CHAPTER 1

NATURE AND RATIONALE OF THE STUDY
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The Chapter explains the Concept of Business Practice and its relevance for the Business Organizations. During the past decades the Indian Banking System has come a long way, the Chapter retrospect’s the milestones achieved by the Banks and the current status of the industry. In Banking Sector, the whole range of activities and generation of income revolve around the Customers and Products, the Chapter tries to analyze the significance of service quality and innovations as an important Business Practice in Banking Industry.

1.1 INTRODUCTION

Business was considered to be a money making activity which revolved around capturing market share and profitability. For thousands of years, business existed only at the periphery of society. Society thought little of people in business, and people in business expected little of society. Profit was their only reward because power, social status, and even social acceptability were close to them. In this context the idea that making a profit was the only goal of business might have some sense, but in a time when the values of the business world largely influence the values of society as a whole and the possibilities of future generations, the purposes and goals of business need to be redefined and expanded, which lead to the transformation in the overall business practices of the organizations.

Traditional concept of business was confined to earning profits only gradually over the decades the changes in the external environment has made businesses more competitive, sustainable and to redefine its objectives from earning profits to utilization of it for the benefit of the society as a social responsibility. Success of business is dependent on the business practices adopted by the organization. Business practices set successful firms. There is a strong relationship between firm’s performance with firm’s business practices.
and characteristics of the external environment. Business Practices in India are undergoing massive transformation; the vision of success requires new business tools, practices and relationships. Being receptive to new ideas and suggestions opens the door to an array of business opportunities.

1.2 MEANING AND SIGNIFICANCE OF GOOD BUSINESS PRACTICES FOR ORGANISATIONS

Business Practices are conceptualized as sets of coordinated business processes that organizations develop in order to perform organizational tasks. Business Practices comprises of methods, processes, procedures and rules employed or followed by a firm in achieving its organizational objectives. Methods can be described as the systematic process followed in achieving certain goals with accuracy and efficiency in an ordered sequence comprising of fixed steps in accomplishing the activities. Business processes can be explained as the specifications of how certain tasks are to be performed in an organization for meeting its end objectives. Over the time period of the business implementation and experience of these processes become organizational routines, which create capabilities as the organization learns how to perform the different tasks. Procedures can be prescribed as sequence of activities or course of action in an orderly manner for the conduct of given tasks in order to achieve the desired outcomes of the business enterprise. Rules are the standards which serves as a norm for guiding the conduct of activities within the organizations. Well-specified and documented business practices set in practical organizational knowledge which becomes one of the measures of performance. A business practice may be initially improved by making changes to its routines without significantly changing the overall competence. Best Business Practice embodies a philosophy based on a desire to determine ideal ways to perform given tasks. New business practices emerge from business process and management innovations that organizations adopt and develop for their sustainability.

Business today is being impacted by multiple forces and is under a tremendous pressure to perform. Whether a new business is to be launched or if any entity wants to take the existing business organization to the next level, implementation of sound business practices is a necessity. There is an overall process for operational success: the organization must establish the vision, execute the mission, follow the business model plan, execute it and then review and redirect the set of activities for continuous
improvement in its operations and to elevate the business to the next level of growth. Execution of activities in the organisation requires good, trained, motivated employees for which the organizations should follow sound business practice process to: evaluate the workforce, rank the productivity, and compensate them in order to retain the valuable employees, and to ensure the future success of your developing business. Every business entity must strive for best business practices, best practices are finding and using the best ways of working to achieve the business objectives which involves keeping up to date information of peer groups, external environmental changes and also measuring its performance against the market leaders within the same industry.

Best Business Practices will enable the Business Organisations to:

i) Become more competitive
ii) Increase market share and develop new markets for their products and services
iii) Substantial Cost Reduction
iv) Increase operational efficiency
v) Increase productivity of employees
vi) Usage of information technology more effectively and efficiently
vii) Improving service quality
viii) Adaptability towards innovations

The performance of the organization can be measured in terms of its key performance areas. Key performance indicators can be used for measuring the effectiveness of business practices such as growth, profitability, productivity and revenues. Best Business Practices are a vital part for business management and sustainability. Best Practices are the most efficient and effective way of accomplishing a task, based on repetitive procedures that have proven themselves over a time period for large number of people.

The research relates to the business practices of the financial sector, understanding the role of financial sector in India becomes indispensable. Business practices are an important aspect for the financial institutions. The Indian financial sector comprises a large network of Commercial Banks, Financial Institutions, Stock Exchanges and a wide range of Financial Instruments. The Indian financial system comprises of the following Institutions:

Chapter 1: Nature and Rationale of the Study
A) Commercial Banks
   a) Public Sector
   b) Private Sector
   c) Foreign Banks
   d) Cooperative Institutions
      i) Urban Cooperative Banks
      ii) State Cooperative Banks
      iii) Central Cooperative Banks

B) Financial Institutions
   a) All-India Financial Institutions (AIFIs)
   b) State Financial Corporation’s (SFCs)
   c) State Industrial Development Corporations (SIDCs)

C) Non Banking Finance Companies (NBFCs)

D) Capital Market Intermediaries

Financial system is an integral part of the economy the viability of the economy depends on the efficient and dynamic business practices adopted by the financial sector, therefore need arises to study the business practices followed by these financial institutions. In any economy the objective of household sector and corporate sector is optimum utilization and allocation of scarce resources which is considered to be of prime importance; to accomplish this objective the mobilization of resources from surplus to deficit units is crucial. Well developed financial system comprises of Central Bank, Commercial Banks, Non Banking Financial Institutions and Financial Markets. Development of financial sector is positively related to the countries overall development. Financial development involves establishment and expansion of Institutions, instruments and markets that support this investment and growth process, one of the major promoters of the growth and development amongst the financial institutions are the Banks.

Banks are the major financial institution of the country; banking business practices play a prominent role in the sustainable growth and development of the nation.
1.3 BANKING SECTOR: AN OVERVIEW

Banking is a service industry; Banks are financial intermediaries which channelize the funds through mobilization of resources, they accept deposits from the customers and use it in the financial markets. A Bank is a company which transacts the Banking business in an across countries. The main function of the Banking System in any economy is to mobilize the resources and channelize them into productive purposes. Banking sector performs three primary functions in an economy: the operation of the payment system, the mobilization of savings and the allocation of savings to investment projects. The Indian Banking Sector has made progress during the decade in extending its geographical spread and functional reach. The spread of Banking System has been a major factor in promoting financial intermediation in the economy and in the growth of financial savings.

1.3.1 Structure of Banking Sector in India:

The Banking System in India is significantly different from that of other Asian nations because of the country’s unique geographic, social, and economic characteristics. Banking is the epicenter of economic development. About 92 percent of the country’s Banking segment is under State control while the balance comprises Private Sector and Foreign Banks. Prior to the Reforms, India’s financial sector had long been characterized as highly regulated and financially repressed. The prevalence of reserve requirements, interest rate controls, and allocation of financial resources to priority sectors increased the degree of financial repression and adversely affected the country's financial resource mobilization and allocation. The Banking System in India is undergoing structural transformation under the influence of globalization, deregulation, technological advances and institutional and legal reforms. To survive and excel in a competitive environment, Banks have been innovating, diversifying and sharpening their Banking skills. Banking regulation and supervision has been progressively aligned with international best practices with suitable adaptations. Understanding the meaning of Bank, Banker and Banking Company is essential to grasp their role in the Banking System.
A Study on the Impact of Business Practices on Profitability and Cost Effectiveness of Selected Banks from Pune City

> **Bank**

A Bank can be defined in terms of (i) economic functions it serves (ii) the services it offers its customers (iii) the legal basis for its existence.¹

According to The Banking Companies Act, 1949 “Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawable by cheques, draft, pay order or otherwise.”

> **Banker:**

Banker is a person who accepts deposits, issues and collects for his customers.

> **Banking Company:**

It is a company which transacts the Banking business in India.

