CHAPTER NO II

REVIEW OF LITERATURE

"There is no necessity to re-invent the wheel" goes a popular proverb. To reinforce this, here is a detailed review of the major studies conducted on the various performance aspects of Nationalised Banks in India. Year 1969 witnessed the first wave of nationalization of 14 Indian banks followed by six more in 1980. The last decade (1991-2001) saw a plethora of research papers and articles been published on the Indian banking industry in general and the nationalized banks in particular. This was primarily due to the multifarious reforms initiated by the Narsimham Committee Recommendations and the entry of both private and foreign banks in India. Keeping this in view, this chapter presents a literatures review on various academic works on nationalised banks since 1972 onwards till date.

Banking Commission (1972)\(^1\) reviewed bank operating methods and procedures and made recommendations for improving and modernizing operating methods and procedures, particularly relating to customer service, credit procedures and internal control systems. It also examined other important aspects of banking like information systems, management development, training and employee appraisal, etc., which influence the productivity of banks and banking system. The commission observed that present methods of working out branch profitability are not appropriate and an integrated cost and financial reporting system is needed.
Varde (1973) in an empirical study on efficiency of rural branches, maintained that the success of a rural branch has to be studied in relation to the objectives of rural banking which are two-fold; to act as an active catalyst in the integrated socio-economic development of the area served by the branch, and to become a commercially banking unit. The study led to the conclusion that: (i) Instead of a standard complement of staff, the determination of the manpower requirements for an individual rural branch will be more appropriate. (ii) The rural branches operating in groups of 4-5 sufficiently proximate branches would function more effectively than single individual branch. (iii) It is necessary as well as possible to make efforts to rescue the rural branches operating at a low volume of business and those having large volume of over dues. (iv) Location of a rural branch should be at the hub of the activity.

Singh (1974) compared the fourteen nationalized banks in terms of changes in their profitability between pre-nationalisation and post-nationalisation periods. He concluded that if recruitment, promotion, branch expansion, deployment of personnel and business growth are carried out in a judicious manner, it makes a very favorable impact on profitability and profit. He went ahead with his comment that key to profitability should lie essentially in higher volume of business: total per employee and per branch.

Luther (1976) chaired the committee appointed by Reserve Bank of India to study Productivity, Efficiency and Profitability of commercial banks.
The major recommendations of the committee were: (i) The capital base of banks needs to be improved. For this, banks should transfer at least 40 percent of the disclosed profits to reserves, free of taxation. (ii) The interest on additional cash profits to reserves, free of minimum 3 percent should be related to cost of funds for banks. (iii) In the light of social obligations cast on the banks, tax law need to be revised. (iv) To estimate the cost of various services and profitability of different activities, the Reserve Bank of India, in collaboration with commercial banks, should organize regular and systematic surveys. (v) To improve productivity, efficiency and profitability of banks, a systematic, prompt and regular flow of information and its analysis is essential for banks to contemplate timely corrective actions. (vi) There should be uniform system of audit for all categories of banks, on the lines of the one prevailing in the State Bank of India.

Mathur (1978) studied the public sector banks in Indian economy by conducting a case study of the State Bank of India. The main finding of his study was that the State Bank of India, in its two decades of services, has accelerated the growth of Indian economy in two significant ways: (i) by pursuing the policy of vigorous branch expansion in general and its rural orientation in particular, and (ii) by paying a leading role in introducing bank credit facility to the new fields of the priority sectors of the Indian economy. The bank has also played a leading role in developing the backward regions of the country.
Bhatia (1978) attempted to describe and analyze the economic performance of the Indian banking system, as reflected by its output, price and profitability during the period 1950-68. Surrogates were used to measure the output of the Indian Banking system. Profitability of the banking system was measured by the ratios of profit (before taxes) as percentage of capital; and profit (before taxes) as percentage of assets. The major findings of this study were: (i) the profit performance of the Indian banking system during the period 1950-68 has an upward trend, (ii) the structure of the banking system represented by the number of bank offices and the deposit concentration ratio had an insignificant effect on its performance during the period under review, (iii) there were significant differences in the levels of intermediation of various banking sectors in India during the period 1950-68. However, none of the sectors had significant profitability differences, (iv) in order to improve the output performance of the Indian Banking System, the study suggested that the banking regulations in India should not emphasize direct regulation of the rate of return, as much as the regulation on the asset portfolio of banks.

Sankar (1978) in this paper analyzed the profits of public sectors banks over a time frame and concluded that banks require greater maneuverability in their operations so as to achieve the dual objectives of profit with growth.

Kulkarni (1979) in this paper highlighted the juxtaposition of development responsibility of banks. He viewed that one of the main reason
for the decline in profitability of banks is the 'development responsibilities' undertaken by them. He inferred that carrying of development business could be possible as well as profitable only by reducing costs, improving systems and improving productivity.

