sector competitive in the deregulated environment. They should prefer non-interest income sources.

Vashisht A.K. (2004) studied the recent global development, which has transformed the environment in which commercial banks operate. Globalization has expanded economic interdependence and interaction of countries greatly. Under the regime of globalized environment, the financial performance of the commercial banks has changed and the commercial banks will face new challenge and also new opportunities in the coming years.

The number of Scheduled Commercial Banks (SCBs) nearly doubled to 55,537 in 2005 from 29,677 in 1980 and the same trend can be observed in case of every bank group.
Some of the recommendations, made in 2006, were that the need of banks to set strategies for their operations and establish accountability for executing these strategies. To allow banks to raise capital, the RBI has provided several options. In January 2006, the RBI allowed banks to issue innovative capital instruments for inclusion under Tier I capital, and hybrid debt capital instruments for inclusion under Tier II. Tier III capital was not considered owing to the short-term nature of such capital. The new electronic cheque system is introduced by N.C.R. Corporation in banks in the year 2006. As a beginning 83 banks participates in it. Processing of cheques will be from electronic images and need for carrying changes in clearing houses will be wiped off.

In March 2005 and again in March 2007 the finance minister, put forth a new agenda for seven leading nationalized banks, asking them to draw up proposals for consolation through the acquisition of smaller government banks or other private banks. The idea is to ensure that four to five “giant banks” could match any such consolidation proposal by the board’s seven banks. The seven leading nationalized banks that have assets, worth more than Rs. 50,000 crores each are SBI, Punjab National Bank, Canara Bank, Bank of India, Bank of Baroda, Union Bank of India and Central Bank of India.

In October 2007, the RBI allowed Indian banks to also issue preference shares as capital. Under the new guidelines, perpetual Non-Convertible Preference Shares (PNCPs) will be treated at par with equity. All other types of preference shares will, however, are treated as debt. The growth in deposits in 2008-09 at 22% was less than the 23.1% recorded in 2007-08.

In August 2008, State Bank of Saurashtra merged with SBI, reducing the number of associate state banks from seven to six.

Ram Mohan (2008), studied the Indian banking system is among the healthier performers in the world. This sector is tremendously competitive and recorded as growing in the right trend.

During 2010-11, banks were able to improve their profitability and asset quality. Stress test showed that banking sector remained reasonably resilient to liquidity and interest rate shocks. Yet, there were emerging concerns about banking sector stability related to disproportionate growth in credit to sectors such as real estate, infrastructure, NBFCs and retail segment, persistent asset-liability mismatches, higher provisioning requirement and reliance on short-term borrowings to fund asset growth.
Various ratios are examined to analyze of the banking reforms.

- Gross NPAs as percentage of Gross Advances.
- Net NPAs as percentage of Net Advances.
- Interest Income as percentage of Total Income.
- Non-Interest Income as percentage of Total Income.
- Interest paid as percentage of Total Expenditure.
- Priority sector Advances as % age of Total Advances.
- Capital Adequacy Ratio.
- SLR & CRR.

1.8.1 Recent Trends in Banking:

1. **Electronic Payment Services – E:**
   
   Now-a-days we are hearing about e-governance, email, e-commerce, e-tail etc. In the same manner, a new technology is being developed in US for introduction of e – cheque, which will eventually replace the conventional paper cheque. India, as harbinger to the introduction of e – cheque, the Negotiable Instruments Act has already been amended to include; Truncated cheque and E – cheque instruments.

2. **Real Time Gross Settlement (RTGS):**
   
   Real Time Gross Settlement system, introduced in India since March 2004, is a system through which electronics instructions can be given by banks to transfer funds from their account to the account of another bank. The RTGS system is maintained and operated by the RBI and provides a means of efficient and faster funds transfer among banks facilitating their financial operations. As the name suggests, funds transfer between banks takes place on a ‘Real Time’ basis. Therefore, money can reach the beneficiary instantaneously and the beneficiary’s bank has the responsibility to credit the beneficiary’s account within two hours.

3. **Electronic Funds Transfer (EFT):**
   
   Electronic Funds Transfer (EFT) is a system whereby anyone who wants to make payment to another person / company etc. can approach his bank and make cash payment or give instructions / authorization to transfer funds directly from his own account to the bank account of the receiver / beneficiary. Complete details such
as the receiver’s name, bank account number, account type (savings or current account), bank name, city, branch name etc. should be furnished to the bank at the time of requesting for such transfers so that the amount reaches the beneficiaries’ account correctly and faster. RBI is the service provider of EFT.

