CHAPTER -1

INDIAN BANKING INDUSTRY: AN OVERVIEW
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1.1 INTRODUCTION

“A good bank is not only the financial heart of the Community, but also one with an obligation of helping in every possible manner to improve the economic conditions of the Common People.” - A Subha Rao Pai, Founder of Canara Bank

Generally a bank means an institution that provides fundamental banking services such as accepting deposits & providing loans.

A healthy banking system is essential for any economy striving to achieve good growth and yet remain stable in an increasingly volatile global business environment. The banking system must be hassle free and capable to meet the new challenges that may come either from internal and external sources.

In the past several years, Indian Banking System has achieved some good milestone and outstanding achievements to its credit. Indian banking has spread even to the remote area of the country that shows the extensive reach of it and for inclusive Indian Growth Story, it is also a necessity. The banks are the main and major participants of the financial system in India. In this cyber age, banking sector offers various facilities & services to their customers, e.g. Insurance, Investment and Wealth Management etc. for these services various models for co-operation have been emerging among various finance entities. Inspite of all these developments, Banks Continue to perform their main & primary role to accept deposits and lending funds.

Banking sector is the backbone for economy and it is one of the key indicators to analyze the level of development of any country.

According to IBA – FICCI – BEG Report titled “Being Five Stat in productivity- Road Map for excellence in Indian Banking” India’s GDP Growth will make the Indian Banking Industry the third largest in the world by 2025. According to the report, the domestic banking industry is set for an exponential growth in coming years with its assets size poised to touch USD 28500 billion by the turn of 2025 from the current asset size of USD 1350 billion (2010-11)
1.2 THE WORD “BANK” ORIGIN

There is no common view regarding the origin of word ‘bank’, because banking transactions were started in different periods in different countries. One opinion is that, the word “Bank” is derived from the French word ‘Banco’ or ‘Banque’ that means a ‘bench’. During that time the early bankers, the Jews in Lombardy transacted their banking activities on benches. When a banker or their business failed, his benches or ‘Banco’ were broken and it was named ‘bankrupt’.

Another view is that the word ‘Bank’ might be derived from the German word ‘bank” means a Joint Stock Fund. Then it was Italianized into ‘banco’, franchised into Banque and finally anglicized into bank.\(^1\) This view seems to be possible and prevalent even today.

1.3 MEANING OF BANK

A bank is a financial institution that accepts deposits and provides loans from deposits. Banking institution are operates in money. So they are money traders. But with the passage of time, functions of banks have been increasing and diversifying. So now, banks are not merely the traders of money only but they also create credit.

Today, nature and activities of banks are becoming so diversifying that it is very difficult to give a universally acceptable definition of bank.

1.4 DEFINITION OF BANK

Section 5(1) (b) of the Banking Regulation Act, 1949 has defined banking as:

“Accepting for the purpose of the lending of Investment of deposits of money from Public repayable on demand or other wise and withdraw able by cheques, draft, order or otherwise.”\(^2\)
“Bank is an establishment for custody of money received from or on behalf of its customers. Its essential duty is to pay their drafts unit. Its profits arise from the use of the money left employed them.”

“Bank is an institution which trades in money, establishment for money, as also for making loans and discounts and facilitating the transmission of remittances from one place to another.”

1.5 **HISTORY OF BANKING INDIA**

Banking in India started in the last leg (decade) of the 18\textsuperscript{th} Century. The English business community that came to India in the 17\textsuperscript{th} century could not use indigenous banking or bankers, due to language and other problems. The first bank in India called the general bank of India was established in the year 1786. Then, East India Company started the Bank of Bengal in Calcutta in 1809.

Banking in India is as old as mountains according to the Central Banking Enquiry Committee (1931). Money lending activity in India could be traced back to the Vadic period. Money was accepted on deposit and given on the form of advances. In the second or Third century A.D., Manu the Hindu Jurist, dedicated a part of his work to deposits and advances and established same rules regarding to the rates of interest to be charged or paid.

The existence of professional banking in India could be traced to the 500 BC. Kautilay’s Arthashatra, dating back to 400 BC reveals references related with creditors, lenders and lending rates. Banking was fairly varied and catered to the credit requirements of the agriculture, trade, commerce and individuals in the country. Mr. W.E. Preston, Member, Royal Commission on Indian currency and finance, setup in 1926, observed, “…. It may be accepted that a system of banking that was eminently suited to India’s then requirement was in force in that country many centuries before the science of banking became an accomplished fact in England.”
During mogul time, the indigenous as bankers played an important role in money lending and financing of trade. They were also doing money changing activity, which was a profitable business then. Every city, Town or Village had a ‘Sheth’, somewhere known as a ‘Shah’ or “Shroff” who were performing a number of banking tasks or functions. These people were respected by all sections of people in the society as an important and necessary citizen. Very often they acted as Royal treasurers. In big towns, besides this ‘Shah’ or ‘Shroff’, there was a ‘Nagar Sheth’. These people were very instrumental in fund transfer from one place to another and doing collection business mainly through Hundis. The Hundis were an accepted mode of transfer of money for commercial transactions.6

Banking practices that was prevailing then were vastly different from the European Counterparts. The dishonoring of Hundis were few and rare occurrences. Most banking worked on mutual trust, confidence and without having any securities that were considered very important and essential by British and European bankers. Banking Regulation also had a rich tradition and evolved along with banking in India. In fact the classic “Arthashatra” also had norms for banks going into liquidation. If anyone became ‘bankrupt’, debt owed to the state had priority over the creditors (Leeladhar, 2007).7

In the abovementioned backdrop, for ease and understanding, History of Indian Banking can be divided or explained in to four parts or phases:
History of Banking in India

<table>
<thead>
<tr>
<th>No.</th>
<th>Year</th>
<th>Period</th>
<th>Characterized by</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.5.1(A)</td>
<td>Up to 1947</td>
<td>Early Phase (Colonial period to pre Independence)</td>
<td>Small and localized, less regulation and bank failures.</td>
</tr>
<tr>
<td>1.5.2(B)</td>
<td>1948 to 1968</td>
<td>Post Independence (Before Nationalization)</td>
<td>Beginning of Regulation, Private Sector’s Dominance</td>
</tr>
<tr>
<td>1.5.3(C)</td>
<td>1969 to 1991</td>
<td>Nationalization (And Thereafter)</td>
<td>Nationalization of banks by Government, Imposition of High Regulations, expansion of Secular Growth and Increasing inefficiencies.</td>
</tr>
</tbody>
</table>

1.5.1(A) First Phase: Up to 1947: Early Phase

(Colonial Period to Pre Independence)

The Pre-Independence period was mainly identified or recognized by the existence of localized small and private banks, organized as joint stock companies having private share holding. The indigenous bankers, moneylenders and Shroff remained isolated from the institutional part of the system. They came under the preview of Reserve Bank of India that was established as a Central Bank in 1935.⁸

The Seventeenth Century witnessed the coming of English traders in to India. The First joint stock bank established in the country was Bank of Bombay in 1720 in Bombay.⁹ Followed by bank of Hindustan in 1770 by the English agency house M/s. Alexander and Company. The bank closed down in 1832. The East India Company established three banks. First presidency Bank was the Bank of Bengal, established in Calcutta in 1806 as Bank of Calcutta with a Capital of Rs. 50 Lakh. Then, it was renamed in 1809, as Bank of Bengal.
Second presidency bank was the Bank of Bombay setup in 1840 with a capital of Rs. 52 Lakh and third one was the Bank of Madras established in 1843 with a capital of Rs. 30 lakh. These three banks were known as presidency banks and governed by Royal Charters. These banks were also embowered to issue currency notes. However, after the enactment of paper currency Act-1861, this right to issue currency note was abolished and handed over to Government.

One of these three presidency banks, namely Bank of Bombay suffered big losses and collapsed in 1868. To replace it, a new Bank of Bombay was established. The presidency Banks Act, 1876 came into existence and imposed some restrictions on the business function of these banks.

These three presidency banks were independent units and had branches in important towns of the India. Later on, However, It was felt that it would be advisable to have a single presidency bank in the interest of these three banks as well for the country also. The three banks were merged or amalgamated in to a single bank, under the name of The Imperial Bank of India in 1921. It was mainly a commercial Bank giving competition to other banks. Upon India’s independence, it was nationalized and became state Bank of India in 1955 by the SBI Act.

The Swadesi movement motivated local businessmen and politicians to found and form banks for the Indian People. A number of banks with Indian Management were established then in the country. The first Indian owned bank was the Allahabad Bank established in 1865. The second Punjab National Bank was set up in 1895. The third, Bank of India was founded in 1906. Between 1906 and 1913, more Indian Banks such as Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank and Bank of Mysore were set up. All these banks were set up as a limited liability company.

Due to Swadesi movement, number of new banks having Indian Management was established. During this time a big spurt was visible in the commercial banking activity.