Shah (1979) pointed out weaknesses of the banks and pointed out the specific areas where action and be taken to improve profitability. Weaknesses, he revealed, were rising expense and overheads, increase in wasteful work practices, decline in productivity, etc. He suggested following areas where proper attention be given to enhance profits of banks: (i) locating profit centers and cost centers in the bank (ii) identifying the elements that control or determine the income and cost structure at each such center and for the bank as a whole (iii) evolving measures that could widen the spread between the cost of funds, service and administration, and the return on them (iv) developing supplementary sources of income on profit.

Singh (1979) studied the relationship between cost of bank credit and prices and drew the following conclusion: (i) The present high rates of interest produce has, in general, insignificant tendency for the prices to rise further, and (ii) The effect of rise in interest rates is, some what, significant only in case of those companies, which are inefficient and burdened with excess borrowings form commercial banks.

Ganesh (1979) in his paper on the system of profit monitoring in banks emphasized that the effectiveness of monitoring systems would depend
upon profit plan, identification of profit centers, setting of standards for comparisons and a proper management information system. The study indicated that the working funds, as the base for the purpose of comparing profitability at the branch level, is inadequate and relating it to the total business (i.e., the sum of the total deposits and total advances) will be more suitable. Finally, the study suggested a proforma of monthly profitability monitoring for reporting to central office.

Makrand (1979)\textsuperscript{12} attempted to evaluate each of the public sector banks using six quantitative indicators viz., branch expansion, priority sector credit, deposit mobilization, export credit, net profit to working funds and wage cost of business development. These indicators were assigned appropriate weights and incorporated in the Integrated Priority Index, on the basis of which inter-bank comparisons were made. The study suggested that: (i) Counseling and expert advice to the priority sectors on diversified activities is essential, (ii) Apart from top management, the staff at a lower level should also be actively involved in the priority sector credit, and (iii) Necessary lending powers should vest with the branch managers.

Aggarwal (1979)\textsuperscript{13} examined the concept of social obligations of banks. The main recommendations of his study were: (i) Providing more branch offices to the public, particularly in semi-urban and rural areas and in the lead districts, (ii) Providing greater credit facilities to the public as well as to the priority and neglected sectors, (iii) Helping generation and maintenance
of employment opportunities in the country, (iv) Financing the government securities, and (v) Popularizing the bill form of credit.

**Zahir (1980)** advocated transfer pricing as one of the important methods for evaluating branch level performance of commercial banks. The study suggested that: (i) Branches should be given credit at a minimum transfer price than at which excess funds are transferred to the head-office (ii) Other than profits, necessary weightage should also be given to management objectives, such as priority sector lending, recovery, deposit mobilization, etc. When applied to a selected number of different kinds of branches of a particular nationalised bank, the suggested transfer price mechanism made the profit statement of branches more meaningful and informative for evaluating the branch level performance.

**Bilgrami (1982)** studied the banking growth imbalances since nationalization (for a decade) on parameters of branch expansion, deposit mobilization, credit disbursement and priority sector lending. The study concluded that: (i) The rapid expansion of bank branches since 1969 has substantially increased the average number of bank branches per million population in all regions, but such expansion could not actually prove helpful in eliminating the wide variations between backward and developed regions, (ii) The regions which were above the national average population served by a bank in 1969 recorded more progress than the regions which were below the
national average. Similar trends also emerged in case of deposits, credits and priority sector lending.

Nayan (1982)\textsuperscript{16} suggested a model for performance evaluation of commercial banks in India. His study led to the conclusion that at the micro level, the existing system of performance budgeting has left much to be desired, and thus can not be objectively used for evaluation of branch level performance. He stressed the need for developing an integrated performance index that will act as a model for evaluating the performance of commercial banks.

Varde and Singh (1983)\textsuperscript{17} of National Institute of Bank Management, Pune conducted a number of studies on the profitability of commercial banks and have compiled them in a book titled “Profitability of Commercial Banks”. The book covers different issues related to profitability of banks like profit management in banks, productivity in banks, profit planning in banks, monitoring profitability of bank branches, measuring cost of funds for banks, matching revenues and costs of commercial banks and operating cost of rural retail banking.

Verghese (1983)\textsuperscript{18} conducted an in-depth study on profits and profitability of commercial banks during the decade 1970-79. The major issues analyzed by her were: (i) Has there actually been a declining trend in the profits and profitability of Indian Commercial Banks in the seventies? (ii) What are main determinants of profits and profitability of the Indian banks?
during this period? (iii) Are the conventional profit accounting standard adequate to reject a true picture of the financial performance of the Indian banks?; and (iv) Are the present systems and procedures of drawing up the balance-sheet and profit and loss accounts adequate to give a true and fair picture of the banks' financial position and if not, what improvements are called for? Owing to data and time constraints, however, the scope of her study was limited to the analysis of profits and profitability of groups of Indian commercial banks, leaving aside the analysis of financial performance of individual banks.

