Chapter-3
Background of Commercial Banks in India

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The previous chapter has reviewed of existing literature on asset quality and NPAs of SCBs to pinpoint the implications of the present study. Conceived with the frame work of the study, the present chapter is an attempt to analyze the importance of banking sector in the institutional set up of Indian financial system. It has also covered an overview of the history of emergence of commercial banks which would provide the background of the whole study. This has followed by an assessment of operational performance of commercial banks in Indian context.

1. Introduction:

Banking is the major sector of the economy that has achieved renewed focus after financial sector reforms and the entry of private sector banks. This sector is the foundation of modern economic development and key player for development strategy (Angadi, 2003)[1]. It forms the core of the financial sector of an economy. Through mobilization of resources and their better allocation, commercial banks play an important role in the development process of underdeveloped countries. Banks directly or indirectly affect economic development (Schumpeter, 1961)[2], (Gold Smith, 1969)[3] and established all over the world to mobilize savings and invest into economy for production and generation of income and employment (Shrivastav, 1981)[4]. During colonial rule in India, banks were geographically confined to urban areas and provided credit particularly to business and trading class (Gupta, 2001)[5]. The importance and necessity of banking system has been realized in post-independence period and were restructured into nationalized or public sector banks till eighties to achieve broader economic objectives and registered an impressive achievement in terms of branch expansion, deposits, credit and investment (Ram Mohan and Ray, 2004)[6]. Hence an attempt has been

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[1] Angadi, V.B.(2003), "Financial Infrastructure and Economic Development: Theory, Evidence and Experience" *Occasional Papers,* RBI, .24 (1&2)

[2] Schumpeter, J.(1961), "*Theory of Economic Development"* Oxford University Press, Oxford

[3] Gold Smith. R.(1969), "*Financial Structure and Development*", New Haven Yal university Press

[4] Shrivastav, P.K.(1981), "*Banking Theory and Practices,"* Himalaya Publishing House Pvt Ltd, Mumbai.

[5] Gupta, S.B. (2001), "*Monetary Economics: Institutions Theory and Policy,"* Sultan Chand & Company, New Delhi.

[6] Ram Mohan, T.T. and Ray, S.(2004), "Comparing Performance of Public and Private Sector Banks, A Revenue Maximization Efficiency Approach", *Economic and Political Weekly, March,20,* pp- 1271-1275.

made in the following paragraph to highlight the background of commercial banks in India.

2. Growth of Commercial Banks:

The growth and development of banking is as old as authentic history and origin of modern commercial banking is visible in ancient times. The money lending has been practiced in India as most of the countries from time immemorial (Vaish, 1978)[7]. At the time of independence there were 648 numbers of banks in Indian union with a total of 4,820 number of branch offices. The commercial banks were mostly concentrated in major cities and provincial headquarters in the independence era (Thingalaya, 1987)[8]. The identical operation of banks started only when economic planning was ushered in the fifties. Following the nationalization of many European Central Bank after the second world war, the RBI was formed as bankers bank under the banking companies Act in 1949 (Chandrasekhar, 1987)[9] which is a landmark in the history of banking legislation in India which provided the RBI with a number of controlling powers for regulating the banking business in the country. The All India Rural Credit Survey Committee recommended (1954)[10] the creation of one strong integrated state sponsored and state partnered commercial banking institution with an effective machinery of branches spread across the country. In pursuance of its recommendations, the Imperial Bank of India, was nationalized and renamed as State Bank of India (SBI) from July 1, 1955. The nationalization of Imperial Bank of India paved the way of the entry of public sector banks (PSBs) into commercial

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[7] Vaish, M.C. (1978) "*Modern Banking*", Oxford and IBH Publishing, New Delhi.

[8] Thingalaya,N.K. (1987) "Banking Development in India Since Independence, *Pigmy Economic Review,* (August), 33 (1):1

[9] Chandrasekhar, K. (1987) "History of Indian Banking", in Subrahmanya S. (Ed), *Trend and Progress of Banking in India*, P-3

[10] Govt. of India (1954) "*The All India Rural Credit Survey Committee".*

banks (Rangaswamy, 1985)[11]. Further, for strengthening the public sector banking structure, eight small associated banks were taken over by the State Bank of India as its subsidiaries under of the SBI Act 1959 (Chandrasekhar, 1987)[12]. After independence, some serious gap existed in the development of banks, although it made considerable progress both functionally and geographical coverage. In order to bring out a far reaching changes in concept and working of banks in the country, the scheme of social control over banks was introduced with a view to ensure equitable and purposeful distribution of credit within the economic sectors. The government felt that the social control experiment failed to achieve the social goals and objectives.