4. **Electronic Clearing Service (ECS):**

   Electronic Clearing Service is a retail payment system that can be used to make bulk payments/ receipts of a similar nature especially where each individual payment is of a repetitive nature and of relatively smaller amount. This facility is meant for companies and government departments to make / receive large volumes of payments rather than for funds transfers by individuals.

5. **Automatic Teller Machine (ATM):**

   Automatic Teller Machine is the most popular device in India, which enables the customers to withdraw their money 24 hours a day 7 days a week. It is a device that allows customer who has an ATM card to perform routine banking transactions without interacting with a human teller. In addition to cash withdrawal, ATMs can be used for payment of utility bills, funds transfer between accounts, deposit of cheques and cash into accounts, balance enquiry etc.

6. **Point of Sale Terminal:**

   Point of Sale Terminal is a computer terminal that is linked online to the computerized customer information files in a bank and magnetically encoded plastic transaction card that identifies the customer to the computer. During a transaction, the customer’s account is debited and the retailer’s account is credited by the computer for the amount of purchase.

7. **Tele Banking:**

   Tele Banking facilitates the customer to do entire non – cash related banking on telephone. Under this devise Automatic Voice Recorder is used for simpler queries and transactions. For complicated queries and transactions, manned phone terminals are used.
8. **Electronic Data Interchange (EDI):**

   Electronic Data Interchange is the electronic exchange of business documents like purchase order, invoices, shipping notices, receiving advices etc. in a standard, computer processed, universally accepted format between trading partners. EDI can also be used to transmit financial information and payments in electronic form.

1.9 **Challenges for Banking Sector:**

   The Indian banking system has once again established its dominance in the financial markets. It continues to be strong, stable and vibrant. There are, however, many challenges it would face in the year to come.

1. **The Prospects of Monetary Tightening:**

   The Governor of RBI has categorically stated that the present easy monetary policy cannot be continued for long and a phased tightening in expected. With inflation fears proving to be real, very soon, there could be upward revision of statutory pre-emptions and even interest rates. Banks may find it difficult to sustain profitability in an environment of slow asset growth and a little faster accumulation of bad debts due to the economic slowdown.

2. **Credit Build Up Not Happening:**

   While credit growth has evidently slowed during 2008-09, there are no signs of appreciable pick up even during the current fiscal, essentially because of lack of demand for credit, even though the liquidity conditions are comfortable. Banks are unable to identify any tangible growth drivers to pump loan funds. Retail credit continues to experience a slow off take, while industrial credit has only marginally picked up. In the absence of any decisive measures to improve the hapless conditions in many parts of rural India, farm credit may not rise appreciably. Credit to the services sector does not hold much promise ether.

3. **Unwinding Effect:**

   The central banker last year has appropriately relaxed the provisioning and classification norms for assets, in view of the economic slowdown. These relaxations are only short-term solutions in nature and their tightening could be
happening in the near future. And that would create the ‘burden of unwinding’ on banks, with a telling effect on their profitability.

4. Basel II Imperatives:

Indian banks are in the process of transforming into Basel II compliant entities within a well-defined time frame. Basel II norms themselves have become a little more stringent in the wake of the global meltdown recently. As banks are called upon to “ensure that loan loss provisions are adequate and based on sound methodologies that reflect expected credit losses over the life of the loan portfolio”, banks will be obliged to set aside higher provisions in the near future. Their profitability, consequently, will be under additional stress, so also their regulatory capital requirements.

5. The Impact of Global Slow Down:

While Indian banking system has acquitted itself creditably so far, the global slowdown could still hurt the system in the near future, as it obviously does not operate in isolation. The economy is not insulated from the global contagion and so is its banking system. The banking system, therefore, should be watchful in critical areas like efficient risk management and overseas exposures. There is certainly a need to be more cautious. May be conservation could still be paying off in the near future.