Angadi and Devraj (1983)\(^9\) in their paper revealed that difference in cost of working funds (deposits) interest earning, social banking, funds managements, earning from sources other than the interest earnings, expansion of banking business, retail banking services, are main factors contributing to differences in productivity and profitability ratios of the bank groups. They concluded that in the prevailing circumstances, change in interest rates on deposits and credit have a decisive impact on earnings and expenses and consequently on profitability of banks.

Angadi (1983)\(^9\) measured bank efficiency in commercial banking sector of India and pointed out some important yardsticks like operating cost responsiveness, administrated prices/interest rates to output of operational efficiency of banks, etc that affect profitability of banks.

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Kanthale (1984)\textsuperscript{21} observed that credit policy of the Government has a great impact on the profitability of banks. He concluded that there remains hardly a factor or determinant of working result, which is independent of credit monetary policies. He opined that the monetary and credit policies of the government needs to be attuned keeping in view of the contemporary needs.

Raut and Mohanty (1985)\textsuperscript{22} attempted to analyse the reasons for declining profitability of a co-operative central bank. The authors used the statistical tool, co-efficient of determination in their analysis to study the effect of individual variables on the profitability of the bank. They concluded that the declining trend of profitability could be arrested by increasing the ratio of time deposits in total deposits.

Joshi (1986)\textsuperscript{23} has analysed the trend of gross and net profits of all scheduled commercial banks and found that lower capacity for fund management of the banks is due to SLR (Statutory Liquidity Ratio), CRR (Cash Reserve Ratio) and priority sector lending. He found out that there had been lowering yield rate and rising cost rate year by year which contributed a lot to the declining trend in profitability. He viewed that declining demand from the corporate sector for bank funds has serious implications for bank profitability.

Punjab National Bank (1986)\textsuperscript{24} hosted 9\textsuperscript{th} Bank Economists' Meet at New Delhi. The major issue deliberated was that banks profitability is a
function of both exogenous and endogenous factors, wherein the former play a greater role. The exogenous factors include large pre-emptions of bank funds for the purpose of liquidity requirements (viz., SLR and CRR with low yields), administrated interest rate structure with consessional rates on several categories of loans, and massive branch expansion in the rural areas. The endogenous factors include increase in establishment expenditure, growing proportion of term deposits in the deposit-mix, inadequate non-found business and low return from ancillary services. The major recommendations which emerged from the discussion were (i) Professionalisation of credit management, diversification of business, increasing service charges and computerization of operations. (ii) Increase in rates of interest on priority sector credit. (iii) Take over of sick units and their management by banks. (iv) Better cost management and (v) Adoption of techniques like Linear Programming and Zero-based budgeting for profits planning.

Chopra (1987)\textsuperscript{25} in her empirical work “Managing Profits, Profitability and Productivity in Public Sector Banking”, studied the emerging trends in the profits and profitability of some selected public sector banks at micro level. She highlighted the need for proper management of both costs as well as earnings in these banks.

Vashist (1887)\textsuperscript{26} in his empirical work “Performance Appraisal of Commercial Banks in India”, evaluated the performance of public sector banks with regard to six indicators i.e., branch expansion, deposits, credit
priority sector advance, DRI advances and net profit, over the period 1971-83. A composite weighted growth index was developed to rank the banks and to classify them into four performance levels viz., excellent, good, fair and poor. The study ranked Indian Overseas Bank at the top and Dena Bank at the bottom. The study suggested: (i) The developing of marketing strategy for deposit mobilization, (ii) Profit planning, and (iii) SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis in banks.

Gode, V.T. and Padwal, S.M., (1987) studied the issues of bank profitability under the conditions observed that any emphasis on the increase of the volume of business and proper management of burden would definitely result in enhancing the profitability of commercial banks. They concluded that, the key to profitability of commercial banks in India are high volume of business (in total, per employee) and not the expenses (per branch and per person) which is popularly practiced.

Singh (1987) has noted that profitability of the Indian banking system has been subject to several stresses and strains due to many exogenous and endogenous factors. The major of them being continuous increase in the SLR, CRR, persistent emphasis on social goals, growing incidence of industrial sickness, rapid branch expansion in rural areas, unfavorable change in the deposit mix and growing incidence of financial disintermediation.

opined the chief reason for less profits in the low volume of business. He suggested, that monitoring the break-even business level for the banking sector is of great importance for improving profitability.

Garg (1989)\textsuperscript{30} studied the main determinants of cost, profits and profitability of the banking sector and also observed the inter group differentials of SBI and its subsidiaries, the nationalized banks, foreign banks and private banks. He also studied the impact of monetary policy on bank earnings. He concluded that the profitability of various bank groups excluding foreign banks showed a steeply declining trend during 1977-82. Further, he observed that the operating income of all bank groups increased at a lower rate as compared to operating expenses which resulted in the decline in the profitability.