The Bank market structure in India can be broadly classified into; (A) Commercial Banks (B) Financial Institutions (C) Non Banking Financial Companies and (D) Co-operative Credit Institutions.

**Figure: 1.1 - Bank Market Structure**

(Source: Suresh Padmalatha, Paul Justin (2010), Management of Banking and Financial Services, Second Edition, Pearson)

¹ Peter S Rose, Sylvia C. Hudgins “Bank Management & Financial Services” Tata McGraw-Hill
A) Commercial Banks:
Commercial Banks are the oldest and fastest growing Banks in the organized sector in India; they are most important depositaries and lenders and are simple business organizations which provide various financial services to customers. Profitability, liquidity, safety, social welfare is the major principles of Commercial Banks. Commercial Banks attract the idle savings of the people in the form of deposits, they are creators of credit. A Bank creates a deposit and creates a credit for the borrower. The commercial Bank performs a variety of functions such as safe deposit custody; provide references about the financial position of the customers, payment of insurance premium and gives guarantee of payments to third parties. They cater to the needs of trade, commerce, industries, agriculture, small business, transport and other activities with wide network of branches throughout the country.

The Commercial Banking System consists of Scheduled Banks and Non Scheduled Banks. Schedule Banks are one which is registered in the Second Schedule of the RBI. Bank which are not included in the Second Schedule of RBI are known as Non Scheduled Banks.

Scheduled Commercial Banks are categorized into five different groups:

i) SBI and its associates [SBI and 6 associates]

ii) Public Sector Bank [20]

iii) Regional Rural Banks

iv) Private Banks

v) Foreign Banks

The Indian Banking Sector has been dominated by the Public Sector Banks in terms of number and asset share. Presently the Scheduled Commercial Banks in India comprises\(^2\) of:

- Public Sector Bank [27] [SBI and 6 Associate Banks and 20 Nationalized Banks]
- Private Sector Banks [22] [7 new and 15 old Private Sector Banks]
- Foreign Banks [32]
- Regional Rural Banks [84]

\(^2\) Number of Commercial Banks as per IBA Statistics 2011
B) **Financial Institutions:**
Financial Institutions fall under the category of Non Banking Financial Institutions that complement Banks in providing a wide range of financial services to a variety of customers and stakeholders. These Institutions provide equity and risk based products.

Financial Institutions are classified into:

i) **Term lending Institutions (EXIM Bank)**

ii) **Refinancing Institutions (NABARD, SIDBI and NHB)**

iii) **Investment Institutions (LIC, GIC)**

iv) **State level financial Institutions (SFC’s, SIDC’s)**

v) **Other public financial Institutions (IFCI, TFCI)**

C) **Non Banking Financial Companies:**
NBFCs are allowed to raise money as deposits from public and lend through various instruments including hire purchase, leasing and bill discounting. They are licensed and supervised by Reserve Bank of India. NBFC is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisitions of shares or securities issued by the government or local authority, leasing, hire purchase, insurance business, chit business but does not include agriculture activity, industrial activity, sale or purchase of immovable property.

D) **Co-operative Credit Institutions:**
The Co-operative Sector was conceived as the first formal institutional channel for credit delivery to rural India. It has been regarded as a key instrument for achieving the financial inclusion objective. Co-operative Banks generally provide their members with a wide range of Banking and Financial Services such as loans, deposits and other allied services. Co-operative Banks differ from other commercial Banks with respect to their organization, goals, values and their governance. Figure: 1.2 indicates the framework of Cooperative Credit Institutions in India.

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1.3.2 Regulatory Framework:

**Evolution of Banking Law in India [Banking Legislations and Reforms I]**

The regulatory framework for the financial system has been felt universally to safeguard the interest of depositors and to ensure proper and efficient functioning of the Institutional part of financial system. Banking Law is the outcome of the gradual process of evolution. The Indian Companies Act, 1913 was inadequate and therefore a separate legislation was passed in 1949 under the name of Banking Companies Act, 1949. In 1966 this Act was renamed as Banking Regulation Act. Several amendments have been made to the Act to cater to the changing needs of the society and also to remove the loopholes. An important amendment in 1968 was the introduction of ‘Social Control’ on the Banks. The takeover of 14 Commercial Banks in India with effect from 19th July, 1969, the Banking Companies (Acquisition and Transfer of Undertakings) Act was passed in 1970. The subsequent changes included the enactment of Public Financial Laws (Amendment) Act 1975, the Regional Rural Banks Act, 1976 and the Banking Companies (Acquisition and Transfer of Undertakings) Act was passed in 1980.
The Reserve Bank of India Act was passed in 1934 to establish RBI as the guardian of the Banking System in India; it started functioning with effect from 1st April, 1935. The Act contains provisions relating to Commercial Banks and it classifies the Commercial Banks into Scheduled Banks and Non Scheduled Banks. Scheduled Banks are one which is included in the Second Schedule to the RBI Act. The Second Schedule includes the following conditions:

i) Bank must have a paid up capital and reserves of not less than 5 Lakhs rupees.
ii) Bank does not conduct its affairs in the manner detrimental to the interest of the depositors and
iii) It must be a State Co-operative Bank or a Company defined under the Companies Act, 1956 or an Institution notified by the Central Government in this behalf or a Corporation or a Company incorporated by or under any other law in force outside India.

The Central Banking Authority (RBI) has distinct roles to play which include:

i) Governments Banker
ii) Issuance of Notes
iii) Bankers Bank
iv) Bank Supervision
v) Development of Financial System
vi) Monetary Control and
vii) Exchange Control.

Central Bank Monetary Control Tools include:

i) Cash Reserve Ratio (CRR)
ii) Statutory Liquidity Ratio (SLR)
iii) Bank Rate
iv) Repo Rate
v) Open Market Operations (Sale/ Purchase of Government Securities)
vi) Selective Credit Control (Restriction on Bank Advances against Sensitive Commodities)

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RBI and SEBI are the prime authorities who are entrusted with the responsibility of development and regulation of financial system in India.

1.3.3 Development of Banking Sector in India

The entire evolution can be classified into two major categories:

A) Stages of Evolution comprising of three distinct phases.

B) Since Independence

The developments during the phases of evolution of banking sector can be viewed as:

A) Stages of Evolution comprising of three distinct phases.

- Phase I- Pre-Nationalisation Phase (Prior to 1955)
- Phase II- Era of Nationalisation and Consolidation (1955-1990)
- Phase III- Introduction of Indian Financial and Banking Sector Reforms and Partial Liberalisation (1990 onwards)

➢ Pre Liberalisation Period (Prior to 1955):

The development of Bank is evolutionary in nature. To trace the origin of the word Bank, relates to the German word “Banck” means heap or joint stock fund similarly Italian word “Banco” meaning heap of money was coined and the French word “Bancus” or “Banque” which means a ‘bench’. Initially the Jews transacted their business on benches in the market place and the bench resembled the Banking counter, if the Banker failed the bench was broken up by the people, hence the word ‘Bankrupt’ has come into existence. The English word ‘Bank’ has the meaning, as an institution accepting money as deposit for lending.

Banking in India originated in the 18th century. The first Banks were the General Bank of India which was started in 1786 and Bank of Hindustan, both of which are defunct. The oldest Bank in existence in India is the State Bank of India, which originated as “The Bank of Bengal” in Calcutta in the year 1806. This was one of the three presidency Banks, the other two being the Bank of Bombay and Bank of Madras. The presidency Banks were established under charters from the British East India Company. They merged in 1920 to form the Imperial Bank of India which after Independence became State Bank of India. The Reserve Bank of India formally took on the responsibility of
regulating the Indian Banking sector from 1935. The first fully Indian owned Bank was the Allahabad Bank, established in 1865.