Table: 1.1

Branches and ATMs of Scheduled Commercial Banks
(As at end – March 2012)

<table>
<thead>
<tr>
<th>Bank Group</th>
<th>Number of Bank/Branches</th>
<th>Number of ATMs</th>
<th>Off-site ATMs as Percentage of total ATMs</th>
<th>ATMs as Percentage of Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural</td>
<td>Semi urban</td>
<td>Urban</td>
<td>Metro Urban</td>
</tr>
<tr>
<td>National banks</td>
<td>15,606</td>
<td>12,154</td>
<td>10,132</td>
<td>10,132</td>
</tr>
<tr>
<td>State Bank Group</td>
<td>6,582</td>
<td>5,619</td>
<td>3,504</td>
<td>3,125</td>
</tr>
<tr>
<td>Old private sector banks</td>
<td>881</td>
<td>2,025</td>
<td>1,395</td>
<td>1,085</td>
</tr>
<tr>
<td>New private sector banks</td>
<td>700</td>
<td>2,662</td>
<td>2,174</td>
<td>2,530</td>
</tr>
<tr>
<td>Foreign banks</td>
<td>7</td>
<td>8</td>
<td>61</td>
<td>246</td>
</tr>
<tr>
<td>Total (I to v)</td>
<td>23,776</td>
<td>22,468</td>
<td>22,468</td>
<td>17,118</td>
</tr>
</tbody>
</table>

[Source: RBI, Report on Trend and Progress of Banking in India, 2011-12]
During 2011-12, the total number of ATMs installed by the banks grew by 95,686 at end-March 2012. While, the ATMs installed by foreign banks and new private sector banks were nearly four and three times of their respective branches, the ATM to branch ratio was much lower for public sector and old private sector banks. At individual bank level, the number of ATMs exceeded branches in respect of all new private sector banks. Except Centurion Bank of Punjab Ltd, this was later merged with HDFC Bank Ltd. In the case of old private sector banks, the ATM to branch ratio was less than 100 per cent for all banks barring two, viz., SBI Commercial and International bank Ltd. and Karur Vysya Bank Ltd. As most foreign banks operated with limited branches in urban and metropolitan areas, the number of ATMs operated by them, in general, far exceeded the number of branches.

1.10 Deposits:

Deposits are the main source of funds for commercial banks. The amount mobilized as deposits is then lent in the form of advances. The higher the amount of deposits mobilized, the higher is the amount of funds lent. The growth of deposits depends on savings. Savings held in the form of currency or gold and jewellery are unproductive. For economic growth to take place, it is essential that these savings are mobilized and channelized for capital formation which, in turn, accelerates economic growth. Banks are important financial intermediaries between savers and borrowers. Banks mobilize savings by accepting deposits. Deposits may be categorized into (i) demand deposits and (ii) time deposits.

Demand deposits are deposits which can be withdrawn without notice and they can be repaid on demand. Current accounts and savings accounts are classified as demand deposits.

Time deposits are deposits which are repayable after a fixed data or after a period of notice. Fixed deposits, recurring/cumulative deposits, miscellaneous deposits, and cash certificates are classified as time deposits.

A significant proportion of funds are contributed by deposits which account for more than 80 per cent liabilities of scheduled commercial banks (SCBs).
Table: 1.2
Variation in Deposits of Scheduled Commercial Banks-Bank GroupWise
(As at end – March 2012)

<table>
<thead>
<tr>
<th>Bank Group</th>
<th>As at end - March</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2010-11</td>
</tr>
<tr>
<td></td>
<td>Deposits</td>
</tr>
<tr>
<td>Public Sector Banks</td>
<td>18.4</td>
</tr>
<tr>
<td>Old Private Sector Banks</td>
<td>14.9</td>
</tr>
<tr>
<td>New private Sector Banks</td>
<td>24.6</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>3.7</td>
</tr>
<tr>
<td>All SCBs</td>
<td>18.3</td>
</tr>
</tbody>
</table>

[Source: RBI, Report on Trend and Progress of Banking in India, 2011-12]

Aggregate deposits of scheduled commercial banks showed a lower growth of 14.9 percent during 2011-2012 as compared with 18.3 percent in the previous year. The declaration in aggregate deposits was on account of moderation in the growth of term deposits (18.6 percent) as compared with that in the previous year (18.2 percent). Demand deposits and saving bank deposits decreased than that in the previous year.