Karup (1990)\textsuperscript{31} conducted an interesting study on nationalized banks, The author sixteen crucial parameters, each having an impact on profitability. Government of India in 1984 ranked the nationalized banks according to the ratio of gross profits to working fund and put them in five categories. Group ‘A’ comprised 7 banks who has the ratio more than 1.5 percent and group ‘E’ consist of 8 banks scored lowest ratio below 0.5 percent. The author analyzed the parameters of ‘A’ bank group and ‘E’ bank group to find out the factors that distinguish high profit earring banks in Group ‘A’ and low profit earning banks in Group ‘E’.
Satyamurty (1990) identified twenty six ratios (including fourteen explanatory ratios) categorized into six groups of performance. Their inter-relationship, he observed, can be interpreted for a systematic and meaningful evaluation of profitability and productivity performance of banks.

Shanbhag (1991) has critically evaluated various target based on social obligations assigned to banks from time to after their nationalisation. The author did not dispute the basic need and principles behind social banking in a highly structured society. However, he urged the necessity of redefining the basic ideas concept behind social banking, and suggested re-grouping of the priority sectors with the contemporary relevance.

Panda and Lall (1991) in their paper attempted to develop certain internal management techniques for improving the profitability of the Indian banking system. The authors have identified productivity, development of funds, quality of advances, information system and organizational set up and branch expansion policy as the most important factors influencing the profitability.

Ramachandran (1992) attempted to trace out the causes for declining profitability of Indian banks and suggested possible measures for arresting this trend. He observed that the main causes are: (a) emphasis on social goal (b) increase in establishment cost (c) blocking fund in sick unit (d) compliance to statutory requirement (e) rural branch expansion (f) leakage in income (g) poor cash management and other.
Mishra (1992) analyzed the profitability of scheduled commercial banks in India taking into account the interest and non interest income, interest expenditure, manpower expenses and other expenses. He concluded that the growing pre-emption of funds in the form of SLR, CRR, faster increase of expenses as compared to the income, advances and total investment than interest income and few more have contributed to the declining profitability of commercial banks.

Sadare (1992) in his note has briefly analysed public sector banks, private sector and foreign banks for a period of six years covering 1985 to 1990. He suggested that policy support as well as increasing branch efficiency are important factors for improving that profitability of banks.

Gooporia (1992) maintained that if adequate profit have to flow in Indian banks, following priorities will have to be observed: (a) among fund-based operations, the lending operation have to be directed to areas which would maximize profitability and growth, consistent with the long-term objectives of the institutions, (b) to promote non-fund based operation, and (c) charging fees for banks’ services after taking into consideration the cost benefit of service offered.

Chandra (1992) highlighted the step-motherly treatment and discrimination, public sector banks are being subjected to, inspite of their predominant role in mobilizing resources and substantial contribution made to the society. He concluded that despite massive working funds, public sector
banks were not able to show better result due to high cost operation on account of priority sector advances and more than 56 percent branches being rural.

Vysya Bank (1992)\(^{40}\) hosted Bank Economists’ Conference at Bangalore, 1991, on ‘Banking for better profitability’. Different experts and eminent persons in banking sectors presented papers on profitability of banking operations with their valuable suggestion for enhancing bank profitability.

Oslen (1992)\(^{41}\) in his survey based report concluded with the three dimensions of service quality in financial services (like banking) which are design quality, production quality and process quality. Design quality concerns the existence of the available tangible and intangible infrastructure for providing services; production quality concerns the readiness and quality of staff to provide services; and process quality is mainly concerned with the ability of the staff to deliver adequate service to its customers.

Aggraswal (1992)\(^{42}\) Malhotra and Kaur (1992)\(^{43}\) and Elvia and Bansal (1993)\(^{44}\) have adopted the regression model and empirically stated that reserve requirements, bank rate, lending to priority sector at lower rate of interest, unprofitable expansion of bank branches in rural areas are the major determinants of profits and profitability sector banks in India.

Toor (1993)\(^{45}\) made an attempt to find a link between the nature of business being handled by banks and their earnings in case of nationalized banks. The various aspects of the business mix like deposits (category wise),
advances (nature wise category wise), expenditure incurred on deposits and income earned on advances have been examined and discussed by the author. The author viewed that the business mix in the nationalized banks is of highly varying degree and it certainly has bearing on their operational efficiency and profitability trends.

Rajagopalan (1993)\textsuperscript{46} has given a general view on productivity in banks. He opined that profitability and productivity depends on various factors like reduction of costs, recovery of overdue, work reorganization, introduction of computers, etc. He also identified that establishment expenses play a key role in determining the level of profit. He viewed that attention should be paid on the staffing pattern in banks.