But during the first phase, there have been a number of setbacks in the form of bank failures that gave a rude shock to banking development. The world
economy was gripped by the series of events like the world war-I (1913 to 1918). Great Depression (1928 to 1934), World War-II (1939-1945). These events also had a bad impact on the Indian banking sector, as well as on Trade and Commerce also. Many weak business units wiped out completely. Loss in business affected credit and solvency of the banks. Number of banks got failed due to sharp rising in their bad loans. One more crisis that had also an impact on Indian banking sector was the partition of the country into India and Pakistan. During this period of 1948-53, many banks failed because majority of the Hindu depositors migrated from Pakistan to India and most of the assets of these failed banks remained in Pakistan.

“During the period of first world war (1913 to 1918), 98 banks failed and during 1919 to 1934, 208 banks failed. Between 1935 to 1945 (During the period of Second World War) approximately 759 banks failed and between 1946 to 1955, 388 banks failed.10

From time to time, there have been suggestions and demands that India ought to have a Central Bank. The setting up of a Central Bank for India was recommended by number of committees that went into reasons of bank failures.11 worldwide; many Central Banks were set up specifically to take care of bank failures. After having due constitutional reform law process, The Reserve Bank of India Act, 1934 was enacted and RBI was established in April, 1935. There were two main reasons for the establishment of Reserve Bank of India. First, was the issue of Bank failures and second was the need for providing to the requirement of Agriculture. Government of India came up with Banking Companies Act, 1949, which was later converted or changed into Banking Regulation Act, 1949 which passed in 1949.

1.5.2(B) Second Phase: 1948 to 1968 Post Independence

(Before Nationalization)

During this phase, some important development took place. It is interesting to verify Indian banking situation at the time of independence of the country in 1947. The country was inherited a banking system that was designed on the
British Banking System. When the country got independence, Indian banking was entirely in the hands of the private sector.

In addition to the imperial Bank, there were five big banks, each holding deposit aggregating Rs. 100 crore and more. All other commercial banks with having regional character and deposit of less than Rs. 50 crore were also in the private hand. These were doing business mostly in major towns and with a focus on traditional business and industries like Jute, tea, cotton etc. In the absence of any considerable regulatory framework, banks were at liberty for banking transactions and resultantly bank failures were also frequent and common during the period. The partition of the country hurt the economy and the banking sector was no different. In 1948 only, 45 banks were closed down. Banking sector was feeling lack of sufficient attention of the authority and policy makers. Though, some efforts were made towards the creation of regulatory environment for the banking sector.

1.5.2.1 Post Independence

After independence, the first test before the Reserve Bank of India was to create a sound legislative framework for banking in a newly independent nation. In 1949, The Banking Regulation Act was passed that empowered the RBI to regulate, control and inspect the banks in the country. It gave wide powers to Reserve bank to supervise and develop the banking system. As a result, a common platform having some uniform parameters was being built up for the first time. The Act was the first important regulatory step taken by the government of independent India, enacted with a broad view to streamlining the functioning of banks in India. One of the important features of this act was to describe “Banking as distinct from other commercial operations.”

After independence and with enactment of Banking Regulation Act, Bank failures continued, though it was reduced considerably. The RBI started collecting data from 1949 on different aspect of banking. The biggest bank was the Imperial Bank of India during that time with having 433 branches. There were 620 banking companies in all, working mostly in state capital and
Urban Towns. The total number of branches were 4,263, while total deposits and advances were Rs. 997 crore and Rs. 518 crore respectively. Investments were Rs. 376 crore. There were 15 Exchange banks (Foreign Banks) having a focus on international banking. Though, their branches were located in big major cities only.

With Independence, not only was the operating environment charged, but policies were also diverted towards planned objectives. The Government of India’s desire to use banking sector as an important agent of change was at the heart of various policies that were designed or framed after Independence.

At the time of Independence, Indian banking system was passing through so many deficiencies. Banking had not spread into the rural and semi-urban centers. A major part of Rural Population was dependent on money lenders for their credit requirement. Credit was not available to agriculture and small industries, as rural penetration was very low and agriculture was not considered a good economic activity by banks. During this time, major part of the bank credit went to commerce and Industry and very little part to agriculture and it was despite the fact that agriculture sector was contributing 55 per cent in GDP in 1950. This can be seen from following table also.

<table>
<thead>
<tr>
<th>As at End</th>
<th>Total (Rs.crore)</th>
<th>Industry</th>
<th>Commerce</th>
<th>Agriculture</th>
<th>Personal and Professional</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>December, 1949</td>
<td>439</td>
<td>30.4</td>
<td>51.4</td>
<td>1.9</td>
<td>8.7</td>
<td>7.6</td>
</tr>
<tr>
<td>March, 1950</td>
<td>498</td>
<td>31.5</td>
<td>52.1</td>
<td>2.3</td>
<td>7.9</td>
<td>6.3</td>
</tr>
<tr>
<td>June, 1950</td>
<td>476</td>
<td>32.5</td>
<td>50.1</td>
<td>3.2</td>
<td>8.2</td>
<td>6.0</td>
</tr>
<tr>
<td>September, 1950</td>
<td>435</td>
<td>34.0</td>
<td>47.6</td>
<td>3.3</td>
<td>9.4</td>
<td>5.6</td>
</tr>
<tr>
<td>December, 1950</td>
<td>476</td>
<td>32.0</td>
<td>51.7</td>
<td>2.3</td>
<td>8.9</td>
<td>5.1</td>
</tr>
</tbody>
</table>

(Source: Various issues of RBI Bulletins & Statistical tables relating to Banking in India)
Above Table No. 1.5.2.1 reveals sectorial Deployment of Credit by Commercial Banks. In Dec. 1949, Industry and Commerce got 30.4 and 51.4 per cent Credit respectively while Agriculture got only 1.9 per cent in that year. While in Dec. 1950, Industry and Commerce were getting 32 and 51.7 per cent credit respectively while Agriculture was getting 2.3 per cent only in Dec. 1950. So, it clearly displayed that during this period, major part of bank credit went to Industry and Commerce and very little to Agriculture.

Moreover, many banks were run by business houses with other interest like as profit and weight age of financing to parent industries. Thus, Agriculture banking was not their focus or interest area. In addition to this, lending activities were largely security oriented and the small borrowers had very little security to give. Only 4 per cent of total advances were made without having any security.

Banks were mainly focused on short term credit. So long term credit or finance was a big problem of that time. Baring the Industrial Finance Corporation of India, which was set up in 1948, there were no other long term lending institutions.

**1.5.2.2 ERA of Economic Planning**

During this period, some important development took place. Concept of economic planning was begun in 1951. During this time, Branch expansion in rural areas and an increase in rural credit were became imperative.

First, the all India Rural Survey Committee was set up in 1951, which examined the issue of rural credit scheme and its survey results were submitted in August 1954 and published in December 1954. For the improvement of Rural Credit flow, committee had made some major recommendations. Accepting these recommendations, the state Bank of India Act, 1955 was passed and RBI took control of The Imperial Bank of India (Nationalized) and renamed as State Bank of India from July, 1955. The bank was mandated with the responsibility of expanding its rural branch network within a timeframe. In 1959, The State Bank of India (Subsidiary Bank) was passed to enable SBI to take over princely-state-associated banks as their
subsidiaries. These were seven subsidiaries banks State Bank of Hyderabad, State Bank of Travancore, State Bank of Indore, State Bank of Mysore, State Bank of Patiala, State Bank of Saurashtra and State Bank of Bikaner & Jaipur. These banks were converted into subsidiaries of state bank of India in 1960 and known as associate banks of SBI. Nationalization of The Imperial Bank of India into The State Bank of India and Constitution of the associated banks increased the speed of extending banking facilities in the country. The SBI was envisaged to act as the principal agent of the Reserve Bank to handle banking transactions of the Governments (Union as well as state Governments) all over the country.

To protect the interest as well as for boosting confidence of small depositors in the banking system, Reserve Bank introduced two schemes in 1961. First was the setup of Deposit Insurance Corporation and second were the compulsory mergers and amalgamations of weak financially structured banks with bigger and sound banks. Co-operative banking system was also brought under the statutory control of RBI in 1966.

Some positive changes took place in the banking industry and its activity during these years. Pattern of financing was also changed and it was shifting from Textile and Sugar Industries to steel, Iron, Cement, Chemicals and Engineering Industries. Due to importance of Export Finance, Export Credit Guarantee Corporation was also established in 1964. During this period, pattern of bank deposit was giving clear indication about the nexus between being business houses and banks, indicating command of business houses over the banks.