On July 19, 1969 the Indira Gandhi Government nationalized 14 major banks each with a deposit of Rs. 50 crores and above. One of the main objectives of bank nationalization was to extend credit facilities to all segments of the economy and also mitigate regional imbalance through proper supply credit requirements. The banks in collaborations with central and state governments were authorized to sponsor Regional Rural Banks (RRBs) in different parts of the country. On the basis of the RRBs Act 1975, the RRBs started appearing in the scene specially in those areas where co-operative system was weak and the commercial banks were not very active (Bilgrani, 1982)[13]. On 15 April 1980, another 6 commercial banks were nationalized. Thus, from 1980 onwards, the government came to own 27 PSBs comprising 19 nationalized Banks and SBI along with seven subsidiaries (Chandha, 1994)[14]. During post nationalization era there has been a significant progress in the expansion of branch network, deposit

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[11] Rangaswamy, B. (1985) "*Public Sector Banking in India*", Govt. of India, New Delhi, Pp- 89

[12] Chandrasekhar, K. (1987) *Ibid*, PP – 13

[13] Bilgrani, S.A.R. (1982) "*Growth of Public Sector Banks*" Deep and Deep Publications, New Delhi, p-17

[14] Chandha, B.L. (1994) "Changing Phases of India Banking Since 1969; Emerging Scenario", *Pigmy Economic Review*, (Nov- Jan), 38 (2) : 3.

mobilizations, credit channelization, priority sector lending, number of rural branches etc across the country.

3. The Background:

The Indian financial system has conquered praiseworthy stature in promoting financial intermediation in the economy, accelerating the pace of growth of financial savings, extending credit support to vital sector; agriculture, industry of the economy, providing liquidity and payment services to the real sector of the economy, catering credit requirement of all sections of the economy: household, industry, govt., weaker section of the society and so on (Khanna, 1999)[15]. In the Indian financial system, banking sector absorbed exclusive place. It has played a vital role as growth facilitators and achieved commendable heights in the national economy. The commercial banks have shown momentous responsiveness to the requirements of a planned economy. It has brought about a considerable progress in its efforts at deposit mobilization and has taken a number of measures in the recent past for accelerating the growth rate of deposit. A recourse to this, the commercial banks have opened a number of branches in urban, semi-urban and rural areas and have introduced a number of attractive schemes and free services to the customer to attract more deposits (Ahmed, 2008)[16].

In the present reform regime, banking sector has been characterized as inefficient sector with low profitability, extra-ordinary low average return on assets compared to international standard, low capitalization, low ratio of capital and reserve to total assets, gradual decline in the ratio of spread to total assets,

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[15] Khanna, S. (1999) "Financial Reforms and Industrial Sector in India", *Economic and Political Weekly,* (November 6). Pp – 3231

[16] Ahmed, J.U. (2008) "*Efficiency of Commercial Banks in Backward Region*", ICFAI University Press, Hyderabad, India

inadequate capital base to cover credit risk, unhealthy bottom lines, lack of transparency in balance sheet/profit and loss statements and so on. The actual picture of financial health was even worse as the indicators are based on accounting concept of profit constructed by an alternative set of accounting rule, GAAP and Accounting Standards not based on "income recognition and provisioning criteria". Therefore, this sector needs to be strengthened and consequently financial sector reform in India has emphasized much on reforms of the banking sector. The RBIs decentralization and autonomy package will require the banks to redress their role under the market driven economy (Dhanasekran, 2002)[17]. Deepening and widening of the financial markets, growing disintermediation process, adoption of modern technology, rising customer expectation, innovative financial services and scheme supplement with suitable credit delivery mechanism and challenges for which banks would be required to reorient their organizational structure and modify their strategies. The guidelines in respect of changing and transparency of the balance sheet, capital adequacy, and provisioning norms and so on have been put in place vis-a-vis global standards (Mitra, 2007)[18].

4. Commercial Banks in the Post Nationalization Period:

The bank nationalization witnessed a fantastic achievement in the banking system through the expansion of bank branches. The establishments of more rural branches undoubtedly have served the twin objective of mobilization of rural deposits and channelization of credit to the rural areas. However, the pace

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[17] Dhanasekran, K.B. (2002) "*Banking Sector Reforms in India; An Assessment*", in Banerjee, A and Singh, S.K., (edn.). Banking and Financial Sector Reform in India, Deep and Deep Publications Pvt. Ltd., pp-97

[18] Mitra, D. (2007) "Effects of Reforms Process on Financial Performance: A Case Study on Indian Banking Sector", *The Management Accountant*, May, pp-389-391

of acceleration of deposit mobilization depends on the economic and industrial infrastructure of higher magnitude as well as creating greater awareness among rural population for effective use of bank credit. Otherwise rural deposit would continue to be siphoned off to urban centers (Raul, 1997)[19]. Therefore, the credit absorption capacity in the rural areas largely depends on the availability of required infrastructure.