Singh (1993)\textsuperscript{47} in his paper has given an overall view about profit planning in banks and stressed on the awareness of break even point to improve the profitability. He concluded that the level of profitability would largely depend on cost consciousness, overall monitoring management, quality of asset management, level on non-fund business and the customer services.

Singh (1993)\textsuperscript{48} in his work on productivity of Indian banks has divided public sector banks into two groups-SBI group and 14 nationalised banks. He has used seventeen indicators to analyse productivity trends of the Indian banking sector and study the inter group differentials of SBI group and nationalised bank over 1969 to 1985.
Amandeep (1993)\textsuperscript{49} in her study on profitability of commercial banks has attempted to examine the trends in profits and profitability of twenty nationalised commercial banks, with the help of trends analysis, ratio analysis and concentration indices of the selected parameters. The study focused at identifying factors have significantly contributed towards banks profitability in either direction. Using the multivariate analysis, she concluded that it is the efficient management of the burden (as against the widely believed ‘interest spread’ element) which pays a major role in determining the profitability of commercial banks. In spite of lack of control of few determinants of burden, it is inferred that bank profitability can significantly be enhanced by judicious management of the burden.

Athanassopoulus (1997)\textsuperscript{50} has examined the operating efficiency of bank branches of a large banking network in Greece with the use of non-parametric methods. The assessment is pursued using data envelopment analysis (DEA) enhanced by the value judgement of individual branch managers. He defined effort effectiveness (EE) of bank branch as a function consisting of the tangible operating efficiency and intangible service quality. Efficiency is considered at the market, production and intermediation levels whilst quality is considered at the physical, corporate and interactive levels. The study, embodying service quality into branch efficiency, concluded that both physical and corporate of service quality has (where significant) mainly a positive influence on branch outputs. Interactive component of service
quality (like reliability, service time etc) had both positive and negative effects on the generation of branch outputs. The branch outputs studied were number of deposit accounts, number of credit, number of debit, number of loan applications evaluated, number of transactions on service involving commissions, non-interest income, total value of loans, time deposit accounts saving deposit accounts and current accounts.

Bhattacharya, Lovell and Sahay (1997)\textsuperscript{51} have examined productive efficiency of 70 Indian Commercials banks during 1986-1991. They have used data envelopment analysis to calculate the efficiency of service provision for individual banks of three different ownership forms (Public, Private and Foreign Banks) over a period of six year (1986-1991). The study concluded that, the publicly owned banks are the most efficient, followed by foreign owned banks and privately owned banks. However, the most striking finding is the rise of foreign owned banks which were least efficient at the beginning of the sample period. This has been partly due to their ability to efficiently extend their small branch network into metropolitan areas. Their study found virtually no trend in the performance of privately owned Indian banks and a temporal decline in the performance of publicly owned banks.

Aurora & Malhotra (1997)\textsuperscript{52} conducted an interesting study on comparative analysis on the factors determining customer satisfaction in public and private sector banks. The opinion of 200 bank customers (from both private and public sector banks) on 20 reasons for satisfaction /
dissatisfaction were measured on a five point scale (Likert scale). Factor analysis with Varimax Rotation technique was used. They concluded that the six factor determining satisfaction of public sector bank customers in the order of their importance are routine factors, price factor, situational factor, environmental factor responsible for the satisfaction of private bank customers are the staff factors and the service factors. The public sector banks were found to be lagging behind the private banks in most of these factors. Even the Routine operations factor which pertains to daily procedure process like depositing and withdrawing money, satisfied the customers moderately (average score of 3.14 out of 5.00) According to them, the main reason contributing towards the lower level of customer satisfaction seem to be the low service charge that the public sector banks charge from their customers.

Ramamoorthy (1998)\textsuperscript{53} studied the profitability of Indian banks during the four year period of reforms 1993-96 and also made international comparison with the banking system in 23 OECD countries. He concluded that Indian banks have higher interest spreads, higher operating profits and higher risk provision levels than banks in foreign countries. The productivity in Indian banks as measured in terms of per employee business increased by 12.80 percent during the period of study i.e. 1992-94. He opined that in the last decade or so the per employee business growing primarily due to restrictions in level of recruitment.
Kumar (1998)\textsuperscript{54} in his paper on profitability of Indian commercial banks has used the technique of stepwise multiple discriminant analysis (MDA) to identify the most critical profitability ratios relating to Indian banks. The sample comprise of 51 banks – 26 public sector banks and 25 private sector banks. 12 ratios representing spread and burden and their components were taken, in addition to two decomposed ratios of equity multiplier, totaling 14 ratios/independent variables. The data related to year 1994-95. The study identified only for variables among the 14 variables as the significant discriminators of profitability (measured by Return of Assets). They were: Earning Assets/Shareholder’s Equity, Spread/Working Fund, Non-Interest Expenditure/Working Fund and Operating Expenses/Total Income. The canonical correlation of the discriminant function was 0.8139 which indicated a fairly strong relationship between the groups (non-profitable bank group and profitable group) and the discriminant function. The classification accuracy for the analysis sample was 98.04%.