During this phase, Indian banking though, made good progress, but still there were many rural and towns which were not covered by banking services. The flow of financing or credit towards agriculture, small scale industries and weaker section of the society was very low. While big and well established business houses were getting big flow of credit facilities. In order to address all these concerns, the concept of social control over banking was imposed or introduced by the government of India in 1968.
The main objective of social controls was to achieve wider spread and efficient distribution of bank credit, prevent its misuse and direct a major part of credit flow towards priority sector as well as in conformity with the need or requirement of economy and make it more effective instrument of economic development to serve Socio-economic objectives. Reserve Bank of India vested with powers in matter of appointment and removal of the services of chairman as well as directors.

The main features of the social control scheme were the establishment of the National Credit Council in 1968, for helping the RBI and the government to allocate credit as per plan priority. Social control became a very important tool in the formation of overall banking policy.

1.5.3 (C) Third Phase: 1969 to 991: Nationalization (And Thereafter)

After independence banking system had made some good progress especially in the 1950s and 1960s, but social objective progress was not satisfactory, and Indian had adopted a social pattern of society as its goal. The need of nationalization was looming large on the horizon because private banks were not catering the social and development need of banking. Private commercial banks had opened number of new branches but their lending activities were not meeting the credit need of priority and other needy and weaker sectors of the society. Moreover, they were reluctant to open new branches in rural areas. These private banks running bank operations with considerable ‘public money’. The total deposit of all the banks in December 1968 were Rs. 2750 crore, whereas the paid up capital was only Rs. 28.5 crore (i.e. hardly more than 1%). Moreover, these private banks did not have any social or economic responsibility to the big general public.

Banking Commission was set up in 1969. Prior to 19th July 1969 state bank of India and its associate banks were the only public sector banks. On July 19, 1969, 14 banks having demand and time Liabilities of Rs. 50 crore and more were nationalized.
These banks were as under:

[8] The Dena Bank Ltd.
[10] The Union Bank of India Ltd.
[12] The Indian Bank Ltd.
[14] The Indian Overseas Bank Ltd.

On 15th April, 1980 six more private banks having demand and time liabilities not less than Rs. 200 crore were nationalized. These banks were:


After nationalization, the prefix ‘The’ and Suffix ‘Ltd.’ were removed from the names of these banks. With the nationalization of these six banks by the government, the number of public sector banks including SBI and its associate banks rose to 28 in April, 1980.
This step of nationalization was seen as a big step to ensure sufficient credit flow into needy and genuine productive areas in conformity with plan priorities. The key objectives of nationalization were to bring large rural area and economic activity under the organized banking system to reduce regional imbalance of economic activity.

There were some effects and achievements of nationalization of banks. The two significant aspects were rapid branch expansion and alignment of credit with that of priorities. In this era of nationalization, development of the banking system was such that it may be explained or described as banking explosion. Some of aspects of growth are Branch expansion, Deposit (Resource) mobilization, credit operations etc. were as under:

1.5.3.1 Branch Expansion

Indian banking system underwent major structural transformation after the nationalization in 1969, to reduce inter-regional disparities and making banking facilities available in the rural and other unbanked areas, RBI laid down branch licensing policy. Progress of branch network of this phase is shown in the table below:

<table>
<thead>
<tr>
<th>Table No. 1.5.3.1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Branch Network of Commercial Banks</strong></td>
</tr>
<tr>
<td><strong>As at End</strong></td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>June, 1969</td>
</tr>
<tr>
<td>December, 1975</td>
</tr>
<tr>
<td>December, 1980</td>
</tr>
<tr>
<td>December, 1985</td>
</tr>
<tr>
<td>December, 1990</td>
</tr>
</tbody>
</table>

(Source: Various issues of RBI Bulletins & Statistical Tables relating to Banking in India)
Table No. 1.5.3.1.1
Growth of Rural Banking in India 1969-1990

<table>
<thead>
<tr>
<th>As at End</th>
<th>Number of Bank Offices</th>
<th>Credit Outstanding</th>
<th>Deposits – Outstanding</th>
<th>Credit-Deposit Ratio (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural</td>
<td>% of Total</td>
<td>Rural (Rs. Cr.)</td>
<td>% of Total</td>
</tr>
<tr>
<td>June, 1969</td>
<td>1443</td>
<td>17.6</td>
<td>115</td>
<td>3.3</td>
</tr>
<tr>
<td>December, 1981</td>
<td>19453</td>
<td>51.2</td>
<td>3600</td>
<td>11.9</td>
</tr>
<tr>
<td>March, 1990</td>
<td>34857</td>
<td>58.2</td>
<td>17352</td>
<td>14.2</td>
</tr>
</tbody>
</table>

(Source: Various issues of RBI Bulletins & Statistical Tables relating to Banking in India)

Above Table No. 1.5.3.1 shows that bank branches were increased more than seven times between 1969 to 1990, of which major or bulk of the increase was on account of rural branches, which was increased from less than fifteen hundred in 1969 to around thirty five thousand in 1990. The percentage share in total number of branches of rural branches increased from 17 per cent in 1969 to 46 per cent in 1980 and 58 per cent in 1990. While the share of other centers like urban and metropolitan centres reduced from 23 per cent and 18 per cent respectively in 1969 to 13 per cent and 9 per cent in 1990. A notable part of increases in Rural Branch expansion took place in the first decade after nationalization. It increased from 17 per cent in June, 1969 to 46 per cent in December 1980.

Likewise, as per Table No. 1.5.3.1.1 credit outstanding and deposit outstanding in rural offices were increased from 3 and 6 per cent in June 1969 to about 12 and 13 per cent respectively in Dec. 1981. Credit- deposit ratio of the same period rose from 37 percent to 60 per cent. The big impact of this huge growth was to bring down the population per branch from 65000 in 1969 to about 14000 per branch in 1990 (Table No. 1.5.3.1). So, one of the main objectives of nationalization, i.e. to spread banking facility in rural areas was served to a great extent.
1.5.3.2 **Deposit (Resource) Mobilization**

One of the important and key aims of branch expansion in unbanked rural and semi-rural area was to raise national savings and directing them into investments or financing as per plan priorities. Deposit mobilization by banks during this phase is shown in the Table below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Deposits</th>
<th>Term Deposits</th>
<th>Saving Deposits</th>
<th>Other Deposit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>5173</td>
<td>3280</td>
<td>1524</td>
<td>369</td>
</tr>
<tr>
<td>1980</td>
<td>37988</td>
<td>19253</td>
<td>10937</td>
<td>7798</td>
</tr>
<tr>
<td>1991</td>
<td>230758</td>
<td>128768</td>
<td>56902</td>
<td>45088</td>
</tr>
</tbody>
</table>

(Source: Various issues of RBI Bulletins & Statistical Tables relating to Banking in India)

Above Table No. 1.5.3.2 shows that, total deposits increased more than seven times between 1969 and 1980, whereas it was increased more than six times between 1980 and 1991. This big rise in total deposits became possible due to increases in term and saving deposits, which represents the community savings. These two categories of deposits rose more or less six times in each of the periods, i.e. 1969-80 and 1981-1991. Other type of deposit also increased substantially during this period.

1.5.3.3 **Credit Operation**

One of the objects of nationalization was to divert credit flow to needy and productive sectors of economy in conformity with plan priorities. Banks were expected to play a more active role in aiding sectors such as agriculture, small scale industries and other necessary area of economy. Because once the main constraint or limiting factor of credit was resolved, these sectors were expended to do better. After nationalization, RBI’s credit policy over the years was used to divert bank credit to preferred and genuine sectors. For priority sectors and other needy sections of economy annual targets were decided.

The Credit Operations of banks during this phase have shown in the table below:
From the above Table No. 1.5.3.3 it can be seen that bank credit rose seven times between 1969 and 1980, and portion of bank credit for priority sector in total bank credit rose from 17.67 per cent in 1969 to 33.51 per cent in 1980 and 36.17 per cent in 1991. Among the priority sector group, the share of Agriculture which was 39.15 per cent in 1969, went up to 42.16 per cent in 1980 and declined marginally to 39.97 per cent in 1991. While the share of small scale industries sector in total bank credit which was 52.66 per cent in 1969 went down to 37.98 per cent in 1980 and 39.96 per cent in 1991. Share of other priority sector in total bank credit, which was 8.19 per cent in 1969 rose more than doubled in 1980 (i.e. 19.86 per cent) and then remained more or less same in 1991 (i.e. 20.07 per cent)

From the above various tables (i.e. No. 1.5.3.1, to 3.3, it was very clear that banking services were expanded in a big way during this phase.

After Nationalization, a new concept also emerged for banking sector and that it can be used for promotion of Socio-economic objectives of development. GOI and RBI took number of steps and sponsored number of schemes to attain such objectives. Some of them were as under:

[1] Credit Guarantee Corporation was established in 1971 with an object to cover the default risk by providing guarantees for loans given to small
borrowers, under which various schemes were launched, e.g. 20 point economic programme introduced.

[2] Integrated Rural Development Programme (IRDP) and scheme for self employment for educated unemployed youth etc.