Indian banking system has undergone a sea change with positive support in economic development of the country. It however, appears that banking system has grown randomly. The free for all sort of banking scenario prevalent in the early forties invited strict control measures through the enactment of Banking Companies Act of 1949. Despite regulatory measures, when a few banks failed in the sixties, the compulsory merger of banks was imposed on weaker banks. Social controls were introduced in 1968 and before giving them a fair trial, the major banks were nationalized. From 1969 to 1992, various control measures were introduced before starting in liberalization measures were initiated.

The number of commercial banks operating in India has undergone rapid changes as a result of the controlled expansion. There were 648 banks operating in India in 1947. A large number of them were very small non-scheduled banks with high mortality rates and poor capital base. Introduction of minimum capital base for the banks under banking companies Act 1949 was succeeded largely in eliminating the weaker banks. It aimed at to strengthen the financial base of trimming their number. At the time of nationalization of banks, there were only 85 banks. The establishment of regional rural banks (RRBs) in 1975 reversed the trend of healthy the banking structure. Since then, 196 RRBs have joined the banking system, fattening it beyond recognition. Moreover, in the latter period

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[19] Raul, R. K. (1997) "*Industrial Finance in India*", Anmol Publications, New Delhi, pp- 111 –112.

the number of banks, both the private sector banks set up by the term lending institutions and foreign banks have joined the bandwagon of Indian banking. The banking sector is dominated by scheduled commercial banks (SCBs) which accounted about 95 per cent of banking operation. It includes public sector banks (PSBs) namely State Bank of India and its seven subsidiaries, 19 other nationalized banks (NBs) and 196 regional rural banks (RRBs) accounts for 90 per cent of the total banking operation.

Prior to 1969, all banks except State Bank of India and its seven associate banks were privately owned. However, there was a perception among policy makers that under the private ownership the rural and most part of semi-urban areas remained un-served by banks. Further, as India increasingly became planned economy, they felt that it would be difficult to undertake credit planning for the industries without nationalization of banks (Tandon,1989) [20] . These considerations sparked off the drive for 'social control' of banks by the government of India (GOI) and under the nationalization Act of 1969. As a result, fourteen privately owned commercial banks were nationalized. In 1980, Govt. of India acquired the ownership of other six more banks, bringing the total number of nationalized banks to twenty. The privately owned banks, on the other hand, were allowed to function side by side with nationalized banks. However, the foreign banks were allowed to continue their operation under the strict regulation. The spread of commercial banking since nationalization is shown in table-3.0.

The table discerns that there is significant expansion of the banking sector between 1969 and 1991 on the basis of all major development indicators such as number of branches, deposit mobilization, credit disbursed, per capita deposit,

[20] Tandon, P. (1989) "*Banking Century ; A Short History of Banking in India and the Pioneer*" - PNB' New Delhi' Penguin Bank (India) P - 256

and per capita credit, bank deposit as per cent of GDP at current prices. The spread of banking with a view to serve the masses is evident from an increase in the share of rural branches, a drastic reduction in population served per bank branch, and an increase in deposits and credits per branch. The share of rural bank branches increased from 22.2 per cent in June 1969 to 58.5 per cent in March 1991. This indicates that the banks had performed the duty of expanding banking activities in the rural/ backward regions of the country.

Table- 3.0
Progress of Commercial Banking in India 1969-1991

Indicators	**June 1969**	**March 1980**	**June 1985**	**March 1987**	**March 1991**
A. Nos. of Commercial Bank	71	153	267	276	272
1. SBI and Its Associates	8	8	8	8	8
2. Nationalized Banks	14	20	20	20	20
3. Private Sector Banks	36	104	31	33	25
4. Foreign Banks	13	16	20	21	23
5. Regional Rural Banks	-	5	188	194	196
B. Nos. of Bank Offices	8832	32419	53165	53565	60646
1. SBI and Its Associates	2602	8351	10742	10833	12461
2. Nationalized Banks	4617	20511	25145	25485	29812
3. Private Sector Banks	1483	2719	4540	4202	3703
4. Foreign Banks	130	136	136	136	139
5. Regional Rural Bank	-	-	12602	12909	14531
C. Quantitative Expansion:					
i) Population per office (,000)	64	20	15	14	14
ii) Deposit per office (Rs. bn)	16.6	13.2	12.0	15.1	18.3
iii) Credit Per office (Rs. bn)	13.0	10.1	7.9	8.3	11.0
iv) Per capita deposit (Rs.)	261.1	440.1	818.2	1374.2	1296.1
v) Per capita credit (Rs.)	201.7	316.2	540.7	618.6	784.9
vi) Share of rural branches to total branches (per cent)	22.2	46.9	58.7	56.2	58.5
vii) Bank deposit as percent of GDP at current prices.	13.7	32.6	39.4	40.1	42.4

Source: *RBI, Banking Statistics and RBI, Annual Report, Various Issues.*

5. Need for Financial Sector Reform:

After gaining independence in 1947, India followed the Soviet model of planned economic development with emphasis on heavy industries and self-sufficiency.