Bank group-wise analysis reveals that deposits of foreign sector banks grew at the highest rate (21.0 percent). While deposits of public sector banks and new private sector banks showed deposits decreased, old private sector banks deposits increased by 19.6 percent during 2011-12. Though the growth in deposits of old private sector banks was significantly higher than that in the previous year, their share in aggregate deposits of SCBs declined further albeit marginally during 2011-12. The share of foreign banks in aggregate deposits increased marginally during 2011-12. While that of public and new private sector banks remained at the previous year’s level.
### Table: 1.3

**Variation in Loans and Advances of Scheduled Commercial Banks**

(Amount in Rs. Billion)

<table>
<thead>
<tr>
<th>Bank Group</th>
<th>As at end – March</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2010-11</td>
<td>2011-12</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Amount</td>
<td>Percent to Total</td>
<td>Amount</td>
</tr>
<tr>
<td>Loans and Advances</td>
<td>42,975</td>
<td>22.9</td>
<td>50,746</td>
</tr>
<tr>
<td><strong>1.1</strong> Bills purchased and Discounted</td>
<td>2,399</td>
<td>26.6</td>
<td>2,922</td>
</tr>
<tr>
<td><strong>1.2</strong> Cash Credits, Overdrafts, etc.</td>
<td>16,817</td>
<td>26.2</td>
<td>20,044</td>
</tr>
<tr>
<td><strong>1.3</strong> Term Loans</td>
<td>23,759</td>
<td>20.3</td>
<td>27,780</td>
</tr>
</tbody>
</table>

[Note: Percentage variation could be slightly different as absolute numbers have been rounded off to ‘billion Sources: RBI, Report on Trend and Progress of Banking in India, 2011-12]

The growth rate of loans and advance moderated as compared with that in the previous year, partly reflecting the impact of measures taken by the Reserve Bank such as increase in cash reserve ratio (CRR), which, in turn, was reflected in the significant increase in cash and balances with the Reserve Bank.

In March 2010-11 total amounts of Loans and Advances 42,975 which can further classified into three categories Bills purchased & Discounted 2,399, cash Credit, Overdrafts, etc. 16,817 and Term Loans 23,759.

In March 2011-12 total amounts of Loans and Advances 50,746 which can further classified into three categories. Bills purchased and Discounted 2,922, Cash Credit, Overdrafts, etc. 20,044 and Term Loans 27,780.
Table: 1.4

Variation in Income-Expenditure of Scheduled Commercial Banks

(Amount in Rs. Billion)

<table>
<thead>
<tr>
<th>Item</th>
<th>2010-11</th>
<th></th>
<th></th>
<th>2011-12</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>1. Income (a+b)</td>
<td>5,712</td>
<td>15.5</td>
<td>7,408</td>
<td>29.7</td>
<td></td>
</tr>
<tr>
<td>a. Interest Income</td>
<td>4,913</td>
<td>18.3</td>
<td>6,551</td>
<td>33.3</td>
<td></td>
</tr>
<tr>
<td>b. Other Income</td>
<td>799</td>
<td>0.7</td>
<td>857</td>
<td>7.3</td>
<td></td>
</tr>
<tr>
<td>2. Expenses (a+b+c)</td>
<td>5,009</td>
<td>14.5</td>
<td>6,591</td>
<td>31.6</td>
<td></td>
</tr>
<tr>
<td>a. Interest Expenses</td>
<td>2,989</td>
<td>9.9</td>
<td>4,305</td>
<td>44.0</td>
<td></td>
</tr>
<tr>
<td>b. Other Expenses</td>
<td>1,231</td>
<td>23.1</td>
<td>1,371</td>
<td>11.3</td>
<td></td>
</tr>
<tr>
<td>c. Provisioning</td>
<td>788</td>
<td>20.8</td>
<td>915</td>
<td>16.1</td>
<td></td>
</tr>
</tbody>
</table>

(Note: Percentage variation could be slightly different as absolute numbers have been
To 'billion Sources: RBI, Report on Trend and Progress of Banking in India, 2011-12]

Income of SCBs (Scheduled Commercial Banks) increased by 29.7 percent during 2011-12 as compared with 15.5 percent in the previous year. Interest income increased sharply by 33.3 percent as compared with 18.3 percent and the other income increased by 7.3 percent as compared with 0.7 percent in the last year.

Expenditure of SCBs is increased by 31.6 percent during 2011-12 as compared with 14.5 percent in the previous year. Among the major components of expenditure of SCBs, reflecting the impact of deposits contracted at different interest rates, interest expended increased sharply by 44.0 percent as compared with 9.9 percent in the previous year. Non-interest or operating expenses decreased by 11.3 percent as compared with 23.1 percent in the last year Provisioning made decreased marginally.