[4] The Differential Rate of interest (DRI) Scheme was instituted in 1972 for the need of weaker sections of the society.

[5] Regional Rural Banks were set up in 1975 with a view to developing the rural economy by providing credit to various small and marginal categories of people. Under this scheme, banks were set up in selected regions, where either co-operative system or commercial banks were not much active.

There were some effects as well as achievements of this era of nationalization. The focus in this era was to break the nexus between banks and industry and divert the flow of credit towards agriculture and other genuine area as per planned priorities. The nationalization of banks brought a major segment of the banking sector under government ownership. Banks reached out to smallest men of rural areas and covered agriculture & SSI also. Earlier banks were focused on industrial segment of urban area. Branch expansion happened in this phase was a phenomenon. Bank branches in unbanked area rose very rapidly after the 1:4 licensing rule of 1977. Because, between 1977 and 1990 only, more than three fourth of branches that were opened were in unbanked area. However, there were some problems that became visible clearly, excess state intervention brought dominance and intervention of bureaucracy. Moreover, lower profitability, worrisome level of NPAs, Competition, inefficiency; overstaffing, unhealthy balance sheets were the areas of deep concern. Nationalization has decreased the spirit of competition.

Though in the Mid-1980s, some efforts were made to improve and increase the health, profitability and soundness of the banking sector. But, it was an insufficient attempt considering the level of controls that was prevailing
during that time. Even though, undoubtedly this was an era of expansion and consolidation in many ways. Benefits of nationalization were clearly evident in terms of Branch expansion, resources mobilization and credit expansion etc., due to which even a common man was also banking with great trust.

1.5.4(D) **Fourth Phase: 1991 to 2012: Reformatory Phase**

*(Phase of Financial Sector Reforms)*

Liberalization, Privatization and Globalization (LPG) Policy was implemented by India in 1991. In the backdrop of a serious balance of payments crisis that arose in 1991, Government of India initiated economic reforms programme. In order to realize the full potential of reforms in the real economy, the need was felt for a vibrant and competitive financial sector in general and banking sector in particular.

In August, 1991 Government of India appointed a high power committee under the chairmanship of Shri M. Narasimham, to examine all aspects relating to the structure, organization, functions and procedure of the Financial System. The Committee submitted its report in Nov. 1991, made wide-ranging recommendations that formed a basis of financial sector reforms relating to banks, financial institutions and capital markets for the coming years. The recommendations on the banking sector were such that it has transformed the banking sector from a highly regulated to a market-oriented system. Some of the main recommendations of committee were as under:

### 1.5.4.1 **Narasimham Committee – 1991**


[6] To bring financial Institutions and non-banking financial institutions (NBFC) under the regulatory framework of RBI.


1.5.4.2 Narasimham Committee (1998)

One more (second) high level committee, “Committee on Banking sector reforms (CBSR)” was set up by GOI under the Chairmanship of Shri M. Narasimham. Aim was to review the progress of the implementation of the banking reforms since 1992 and to chart out necessary reforms to make Indian Banking Sector well equipped in the fast changing local as well as global environment. The committee submitted its report in April, 1998 and made wide and far reaching recommendations for the Indian banking Sector.

The committee covered various aspect of banking, like capital adequacy norms. Asset quality, systems and methods, regulations and supervisions, structure of banking, earning and profitability etc. some of the main recommendations were as under:

**Recommendations of the Narasimham Committee**:¹³

[1] Reduction of Government stake in Public Sector Banks to 33 per cent.


[4] Public Sector banks to start a system of recruitment from the open market and to be given flexibility and freedom in remuneration structure.

[5] Encouragement of Bank mergers, not to merge weak banks in to strong bank, but to be driven by market and business considerations.


[7] To separate regulatory and supervisory functions of RBI.
[8] Creation of 3 to 4 large banks having potential to have international character, 8 to 10 banks having national presence with nationwide branch network and local banks having presence restricted to a specific region.

[9] Setting up of Asset Reconstruction Fund.

[10] To rationalize staff strength, an appropriate VRS must be introduced.


[12] Banks should avoid ever greening of their advances.

These recommendations were being progressively implemented.

Verma Committee was established in 1999 with a specific task of examining the problems and suggesting strategies for weak public sector banks. Committee’s main recommendations were as under:

[1] Greater use of IT in Public Sector Banks

[2] Introduction of VRS for at least 25% of the Bank Staff.


1.5.4.3 Response to reformatory Phase (1991-2002)

A considerable progress was made in first decade (i.e. 1991-2002) of this phase of reforms. Some of them were:


[2] CRR came down to 5.5 per cent in December 2001 from 15 per cent in January 1992.


[6] To improve supervisory system for banks, a three-tier supervisory model having on-site inspection, off-site monitoring and external auditing based on “CAMELS” introduced.

Response to this reformatory phase in the context of performance was clearly visible in banking sector. Some striking points were:

1. Deposit mobilization increased almost four times between 1992 and 2000. Same was the position of credit deployment in the period of 1991 to 2000.

2. In 1992-93, 12 out of 27 public sector banks had reported net losses, while in March 2001, only 2 public sector banks reported net losses.

3. The ratio of Gross NPAs (Non-performing Assets) to gross advances came down to 12.4 per cent in March-2001 from 23 per cent in 1992-93.

4. Capital Adequacy Ratio of 23 Public Sector banks was more than 10 per cent versus prescribed ratio of 9 per cent at the end of March 2001.

5. In 2001, net profit of Public Sector bank was Rs. 2095 crore versus a net loss of Rs. 4705 crore in 1993-94.

6. One of the key successes of this phase of reform was rapid branch expansion. There were 65901 branches, out of which portion of rural and semi-rural branches combinedly was 70 per cent in March-2001, indicating spreading of banking across the country.

In nutshell, majority of the reforms have targeted and achieved international best practices and good standards in a phased manner. During the economic crisis that began from USA in 2007-08, Indian banking sector performed better than their international counterparts. It was due to successful implementation of the report of the Narasimham committee. Though it should be noted that reforms cannot be a one-time affair. It has evolutionary elements and a time and situation based continuous process.
1.5.4.4 **Further Steps of Reforms (in Brief) (2002 to 2012)**

Following further steps of reforms were taken during this period.\[^{15}\]

[1] The Banking ombudsman scheme (BOS) was revised during the 2002 and 2006. It covered all commercial banks, Regional rural Banks and scheduled, primary co-operative banks under its ambit. New areas covered or included in BOS, 2006.


[3] Income Recognition norms were tightened further from March, 2004.

[4] In March-2004, The Government announced an increase in FDI Limit in private sector banks under the Automatic route further to 74 per cent, inclusive of FII investment. This was subjected to RBI Guidelines.

[5] The Banking codes and Standard Board of India (BCSBI) was set up by RBI.

[6] In April-2004, a risk based supervision (RBS) approach, which monitors institution according to the risk profiles was initiated on a pilot basis.

[7] In Feb. 2005, a comprehensive policy framework for governance in private sector banks was introduced.


[9] In March-2006, RBI allowed Warburg pincus to increase its stake in Kotak Mahindra Bank to 10 per cent. It was for the first time that an investor was allowed to hold more than 5 per cent in a Private Sector Bank.

[10] In Dec. 2012, Banking Laws (Amendment) Bill, 2011 has been passed by parliament. Some important provisions of this bill like, Issue of new banking Licenses, raising the limit of voting rights and some steps related to consolidation of banking sector are very important.
1.6 CHALLENGES OF INDIAN BANKING SECTOR

Indian banking sector faces various difficult challenges; some of the challenges are internal while some are external. The role and importance of banking sector in economy, increasing level of deregulation and rapid changes that are taking place at National and International level in the field of Finance and banking development affects and create challenges for Indian banking sector. In the context of this development, it is necessary for the banking sector to plan out strategies for effective and competitive banking in the present era of competition. While operating in this highly demanding and competitive environment, the banking sector is exposed to several challenges that need to be addressed. Some of them are discussed at under:

1.6.1 Non Performing Assets (NPA)

One of the biggest challenges for Indian banking sector is management of non-performing assets. The level of non-performing assets is continues to be a big problem for banking sector in general and for public sector bank in particular. High level of NPAs affects banks performance and profitability.

Profitability of banking sector can be increased substantially by reducing the level of NPAs that prevails in the banking sector today.