Moreover, in 1954 it adopted the goal of socialistic pattern of society that necessitated curbing concentration of economic power in a few hands. Coupled with pessimism on exports the whole development strategy in India centered on direct intervention of the state in terms of providing direction, controls, regulation and even direct participation in economic activities. The restrictive interventionist policies meant the existence of a complex structure of permissions, licenses, quotas, rationing and absolute bans in many spheres including industrial production, infrastructural facilities, raw-materials, credit, foreign exchange and trade. In short, government policy interventions have distorted the price and quality signals in all three markets - goods, money and factors (Dholakia and Kapur, 2001)[21]. The wave of economic reform in India started in 1985 with internal liberalization in respect of like selective price decontrol and deregulation of industries, increased exchange rate adjustments, monetary policy reforms and so on.

The major objectives of economic reforms were particularly to attain the productivity with the help of modern technology. The basic thrust of the new reforms was to assign greater role to the private sector. To provide a level playing field to the private sector, a number of changes in policy were introduced with regard to the industrial licensing, export import policy, foreign direct investment (FDI), rationalization and simplification of the system of fiscal and administrative regulation. These economic reform measures had not produced with desired result rather the country faced a serious balance of payment crisis in the later period. The country earned high percentage of current account deficit. The foreign exchange reserves had plummeted to US $ 1.2 billion, barley sufficient to pay for two weeks of imports. The fiscal deficit of the country

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[21] Dholakia,H.R. and Kapur, D. (2001) "Economic Reforms and Trade Performance; Private Corporate Sector in India", *Economic and Political weekly*, (December 8), p - 4560

for 1991 accounted 8.5 per cent of GDP. Industrial production was falling and inflation was rising which touched all time high to an uncomfortable level of 17 per cent by mid 1991. The current account deficit constituted 3.5 per cent of GDP in 1990-91. The country was on the verge of defaulting on its external debts. To overcome from the situation particularly to maintain external liquidity, the government transferred abroad a part of country's gold stocks. This macro-economic imbalance led the govt. of India to conceive the idea of pursuing economic reforms. In mid 1991, India was forced to seek assistance from the International Monetary Fund and World Bank to provide a huge loan of about $7 billion to bail India out of the crisis. The World Bank and IMF while agreeing to provide assistance to India insisted that it must put its economy back on rail (Hajela and Goswami, 1999)[22]. The economic reforms 1991, adopted a number of stabilization measures that were designed to restore internal and external confidence. Monetary policy was tightened through increase in interest rates; consequently the exchange rate of the rupee was adjusted. Further, fiscal policy rationalization along with procedural simplification and liberalization in the trade policy were announced. The new reform policies, therefore, were essential to import a new element of dynamism to the growth process of the economy.

The financial sector reforms programme follows the well known path of deregulating capital markets and banks, interest rates, withdrawing directed credit and subsidies and encouraging stricter income recognitions norms and integrating the domestic financial market with global financial flows (IMF, 1995)[23]. The objective of financial sector reforms was to make the financial sector more efficient as well as to put an end to the so called 'financial repression' that

[22] Hajela,P. D. and Goswami,P.D. (1999) "*Economic Reform and Employment*", Deep and Deep publication, New Delhi

[23] International Monetary Fund (IMF), (1995) "India: Economic Reforms and Growth". *Occasional Paper, Washington.* No- 134

had held back the growth of financial savings and their efficient channelization in to industrial activity (Khanna, 1999)[24].

6. Banking Sector Reform in India:

The commercial banks emerged as the purveyor of credit requirements of the small borrowers and played a positive role in institutionalizing the community savings. An excessive focus has been laid on quantitative achievement and social obligations at the expense of achieving profitability and efficiency. On the other hand, the reason of expansion of bank branches may be attributed to develop a strong banking base to serve the economy efficiently and meet the banking needs of various segments of the economy by developing specialized banks. However, the environment in which banks operated is characterized by extra ordinary high level of pre-emption of bank resources through statutory liquidity ratio (SLR) and cash reserve ratio (CRR), insufficient attention to prudential accounting norms and capital adequacy excessive recourse to subsidized credit channeled through unduly complex system of administered interest rates, negligent in regulation and supervision of banking operation, inadequate internal control and rigidities in personnel policies and management structure, political interference, inconvenience and non-uniform system of loan recovery of banks.

