CHAPTER - 5

BANKS AND PRIVATE FINANCE CORPORATIONS

A COMPARATIVE STUDY
5.1 REVIEW OF INDIAN BANKING SYSTEM

Banking sector is the backbone of our economy. Banks are mobilising the idle funds from various sources and transferring to productive channels. Since independence there is a seachange in the functioning of the banks. The number of bank branches expanded from 4,288 in 1947 to 63,534 in 1997, an expansion of nearly 15 times.

At the beginning there was a belief that the banks are meant for only a few people, particularly for the rich. The banks mainly were established in urban areas, the rural poor not having any role in the banking system.

The Government of India promulgated an ordinance called the Banking Companies Ordinance, 1969 by the terms of which the Central Government acquired the undertakings of the following 14 major Indian banks which have deposits of not less than Rs. 50 crores each.
1. The Central Bank of India Limited.
2. The Bank of India Limited.
4. The Bank of Baroda Limited.
5. The United Commercial Bank Limited.
7. The United Bank of India Limited.
10. The Union Bank of India Limited.
12. The Indian Bank Limited.
14. The Indian Overseas Bank Limited.

These banks together had a total deposits of Rs. 2,741.76 crores. Nationalisation of Banks brought the following radical changes in the concept of banking system.

From Class Banking to Mass Banking:

Before Nationalisation banking activities were limited to only rich people. After nationalisation banking facility is provided to millions of poor people.
Shifting from Urban to Rural:

Prior to Nationalisation banks were established only in urban areas. After Nationalisation so many bank branches have been opened in rural areas.

Equitable favour to Small Scale Industries

Prior to Nationalisation only large scale industries were given preference for credit. After nationalisation small scale industries also have been favoured to receive the advances.

From the Profit Concept to Service Concept:

Before Nationalisation the main objective of the banks was to earn profit. After nationalisation it has shifted to satisfaction of the customers.

As a further step the Government wanted the other large banks to fall in line with its goal of obtaining national objectives and six more banks were nationalised in April, 1960. These banks were:

1. The Andhra Bank
2. The Corporation Bank
3. The New Bank of India
4. The Punjab and Sind Bank
5. The Oriental Bank of Commerce
6. The Vijaya Bank
The individual deposits of all these newly nationalised banks were below Rs. 50 crores at the time of the first Nationalisation in July, 1969. Between 1969 and 1978 almost all of them had crossed the Rs. 200 crore mark.

Even though Nationalisation concept accelerated the growth of banking sector, certain elements weakened the system as a whole, consequently, the concept of Nationalisation is replaced by the concept of privatisation.

Political interference affected the autonomy of banks, inefficient operating system became order of the day, bad debts threatened the very survival of the banks.

The concept of privatisation gave a new direction to the banking sector. Narasimham Committee made the following recommendations in the year 1991 to reform the banking sector.

1. Functional Autonomy and Competition: Private banks and Foreign banks are allowed to operate in the market. Functional autonomy is given to public sector banks to compete in the market, to improve their efficiency.
2. Profitability: For achievement of social objectives the profitability of banks is not to be sacrificed, in the long run with profitability only the banks can survive, therefore, every bank should try to improve their profitability.

Capital adequacy and bad debts:

The capital adequacy ratio, in relation to risk weighted assets, is upto the acceptable norm if it is 8 per cent.

Structure of banking system:

According to Narsimham Committee's Report three or four large banks could become international in character. Upto 10 national banks with a net work of branches throughout the country should engage in Universal banking. Local banks' operations should generally be confined to specific region. Rural banks' operations should be confined to the rural areas.

The Government of India seriously implemented the Narsimham Committee recommendations. After implementing the reforms process, again the Narasimham Committee was asked to submit its report. In the second
report the committee advised, close down of the inefficient banks, merger of weak branches, and autonomous status in recruiting the personnel. But there is a lot of resistance from the Bank employee organisations to the steps towards privatisation.

5.2 BANK DEPOSITS AND ADVANCES:

The banking business depends upon the mobilisation of various deposits. The deposits can be classified as under:

Savings Deposits:

People who intend to save their small amounts of money deposits in these accounts. Generally the rate of interest allowed on these deposits is 4.5%.

Current Deposits:

Businessmen open these accounts and have regular transactions and are given overdraft facility. Nominal interest is allowed on these deposits.

Term Deposits or Fixed Deposits:

These deposits are collected for a particular term. The following table shows the rate of interest allowed on these deposits.
# Table 5.1

<table>
<thead>
<tr>
<th>Term</th>
<th>Rate of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 15 days</td>
<td>5%</td>
</tr>
<tr>
<td>15 to 90 days</td>
<td>6%</td>
</tr>
<tr>
<td>91 to 181 days</td>
<td>7.5%</td>
</tr>
<tr>
<td>6 months to 1 year</td>
<td>9.5%</td>
</tr>
<tr>
<td>1 year to 2 years</td>
<td>10.5%</td>
</tr>
<tr>
<td>over 2 years</td>
<td>11.5%</td>
</tr>
</tbody>
</table>

**Recurring Deposits:**

These deposits also are treated on par with term deposits for calculating interest.

**Bank Advances:**

Bank Advances are given to priority sectors and non priority sectors.

The following activities come under the priority sector.