The deterioration in Assets Quality was higher in the case of public sector banks during 2011-12, the gross NPAs of public sector banks increased at a higher rate than that of system level (see below Table No.1.6.1, 1.6.1.1 & 1.6.1.2)
## Table No. 1.6.1
### Trends in Non-performing Assets - Bank Group Wise

(Amounts in Billion)

<table>
<thead>
<tr>
<th>Item</th>
<th>Public Sector Banks</th>
<th>Nationalized Banks</th>
<th>SBI Group</th>
<th>Private Sector Banks</th>
<th>Old Private Sector Banks</th>
<th>New Private Sector Banks</th>
<th>Foreign Banks</th>
<th>Scheduled commercial banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Gross NPAs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing Balance for 2010-11</td>
<td>1131</td>
<td>422</td>
<td>303</td>
<td>182</td>
<td>36</td>
<td>145</td>
<td>50</td>
<td>979</td>
</tr>
<tr>
<td>Opening Balance for 2011-12</td>
<td>1172</td>
<td>690</td>
<td>482</td>
<td>187</td>
<td>42</td>
<td>145</td>
<td>62</td>
<td>1423</td>
</tr>
<tr>
<td>Addition During 2011-12</td>
<td>928</td>
<td>586</td>
<td>341</td>
<td>98</td>
<td>27</td>
<td>71</td>
<td>45</td>
<td>1071</td>
</tr>
<tr>
<td>Recovered During 2011-12</td>
<td>478</td>
<td>325</td>
<td>152</td>
<td>73</td>
<td>20</td>
<td>52</td>
<td>32</td>
<td>585</td>
</tr>
<tr>
<td>Written off during 2011-12</td>
<td>23</td>
<td>13</td>
<td>10</td>
<td>19</td>
<td>1</td>
<td>18</td>
<td>-</td>
<td>43</td>
</tr>
<tr>
<td>Closing Balance for 2011-12</td>
<td>1172</td>
<td>690</td>
<td>482</td>
<td>187</td>
<td>42</td>
<td>145</td>
<td>62</td>
<td>1423</td>
</tr>
<tr>
<td>Gross NPAs as per cent of Gross Advance**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010-11</td>
<td>2.4</td>
<td>2.1</td>
<td>3.4</td>
<td>2.5</td>
<td>1.9</td>
<td>2.7</td>
<td>2.5</td>
<td>2.5</td>
</tr>
<tr>
<td>2011-12</td>
<td>3.3</td>
<td>2.8</td>
<td>4.6</td>
<td>2.1</td>
<td>1.8</td>
<td>2.2</td>
<td>2.6</td>
<td>3.1</td>
</tr>
<tr>
<td>Net NPAs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing Balance for 2010-11</td>
<td>160</td>
<td>212</td>
<td>147</td>
<td>44</td>
<td>9</td>
<td>34</td>
<td>12</td>
<td>417</td>
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<tr>
<td>Closing Balance for 2011-12</td>
<td>591</td>
<td>389</td>
<td>202</td>
<td>44</td>
<td>13</td>
<td>30</td>
<td>14</td>
<td>649</td>
</tr>
<tr>
<td>Net NPAs as per cent of Net Advances***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010-11</td>
<td>1.2</td>
<td>1.0</td>
<td>1.7</td>
<td>0.6</td>
<td>0.5</td>
<td>0.6</td>
<td>0.6</td>
<td>1.1</td>
</tr>
<tr>
<td>2011-12</td>
<td>1.7</td>
<td>1.6</td>
<td>2.0</td>
<td>0.5</td>
<td>0.6</td>
<td>0.5</td>
<td>0.6</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Notes:
1. * Includes IDBI Bank Ltd.
2. ** Calculated taking gross NPAs from annual accounts of respective banks and gross advances from offsite returns.
3. *** Calculated taking net NPAs from annual accounts of respective banks and net advances from offsite returns.
4. Nil/negligible

(Source: Balance sheets of respective banks)

(Source of Table = Trend and progress Report 2011-12, RBI)

Above Table No. 1.6.1 highlights the trends in non-performing assets of Banks (Group wise). In terms of Gross NPAs as per cent of Gross Advance, Gross NPAs of Public Sector Banks deteriorated more than other banks, it was increased from 2.4 per cent in 2010-11 to 3.3 per cent in 2011-12. While in
terms of Net NPAs also, Net NPAs of Public Sector Banks increased from Rs. 360 billion in 2010-11 to Rs. 591 billion in 2011-12. This was highest among other banking group category. While in other banking group, either they (both Gross NPAs and Net NPAs) have remained constant or reduced or increased but only marginally. So, clearly Public Sector banks were in big trouble in the context of NPAs.

Above Graph No. 1.6.1.1 reveals that Gross NPAs as percentage of Gross Advances of SBI Group was increasing continuously in the time span of 3 years i.e. 2009-10 to 2011-12 and SBI group was leading in that category in the context of Gross NPA to Gross Advance.

Apart from increases in NPAs, the deterioration in Asset Quality was also clearly visible in the form of increasing sub-standard/doubtful assets as a percentage of gross advances. Increases in these two categories of NPAs as a
percentage of Gross advances showed that NPAs became a stickier issue (see below Table No. 1.6.1.2)

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Amount</td>
<td>Per cent*</td>
<td>Amount</td>
<td>Per cent*</td>
</tr>
<tr>
<td>1</td>
<td>Public Sector Banks</td>
<td>2011</td>
<td>32718</td>
<td>97.8</td>
<td>350</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>38.255</td>
<td>97.0</td>
<td>623</td>
<td>1.6</td>
</tr>
<tr>
<td>1.1</td>
<td>Nationalized Banks**</td>
<td>2011</td>
<td>22900</td>
<td>98.1</td>
<td>218</td>
<td>0.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>26910</td>
<td>97.5</td>
<td>402</td>
<td>1.5</td>
</tr>
<tr>
<td>1.2</td>
<td>SBI Group</td>
<td>2011</td>
<td>9818</td>
<td>97.0</td>
<td>132</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>11345</td>
<td>95.9</td>
<td>221</td>
<td>1.9</td>
</tr>
<tr>
<td>2</td>
<td>Private Sector Banks</td>
<td>2011</td>
<td>7936</td>
<td>97.8</td>
<td>45</td>
<td>0.6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>9629</td>
<td>98.1</td>
<td>52</td>
<td>0.5</td>
</tr>
<tr>
<td>2.1</td>
<td>Old Private Sector Banks</td>
<td>2011</td>
<td>1836</td>
<td>98.0</td>
<td>13</td>
<td>0.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>2287</td>
<td>98.2</td>
<td>18</td>
<td>0.8</td>
</tr>
<tr>
<td>2.2</td>
<td>New Private Sector Banks</td>
<td>2011</td>
<td>6100</td>
<td>97.7</td>
<td>33</td>
<td>0.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>7342</td>
<td>98.1</td>
<td>34</td>
<td>0.4</td>
</tr>
<tr>
<td>3</td>
<td>Foreign Banks</td>
<td>2011</td>
<td>1943</td>
<td>97.5</td>
<td>19</td>
<td>0.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>2284</td>
<td>97.3</td>
<td>21</td>
<td>0.9</td>
</tr>
<tr>
<td>4</td>
<td>Scheduled Commercial</td>
<td>2011</td>
<td>42596</td>
<td>97.8</td>
<td>414</td>
<td>0.9</td>
</tr>
<tr>
<td></td>
<td>Banks</td>
<td>2012</td>
<td>50168</td>
<td>97.2</td>
<td>695</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Notes: 1. Constituent items may not add up to the total due to rounding off.
2. * As per cent to gross advances.
3. ** Includes IDBI Bank Ltd.

Source: RBI returns.

(Source of Table: Trend and Progress Report 2011-12, RBI)

Above Table No. 1.6.1.2 shows (Bank Group Wise) the deterioration of (Loan) Assets Quality in terms of sub-standard and doubtful assets. Share of Public Sector banks for these two categories has been increased in 2012 than 2011. For sub-standard assets, it has been increased from 1.0 per cent of loan...
in 2011 to 1.6 per cent in 2012, while doubtful assets also increased from 1.0 per cent in 2011 to 1.2 per cent in 2012. For private sector banks it has been reduced marginally in 2012, while in case of Foreign Banks either it remains constant or reduced a little bit.

The assets quality of banking sector is an important indicator of its financial health. The asset quality of the banking system has deteriorated significantly during the year 2011-12 and onwards. Insufficient credit appraisal during the boom period of 2003-’07 along with weak economic situation in the domestic and at external front resulted in the current increases in NPAs.