The government of India employed a committee under the chairmanship of M. Narasimham, Ex-Governor of Reserve Bank of India to address the problems and suggest remedial measures (Committee on Financial System, 1991) [25]. The committee had identified some of the major issues like erosion of profitability, un-remunerative branch expansion, political involvement, social banking, un-

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[24] Khanna, S. (1999) "Financial *Reforms and Industrial Sector in India"*, op.cit, pp- 3234

[25] Govt. of India, (1991) *Report of the Committee on Financial System* (Narasimham Committee-1), Ministry of Finance

uniform accounting practices etc confronting the operation of Indian commercial banks. The committee submitted its reports on November 1991. It recommended gradual deregulation of banking sector in particular and financial sector in general. The recommendations included-

a) A reduction of statutory liquidity ratio (SLR) to 25 per cent over the next five years with a reduction in current year itself.
b) Reduction in the CRR to 10 per cent, payment of interest on the CRR and use of CRR as an instrument of monetary policy.
c) Gradual phasing out of the directed credit programmes by redefining the priority sector. The stipulation that 40 per cent of all credit should go to the priority sector. Priority sector should be defined as "small and marginal farmer, tiny sector of industry, small business and transport operations, village and cottage industry, rural artisans and other weaker section" and should be fixed at 10 per cent of aggregated bank credit.
d) Deregulation of interest rates in a phased manner and bringing interest rates on government borrowing in the line with market determined rates.
e) Attainment of Basle norms (BIS) for capital adequacy in a phased manner, 4 per cent by March 1993 and full 8 per cent by March 1996.
f) Tightening the prudential norms. It is necessary for banks to follow a uniform practice of income recognition, valuation of assets and provisioning against doubtful debt.
g) Bringing more transparency in bank's balance sheet.
h) Accelerating the pace of loan recoveries and tackling doubtful debts through establishment of assets reconstruction fund (ARF) and debt recovery tribunals (DRTs).
i) Entry of private banks and easing of foreign banks.
j) Sale of bank equity to public.

k) Phase out the development finance Institutions (DFIs) to access to fund.
l) Increased competitions in lending between DFI, and a switch from consortium lending to syndicate lending.
m) Easing of regulations on capital markets, combined with entry of foreign institutional investors (FIIs) and better supervision.

Further, there are other reforms and regulations in the banking sector like rationalization of branches, linkage of branch licensing policy to performance, dismantling of centralized recruitment system - Banking Services Recruitment Board for Public Sector Banks and implementation of voluntary retirement schemes for PSBs under which about one lakh employees have been retired following staff redundancy on account of large scale automation. Banking reforms, in India, were imaginatively sequenced: the first priority was given to the prudential norms, supervisory oversight and risk management policies. Later, deregulations of interest rates, reduction in statutory pre-emption were introduced. Subsequently, corporate governance practices were introduced so that the banks hold themselves responsible not only for the stockholders, but for all the stakeholders in a regime of sound audit, accounting and financial reporting standards.

However, the reform package has little impact on the performance of commercial banks. Some of the practices of banking sector were archaic. Many scheduled commercial banks had large NPA. During the first phase of the reforms, the surge of the higher profits encouraged by many banks to divert their funds to the booming stock market which further added to the losses of these banks. Moreover, bank loan as a proportion of total domestic financing to the commercial sector declined from 60 per cent of total finance in 1988-89 to 37 per cent in 1993-94 (IMF, 1995)[26]. The rate of deposit mobilization has reduced. The compulsory capture of bank deposit by the Govt. through CRR and SLR has been reduced. The accumulation of NPAs continues to serious strain on the profitability of banks. The performance of commercial banks during first phase of reforms is presented in table-3.1.

The populations per bank office have been increased from 14,000 in 1991-92 to 15,000 in 1997-98. The total number of bank offices in absolute term has been increased while the share of rural branches has declined from 58.5 per cent in 1991-92 to 51.2 per cent in 1997-98. The deposit mobilization of commercial banks was impressive during the post reform era, reflected by per capita deposits. However, bank deposit as percentage of gross domestic product (GDP) at current prices remain constant (around 42 per cent) during the period under consideration. The credit deposit ratios have been declined from 61 per cent in 1991-92 to 55.5 per cent in 1997-98. However, the reform era experienced a slow growth of deposit, 6.8 per cent during 1990-91 to 1995-96 while the same was 9.8 per cent during 1980-81 to 1989-90 (base 1981-82 = 100)[27]. In spite of deregulation of interest rates and reduction in CRR and SLR requirements the trends in credit deployment and investment shows that asset portfolio of banks was not in favour of loans. The rate of growth of real credit has significantly declined to 4.2 per cent during 1990-96 compared to the average growth rate of 8.7 per cent during 1980-90. However, there was a fluctuation in the rate of growth of credit in the consecutive years. The financial years 1994-95 and 1995-96 experienced a negative growth rate over previous year.

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[26] IMF, (1995) :India: Economic Reforms and Growth". *Occasional Paper,* Washington. No- 134

[27] Reserve Bank of India, Annual Report, (1996-97).