Gupta (1999)\textsuperscript{55} has examined the performance of State Bank of India (SBI) over a period of five years 1994-1998, using the international CAMEL Approach. The main finding of the study was that during 1994-98, SBI has shown substantial growth in assets and corresponding growth in profits and has expanded its network of branches. He opined that intensive competition in the Indian banking industry and the continued economic slowdown has seriously impaired the interest income growth of SBI in 1997-98 and the bank
had to rely on volatile income sources and non-interest income to sustain growth. The study also presented a brief outline of ownership, business operations and SWOT analysis of State Bank of India (SBI). The study found that SBI’s capital adequacy ratio (CAR) had improved mainly due to increase in profit owing to writing back of excess depreciation on government securities and a 20% fall in provisions and contingencies. Asset quality also improved during 1994-98 as SBI was able to reduce its net non-performing assets (NPAs). The most striking conclusion was the narrowing of Net Interest Margin (NIM) to 4.10% (119) from 4.47% (1997) inspite of return on assets (ROA) improving substantially to 1.11% (1998) from 0.88% (1997).

Bhatia & Verma (1998-99)\textsuperscript{56} maintained that profitability of bank depends both on exogenous variables (i.e. policy determined variables such as reserve requirements and direct credit programmes) and on endogenous variables such as composition of deposits, establishment expenses, burden and spread, etc. The study used the technique of step wise multiple regression with the dependent variable as net profit as percentage of working funds. The study led to the conclusion that: (i) Net spread (interest spread minus burden) influenced, positively and significantly, the profitability of banks.; (ii) Priority sector advances (in absolute term for Nationalised banks) and as ratio of total advances (for SBI group of banks) influenced negatively the profitability of public sector banks. The same was with fixed/current deposit ratio and establishment expenses: and (iii) Although credit-deposit ratio was found to be
positively influencing profitability, its impact was statistically non-significant. The study suggested that burden ratios can be reduced by banks by way of introducing new technology for superior operational efficiency and by observing strict cost control at all levels. They opined the need of mobilizing more of current and saving deposits with banks and a lesser dependence on term deposits.

Money and Banking Division of the Economic Research Department, State Bank of India (2000)\textsuperscript{57}, Mumbai have analyzed the performance of public sector banks for year 1998-99 vis-à-vis. The preceding year on four broad parameters: Business performance –which, focused on deposits, advances, investments and net profit; Efficiency indicators – using return on equity ROE decomposition model; Vulnerability – measured by Capital-to-Risk weighted Assets Ratio (CRAR) and Non-Performing Assets (NPA); and Labour Productivity - measured by 3 ratios – Business per employee, Profit per employee and Average assets per employee cost.

Eresui and Hossian (2000)\textsuperscript{58} has made an interesting review on performance evaluation of the nationalized banks in India for last three decades. In retrospect, the study found that the effectiveness of nationalized banks has been justified so far by the progress of the various banking activities viz. mobilization of deposits, expanding of bank credit, credit to the priority sector (agriculture, small scale industries and exports), bank’s profitability, solvency and effectiveness of asset utilization. A comparative analysis
among the different banking groups for year 1997 on important parameters like deposits, credits, employee strength and non-performing assets, was also featured in the study.

Reddy, et(2000)\textsuperscript{59} has suggested few strategies to achieve better customer service in Indian banks. They opined that banks needs to stratify different customer groups and device products and delivery system to suit their specific requirements. Continuous customer survey and customer contact programmes, along with educating customers in the various aspects of banking are essential strategies to deliver best customer service. Customers convenience can be enhanced through upgraded banking technology. The entire banking organization has to be leveraged to play a supportive role in this endeavor, they opined.

Parasuraman (2001)\textsuperscript{60} attempted to measure the performance of major banks in India in the year 1998-99 and seeked to compare their ranking under various criteria with a possible ranking under the criteria of EVA (Economic Value Added). For this purpose, EVA has been computed taking certain assumptions as to the cost of equity and operational profit adjustments. A rank correlation coefficient has struck between the ranks under different criteria in comparison to that under EVA. The study found that ranking of banks under Return of Assets assumes close resemblance to the ranking under EVA, whereas the ranking under other criteria like total income, interest, as
percentage of total assets, spread, and net profits did not match with the ranking under EVA.