1.11 Non – Performing Asset:

Nonperforming asset is a debt obligation where the borrower has not paid any previously agreed upon interest and principle repayments to the designated lender for an extended period of time. The nonperforming asset is therefore not yielding any income to the lender in the form of principle and interest payments.
Table: 1.5
Gross and Net NPAs (Non-performing Assets) of Scheduled Commercial Banks Group-wise (As at end – March)

<table>
<thead>
<tr>
<th>Bank Group/Year</th>
<th>Gross Advances</th>
<th>Gross NPAs</th>
<th>Net Advances</th>
<th>Net NPAs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percent to Gross Advances</td>
<td>Amount</td>
<td>Percent to Total Assets</td>
</tr>
<tr>
<td>Scheduled Commercial Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>25,079</td>
<td>564</td>
<td>2.3</td>
<td>1.3</td>
</tr>
<tr>
<td>2009</td>
<td>30,382</td>
<td>683</td>
<td>2.3</td>
<td>1.3</td>
</tr>
<tr>
<td>2010</td>
<td>35,449</td>
<td>847</td>
<td>2.4</td>
<td>1.4</td>
</tr>
<tr>
<td>2011</td>
<td>40,121</td>
<td>979</td>
<td>2.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Public Sector Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>18,190</td>
<td>406</td>
<td>2.2</td>
<td>1.3</td>
</tr>
<tr>
<td>2009</td>
<td>22,834</td>
<td>450</td>
<td>2.0</td>
<td>1.2</td>
</tr>
<tr>
<td>2010</td>
<td>27,335</td>
<td>560</td>
<td>2.2</td>
<td>1.4</td>
</tr>
<tr>
<td>2011</td>
<td>30,798</td>
<td>746</td>
<td>2.3</td>
<td>1.4</td>
</tr>
<tr>
<td>Old Private Sector Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>1,134</td>
<td>26</td>
<td>2.3</td>
<td>1.3</td>
</tr>
<tr>
<td>2009</td>
<td>1,303</td>
<td>30</td>
<td>2.4</td>
<td>1.3</td>
</tr>
<tr>
<td>2010</td>
<td>1,563</td>
<td>36</td>
<td>2.3</td>
<td>1.3</td>
</tr>
<tr>
<td>2011</td>
<td>1,872</td>
<td>37</td>
<td>2.0</td>
<td>1.2</td>
</tr>
<tr>
<td>New Private Sector Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>4,124</td>
<td>104</td>
<td>2.5</td>
<td>1.4</td>
</tr>
<tr>
<td>2009</td>
<td>4,547</td>
<td>139</td>
<td>3.1</td>
<td>1.7</td>
</tr>
<tr>
<td>2010</td>
<td>4,877</td>
<td>140</td>
<td>2.9</td>
<td>1.6</td>
</tr>
<tr>
<td>2011</td>
<td>5,450</td>
<td>145</td>
<td>2.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>1,630</td>
<td>29</td>
<td>1.8</td>
<td>0.8</td>
</tr>
<tr>
<td>2009</td>
<td>1,697</td>
<td>64</td>
<td>3.8</td>
<td>1.5</td>
</tr>
<tr>
<td>2010</td>
<td>1,674</td>
<td>71</td>
<td>4.3</td>
<td>1.7</td>
</tr>
<tr>
<td>2011</td>
<td>1,993</td>
<td>51</td>
<td>2.5</td>
<td>1.0</td>
</tr>
</tbody>
</table>

[Note: Percentage variation could be slightly different as absolute numbers have been rounded off to ‘billion Source: RBI, Report on Trend and Progress of Banking in India, 2011-12]

Notwithstanding an increase in the fresh accretions to gross NPAs of SCBs during 2010-11, gross NPAs as percentage of gross advances declined during the year. The net NPA ratio (net NPAs as percentage of net advances) declined in respect of old private sector banks, new private sector banks and foreign banks, while it increased in respect of public sector banks. The net NPAs to net advances ratio at end-March 2011 was highest (1.1 percent) in respect of public sector banks, followed by old private sector, new private sector and foreign banks at 0.5 percent, 0.6 percent and 0.7 percent, respectively.
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