Table- 3.1
Performance of Bank during First Phase of Reform (1991-98)

Sl No	Performance Indicators	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
1.	Population per bank offices (000,)	14	13	14	14	15	15	15
2.	Percentage share of rural bank offices	58.5	57.6	57.2	56.2	52.4	50.2	51.2
3.	Per capita deposit (Rs)	1296	1986	2975	4242	4644	5323	6270
4.	Per capita credit (Rs)	619	962	1320	2719	2908	3356	3759
5.	Bank deposit as percent of GDP (current prices).	42.4	41.2	42.8	39.8	43.3	42.6	NA
6.	Credit Deposit ratio's	61.0	60.5	56.6	59.2	61.9	57.3	55.5
8.	Percentage of NPAs to total advances	Nil	23.2	24.8	19.5	18.0	17.8	16.0
9.	Percentage of net NPA to total assets	Nil	Nil	Nil	4.0	3.6	3.6	3.3
10.	Gross profit as percent of total assets	1.84	0.94	1.90	1.41	1.49	1.60	1.58
11.	Net profit as percent of total assets	0.28	- 0.99	0.99	0.25	- 0.07	0.57	0.77
12.	Intermediation cost as % of total assets	2.61	2.63	2.65	2.83	2.99	2.88	2.66
13.	Provisions & contingencies as % of total assets.	1.57	1.92	2.14	1.16	1.56	1.03	0.81

Source: *Computed from Indian Banks' Association, Performance High light of Banks*

The decline in the rate of growth of credit has occurred concurrently with an increase in the rate of growth of investment in government securities and an increase in the proportion of government investment in major earning assets. The trends in profitability during 1991-1998 shows a significant variability for all banks except private banks measured in terms of return to working fund. The gross profit increased from 0.94 per cent in 1992-93 to 1.58 per cent in 1997-98, and net profit from a negative figure of -0.99 per cent to 0.77 per cent during the same period. The number of loss making banks reduced from 8 in 1993-94 to 3 in 1996-97.

The target set by RBI, for attaining BIS norms of an 8 per cent of risk weighted capital to assets ratio had nearly been achieved. As on 1996-97, 25 out of 27 PSBs have attained BIS norms which indicate an improvement in the soundness of Indian banking sector. This improvement may be due to compromise on their lending activities (Sen and Vaidya, 1999)[28]. The average percentage of NPAs to total advances for 27 PSBs declined from 23.2 per cent in 1992-93 to 16.0 per cent in 1997-98. The number of banks above 20 per cent gross NPA has also reduced from 16 in 1993-94 to 10 in 1995-96. According to RBI estimates, priority sector NPAs to total NPAs reduced from 50.0 per cent in 1994-95 to 46.4 per cent in 1997-98. This drastic reduction of NPAs may be due to liberal definitions in India compared to international standards as India recognizes NPAs only after 180 days of default, while the international norms is 90 days to 45 days.

The foregoing discussion revealed a positive impact of the first phase of reform on the performance and the soundness of Indian banking. Banks have been recapitalized and became healthier than pre-reform era. It has been discerned that the rate of deposit mobilization has reduced over the years. The compulsory capture of bank deposits by the govt. through CRR and SLR has also been reduced. There has been a significant deregulation of interest rate. Indian banking system attempted to improve the quality of services through technology up-gradation. In spite of expansion of private and foreign banks, the oligopolistic dominance of PSBs still continues (Tarapure, 1999)[29] and NPAs continue to drug down banks profitability. The indicators measuring profitability and efficiency of banks do not conclusively suggest an improvement in their performance. There exists a significant difference in profitability between public sector banks, private sector bank and foreign banks. Further, there had not been much progress in the expediting the of debt recovery. Similarly further reform measures require on directed credit which has been imposed over the year on institutions lending to agriculture and small sector as well as concessional credit to specified sector.

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[28] Sen, K. and Vaidya, R. (1999) "*The Process of Financial Liberalization in India*", Oxford University Press, Oxford

[29] Tarapure, S.S. (1999) "*Indian Banking; Preparing for the Next Round of Reform*", In Hanson J.A and Kathuria S., et al. India; A Financial Sector For the 21st Century Oxford University Press., pp-57

Concessional credit is not a cost-effective method of poverty alleviation. There had been signs of portfolio shift of banks from credit to risk-less government securities (Sarkar, 1999)[30].

The banks had attained BIS norms of capital adequacy which is neutralized by the existence of high volume of NPAs, periodic injection of capital by the Government. It is in this context that a proactive policy will only ensure the corrective measures of the problem. The Narasimham Committee (1998)[31] in view of the poor performance of financial sector (banking sector in particular) recommended a package of measures in October, 1998 such as increase of minimum capital adequacy ratio, recognition of market risks, tighter assets classification, income recognition and provisioning norms, introduction of formal Asset Liability Management system and for further enhancing transparency in accounting and disclosure practices etc. Verma Committee (1999)[32], third committee in the banking reform trilogy was appointed under the chairmanship of M. S. Verma to deal with the broad-based measures for accelerating the momentum of progress of banking sector. The committee identified three banks viz., Indian banks, United Commercial Banks and Union Banks of India out of 27 public sector commercial banks are weak on the basis of the criterion; (i) accumulated losses and net NPAs exceed the net worth of banks (ii) negative operating profits for three consecutive years.