Foreign Banks started to arrive in Calcutta in the year 1860, Comptoir 'Escompte de Paris opened a branch in Calcutta and Bombay. Indian had established small Banks, most of which served particular ethnic and religious communities. The presidency Banks dominated Banking in India. There were also few exchange Banks and Indian joint stock Banks which were owned by Europeans and concentrated on financing foreign trade. Indian joint stock Banks were undercapitalized and lacked the experience and maturity to compete with the presidency and exchange Banks. By 1900 the market expanded with the establishment of Banks such as Punjab National Bank in 1895 in Lahore and Bank of India in 1906 in Mumbai both were formed under private ownership.

The period during the First World War (1914-1918) through the end of the Second World War (1939-1945) and two years thereafter until the Independence of India were challenging for Indian Banking. During the Post Independence Era the Government of India initiated measures to play an active role in the economic life of the nation and industrial policy resolution adopted by the Government in 1948 envisaged a mixed economy which resulted in greater involvement of the state in different segments of the economy including Banking and finance. A major step to regulate Banking occurred in 1948, when the Reserve Bank of India, India’s Central Banking authority was nationalized and it became an institution owned by the Government of India. In 1949, the Banking Regulation Act was enacted which empowered Reserve Bank of India to regulate control, and inspect the Banks in India.

At the time of Independence in 1947, the Banking System in India was fairly well developed with over 600 Commercial Banks operating in the country. However, soon after independence, the view that the Banks from the colonial heritage were biased in favor of working-capital loans for trade and large firms and against extending credit to small-scale enterprises, agriculture and commoners, gained prominence. To ensure better coverage of the Banking needs of larger parts of the economy and the rural constituencies, the Government of India (GOI) created the State Bank of India (SBI) in 1955.
Despite the progress in the 1950s and 1960s, it was felt that the creation of the SBI was not far reaching enough since the Banking needs of small scale industries and the agricultural sector were still not covered sufficiently. This was partly due to the still existing close ties commercial and industry houses maintained with the established Commercial Banks, which gave them an advantage in obtaining credit. Additionally, there was a perception that Banks should play a more prominent role in India's development strategy by mobilizing resources for sectors that were seen as crucial for economic expansion.

In India, Prior to Nationalization, Banking Services was restricted mainly to the urban areas and neglected in the rural and semi-urban areas. Large industries and big business houses enjoyed major portion of the credit facilities. Agriculture, small-scale industries and exports received little or no attention.

Nationalization of Commercial Banks in India:
The Indian economy came under strain around the mid 1960s. The leveling off of foreign aid and the increase in defence expenditure in the wake of conflicts with China (1962) and Pakistan (1965) were followed by serious droughts for two consecutive years in 1966 and 1967. The economic and political fallout of the 1966 devaluation cast a long shadow on economic policy making in the country. The Five Year Plan exercise was suspended for three years. In 1967 the policy of social control over Banks was announced, its aim was to cause changes in the management and distribution of credit by Commercial Banks.

The year 1969 was a major turning point in the Indian Financial System when 14 large Commercial Banks were nationalized. The main objectives of Bank nationalization were:

i) Greater mobilization of savings through Bank deposits.
ii) Widening of branch network of Banks, especially in the rural and semi urban areas.
iii) Re-orientation of credit flows so as to benefit the neglected sectors such as agriculture, small scale industries and small borrowers.

The nationalization of 14 major Commercial Banks in 1969 and six more in 1980 was an instrumental initiative for economic and social change. The rationale behind
nationalization was focused on growth, equitable distribution of credit and to cater to the growing needs of small scale industries and agriculture. After the nationalization the breadth and scope of Indian Banking sector expanded and was remarkably successful at achieving mass participation. Between 1969 and 1980, the number of Private Bank branches grew more quickly than Public Banks, and on April 1, 1980, they accounted for approximately 17.5 percent of Bank branches in India. On April, 1980 the government undertook a second round of nationalization, placing under government control the six Private Banks whose nationwide deposits were above Rs. 2 billion, or a further 8 percent of Bank branches, leaving approximately 10 percent of Bank branches in private hands. The share of Private Bank branches stayed fairly constant from year 1980 to 2000. Since 1980, has been no further nationalization, and the trend appears to be reversing as Nationalized Banks are issuing shares to the public, which is a step towards privatization.

Following the Nationalization Act of 1969, the 14 largest Public Banks were nationalized which raised the Public Sector Banks' (PSB) share of deposits from 31% to 86%. The two main objectives of the nationalizations were rapid branch expansion and the channeling of credit in line with the priorities of the five-year plans. To achieve these goals, the newly nationalized Banks received quantitative targets for the expansion of their branch network and for the percentage of credit they had to extend to certain sectors and groups in the economy, the so-called priority sectors, which initially stood at 33.3%

Six more Banks were nationalized in 1980, which raised the Public Sector’s share of deposits to 92%. The second wave of nationalizations occurred because control over the Banking System became increasingly more important as a means to ensure priority sector lending, reach the poor through a widening branch network and to fund rising public deficits. In addition to the nationalization of Banks, the priority sector lending targets were raised to 40 percent.

However, the policies that were supposed to promote a more equal distribution of funds, also led to inefficiencies in the Indian Banking System. To alleviate the negative effects, a first wave of liberalization started in the second half of the 1980s. The main policy changes were the introduction of Treasury Bills, the creation of Money Markets, and a partial deregulation of interest rates.
Besides the establishment of priority sector credits and the nationalization of Banks, the Government took further control over Banks' funds by raising the statutory liquidity ratio (SLR) and the cash reserve ratio (CRR). From a level of 2% for the CRR and 25% for the SLR in 1960, both witnessed a steep increase until 1991 to 15% and 38.5% respectively. India's Banking System was an integral part of the government's spending policies.

Through the directed credit rules and the statutory pre-emptions it was a captive source of funds for the fiscal deficit and key industries. Through the CRR and the SLR more than 50% of savings had either to be deposited with the RBI or used to buy government securities. Of the remaining savings, 40% had to be directed to priority sectors that were defined by the government. Besides these restrictions on the use of funds, the government had also control over the price of the funds, i.e. the interest rates on savings and loans.

The phases of nationalisation led to increase in rural branches of Banks increased deposit and savings growth considerably, the sharp increase in rural branches of Banks increased deposit and savings growth. There was a marked rise in credit flow towards economically important and neglected activities most notably agriculture and small scale industries. The urban preference of Banks to lend to the industrial sector, especially large industrial houses was fulfilled. The initiation of Financial Reforms in the country during the early 1990s was to large extent conditioned by the analysis and recommendations of various committees which was set up to address specific issues.

➢ **Major Highlights during Pre Reform Period in India:**
Nationalisation of Banks was followed with several important initiatives to the development of Banking Sector. Table: 1.1 depicts the major reforms undertaken in the Banking Sector during different time period.
Table: 1.1 Major Banking Sector Reforms during Pre Liberalisation Phase

<table>
<thead>
<tr>
<th>Year</th>
<th>Initiatives taken</th>
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<tbody>
<tr>
<td>1972</td>
<td>• Special schemes were introduced for the weaker sections, such as the Differential Rate of Interest (DRI) scheme</td>
</tr>
<tr>
<td>1975</td>
<td>• New specialized Institutions were created including Regional Rural Banks (RRBs)</td>
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<tr>
<td>1978-80</td>
<td>• Branch Licensing Policy was announced</td>
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</table>
| 1980 | • Nationalization of six more Banks.  
  • Integrated Rural Development Programme (IRDP). |
| 1984-85 | • Branch Licensing Policy was announced  
  • National Bank for Agriculture and Rural Development (NABARD)  
  • Export and Import Bank of India (EXIM Bank). |

➢ Post Liberalisation Stage [1990 onwards]:

Owing to 1991 crisis of Balance of payment, the government appointed Narsimham Committee on 14th August, 1991. The committee acknowledged the progress of Banking since nationalization; unfortunately the growth was only in the expansion and number of branches, employment generation and mobilization of savings rather than improvement in efficiency. The need for reforms was felt long after 22 years of nationalization to revive the Indian Banks in profitability and overall efficiency viz. satisfying capital requirements, cost effectiveness and control, enhanced customer service, effective manpower planning, introduction of asset liability management, launching new products, better NPA management and becoming competent in facing the upcoming challenges from the Private and Foreign Banks in the era of liberalization.