1. Agriculture
2. Small Businessmen
3. Small Scale Industries
4. Self employment Schemes
Table 5.2
The rate of interest charged to priority sector

<table>
<thead>
<tr>
<th>Amount</th>
<th>Rate of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>below Rs. 25,000</td>
<td>12%</td>
</tr>
<tr>
<td>Rs. 25000 - Rs. 200000</td>
<td>14%</td>
</tr>
<tr>
<td>above Rs. 2,00,000</td>
<td>16%</td>
</tr>
</tbody>
</table>

For non priority sectors the rate of interest charged is more than 16%.

5.3 BANK RATE AND RESERVE BANK OF INDIA REGULATIONS:

According to Banking Regulation Act, 1949 all the banks should follow the guidelines of RBI, which are issued time to time. For every six months RBI announces seasonal credit policy, under this policy bank rate may increase or decrease depending on the economic situation in the country.

Bank rate is, the rate at which all the banks can borrow from the RBI. At present the bank rate is 9%. On the basis of bank rate, the rate of interest on deposits and advances is allowed and charged. All the banks are bound to implement the following guidelines.
Cash Reserve Ratio (CRR):
From the total deposits mobilised by the banks 9% should be kept at RBI. This is called cash reserve ratio.

Statutory Liquidity Ratio (SLR):
From the total deposits mobilised by the banks 25% should be kept in Government securities.

Priority Sector Lending:
From the total advances sanctioned by banks, 40% should be advanced to priority sectors.

Non Performing Assets:
An advance sanctioned by the bank if not recoverable with in the due date is called NPA. The NPA in public sector banks are more than 10%, in private sector banks less than 3%.

Capital Adequacy Ratio:
This ratio shows relation between advances of the banks and capital. The present capital adequacy ratio is 8%.

Bad Debts:
The advance which is not recoverable under any circumstances is said to be a bad debt. Due to political interference the bad debts have gone upto 20% to 30% in the banking sector.
5.4 PROFITABILITY OF BANKS AND PFCS:

Banks are operating with so many restrictions imposed by RBI. The maximum rate of interest charged by the banks on their advances is less than 18%, the maximum rate of interest charged by Private Finance Corporations on loans is more than 40% sometimes it may be 90% depending on the necessity of the customers.

The maximum rate of interest allowed on deposits by banks is less than 12%, in the case of Private Finance Corporations it is more than 24%. The Private Finance Corporations are able to attract the deposits because of above reason.

The establishment expenses in banks, such as payment of salaries, stationery and maintenance costs are greater than the establishment charges in Private Finance Corporations.

Lending to priority sectors and maintaining CRR and SLR are applicable to banks but they don't apply to Private Finance Corporations.

Due to the above reasons the profitability of banks is less than the profitability of Private Finance Corporations.
Table 5.3

Bank Branches in the District
as on _______________

<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>No. of Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Bank of Hyderabad</td>
<td>62</td>
</tr>
<tr>
<td>State Bank of India</td>
<td>13</td>
</tr>
<tr>
<td>Andhra Bank</td>
<td>19</td>
</tr>
<tr>
<td>Syndicate Bank</td>
<td>13</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>10</td>
</tr>
<tr>
<td>Union Bank of India</td>
<td>02</td>
</tr>
<tr>
<td>Central Bank of India</td>
<td>03</td>
</tr>
<tr>
<td>Indian Overseas Bank</td>
<td>02</td>
</tr>
<tr>
<td>Dena Bank</td>
<td>03</td>
</tr>
<tr>
<td>WCO Bank</td>
<td>01</td>
</tr>
<tr>
<td>Vijaya Bank</td>
<td>03</td>
</tr>
<tr>
<td>Indian Bank</td>
<td>02</td>
</tr>
<tr>
<td>HDCC Bank</td>
<td>17</td>
</tr>
<tr>
<td>Goloconda Grameena Bank</td>
<td>20</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>02</td>
</tr>
<tr>
<td>Vaishya Bank</td>
<td>04</td>
</tr>
<tr>
<td>Bank of Maharastra</td>
<td>02</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>03</td>
</tr>
<tr>
<td>Allahabad Bank</td>
<td>01</td>
</tr>
<tr>
<td>Corporation Bank</td>
<td>01</td>
</tr>
<tr>
<td>Bank of Madhura</td>
<td>01</td>
</tr>
<tr>
<td>U.B.T.</td>
<td>02</td>
</tr>
<tr>
<td>B.O.M.L.</td>
<td>01</td>
</tr>
<tr>
<td>V.B.L.</td>
<td>04</td>
</tr>
</tbody>
</table>

Sources: Lead Bank Officer, State Bank of Hyderabad; Hyderabad Annual Action Plan, 1995-96

Private Finance Corporations are able to attract more deposits from public due to payment of higher rate of interest. Still the quantity of deposits money is more with the banks than in the Private Finance Corporations.

The growth rate of deposits of Private Finance Corporations is more than that of banks.
Inspite of the different tactics adopted by Private Finance Corporations, people are showing preference to the banks and are placing confidence in them. The PFCs with all their garish allurements are unable to win wider confidence among the public. Still, however small may be their number, people under the spell of greed for quick, huge profits are falling in to nets spread by the Private Finance Corporations.

In this comparative study, it is revealed that in the short run the PFCs' may appear as successful financial agencies, but in the longrun these organisations are utterly failed to gain the confidence of public.

Even though, banks are passing a critical transitional stage of privatisation, in the longrun these organisations are enjoying the public confidence.