The Reserve Bank of India took various supervisory and regulatory measures during 2005-06 to further strengthen the financial sector covering the scheduled

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[30] Sarkar, J. (1999) "*Indian Banking Sector; Current Status, Emerging Challenges and Policy Imperatives in a Globalized Environment in India; A Financial Sector for the 21st Century*", Oxford University Press, pp-81

[31] Govt. of India (1998) *Report of the Committee on Financial System*, (Narasimham Committee-11), Ministry of Finance

[32] Govt. of India (1999) *Report on the Committee on Restructuring of Public Sector Banks,* popularly known as Verma Committee

commercial banks, urban cooperative banks and NBFCs. The measures aimed at strengthening the financial sector with a view to ensuring financial stability included aspects relating to corporate governance practices, risk management and pricing techniques and counter-cyclical prudential norms. In the context of the rapid expansion of bank credit, banks were urged to undertake a comprehensive assessment of segment-wise credit with special reference to those sectors in which credit has been expanding rapidly. The prudential measures were tightened to ensure safety of the health of the financial sector. In order to augment the capital of the banks in view of the enlarged capital requirement under new capital adequacy framework of Basel II, the Reserve Bank permitted banks to raise capital through new instruments. Simultaneously, the focus was on financial inclusion to reorient financial intermediation to cover the widest sections of society.

The government of India in consultation with RBI constituted a Committee on Financial Sector Assessment (CFSA) in (2006)[33] under the chairmanship of Dr. Rakesh Mohan to identify appropriate ideas, methodologies for financial sector assessment. Based on the objective analysis of the present strengths and weaknesses of financial sector, the CFSA is expected to lay down a roadmap for further reforms.

The overall performance shows that the deposits of scheduled commercial banks as a percentage to national income increased from 15.5 per cent in 1969 to 22.4 per cent in 1975 and further to 49.7 per cent in March 1999. The bank deposits has increased by 11 times during 1991-2006 ie, from Rs.1, 92,540 crores in 1990-91 to Rs.21, 09,050 crores in 2005-06. There has been a steady rise in net profits of state bank groups from Rs.244 crores in 1991-92 to Rs.4, 510 crores in 2002-03; the net

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[33] Govt. of India (2006) *Committee on Financial Sector Assessment* (CFSA), September (2006)

profit of nationalized bank attributed a negative trend during the period 1991-1996. This, however, has improved substantially during the second generation reform and stood a net profit of Rs.15, 170 crores for all public sector banks (State bank of India and its associates plus nationalized banks) in 2004-05. In case of private sector banks, net profits increased from Rs.77 crores in 1991-92 to Rs.3, 530 crores in 2004-05. As per cent of total assets, net profits of private banks were better than that of public sector banks. The profitability of foreign banks has always been excellent. In 2006, the ratio of operating profits to total assets of foreign banks (3.75 per cent) was higher than the public sector banks (2.13 per cent). In respect of the return on assets foreign banks (2.08 per cent) are better off than that of public sector commercial banks (0.87 per cent) during the same period. The quantum of spread as a percentage of total assets of scheduled commercial banks increased from 2.73 per cent in 1999-00 to 2.78 per cent in 2005-06. In the present reform regime, the foreign banks have achieved a better profitability than the Indian segments in the banking industry. Table-3.2 summarizes the performance of banks during the second phase of the reform with established performance indicators of banks efficiency.

It has been observed that although total number of commercial banks went down, the number of bank branches increased throughout the period 1999-2011. The share of rural bank office declined to 39.8 per cent in 2010-11 from 49.9 per cent in 1999-00. The credit deposit ratio witnessed a notable improvement from 53.3 per cent in 1999-00 to 72.7 per cent in 2010-11. The bank deposit as per cent of GDP at current prices is on the rise. The figure has increased from 53.3 per cent to 73.1 per cent during the period under consideration. The deposit per office and advances per office has been improved during the period under consideration. There has been a quantum rise of the per capita deposit and per capita advance from 1999-00 to 2010-11.