The first phase of Banking Sector Reform began during 1992-93 based on twin principles of “operational flexibility” and “functional autonomy”

Narasimham Committees Major Recommendations:

i) Statutory Liquidity Ratio and Cash Reserve Ratio

Statutory Liquidity Ratio to be brought down to 25% over a period of 5 years.
Cash Reserve Ratio to be reduced and interest rate on Cash Reserve Ratio to be fixed at the level of Banks one year deposit\(^5\).

ii) Priority Sector Lending
Priority sector lending to be reduced to 10% of total credit, priority sector credit to be redefined and subsidy in development programmes may be withdrawn\(^6\).

iii) Interest Rates
Interest rates on Government Securities to be in line with market rates.

iv) Capital Adequacy
Foreign Banks to achieve 8% by March 1993, Indian Banks having branches abroad to achieve 8% by March, 1994 and other Indian Banks to reach 4% by March 1993 and 8% by March, 1996.

v) Accounting Policies
- Classification of Loan assets as Standard Assets, Sub Standard Assets, Doubtful Assets and Loss Assets.
- Investment portfolio to be bifurcated as permanent and current category.
- Incase of NPA no interest should be recognized unless it is actually received (Income Recognition)

vi) New Institution
- Debt Recovery Tribunals to be set up
- Asset Reconstruction Fund to be formed to take over bad and doubtful debts.

vii) Entry of Private Sector Banks

viii) Branch Licensing Policy

ix) Legislative Measures

The improvement after the Narasimham Committee I Recommendations could be seen from the various indices:

\(^5\) The CRR requires Banks to hold a certain portion of deposits in the form of cash balances with the Reserve Bank of India. In the 1960s and 1970s, the CRR was 5 per cent, but then rose steadily to its legal upper limit of 15 per cent in early 1991. The statutory liquidity requirement requires Banks to hold a certain amount of deposits in the form of government and other approved securities. It was 25 per cent in 1970 and then increased to 38.5 per cent in 1991 – nearly to the level of its legal upper limit of 40 per cent.

\(^6\) With respect to direct lending, the priority sector target of 33 per cent of total advances was introduced in 1974, and the ratio was gradually raised to 40 per cent in 1985. There were sub-targets for agriculture, small farmers, and disadvantaged sections.
By 1997 all Public Sector Banks could achieve the minimum capital adequacy norm by 8%.

Net profit of Scheduled Commercial Bank as a percentage of total assets during 1994-1995, 1997-98 was around 5%.

Business per Employee and Profit per Employee ratio showed substantial improvement.

The Gross NPA as a percentage of Total Advances declined to 14.4% and 7.8% in 1998.

The Gross NPA as a percentage of Total Assets declined to 7% and 3.3% in 1998.

The Government of India in 1997 set up the Narasimham committee II to review the implementation of the Financial Sector Reform recommended by earlier committees and to chart new reforms to make Indian Banks more competent to face the global challenges.

The Second Phase of Reforms focused more on autonomy to Public Sector Banks with respect to recruitment and promotion of staff, better asset liability management, lesser external intervention and pressure, profit maximization, NPA recovery and diversification through merger etc. Introduction of Banking Sector Reforms have changed the face of Indian Banking industry. The globalization of operations and development of new technologies are taking place at a rapid pace. A paradigm shift in marketing philosophy of Banks is visible from the rising focus towards quality of service for customers, all this has led to the increase in resource productivity, increasing level of deposits, credits and profitability and decrease in non-performing assets.

B) Since Independence

Since independence, Banking in India has evolved through four distinct phases:

i) Foundation Phase (From 1950s and 1960s till the Nationalization of Banks in 1969): The focus during this period was to lay the foundation for a sound Banking System in the country. As a result the phase witnessed the development...
of necessary legislative framework for facilitating re-organization and consolidation of the Banking System, for meeting the requirement of Indian economy. A major development was transformation of Imperial Bank of India into State Bank of India in 1955 and nationalization of 14 major private Banks during 1969.

ii) **Expansion Phase (1960 – 1984):** During this phase effort was made to make Banking facilities available to the masses. Branch network of the Banks was widened at a very fast pace covering the rural and semi-urban population, which had no access to Banking. Priority sector lending was the prime focus during this phase. Credit flows were guided towards the priority sectors. This affected the supervision and quality of assets of Banks whereby declining the profitability and competitive efficiency of the system.

iii) **Consolidation Phase (1985 – 1990):** The phase started in 1985 when a series of policy initiatives were taken by RBI which saw marked slowdown in the branch expansion. Major focus was on improving customer service, credit management, staff development and productivity and increasing profitability of Banks. Measures were also taken to reduce the structural constraints that obstructed the growth of money market.

iv) **Reforms Phase (1991 onwards):** The macro-economic crisis faced by the country in 1991 paved the way for extensive financial sector Reforms which brought deregulation of interest rates, more competition, technological changes, prudential guidelines on asset classification and income recognition, capital adequacy and autonomy packages.

1.3.4 **Business Practices followed by the Banks during different Phases of Evolution**

The major task of Banks and other Financial Institutions is to act as intermediaries channelizing savings to investment and consumption; through them, the investment requirements of savers are reconciled with the credit needs of investors and consumers.

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Banks as financial intermediaries have emerged as unique institutions enjoying the trust of people. As a financial institution, Banks perform the following functions:

i) Financial Intermediary  
ii) Constituent of the Payment System  
iii) Provider of other Financial Services

➢ Pre Liberalization Era:
Before financial liberalization, since mid 1960’s till the early 1990’, the Indian financial system was considered as an instrument of public finance (Agarwal, 2003). The major objective of financial liberalization was to improve the overall performance of the Indian financial sector, to make the financial Institutions more competent and efficient. The main objective of nationalization was “to extend Banking facilities on a large scale more particularly in the rural and semi-urban areas and to diverse other public purposes.”

In India, practice of Banking business is older than the rest of the world. Acceptance of deposits and granting of loans were being performed by a section of community in Vedic period. Vaishyas practiced Banking during Buddhist period and later on Brahmins and Kshatriyas also entered into the foray, similarly it can be observed that in Kautilya’s Arthshastra, maximum rates of interest were fixed. People who did this business were called as ‘Sahukar’ or Sresthis’. The remittance of money through “Hundies”, an indigenous credit instrument, was very popular. The Hundies were issued by Bankers known as Shroffs, Sahukars, and Shahu’s in different parts of the country.

➢ Nationalization Stage:
Nationalization of Banks paved way for Retail Banking and as a result there has been an all round growth in the branch network, the deposit mobilization, credit disposals and of course employment. The first year after nationalization witnessed the total growth in the agricultural loans and the loans made to SSI by 87% and 48% respectively. The overall growth in the deposits and the advances indicates the improvement that has taken place in the Banking habits of the people in the rural and semi-urban areas where the branch network has spread. Such credit expansion enabled the Banks to achieve the goals of nationalization, it was however, achieved at the cost of profitability of the Banks.
Post Liberalization Era:
At the beginning of 1990, revamping the Structure of Banking industry was of great importance as the health of the financial sector and the economy as a whole would be reflected by its performance. The major thrust was on improving efficiency, quality of services and profitability. The need for restructuring the Banking industry was felt greater with the beginning of the real sector reform process in 1992. The reforms have improved the opportunities and challenges for the sector making them operate in a global market. Reforms shifted to efficient and prudential Banking linked to better customer care and customer services. The concept of Banking, which was earlier restricted to accepting of deposits from public for the purpose of lending, has under gone drastic change. At present Banking sector is seen as a vehicle for all inclusive economic growth, social responsibility and equal distribution of national resources. Banks are offering new facilities, products, and services in order to retain or increase their base in market.