One study indicated that gross non-performing assets, which reduced from Rs. 700 billion at end March 2003 to Rs. 500 billion at end March 2007, recorded an average growth of 24.7 per cent during the last six years to reach at Rs. 1839 billion at end March 2013. Similarly, net NPAs have recorded an average growth of 29 per cent since March 2007 and reached Rs. 883 billion by end March 2013. The gross NPA and net NPA ratios have been increasing since March 2008 except during 2010-11 and reached 3.42 per cent and 1.46 per cent respectively by end March 2013. The high level of NPAs cost the banks by way of loss of interest income, besides provisioning, recovery and litigation cost.16

In the monetary policy statement for the year 2012-13, RBI advised banks to put in place a sound mechanism for early detection of signs of distress and measures to preserve the economic value of assets. Banks also advised to have proper system generated segment wise data on their NPA accounts, write-offs, compromise settlements, recovery and restructured accounts.17

1.6.2 Branch Banking

Banks have been eyeing to expansion of their branch network to increase their business. But the private sector and foreign banks have been capable to expend their business by other means also. These banks were taking the benefits by taping the agency arrangement and other outsourcing route. A risk was always associated with this outsourcing process. Hence, banks have to put in place a proper system and strategies to manage this risk.
In spite of uncertain macroeconomic environment, private sector banks have been expanding their branch network rapidly. In fact, the number of branches opened by large public sector banks, excluding SBI, in the last five years is less than the number of those opened by ICICI Bank and HDFC Bank. (See Table 1.6.2 below)

<table>
<thead>
<tr>
<th>Branching Out</th>
<th>Total number of branches March-13</th>
<th>Increase in branch count March’08 March ‘13</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public Sector Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Bank of India</td>
<td>14816</td>
<td>4630</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>5874</td>
<td>1610</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>4336</td>
<td>1483</td>
</tr>
<tr>
<td>Bank of India</td>
<td>4292</td>
<td>1409</td>
</tr>
<tr>
<td>Union Bank of India</td>
<td>3511</td>
<td>1150</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>3728</td>
<td>1050</td>
</tr>
<tr>
<td><strong>Private Sector Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HDFC Bank</td>
<td>3062</td>
<td>2301</td>
</tr>
<tr>
<td>ICICI Bank</td>
<td>3100</td>
<td>1838</td>
</tr>
<tr>
<td>Axis Bank</td>
<td>1947</td>
<td>1276</td>
</tr>
</tbody>
</table>

(Source: Banks)
(Source: Business Standard Report, Dt. 04-09-2013)

Above Table No. 1.6.2 shows that Private Sector Banks namely HDFC and ICICI Banks have opened more branches in the last five years (i.e. March-08 to March-13) than public sector banks except SBI. HDFC Bank Opened 2301 Branches, while ICICI Bank opened 1838 Branches, while in Public Sector banks category, only SBI opened more branches than any other Bank. It has opened 4630 branch in the same period.

State – Run Banks, however continue to top the list in terms of the total number of branches. The financial inclusion agenda along with growing
business opportunities in non-metro centres, led to private banks increasing their branch count aggressively across the country. The introduction of low-cost branches has also encouraged network expansion. Though, acquisitions by ICICI Bank and HDFC Bank also contributed to their network expansion. The uncertain economic environment; however appear to have made public sector banks cautious in branch expansion.

Above Table No. 1.6.2. shows, that leading banks have realized the importance of branch banking, albeit with a significant role change. The branch banking model will remain an important service channel of choice, not only for senior citizens and less tech-savvy customer segment but also for a number of younger and Semi-Urban customers. Some of whom always prefer face-to-face interaction and personal touch for investment related financial products and other financial complex product for the first time. Leading banks have already started such branches having multiple channels inside the premises. Focus of these branches remains on customer awareness, advice and interaction for complex transactions.

If banks want to rated high on customer satisfaction levels, than they will have to adopt an operating branch model that would have processes organized by relevant customer segments and deliver a comprehensive, integrated service package to each customer segment with accountability. Customer centric operational realignment with necessary technological support is imperative for this branch model to work properly and effectively in the coming time.18

1.6.3 Capital requirement for Public Sector Banks

The assets quality of banks has deteriorated significantly due to slow down in the economy and the emergence of sector-specific issues due to structural bottlenecks in the economy. The ratio of gross NPAs to gross advance for schedule commercial banks increased from 2.36 per cent in March 2011 to 3.92 per cent in June 2013.19 Public Sector banks hold a disproportionate share of this
increase, while the private banks managing to lower their NPAs ratio in this difficult time. The amount of restructured advances was also worrisome during this period. For the system as a whole restructured standard assets as a percentage of Gross Advances more than doubled from 2.6 per cent in December 2010 to 6.1 per cent in June 2013.²⁰

Estimate suggest that for public sector banks capital will be needed to expand the loan book and provide for NPAs, which rose to 5.17 per cent (gross) of their advances at end December 2013, against 4.18 per cent a year before and expected to be around 10 per cent including the restructured assets.

Experts says that capital infusion provision by the government is grossly inadequate in public sector banks (See Graph No. 1.6.3)

**Graph No. 1.6.3**
**Capital Infusion by Govt. in PSB**

Money flow: Recent Capital infusion (Rs. Cr.)

* Interim Budget Figures, Source: Finance Ministry
(Source: Business Standard Report)

Advance Table No. 1.6.3 reveals the money infusion by Government in Public Sector banks. It was Rs. 20,000 crore in 2010-11, Rs. 12000 crore in 2011-12, Rs. 12517 crore in 2012-13 and Rs. 14000 crore in 2013-14.
So, Capital requirement and infusion of it will be a big challenge for public sector banks in near future.

**1.6.4 Implementation of Basel III Norms:**

There are certain issues in teams of supervision and regulation with which the banking sector will have to deal in the days to come. The banking sector has to prepare for tightening of prudential norms as the new Basel accord already became effective. Apart from the deterioration in asset quality a medium/long term challenge for the Indian banking sector is the smooth transition of the Basel III framework for improved risk management.

As the global economy tries to stand on its feet, financial regulators agreed on new norms (Basel-III) for Capital Adequacy Standard. India is one of the first countries to come out with the guidelines of Basel-III capital regulations (The Global standard to improve regulation, supervision and risk management) which are effective from April 1, 2013 in a phased manner to be fully implemented by end March-2018, which later extended by RBI to March-2019. The objectives of Basel-III are to improve the banking sector’s ability to absorb any jolt that might come from financial and economic stress, thus decrease the risk of spillover from the financial sector to the real economy.

The Reserve Bank of India (RBI) had prescribed a minimum capital ratio of 9 per cent, which was higher than the regulatory minimum required by the Basel Committee, as was also the case under Basel-II. But Basel-III guidelines mandate a stringent definition of regulatory capital and higher need of common equity than Basel-II. The key elements of Basel-III norms are (A) The definition of capital (B) expanding risk coverage of capital (C) Leverage Ratio and (D) framework of liquidity.

Though Indian banks appears well-capitalized with an overall CRAR at 13.5 per cent (at the June-13), the challenges in implementing Basel-III cannot be underestimated. First important thing is that Basel-III would increase capital need for Indian banks. The credit requirement to finance growth could go up over the years and consequently the need of capital of the banking sector would be very big. Second thing is that public sector banks hold a
strong presence and if government maintains its majority shareholding then Fiscal burden of Basel-III would be significant and cannot be ruled out. While for private sector banks it is not that difficult.

According to official estimates, assuming average annual growth of 20 per cent in their loan book, public sector banks will need Rs. 8 lakh crore over the next five years to fully need the Basel-III norms. They will need Rs. 5 lakh crore if their risk weighted assets grow by 15 per cent than 20 per cent.

The available broad estimate suggests that the full implementation of Basel-III by end March-2018 (extended up to March 2019) would require common equity of Rs. 1.4 – 1.5 trillion on top of internal accruals, in addition to Rs. 2.65 – 2.75 trillion in the form of non-equity capital for public sector banks alone.22

1.6.5 Technological Advancement (Managing Technology)

Managing technology is one of the key challenges which are being faced by the Indian banking sector. With the implementation of CBS (core banking solution) the banking system is now seamlessly integrated. Now there is a need to move from a transaction processing system to an information processing system.

In its IT vision document 2011-17, The RBI has highlighted the need for banks to move forward and leverage IT in areas like management information systems (MIS), overall risk management, financial inclusion, consumer relationship management (CRM) and enhancing automated data flow within the banks and to the Reserve Bank without manual intervention.23

Adoption of CBS in banks almost reaching the final stage of completion, the focus has now shifted for adoption of more advance technologies in the banking sector. Foreign banks have been focusing to provide self-service options to carry out all business activities. The high use of the ATM channel and increasing usage of mobile banking and internet is evident. Though, it is high time now to make a detailed risk assessment exercise before converting entire process into digital or self service mode. Many banks have tried to
replicate a branch based model into the internet channel, but very few banks have successfully transitioned customer service to the internet by redefining the process, the customer interface and other support system.\textsuperscript{24}

So, clearly the focus is now on adoption of more advance technology in banking sector that would enhance their CRM by using appropriate tools, improving internal effectiveness including MIS (Management Information System) and managing big risks that arising out of technology implementation.

**1.6.6 Retail Banking**

Retail banking is gaining importance in the current environment. Indian middle class has an appetite to take debt for their requirement of home, car and other lifestyle products. Noticeable growth has been visible in the automobiles, mortgages, white goods, consumer durables and other life style product financing.