Table-3.2
Performance of Banks during 1999- 2011

Sl. No.	Performance Indicators	1999 -00	2000-01	2001 -02	2002 -03	2003 -04	2004 -05	2005-06	2006 -07	2007-08	2008-09	2009-10	2010-11
1	Number of Commercial Banks	298	300	297	292	290	289	222	183	179	171	165	159
2	Nos. of Branches of Commercial Banks	67868	67937	68115	68478	69180	70373	71177	73836	74121	76891	80369	87541
3	Population per Bank office ('000)	15	15	15	16	16	16	16	16	16	17	17	18
4	Percentage share of Rural Bank offices	49.9	49.4	48.0	47.1	46.5	43.7	42.5	41.4	41.3	40.4	40.3	39.8
5	Bank deposit as percent of GDP at current prices	53.5	56.0	54.4	58.8	59.4	60.0	65.4	70.1	71.2	71.8	72.5	73.1
6	Credit Deposit ratios of banks (in percent)	53.3	53.5	53.8	56.9	55.9	62.6	64.1	66.5	69.4	74.4	72.6	72.7
7	Deposits per office (Rs. lakhs)	1255	1456	1659	1925	2265	2574	3047	3675	3984	4015	4257	4465
8	Credit per office (Rs. lakhs)	669	779	893	1143	1330	1700	2209	2757	3125	3354	3754	4155
9	Per capita Deposit (Rs.)	8542	9770	11008	12253	14089	16281	19130	23382	25414	27541	29541	31542
10	Per capita Credit (Rs.)	4555	5228	5927	7275	8273	10752	13869	17541	20451	22548	26541	29412
11	Priority Sector Advances to total credit(per cent)	35.4	31.0	34.8	35.1	34.5	32.2	33.81	34.3	30.5	31.8	32.4	34.9
12	Investment-Deposit Ratio (per cent)	36.6	37.1	38.7	41.3	45.0	47.3	40.0	35.3	36.5	38.7	38.9	41.8
13	Percentage of gross NPAs to gross advances	14.0	12.4	10.1	8.8	7.2	5.2	3.3	2.5	2.3	2.1	1.9	1.4
14	Percentage of net NPA to total assets	2.9	2.6	2.4	1.9	1.2	1.0	0.7	0.6	0.5	0.4	0.3	0.2
15	Gross profit as % of total assets of commercial banks	1.46	1.53	1.94	2.39	2.66	2.17	1.95	1.90	1.83	1.79	1.71	1.65
16	Provisions & contingencies as % total assets	1.00	1.03	1.19	1.39	1.54	1.28	1.07	1.00	0.9	1.1	NA	NA

Source: *Indian Banks' Association, Performance Highlight of Banks.*

The gross NPAs to gross advances declined from 14.0 per cent in 1999-00 to 1.4 per cent in 2010-11. The priority sector advances to total credit remains constant during the aforesaid period. In 2010-11, the priority sector advances to total advance stood at 34.9 per cent. The investment deposit ratio increased from 36.6 per cent in 1999-00 to 41.8 per cent in 2010-11. The gross profit ratio increased from 1.46 per cent in 1999-00 to 2.66 per cent in 2003-04 which thereafter declined to 1.65 per cent in 2010-11.

The aforesaid analysis on various operational activities of banks indicated that performance of the commercial banks during pre reform era was poor which has been significantly increased during the subsequent years of post reform period. The lower growth rate of deposits over time indicated lack of professionalism in management and stringency imposed over the time on them by the RBI from time to time. The position of PSBs in respect of performance in advances was much lower in contrast to private and foreign banks during the post reform era.

7. Conclusion:

Banking system in India being the dominant segment of financial sector, accounts for a major portion of fund flow (Arora and Verma)[34]. They are the vehicle for monetary policy signals, credit channel and facilitator of payment system. Deepening and widening of the financial markets, growing disintermediation process, adoption of modern technology, rising customer expectation, innovative financial services and scheme supplement with suitable credit delivery mechanism and challenges for which banks would be required to reorient their organizational structure and modify their strategies. The commercial banks in India are highly responsive organizations relax to public security. They must continuously ensure better profitability and productivity which is essential for their growth and viability as also for infusing public

[34] Arora,U. and Verma,R. (2007) "An Analysis of Operational and Productivity Efficiency of Public Sector Banks In India", *Finance India,* (March), XXI(1):167-176

confident. The profitability is the most important indicator of overall financial performance. The level of efficiency is reflected through the bank's profit figure. However, the success of the commercial banks to maintain a healthy profit growth not only depends on the hardening of interest rate owes its origin to reduction in operational expenses but also rests on improvement in their assets quality (Angadi and Devraj, 1983)[35]. Therefore, banks in India, at the present stage have to ensure equilibrium between social banking and profitability and earned a fair return to defend their survival. Thus, in order to ensure this symmetry the asset quality has to be improved by way of an appropriate strategy of managing the level of NPAs of commercial banks. As a matter of fact, the banking sector in India has responded very positively in the field of enhancing the role of market forces. It is, however, suggested that government should formulate bank specific policies and should implement these policies through Reserve Bank of India for upliftment of banks. The commercial banks should formulate the appropriate strategy regarding the prudential regulations of accounting, income recognition, provisioning and exposure and reduction of NPA's and upgradation of technology.

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[35] Angadi, V.B and Devraj, V.J. (1983) "Productivity and Profitability of Banks in India", *Economic and Political Weekly*, (Nov. 26) 18 (48)