Massive branch expansion in the rural and underdeveloped areas, mobilization of savings and diversification of credit facilities to the either to neglected areas like small scale industrial sector, agricultural and other preferred areas like export sector etc. have resulted in the widening and deepening of the financial infrastructure and transferred the fundamental character of class Banking into mass Banking. There has been substantial innovation and diversification in the business of major Commercial Banks. Some of them have engaged in the areas of consumer credit, credit cards, merchant banking, leasing, mutual funds etc. A few Banks have already set up subsidiaries for merchant Banking, leasing and mutual funds and many more are in the process of doing so. Some Banks have commenced factoring business also.

The Banking sector is an integral part of the economy. Hence this sector plays a key role in the well being of the economy. Institutional Reforms helped in reshaping the financial market. The major objective of Banking Sector Reforms has been to enhance effectiveness and productivity through increased competition. There has been a massive transformation in the business practices of Banks after Financial Sector Reforms. Private and Foreign Banks were also permitted more liberal entry. In 1994 Board of Financial Supervision was constituted to exercise supervision and inspection for Banking Companies, Financial Institutions and Non Banking Companies. On similar lines, a Board for Regulation and Supervision of Payment and Settlement Systems (BPSS)
prescribes policies relating to the regulation and supervision of all types of payment and settlement systems.

The system has also progressed with the transparency and disclosure standards as prescribed under international best practices in a phased manner. The legal environment for conducting Banking business has also been strengthened; Debt Recovery Tribunals were part of the early Reforms process for adjudication of delinquent loans. Recently the Securitization Act was enacted in 2003 to enhance protection of creditor rights. To combat the abuse of financial system for crime-related activities, the Prevention of Money Laundering Act was enacted in 2003 to provide the enabling legal framework. The Negotiable Instruments (Amendments and Miscellaneous Provisions) Act 2002 expands the previous definition of 'cheque' by introducing the concept of 'electronic money' and 'cheque truncation'. The Credit Information Companies (Regulation) Bill 2004 has been enacted by the Parliament which is expected to enhance the quality of credit decisions and facilitate faster credit delivery.

Modernization in Banking Sector has changed Banking Services, Products and Operational methods of Banks. The unique feature of India’s Banking Sector is that the Reserve Bank of India has permitted Commercial Banks to engage in diverse activities such as underwriting, dealing and brokerage, foreign exchange transactions, cross selling of other products such as banc assurance and leasing activities.

1.3.5 **Banking as a Service Industry**

Banks have a crucial role to play in the financial system of any country. The objective of financial system is to channelize surpluses in the economy through the activities of households, corporate houses and system of government into deficit units in the economy again in form of households, corporate houses and government. A financial development creates condition for growth either from supply leading or demand following channel.

Services are actions or performances, typically produced and consumed simultaneously. Customers are indispensable to the production process of service organization. Service can be defined as an act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to physical product.
Banking Services

Bank as Service Institution comprises of:

i) Providing Services

ii) Aimed to satisfy customer’s needs and wants

iii) Needs and wants may be Non Financial in nature

iv) Competitive Element, Efficiency and Effectiveness

v) Organizational Objectives are still the driving force

vi) Commercial Objective to make Profit

vii) Social Objectives

‘Banking’ as an activity involves acceptance of deposits and lending or investment of money. It facilitates business activities by providing money and certain services that help in exchange of goods and services. Therefore, Banking is an important auxiliary to trade. It not only provides money for the production of goods and services but also facilitates their exchange between the buyer and seller.

A) Core Banking Functions:

i) Acceptance of Deposits from Public

ii) Lending funds to Public or Corporate houses

iii) Investing funds in various Opportunities

iv) Collecting Cheques or Drafts and Other Negotiable Instruments

v) Remitting Funds

B) Para Banking Services:

i) Providing Safe Deposit Lockers

ii) Acceptance of Safe Custody items

iii) Acceptance of Standing Instructions

iv) Offering Internet Banking Facilities

v) Issuance of Credit and other Cards including ATM Cards

vi) Offering various products like Mutual Funds, Insurance Products, Merchant Banking Services

vii) Acting as Executors and Trustees
Banker Customer Relationship

Banks provide services to the customers, therefore need arises to determine the role and importance of customer in Banking business.

Meaning of Customer:
The term ‘customer’ of a Bank is not defined by law. Judicial decisions summarize the following characteristics of a customer:

i) Customer is one who maintains a deposit account with the Bank.
ii) Duration and state of the account is immaterial
iii) Banker – customer relationship would exist even between two Banks if one maintains accounts with the other and cheques are collected through that account.
iv) Maintenance of deposit account is mandatory to be eligible to be termed as a customer.
v) An agreement to open an account would make a prospective depositor a customer of the Bank.

Relationship of a Banker and Customer can be of:

i) Debtor-Creditor
ii) Creditor-Debtor
iii) Agent-Principal
iv) Lessor-Lessee
v) Bailee-Bailor

There can be several ways of classifying the customers firstly they can be classified as Individual and Organisational. Secondly customers may be of three types: one who never complains and continues the relationship. Second who does not complain but changes the Bank silently and third who complains. First and second type of customers does not give an opportunity to Bank to improve upon its services. However latter customer gives an opportunity to the Bank for improving the quality of the product and services. Customer satisfaction is also dependent upon the delivery channels and the quality of services. Customers prefer effortless, efficient, secure, simple and dependable channels of delivery, whether it is through humans or technology driven channels.
Customers from different backgrounds have different expectations. Unless the service standards fit to each person’s expectations, he will not be satisfied. Therefore one has to understand each type of customer thoroughly to be able to provide customer specific services. Today the customer is more knowledgeable, demanding, analytical and aware of his rights viz. prosumer. Bank is a service industry where physical goods are not delivered to the customers; the products offered are intangible and financial in nature, along with these products Banks also renders services which are non-financial in nature. The demands of customer are subjective in nature; which poses a major challenge for the Banks and therefore flexibility of Banks to adapt to changing needs and expectations of customers and bringing out products and services to cater their need is of paramount importance. Newer products and services based on market preference and futurist visualization is an important aspect in Banking Services. Understanding the factors which affect the customer service in banking business is utmost important.

Factors Determining Customer Service in Banks:

i) Products and Services:
Banks deal in financial products and services, procurement of deposits and deployment of funds profitably are the two major activities undertaken by Banks. Different types of deposits and loan products are available to cater the needs of different set of customers. Bank also provides services to their clients, like remittances, investment services, fund management, financial advisory services, tax collections, bill payment services etc. to earn fee based incomes. Banks should be flexible in its business practices to adapt to the changing needs and expectations of customers and bring out products or services to suit customers requirements which is one of the important area in Banking Services.

ii) Processes:
The customer wants very simple processes to get his work done. The processes for any product or service should be well defined with minimum actions. The processes devised for the services should be very customer friendly, easy to understand, complete and unambiguous.
iii) **Delivery Channels:**
Customer satisfaction depends on the delivery channel used for providing the services. Today customer requires efficient and dependable channels of delivery whether through humans or by usage of technology.

iv) **Human Capital:**
Banking being service function major portion of the work involves human resource. All the functions are undertaken by humans, whether it is selection and recruitment of staff, development of product, software development, formulating policies, devising systems, procedures, defining processes, delivery channels, undertaking market studies etc. Humans may be assisted by the technology for arriving at the decisions. Well trained and satisfied workforce also impacts the effectiveness, quality of service and productivity of Banks.

v) **Customer Feedback:**
Customer feedback at frequent intervals serves in identifying the changing needs of the customers and in evaluating the quality of service rendered by Banks. Customer feedback serves as an effective mechanism for tracking the current inclination of customers which may immensely help in formulating products, refinement of services and in identifying the loopholes in the existing deliverables.

vi) **Grievances Mechanism:**
Organization which has robust mechanism to redress the complaints and resolve problem of the customer gets recognition as a customer friendly organization. Market survey, customer complaints and customer feedback are the essential inputs received by the Banks. Improving upon the quality services is an ongoing process.