Ganesan (2001)\textsuperscript{61} has selected State Bank Group (8 units) and 19 nationalised banks as sample to identify the determination of profit and profitability. The empirical estimation of profit function mode I had used multiple regression technique on data relating to the sample banks for period 1969-1999. The study had shown that interest cost, interest income, other income, deposit per branch, credit to total assets, proportion of priority sector advances and interest income loss were the significant determinants of profit and profitability of Indian Public Sector banks. The analysis found that the average establishment cost positively contributed to the profitability but it adversely affected the net profits of the public sector bank. The study has also identified the fact that banking sector reforms and individual banks policies towards directed investments and direct credit programmes had played a significant role in improving profit and profitability of banking sector.

Tandon (2001)\textsuperscript{62} has studied the actual level of customer satisfaction in four commercial banks in Jammu & Kashmir and found that customers are highly satisfied with the employees and management of the banks. Customer satisfaction level was measured by analyzing attitude of bank customers towards bank, employees and management, measured on five point Likert scale. Customers were selected under three categories-businessman, service class and practitioners. Comparative analysis shows that customers of central
bank of India have higher level of satisfaction with average score of 3.30 (out of 5.0) followed by State Bank of India (3.20), Punjab National Bank (3.06) and Jammu and Kashmir Bank (3.01). Certain suggestions for increased customer satisfaction are also presented like promptness of bank personnel for service, convenient location of the bank, confidently in transactions, etc.

Verma & Israney (2001)\(^\text{63}\) have studied the market orientation in 40 commercial banks in Delhi and found the foreign banks to be most market-oriented. They have measured market orientation on four broad group parameters- intelligence generation, intelligence dissemination, response design and response implementation prepared on the basis of the frame work as suggested by Jaworski and Kohli (1990). [Kohli, Ajay K. and Jaworski, Beenard, “Market Orientation: The construct, research proposition and managerial implication”, Journal of marketing, Vol.54 (April), P 1-8, 1990]. The mean score for overall market orientation was found to be 86.60 with scores for public sector banks, private banks and foreign banks as 74.93, 91.86 and 96.20 respectively. A component-wise analysis revealed the aggregate mean scores for intelligence generation, intelligence determination, and response design and response implementation were 25.77, 15.80, 16.85 and 28.17 respectively for the sampled banks.

Brady and Cronin (2001)\(^\text{64}\), through qualitative and empirical research, found that the service quality construct conformed to a structure of a third-order factor model that ties service quality perceptions to distinct and
actionable dimensions of outcome, interactions and environment quality. In turn, each has three sub dimensions that defined the basis for service quality perceptions. The authors tested and supported this conceptualization across four service industries-fast food, photograph, developing, amusement park and dry cleaning.

Financial Express – IRIS (2001)\textsuperscript{65} four- dimensions dynamic weighted ranking of Indian banks (1999-2000) takes into account four types of parameter: financial, operational, profitability and productivity. The Study considered 96 banks which included 27 public sector banks, 28 private banks and 41 foreign banks. State Bank of India (SBI) was ranked first with overall weighted score of 5164.75. The overall analysis revealed that Citibank, State Bank of India, State of Mauritius and Andhra Bank achieved top ranking among profitability parameters, financial parameters and operational parameters respectively.

Samal (2001)\textsuperscript{66} classified banking development in India into four phases- foundation phase (1950-1969), rapid expansion phase (1970-1984), consolidation phase (1985-1990) and reforms phase (1990 onwards). He presented an overview of Indian banking system with regard potential norms introduced in the reforms phase, the disclosure practices, Non Performing Assets, (NPAs) status and the critical area of rural banking.

Asiamoney’s (2001)\textsuperscript{67} analysis of the health and efficiency of Asia’s strongest banks, complied together with Fitch IBCA Duff & Phelps revealed
that ICICI (Industrial Credit and Investments Corporation of India) bank was the strongest bank in the overall study. The ranking covered 68 Asian banks in 14 Asian countries, the data used was year 1999. Each of the chosen banks were assessed on seven criteria: total assets, net income to total assets, equity to total assets, NPL (Non Performing Loan) to gross loans, cost to income ratio, loan loss reserve to NPLs and net loans to customers and short term funding.

Raghupathy (2001) along with INDUSTRIAL ECONOMIST research team studied 23 South Indian Banks for period 1999-2000 and ranked them on the basis of internationally acclaimed set of CAMEL (Capital, Adequacy, Asset Quality, Management Performance, Earnings Performance, Liquidity) ratios. The Analysis found Karur Vyasa Bank as the best performing among the south Indian banks followed by Corporation bank and Global Trust Bank. The study concluded that for the winners banks to sustain their ranking, they should focus on liquidity and earnings performance, management performance, technology and growth strategies in the long run.