Indian has a big middle class population having an aspiration and appetite for all these goods (areas). Rising income, aspirations of various assets ownership is giving spark to aspirations and fueling the demand of retails credit. Banking sector requires to catch this opportunities by using credit data which is available from the credit bureaus.

As per CRISIL study report, total car and utility vehicle loan payment will grow at a CAGR of 18 to 20 per cent till 2016-17.

Banks can gain a big market share in this area by focusing on the needs of middle income class customers. A big opportunity and challenge exists for banks to identify the demand and develop skills and model that enable them to explore this area for exploiting opportunities in this segment. Banks need branches. Micro and small specific branches provide a way to increase presence without incurring huge cost.
1.6.7 Rural Coverage

Indian is living in village’, sentence shows the importance of rural customer. Rural India constitutes 69 per cent of the total population. Rural banking has its own characteristics. Rural customers have their own requirement of banking needs like agri finance, micro finance, small savings and other banking services. As per RBI vision document on payment system for 2012-15, “only 1 in 6 villages in India have access to banking services.”

Today rural economy is changing very fast and moving beyond agriculture. Apart from rural income, other areas of rural infrastructure like development of Roads, Telecom, Powers, Construction etc. also contributing into growth of rural area and economy.

The growing wealth in rural India has prompted many private banks to explore business opportunities in these regions. For example, the share of Semi-Urban and rural branches of Axis bank’s network rose to 45 per cent at the end of March, 2013 from 40 per cent at the end of March, 2011. ICICI Bank set up 348 branches in 2012-13, out of which 152 were in rural areas. Banks are focusing on introduction of low-cost micro branches to expand their reach in rural areas. HDFC Bank opened 193 Micro Branches last financial year. Primarily, these are two member branches in rural market with low operational cost.

For exploiting opportunities in rural areas, banks need to develop simple products that can satisfy the need of rural people. Use of technology enabled solutions can provide low cost efficient delivery channels for rural customer. Mobile based technology can be used extensively in rural area, as mobile phone is consolidating its position as a connectivity device across the people in India.

1.6.8 Merger, Acquisition and Consolidation

The pressure on capital structure and intense competition are expected trigger for a phase of merger and consolidations. Though, trend has already started especially in private sector banks. ICICI Bank acquired Bank of Rajasthan in
2010-11. HDFC Bank bought centurion bank of Punjab in 2007-08. Bank of Madura acquired by ICICI Bank. So, most of the mergers in the past have been through acquisition of a small bank by a large private bank. Sometime it was a forced amalgamation through RBI controlled process like for a weak failing bank in to a strong bank, i.e. Amalgamation of GTB with Oriental Bank of Commerces.\textsuperscript{25}

But considering the present and potential future situation especially in public sector banking, India requires 3 to 5 large banks that can meet global competition. As per the Banker in 2012, there is no Indian bank in the top 10 amongst the list of top 1000 banks of the world. The Government and RBI must push hard for consolidation of smaller public sector banks and will have to drive to create large banks by the merger of small identified banks.

1.6.9 \textbf{Competition}

Going forward, the systematic opening up of the Indian banking system to National and International Competition, banking sector has to equip itself to work in a highly competitive environment. Foreign banks are also providing competition and once they acquire domestic residency and convert to “wholly-owned subsidiary” (WOS) and will get freedom for new branches than competitive pressure on domestic banks will increase substantially

The winners will be the players who can fulfill customer needs and provide high level of customer satisfaction, leveraging technology, knowledge and human resources to make available quality and innovative products and services and simultaneously manage risks and return also to deliver value to all concern stakeholders.

1.6.10 \textbf{Customer Services}

There are two types of customers-one who use multi-channel of banking services and the other who still use only branch as the anchor channel for banking services.
The challenge is to provide consistent banking services to all customers irrespective of the kind of channel they like to use. A customer who use only branch as the anchor channel selects a bank based on convenience and relationship and would prefer to continue with a particular bank, if it provides good services with these two criteria. While those customers who are multi-channel users insist consistent and latest information across all channels and that is the key requirement of these types of customers. Banks are expected to oblige to provide banking services to all segments of the population on prompt and equitable basis.

### 1.6.11 Corporate Governance

Banks not only accept and deploy large money of un collateralized public funds in fiduciary capacity, but also leverage such amounts through credit creation. Due to some unhealthy events and developments in recent times, corporate governance has assumed greater importance in the banking sector today.

The major ingredients of good corporate governance should be accountability, transparency and enhancing the image of the bank in society. Ethics must be part of good governance. Beyond ethics, it is associated with observing and following rules and regulations, guidelines and clean corporate practices. Corporate governance of the public sector bank is weak. So, they need to give considerable attention to corporate governance practices. As a part of ongoing reform process and global practice, today banks have been given greater autonomy in their function and management. So, it is the responsibility of bank management to adhere good corporate governance practices. Only by doing that, Indian banking sector can raise its level to international standard. So, the focus should be on enhancing and fortifying operation of good corporate governance principles and practices.

### 1.6.12 Infrastructure Financing

As per the planning commission’s XIth and XIIth 5 year plan, the investment that is required in infrastructure is expected to grow at CAGR of 14.6 per cent
from FY08 to FY17. Planning commission has projected infrastructure investment of more than Rs. 40 lakh crore in the XIIth 5 year plan, that is nearly double that of XIth 5 year plan.26

Given the size of India and status of under-development, there is an immense opportunity as well as challenge to establish a basic infrastructure in the country. For long term growth momentum of country, we required big amount of investment in infrastructure sector. Considering various dimension of this sector, it is and will be a big challenge for banking sector to provide long term finance to this sector.

### 1.6.13 New Dimension

Once again, RBI is in the process to open the door of banking sector for private sector Company including corporate sector. On December 20, 2012 the parliament has passed the Banking Laws (amendment) Bill 2011. This bill has empowered the RBI to issue new banking licenses.

RBI had invited applications for new banking licenses and it has received 26 applications for banking licenses to start new banks. RBI has set up a committee for this purpose. After scrutiny, committee will submit its final report and afterwards, RBI will take a final decision regarding the issuance of new banking license. So, competition is going to intensify in the Indian banking sector.

### 1.7 Problem and Prospects of Banking Sector in India

India has opened its economy in 1991. A concept of LPG (Liberalization, Privatization and Globalization) introduced. Indian Banking sector especially Public Sector Banks still struggling in facing some problems of this LPG effects. Some of the problems that are facing by banking sector are as under:

[1] Lack of Professional Attitude & behavior


[3] High Level of NPAs
[4] Efficiency and Productivity
[5] Loss making branches
[7] Post VRS effects
[8] How to deal with depression period that prevails in the Country.
[9] To deal with technological advancement.
[10] Scandals
[12] Poor corporate governance practices.

Through, Indian banks have some prospects also in the current situation or environment. Banks can convert these problems into opportunities and by doing that, avail the advantages. These are as under:

[1] To develop professional behavior & attitude.
[3] Banking service at your door concept.
[4] Merger, acquisition and consolidation
[5] Clean Balance sheet by selling NPAs and Asset reconstruction
[8] Technological Advancement
[9] Good Operating model for rural banking
[10] Branch expansion and special innovative branches that cater the needs of current trend of society.
[11] Big changes in process of lending

[12] Good scope for wealth management related services. As per Dec. 2013 Karvy Report, “Wealth held by individuals in India expected to double by 2017 and Wealth expected to increase from Rs. 202 lakh crore to Rs. 411 lakh crore.”

[13] Need to focus on lending to more profitable segment such as retail and small and medium enterprise sector (SMEs)
1.8  **FINANCIAL PERFORMANCE OF BANKS**

(GROUP WISE)

During the last five year (i.e. 2007-08 to 2011-12) financial performance of Indian banks (Groups Wise) has increased substantially. It can be seen in the following three group wise tables.