Customer is one of the crucial elements of the service industry which can impact the survival of the business. Customer inputs can affect the organizations productivity through both the quality of what they contribute and the resulting quality and quantity of output generated. Customer satisfaction is a person’s feeling of pleasure or disappointment resulting from a product or service’s
performance in relation to his or her expectations (Philip Kotler, 2002). It is expensive to acquire new customers rather than retaining the existing customers; a satisfied existing customer tends to purchase more and also spread the work to others like a referral service, hence focus on customer satisfaction holds prime importance. The trend today is on emphasizing retention of existing customers rather than attracting the new customers. Business enterprises for which products and services become commodities and where competitors offer comparable products, the importance of services increases; therefore shift from product driven differentiation to service driven differentiation is necessary as customer relationship grows in importance⁹.

Customer value is an investment by Companies on making customers happy. Customer buy or re buy products they perceive give them better value than competing products; therefore organizations should focus on how to add value to a customer and how to increase the market share. Customer may care little that they have increased productivity of organization through their participation but they care a great deal about whether their needs are fulfilled. Effective customer participation can increase the likelihood that needs are met and that the benefits the customer seeks are actually attained.

1.3.6 Necessity of Service Quality in Banks

Quality is the combination of the product itself, the service, the brand, the relationship, and the image among other attributes. There is a relation between products, services and price, when quality of products, services and brands is higher; prices are also higher as customer has to pay a premium for value added. Value is the perception of quality by a customer at a perceived price. Commercial Banks due to the pressures of globalization, competition from other financial institutions are constantly seeking new ways to add value to their services. Service quality focuses on the needs and expectations of customers to improve products and services. The measurement of service quality measures the gap between the customer’s level of expectations and their perceptions about a particular service. Banking business is the backbone for any economy; they are the financial intermediaries of the economy channeling savings to productive uses.

⁹ White paper on How to manage and measure customer value and customer profitability by Gary Cokins
Quality has been defined in various ways by quality gurus like Juran, Deming, Crosby and Taguchi, among others. Joseph Juran has defined quality as “fitness for use”. For Banking Industry “Quality” may be defined as the ability to satisfy the customer’s requirements and needs to the fullest and sustain on-going basis. Quality is crucial for Banking Sector as the products and services are homogeneous in nature, as product differentiation is complex. The quality of product or service becomes the only key differentiator amongst the various Banks. Research proved that customers pay for quality and Banks that wish to sustain should build a structure that aims at providing Total Quality Service.

Service operations focus on customer perceived quality. The service-profit chain of Heskett et al. (1994) clarifies the role of quality, and its inter-relationships with operational aspects of a service organization. The opinion in Heskett et al. are: (i) profit and growth are inspired by customer loyalty; (ii) loyalty is a direct result of customer satisfaction; (iii) satisfaction is largely influenced by the value of services provided to customers; (iv) value is created by satisfied, loyal and productive employees; (v) employee satisfaction results primarily from high-quality support services and policies that enable employees to deliver results to customers.

Banks compete in the market with undifferentiated products and service quality becomes the primary competitive weapon. Banks which excel in service quality have distinct marketing edge in terms of higher revenues, higher customer retention and expanded market share. The quality of the service performed can be only assessed during or after consumption. Customer contributes to quality service delivery when they ask questions, take responsibility for their own satisfaction and complain when there is a service failure.

India being a developing country it is important that Banks in India need to determine the service quality factors related to customer selection process as increased competition, International Banking Practices and Innovations, customers are having difficulty in selecting one institution from another. In order to provide excellent service quality identifying the dimensions of service quality construct is the first step in the definition and hence provision of quality service. The financial and resource constraints under which service organization functions, it is essential that customer expectations are
properly understood and measured that, from the customers’ perspective, gaps in service quality needs to be identified. This information will enable in identifying cost-effective ways of reducing service quality gaps and of prioritizing which gaps to focus on – a critical decision given scarce resources.

The Banking industry is facing a rapidly changing market, new technologies, economic uncertainties, fierce competition and more demanding customers and the changing climate has presented an unprecedented set of challenges. Banking is a customer oriented services industry, therefore, the customer is focal point and customer service differentiating factor. With the current change in the functional orientation of Banks, the purpose of Banking is redefined. The main driver of this change is changing customer needs and expectations. Customer satisfaction and service quality are inter-related. The higher the service quality, the higher is the customer satisfaction. Many agree that in the Banking Sector, there are no recognized standard scales to measure the perceived quality of a Bank service. Service improvement effort will produce increased level of customer satisfaction at the process level. Increased customer satisfaction at the process level will lead to increased overall customer satisfaction. Higher overall service quality or customer satisfaction will lead to increased behavioural intentions such as greater repurchase intention. Increased behavioural intention will lead to behavioural impact including positive word of mouth, increased usage and customer retention. Behavioural effects will then lead to improved profitability and other financial outcomes. When services are good, a company gains a positive reputation and through the reputation a higher market share and the ability to charge more than its competitors for services. Customers who are satisfied with a company’s services are likely to increase the amount of money they spend with that company or types of services offered. A business that caters to their customers’ needs will inevitably gain the loyalty of their customers, thus resulting in repeat business as well as potential referrals.

Whenever any organization expands the diversity of its output and types of customers it serves this gives rise to more complexity; more complexity means more inculcation of indirect expenses to manage it. The traditional costing methodology simply allocates these overhead costs on the basis of service lines and volume based averages rather than assigning these costs into calculated costs using cause and effect factors. The Activity Based Management (ABM) begins with the logic that customers and products demands
on work activities, these work activities then draw on the organizational spending. ABM disaggregates cost centers into the work that people and equipment do, and then it calculates the output costs of work as a consumption network. Through ABM, organizations can identify where to remove waste, low value-adding costs and unused capacity.

1.3.7 Overview of Innovative Business Practices in Banking Sector

- **Significance of Innovation:**

  With the rapid development of economy, individual’s standard of living improved due to change in their income levels which led to increase in the demand for credit, Banks retail business became one of the potential profitable areas where Banks ventured into with diversified product range. Strong competition forced Banks to adopt new technologies to redesign business processes, improve products and services, and support other organizational changes necessary for better performance. Liberalisation has intensified international competition, rapid innovations in new financial instruments, and the explosive growth in information technology fuel this change. Financial innovation has become increasingly important in the Banking industry. Financial innovation is the core of the strategic transformation of Commercial Bank. Commercial Banks consider demand-oriented and regard market as the centre for growth. Innovation in the Commercial Banks encompasses product innovation and process innovation. Product innovation arises from understanding the customer’s requirements and redesigning the products or launching a new product. Process innovations leads to simplification of Banking Operations and ease for the customers to access the Banking Services, technology plays a dominant role in the process innovations.