Edirisuriya and Fang (2001) have attempted a comparative study on Indian banks and selected OECD banks based on two aspects: Financial performance and the development in financial deregulation. The performance aspects was measured under three parameters-number of commercial banks, net profit to total assets figure and percentage change in international debt securities in the countries studied over the period 1992-97. They maintained
that deregulation of the financial industry has been as obvious milestone in the financial history of India and deregulation of interest rates on deposits and advances has bought Indian banks under severe competition recently. The analysis found that the average net profit to total asset of Indian banks was minus 0.14 percent during as 1992-97, which reflected the poor performance of the banking sector. Overall, the Australian banks were performing much better than the Indian banks and other OECD banks (except New Zealand banks) with average net profit of 1.212% to the total assets.

Thampy and Baheti (2001)70 have reviewed the performance of twelve Indian banks, both public and private banks, for the period 1995-98, using the Economic Value Added metric (the equity approach). The results showed that several banks, particularly the large public sector banks in the sample were not creating value. The authors opined that there could be two reasons for this: (i) banks could be overcapitalized, and (ii) the returns was low. They maintained that high NPA and low employee productivity was a major problem in public sector banks.

Ahmed and Khababa (2001)71 attempted to analyse the financial performance (profitability) of commercial banks in South Arabia. A regression model has been employed to test the effect of business risk, concentration and market size on the profitability measured in the terms of return on assets (ROA) and the return on equity (ROE) and earnings per share (EPS). Both time series and pooled time series data have been used. The
empirical results generated from the three models have shown that the business risk and bank size are the main variables which determine bank’s profitability.

**Nachane and Ghosh (2002)** seek to identify the factor influencing off-balance sheet (OBS) activities of public sector banks in India. Using pooled data analysis for the period 1995-96 to 1999-2000, the analysis revealed that: (i) size plays an important role in influencing OBS activities, and (ii) higher the levels of capital and liquid assets, lower the incentive of the banks to engage in OBS activities. They maintained that this was in consonance with the hedging theory, which contended that the aversion to risk might be an important determinant for banks not actively engaging in OBS activities.

**Das (2002)** has studied the interrelationships among capital, non-performing loans and productivity using data on public sector banks for the period 1995-96 through 2000-2001 and found the three parameter to be interwined, with each reinforcing and to a degree, completing the other. They observed that inadequately capitalized banks have lowered productivity and were subject to a higher degree of regulatory pressure than adequately capitalized ones. Finally, the result lend some credence to the belief that lowering government ownership tended to improve productivity.

**D'Souza (2002)** found that the efficiency of the public sector banks has declined during the 1990s when measured by the spread/working fund
ratio. He observed that though the profitability of the public sector banks did improve relative to the private and foreign banks, they have lost ground in their ability to attract deposits at favourable interest rates, in their slow technological upgradation, and in their staffing and employment practices, which has implications for their longer-term profitability.

**SUMMARY OF REVIEW**

The Review of Literature enabled researcher to find that no researcher has made an attempt to appraise the cost effectiveness and profitability of commercial banks. The Literature is reviewed to avoid duplication of research on the same topic. Profit is important factor for the growth and expansion of any bank. It the result of bank efficiency and effectiveness in functional areas like deposit mobilization, credit management, recovery management, reduction in operational cost, reduction in cost of obtaining deposit etc. Viewed from this angle, profit is both cause for and effect of bank performance. A detailed investigation of the factors responsible for declining trend in operational profitability and efficiency would reveal various hindrances in the line of banks performance, which, intern, would be useful for designing suitable operational and financial strategies for corrective action. Hence the topic of the study is “Cost effectiveness and profitability in Indian commercial banks".
RATIONALE OF THE STUDY

The Indian bank-management, today, is facing a two-sided challenge—to improve their profitability & productivity, and to serve the public in new ways with greater efficiency and effectiveness. Commercial viability of banking can seldom be ignored. The nationalized banks in India have spearheaded the banking developments as they accounts for a majority share of total deposits and advances in the Indian banking industry. To quote Bahbha, Banking is the kingpin of the chariot of economic progress. As such its role in expanding economy of a country like India can neither progress. As such its role in expanding economy of a country like India can neither be underestimated nor overlooked. The success of our plan is dependent among other things, on the smooth and satisfactory performance of the role by banking industry of our country.

The present study has academic and practical significance. It helps the academicians and researchers to develop deeper and new insights into the overall performance parameters of Indian nationalized banking industry. The study focuses on the development, profitability, productivity and return on investment, which may interest not only those interested in the various nationalized banks but also others to see the process of change and reforms within the industry.

This study will be useful to the policy makers and professional bankers to take investment-related decisions and monitor critical factors
effecting profitability performance of nationalized banks. Identification of critical strength areas and points of weakness is also facilitated by the study which may serve as a guide for operational management in banks and provide an evaluation on performance of Nationalised in India. The study is relevant in the context of the spate of banking reforms initiated since 1991 which has close bearing on overall profitability of the banks.