### Table No. 1.8.1

**Financial Performance Of All Scheduled Commerce Banks**

<table>
<thead>
<tr>
<th>Items</th>
<th>Bank Group-wise Aggregates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007-08</td>
</tr>
<tr>
<td>No. of Banks</td>
<td>79</td>
</tr>
<tr>
<td>No. of Offices</td>
<td>63705</td>
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<tr>
<td>No. of employees</td>
<td>913669</td>
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<tr>
<td>Business per employee</td>
<td>63.45</td>
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<tr>
<td>Profit per employee</td>
<td>0.47</td>
</tr>
<tr>
<td>Capital and Reserve &amp; Surplus</td>
<td>3154879</td>
</tr>
<tr>
<td>Deposits</td>
<td>33200616</td>
</tr>
<tr>
<td>Investments</td>
<td>11773296</td>
</tr>
<tr>
<td>Advances</td>
<td>24769360</td>
</tr>
<tr>
<td>Interest Income</td>
<td>3084823</td>
</tr>
<tr>
<td>Other Income</td>
<td>603910</td>
</tr>
<tr>
<td>Interest Expended</td>
<td>2080011</td>
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<tr>
<td>Operating Expenses</td>
<td>772827</td>
</tr>
<tr>
<td>Cost of Funds (COF)</td>
<td>5.81</td>
</tr>
<tr>
<td>Return on advances adjusted to COF</td>
<td>4.12</td>
</tr>
<tr>
<td>Wages as % to total Expenses</td>
<td>14.01</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>1.12</td>
</tr>
<tr>
<td>CRAR</td>
<td>13.01</td>
</tr>
<tr>
<td>Net NPA ratio</td>
<td>1.00</td>
</tr>
</tbody>
</table>

(Source: A Profit of Banks 2011-12, RBI Report)

Above Table No. 1.8.1 shows the performance of all scheduled commercial banks for last five years. It reveals a drastic increases (an increasing Trend also) in each and every aspect (baring few like cost of fund, wages as % to total expenses & return on Assets etc.) of banking that shows a very good financial performance of banking sector as a whole.
Though net NPA ratio increased considerably in the last year (i.e. 2011-12) and that was not a good sign for banking sector as a whole.

<table>
<thead>
<tr>
<th>Items</th>
<th>Bank Group-wise Aggregates</th>
<th>Public Sector Banks (Amount in Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007-08</td>
<td>2008-09</td>
</tr>
<tr>
<td>No. of Banks</td>
<td>28</td>
<td>27</td>
</tr>
<tr>
<td>No. of Offices</td>
<td>55103</td>
<td>57850</td>
</tr>
<tr>
<td>No. of employees</td>
<td>715408</td>
<td>731524</td>
</tr>
<tr>
<td>Business per employee</td>
<td>59.42</td>
<td>73.44</td>
</tr>
<tr>
<td>Profit per employee</td>
<td>0.37</td>
<td>0.47</td>
</tr>
<tr>
<td>Capital and Reserve &amp; Surplus</td>
<td>1747854</td>
<td>2083419</td>
</tr>
<tr>
<td>Deposits</td>
<td>24538677</td>
<td>31127471</td>
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<tr>
<td>Investments</td>
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<td>10126658</td>
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<tr>
<td>Advances</td>
<td>17974008</td>
<td>22592117</td>
</tr>
<tr>
<td>Interest Income</td>
<td>2130746</td>
<td>2730882</td>
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<tr>
<td>Other Income</td>
<td>327971</td>
<td>424662</td>
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<tr>
<td>Interest Expended</td>
<td>1489021</td>
<td>1934467</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>466627</td>
<td>555037</td>
</tr>
<tr>
<td>Cost of Funds (COF)</td>
<td>5.85</td>
<td>6.06</td>
</tr>
<tr>
<td>Return on advances adjusted to COF</td>
<td>3.67</td>
<td>4.05</td>
</tr>
<tr>
<td>Wages as % to total Expenses</td>
<td>14.66</td>
<td>13.88</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>1.00</td>
<td>1.03</td>
</tr>
<tr>
<td>CRAR</td>
<td>12.52</td>
<td>13.49</td>
</tr>
<tr>
<td>Net NPA ratio</td>
<td>0.99</td>
<td>0.94</td>
</tr>
</tbody>
</table>

(Source: A Profit of Banks, 2011-12, RBI Report)

Above Table No. 1.8.2 reveals the financial performance of all public sector Banks for last five years.

It shows a good increases (An increasing trend also) in each and every aspect (baring few like cost of fund, wages as% of total Expenses & Return on Assets etc.) of banking business which can be said a good performance of public sector banks as a whole.
Net NPA ratio increased drastically in the last year. But it was more than the overall increasing trend of banking sector in General and Private Banks in particular. Consequently, that was clearly reflected on Return on Assets of Public Sector banks. It was reduced considerably from 0.96 in 2010-11 to 0.88 in 2011-12.

Table No. 1.8.3
Financial Performance Of Private Sector Banks

<table>
<thead>
<tr>
<th>Items</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Banks</td>
<td>23</td>
<td>22</td>
<td>22</td>
<td>21</td>
<td>20</td>
</tr>
<tr>
<td>No. of Offices</td>
<td>8325</td>
<td>9241</td>
<td>10452</td>
<td>12031</td>
<td>13408</td>
</tr>
<tr>
<td>No. of employees</td>
<td>166960</td>
<td>176339</td>
<td>182520</td>
<td>187913</td>
<td>214304</td>
</tr>
<tr>
<td>Business per employee</td>
<td>71.48</td>
<td>74.39</td>
<td>79.73</td>
<td>95.81</td>
<td>99.91</td>
</tr>
<tr>
<td>Profit per employee</td>
<td>0.57</td>
<td>0.62</td>
<td>0.72</td>
<td>0.94</td>
<td>1.06</td>
</tr>
<tr>
<td>Capital and Reserve &amp; Surplus</td>
<td>913707</td>
<td>996686</td>
<td>1199839</td>
<td>1385664</td>
<td>1592952</td>
</tr>
<tr>
<td>Deposits</td>
<td>6750329</td>
<td>7363776</td>
<td>8228007</td>
<td>10027588</td>
<td>11745874</td>
</tr>
<tr>
<td>Investments</td>
<td>2785781</td>
<td>3065312</td>
<td>3541169</td>
<td>4220576</td>
<td>5259822</td>
</tr>
<tr>
<td>Advances</td>
<td>5184024</td>
<td>5753276</td>
<td>6324409</td>
<td>7975440</td>
<td>9664182</td>
</tr>
<tr>
<td>Interest Income</td>
<td>709912</td>
<td>850714</td>
<td>828064</td>
<td>967131</td>
<td>1339795</td>
</tr>
<tr>
<td>Other Income</td>
<td>170063</td>
<td>178602</td>
<td>204231</td>
<td>208734</td>
<td>244986</td>
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<tr>
<td>Interest Expended</td>
<td>484951</td>
<td>569574</td>
<td>512056</td>
<td>571491</td>
<td>867843</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>202671</td>
<td>217794</td>
<td>228510</td>
<td>276064</td>
<td>333450</td>
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<tr>
<td>Cost of Funds (COF)</td>
<td>6.15</td>
<td>6.27</td>
<td>4.83</td>
<td>4.60</td>
<td>5.84</td>
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<tr>
<td>Return on advances adjusted to COF</td>
<td>4.88</td>
<td>5.31</td>
<td>5.06</td>
<td>5.11</td>
<td>5.16</td>
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<tr>
<td>Wages as % to total Expenses</td>
<td>10.35</td>
<td>10.83</td>
<td>12.73</td>
<td>14.53</td>
<td>12.29</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>1.13</td>
<td>1.13</td>
<td>1.28</td>
<td>1.43</td>
<td>1.53</td>
</tr>
<tr>
<td>CRAR</td>
<td>14.34</td>
<td>15.23</td>
<td>17.43</td>
<td>16.46</td>
<td>16.21</td>
</tr>
<tr>
<td>Net NPA ratio</td>
<td>1.09</td>
<td>1.29</td>
<td>1.03</td>
<td>0.56</td>
<td>0.46</td>
</tr>
</tbody>
</table>

(Source: A Profit of Banks, 2011-12, RBI Report)

Above Table No. 1.8.3 presents the performance of all Private Sector Banks for last five years. It shows a drastic increases (An Increasing trend also) in almost all aspects (baring few like cost of funds, wages as % total expenses
etc.) of banking performance which is a very healthy financial performance of private sector banks as a whole.

The striking point (difference) in the case of Private Sector Banks is in the terms of Net NPA Ratio. Consistently, it has been decreased for the last three years. While in the last year also, it has been decreased, the same has been increased in the case of Public Sector Banks and that make a big difference in the terms of Return on Assets also.

Return on assets has been increased continuously in the case Private Banks including last year, while in the case of Public Sector Banks ROA has been decreased more or less continuously including last year.

1.9 CONCLUSION

In spite of having problems and challenges, the growth story of Indian banking sector during the last decade has been very good and it was a consistent double digit growth. There were some trends like good regulatory frame work, application of multiple channels and Technology, customer centric banking and growing Indian economy. Though, past couple of years has not been good in terms of economic development. Economy has witnessed a slowdown in the context of high inflation, rupee depreciation, other factors and the after-math of the crisis in Europe and America. Even though, Indian banking sector relatively performed better than many other developing countries in terms of various dimensions of banking.

The Reserve Bank of India has taken and is taking several timely steps for strengthening of banking sector, like entry of private sector banks, guideline for early recognition of bad loans, more operational flexibility, improvement in legal framework, extension of Basel-III guideline etc. But even though, RBI can take more steps in the current economic environment to strengthen the Indian banking sector and system.

With the united and committed efforts of the Government, RBI, Bank management, Bank employees and customers, the Indian banking sector can reach or attain to new highs in this globalized small world.
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