  Remarkable growth in the industrial and service sector has amplified the growth pace of Indian economy. The continuous requirement of finance by industrial and service sector demands for cheaper sources of funding and require variety of financial products as Banks play a pivotal role in financing these sectors therefore Banks need to continuously innovate new business practices to meet the changing customer demands. The major factors that compel innovations at the Commercial Banks can be discussed as:
i) **Need based Technology:**
Today Banks are adopting latest technology for improving the customer service, operational efficiency, product offerings and risk management systems which is becoming a necessity for Banks rather than a competitive tool for sustainability. Technological progress has brought in the speedy processing and transmission of information, easy marketing of Banking products, enhancement of customer access and awareness and wider Banking networking at regional and global level on an unprecedented scale (Jayamaha, 2008:1).

ii) **Untapped Markets:**
Banks are looking forward for catering the unbanked rural areas with new retail products and services which in turn will generate more revenue to the Banks. Proper and adequate research will encourage Banks in attracting more customers from diversified area with different product preferences which in turn would help in enhancing the revenue stream of the Banks.

iii) **Risk Management Strategies:**
One of the effective strategies for future is to set up proper risk management systems and procedures as a separate line function and to integrate it with the main functions of the Bank. Introduction of capital account convertibility will provide additional inflow and outflow of foreign currency channelized through Banks whereby exposing the Banks to additional exchange risk, innovative financial tools and advanced risk management methods are required by the Banks to capitalize on this business opportunity.

iv) **Competitive Market:**
The market has become largely customer centric. Public Sector Banks have already entered the foray of international markets; other Banks in India are also looking forward to expand the locations outside India. There has been innumerable product and process innovations taking place in the Indian Banking Sector. Indian Banks need to have wide array of services besides their traditional ones such as consumer financing, credit cards and leasing etc. Investment Banking, underwriting and other capital market activities, gilt trading and even
brokering which are now being offered by Banks as in group services, will be pitched in for apportioning a major portion of the profit.

v) **Customer Relationship Management:**
The competencies required for a Banker in future include expertise in information technology and functional knowledge. The recruitment, training and skills upgradation system of employees have to be aligned to the desired competencies. Banks need to acquire and offer new skills, process which will enable them to establish with their clients a relationship with mutual advantage.

vi) **Profit:**
In future profit will be the major and decisive parameter for judging the performance of Bank. Prudential norms may compel Banks to make provisions out of their realized income. Profits are the measure of performance and optimum utilization of resources. Profits are one of the vital factors which affect the survival of business entity.

vii) **Efficient Customer Service:**
Customer service has become one of the competitive edge for survival with growth and profit for Banks. Banks ability to reach customers at their doorstep and meet their requirements of products and services in a customized manner, leading to customer delight will call for product, process and marketing innovations. To maintain competitiveness, Banks have to adopt new approaches to improve marketing and operational efficiency.

viii) **Good Governance:**
In future Banks will be compelled to concentrate more on improving the performance with regard to asset quality, liquidity, earnings, management performance, capital adequacy, systems and control. Good governance will enhance shareholders value.

The process of product innovation involves the introduction of a good or service that is new or substantially improved. This includes, but is not limited to improvements in functional characteristics, technical abilities or ease of use. Continuous existence is the
mantra in current competitive business scenario and survival without innovation is almost impossible. The final area of measurement involves a company’s ability to innovate, improve and learn by launching new product, creating more value for customers and improving operating efficiencies.

Technological innovations have paved new business practices in Banks. The early 80s saw the Banks introduce automated ledger posting machines which was the genesis for the introduction of automation in Banks. During 1980 Banks computerized their operations for catering to the needs of the customers and at the same time for improving their operational efficiency of the branch, however branch functioning improved noticeably and the employees of the Banks were exposed to computers. In order to improve the customer service Banks adopted the concept of ‘single window’ which meant the branches move over to a ‘client server’ environment, this led to networking within the branches and the branches were classified as ‘totally automated branch’.

Core Banking offers an ideal platform to meet the challenges in the financial industry. It is an integrated application that supports real time. Multi Banking and Multi Channel strategies; each customer is truly the customer of the Bank and not just the customer of the particular branch. Core Banking facilitates the following benefits to the Banks:

i) Instant availability of accurate information
ii) Introduction of new products
iii) New delivery channels could be integrated easily.
iv) Nationwide payment
v) Improved customer service
vi) Any time and any where Banking facility to customers

Advancement in information technology has had far reaching effects on the Indian Banking sector in the following areas:

i) **Customer service**
   a) Introduction of new Banking channels (ATM, Internet Banking and Tele Banking)
   b) Making routine transactions faster, safe and accurate
   c) Carrying Non Banking services for customers
   d) Enhancing customer convenience
ii) Reporting:
MIS for middle and top management has improved due to data classification and retrieval, integrated accounting system, communication and conferencing system and inter-connectivity of branches.

iii) Delivery Mechanism:
Cross selling of various financial products are made easy due to data mining and electronic marketing channels. Banks need to focus on the service delivery mechanism and should try to encompass all the service delivery options available in order to target higher market share.

iv) Maintenance of Records:
Integrated internal accounting system, Banks book keeping is automated, fast and accurate. Technology alone has demonstrated potential to change the marketing, advertising, designing, pricing and distributing financial products and services and cost saving in the form of an electronic self service product delivery channel.

At present the Banking System is well developed with different classes of Banks; Public Sector, Private Sector, Foreign Banks, Regional Rural Banks and Cooperative Banks with RBI as the apex authority of the system. The unique feature of India’s Banking sector is that the Reserve Bank of India has permitted Commercial Banks to engage in diverse activities such as securities related transactions (Eg: underwriting, dealing and brokerage), foreign exchange transactions and leasing activities. The 1991 Reforms lowered the CRR and SLR, enabling Banks to diversify their activities. During the last 41 years since 1969, tremendous changes have taken place in the Banking industry. The Banks have shed their traditional functions and have been innovating, improving and coming out with new types of the services to cater to the emerging needs of their customers. Usage of information technology plays a vital role in the Banking business, it ensures smooth channel for organized transactions over the electronic medium. The application of IT and e-Banking is becoming the order of the day with the Banking System heading towards virtual Banking. Private sector Banks are offering customer
oriented services such as anywhere banking, 24 x 7 Banking and transactions through ATMs have revolutionized the Banking Practices in India.

Banking scene is changing very fast. With liberalization new competent players at international level has emerged; Indian Banks have to innovate on continuous basis to face the upcoming challenges in the sector. Reserve Bank move towards the Best International Banking Practices will further sharpen the prudential norms and strengthen its supervisory mechanism. There will be more transparency and disclosures in Banking Operations and in the days to come, Banks are expected to play a very useful role in the economic development and the emerging market will provide ample business opportunities to exploit. Today Banks seeks to differentiate themselves through delivery of superior services; therefore the issue of best practices is becoming important. The measures used to assess the performance indicators for Banking Business are: Return on Asset (ROA), Operating Profit Ratio (OPR), Net Interest Margin (NIM) and Operating Cost Ratio (OCR). The first two are generally considered profitability measures, while the others measure the efficiency of various indices. A strong financial infrastructure in the economy leads to prosperity and growth of the nation.

1.4 CO-OPERATIVE BANKS IN INDIA

Co-operative Banking is Retail and Commercial Banking organized on a Co-operative basis. Co-operative Banking Institutions take deposits and lend money in most parts of the country. A Co-operative Bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their Bank. Co-operative Banks are often created by persons belonging to the same local or professional community or sharing a common interest. Co-operative Banking follows a three tier system:

i) A State Co-operative Bank works at the Apex Level (works at State Level).
ii) The Central Co-operative Bank works at the Intermediate Level. (District Co-operative Banks)

iii) Primary Co-operative Credit Societies at Base Level (At Village Level)

Cooperative Banks are involved in local development and contribute to the sustainable development of their communities. The history of Cooperative Banks goes back to the
year 1904. In 1904, the Cooperative Credit Society Act was enacted to encourage co-operative movement in India. But the development of Cooperative Banks from 1904 to 1951 was the most inadequate. The first phase of Cooperative Bank development was the formation and regulation of Cooperative society. The Government of Bombay passed the first State Cooperative Societies Act in 1925 which stressed on the basic concept of thrift, self help and mutual aid.” This marked the beginning of the second phase in the history of Co-operative Credit Institutions.

The first study of Urban Co-operative Banks was taken up by RBI in the year 1958-59 which emphasized the need to establish primary Urban Co-operative in areas where population is one lac or more. Presently, the role of Cooperatives, no longer remains confined to their traditional activities, but expanded to new economic ventures, initiatives are taken by Cooperative Banks to sustain the stiff competition. Technological advancement is the major challenges for the Cooperative Banks to keep their services are par with the other Banks. Technological upgradation required huge capital investment which was supported through foreign direct investments in the Banking Sector.

1.5 BANKS AS CATALYST FOR ECONOMIC GROWTH

The business of topmost three Banks in terms of assets and return on assets proves that the Indian Banking System is amongst the healthier performers in the world. The total asset size of Indian Banking sector has increased more than five times during the previous 10 years (2000-10) from US $250 bn. to more than $1.3 trillion, registering a CAGR by 18% in comparison to the countries average GDP growth rate of 7.2% during the same period. The business of Banks to GDP ratio has almost doubled from 68% to 135%, this could be achieved due to improvement in efficiency and productivity. The overall development has been rewarding with the enrichment in Banking industry’s competence and productivity. The Schedule Commercial Banks showed an increase during the past 10 years (2000-10) in the return on assets which had grown from 0.6% to 1.1% and there had been decline in the gross non performing asset from 11.4% to 2.5% which reflects the improved asset quality simultaneous the CAR has increased from 11.4% to 14.6 %. There has been increase in the year on year growth in money supply in the period up to May 21, 2011 which was 16.8 percent where as growth in the corresponding period [up to May 22, 2010] in the previous year was 15.1 percent. Banks have also broadened the delivery channels by adding new branches, ATM facility,
Internet Banking and Mobile Banking. Micro, small and medium enterprises plays a significant role in the growth of the economy, this sector accounts for 45% of manufactured output, 8% of GDP, 40% of all exports from India. The opportunity for Banks lie in the fact that only 4-5% of Micro Small and Medium Enterprises are covered by institutional funding given that approximately 95% of villages are not covered by Banks.

India’s rapid growth since 2000 has been accompanied by a rise in the savings and investment rates. Procurement of external financial resources by businesses has risen sharply, and Bank borrowing has played a significant role. Rising income levels have brought a steady rise in the household sector’s savings rate. With savings rates higher not only in the household sector but also in the private corporate and public sectors, there has been a rapid rise in savings and investment rates across the entire economy which has resulted in higher boom and economic growth. Achievement of economic growth; priorities in this context include the structural expansion of Bank credit through the expansion of financial savings, and the improvement of the efficiency of financial intermediation and the allocation of financial resources. Financial support to rural areas have been extended through the SHG-Bank Linkage program, which was launched by NABARD in 1992, NGOs act as agents and perform a variety of tasks, including the organization of the poor into groups. Other micro-finance methods include the issuance of credit cards (known as “Kisan Credit Cards”) and the provision of card loans, and the provision of indirect finance in the form of Bank loans to Companies specializing in micro-finance. Cooperative Banks act as catalyst in the development of underprivileged section of the society.

There has been transformation in the capital base of the banks through participation of foreign direct investments in this sector. FDI provide opportunities to host countries to enhance their economic development and opens new opportunities to home countries to optimize their earnings by employing their ideal resources. Until 1993, most Indian Banks were 100 percent owned by the central government and private investment was allowed only in a handful of private Banks formed around the 1940s. Further, Foreign Banks and financial Institutions were allowed only 20 percent ownership stakes in Indian Banks. In 1993-94, nine new Banks were formed in the private sector and one Co-operative Bank was converted to a Private Bank. Banks were permitted to issue
Certificates of Deposits and offer foreign currency deposits to Non-resident Indians. In 2001, the Indian central ministry decided to increase Foreign Direct Investment (FDI) limits in Private Banks from the existing 20 percent to 49 percent long with increase in Non-resident Indian investment from 40 percent to 49 percent. Foreign Direct Investment limits were liberalized in India to allow more than 51 percent ownership of Private Sector Banks in the year 2002 and subsequently raised to 74 percent in 2004.

Foreign Banks having branch presence in India are also made eligible for FDI in Private Sector Banks subject to an overall cap of 49 percent. 

Foreigners, general public and insiders all hold significantly larger ownership stakes in Private Banks, particularly the new breed of Private Banks. In sharp contrast, foreign Institutions tend to almost entirely avoid the Government Banks, with the exception of State Bank of India. The Banks with the largest foreign holdings are Centurion Bank and ICICI Bank.

Foreign Direct Investments brings in technology upgradation, global management practices, and access to international markets and builds competition which helps the Indian Banks to improve their products and services. Recent trends show the phase of consolidation in the Banking sector by way of mergers and acquisitions at global level. Foreign Banks have proved their presence in Indian markets with higher profitability and operational efficiency.

1.6 RATIONALE OF THE STUDY

Indian Banking Sector is growing at a rapid pace and is expected to enjoy greater growth opportunities in future. Banking Sector accounts for a major share in the growth of Indian economy and has been prospering over the years since independence thus it can be said that the good and ethical business practices of Banks have lead to its survival and sustainability. Good business practices are the foundation for any organization and there exist correlation between organizations business practices and performance.

The research attempts to study business practices of Banks which have made them more profitable by bringing in structural changes, process changes and technology upgradation and systematic changes. Structural changes will enable Banks in faster decision making, improving communication network, electronic transfer of money and
proper management information systems. Process changes will bring about change in work environment, duties and responsibilities will be redefined, imparting new skills to the employees and improvement in service quality etc. Technology up-gradation will enable the Banks in automation of services, internet Banking, new job assignments and computer based accounting. Systematic changes will bring about improvement in services, innovations and flexibility in adapting to the changing environment needs.

The Indian Banking industry is passing through a phase of customer market, the customers are given more choices in choosing their Banks. With stiff competition and advancement of technology, the services provided by Banks have become more easy and convenient. Continuous demand from customers for changing Banking products and service, service quality has emerged as an important factor i.e. prosumer. Bank clients and customers have become more educated and knowledgeable and are aware of the expectations of the customers regarding quality of products and services offered therefore demand for excellent quality product is expanding due to increase in the buying capacity of the customers. Poor quality of products and services places a firm at a competitive disadvantage; if a customer perceives quality of service to be unsatisfactory they may shift their preference of service provider elsewhere. Thus, it is very clear that service quality helps in achieving success among competing services, particularly in case of businesses that offer nearly identical services, where establishing service quality may be the only way of differentiating oneself. Such differentiation can yield a higher proportion of customer’s choices which means higher revenue for the business.

The scope of disclosure and transparency has also been raised in accordance with international practices. Usage of technology has placed Indian Banks with their global partners. Banks has started investing huge amount of capital to set up information technology infrastructure which has resulted into the improvement of productivity and efficiency of the industry and also the quality of services rendered to its customers. Internet Banking Services has revolutionized the functioning of the Banking sector; it has reduced the amount of time and cost spent on transactions. To attract business and customers, Banks need to adopt technology based product and service which is suitable to such class of customer.
The financial sector now operates in a more competitive environment than before and intermediates relatively large volume of international financial cash inflows. The Public Sector Banks are in the process of consolidating their position by capitalizing on the strength of their huge networks and customer bases, whereas the Private Banks are venturing into the new game of mergers and acquisitions to expand their area of operations. With the growth in the Indian economy expected to be strong for quite some time-especially in its services sector, the demand for Banking services-especially Retail Banking, mortgages and investment services are expected to be strong. The Banking sector will need to adopt a customer-centric business focus. It will also have to create value for its shareholders as well as its customers which indeed will be the challenge in the coming years.

**Conclusion:**

The Indian Banking Industry has come a long way from an informal market to a highly proactive and dynamic entity with a formal market and standardized products and services, this transformation of business practices has been on largely because of liberalization and economic reforms. There has been a significant development during the past decade in the Banking sector and the business practices pertaining to the service quality and innovations which are evident from the various literatures available. In order to study the Banking Sector proper framework and outline of research is necessary which is indicated in the subsequent Chapter 2: Research Design.

The Research Design Chapter will enable the research student to follow a Structured Framework in conducting research and in analyzing the collected information to arrive at end objectives of the research. The application of the tools and techniques specified in this Chapter will enable the researcher to achieve the desired results and in arriving at appropriate inferences. The methodology prescribed in this chapter will be applied in the subsequent Chapters for assessing the collected information using statistical and financial tools for meeting the desired outcome of the research.

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