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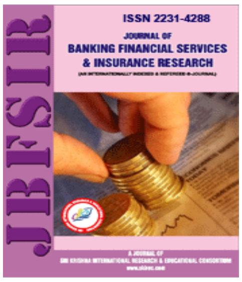

PERFORMANCE OF COMMERCIAL BANKS IN INDIA DURING POST-LIBERALIZATION

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ABSTRACT

This paper attempts to analyze the performance of commercial banks after financial reforms. To compare the performance of public sector, private sector and foreign banks selective indicators were taken into considerations. These Indicators were; Share in aggregate deposits of various banks, Distribution of Branches region wise, Share of various banks in financial indicators like net profit, gross profit etc, non performing assets and capital adequacy ratio. From the analysis it was concluded that share of private sector banks in aggregate deposit was increasing and share of public sector banks were maximum in aggregate deposits.whereas SBI group was having maximum branches in rural areas. All the banks have shown decline in NPA's where increase has been depicted in Capital Adequacy Ratio. Before liberalization there was a monopoly of public sector banks, but after reforms in 1991, the entry of many foreign players have been permitted. Post liberalization demand PSBs to compete with well diversified and resource rich foreign banks and to provide better services and unique products to suit customers need. Public sector banks have already sacrificed a lot of their profits for achievement of social objectives. Due to cut throat competition and technology, the public sector banks are thinking to improve productivity and profitability which is essential to survive in a globalised economy. All these require inner strength and control over costs, new techniques of managing various branches , motivating people, proper consideration for innovation, better system and procedures, fixing adequate and reasonable norms and creation of team spirit in bank management.

KEYWORDS: *Public Sector Banks (PSBs), Private Sector Banks, Non erforming assets (NPAs).*

INTRODUCTION

One of the major areas of economy that have received renewed focus in recent times is banking. This sector has become the foundation of modern economic development and linchpin of development strategy. Any economy can develop by channelizing economic resources towards productive investment. Banks are special as they not only deploy large amounts of uncollateralized public funds in fiduciary capacity, but also leverage such funds through credit creation. Banking system of India consists of the Central Bank (Reserve Bank of India), commercial banks (Public Sector Banks, New Private Sector Banks, Old Private Sector Banks, Foreign banks and Regional Rural Banks), Cooperative Banks and Development Banks (development finance institutions).

Since the establishment of first bank in pre independent period to till date many catastrophic changes have taken place in the banking industry. The first bank in India was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases. These phases are:

Phase--I Pre-Independence Period (from 1786 to 1947)

Phase-II Post-Independence pre reforms (Nationalization of Indian Banks and up to 1991 prior to Indian banking sector reforms).

Phase-III Post Nationalization (from 1991to till date)

PRE-INDEPENDENCE PERIOD

Banking in India originated in the first decade of 18 century The General Bank of India, which came into existence in 1786. This was followed by Bank of Hindustan. The oldest bank in existence in India is the State Bank of India being established as "The Bank of Bengal" in Calcutta in June 1806. Bank of Hindustan and Bengal Bank came into existence immediately after the establishment of Bank of India. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it Presidency Banks. The first fully Indian owned bank was the Allahabad Bank, which was established in 1865. By the 1900s, 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. Between 1906 and 1913 Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. To regulate the issue of bank notes and for keeping reserves to secure monetary stability in India the Reserve Bank of India Act was passed in 1934.The Reserve Bank commenced operations on 1935.During the first phase the growth was very slow and banks also experienced periodic failures between 1913 and 1948. During the same time period public has lesser confidence in the banking industry. During this time period even though there were 1100 (approximate) small banks were in existence the savings bank facility provided by the Postal Department was considered comparatively safer. Moreover, funds were largely given to traders.

POST-INDEPENDENCE PRE -REFORMS

Government took major reforms in Indian Banking Sector after independence. In 1948, the Reserve Bank of India (central bank) was nationalized, and it became an institution owned by the Government of India. In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India In 1955, it nationalized Imperial Bank of India with extensive banking facilities on a large scale especially in rural and semi-urban areas. It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State Governments all over the country. On 19th July 1969; major process of nationalization was carried out with the sincere and concerned efforts of the Prime Minister of India; Mrs. Indira Gandhi. During her regime 14 major commercial banks in the country were nationalized. Second phase of nationalization Indian Banking Sector Reform was carried out in 1980 with seven more banks. This step brought 80percent of the banking segment in India under Government ownership. After the nationalization of banks, the branches of the public sector bank India raised to approximately 800 percent in deposits and advances took a huge jump by 11,000 percent .Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these institutions. The major aim of nationalization was to give priority to meet the credit requirement of neglected sectors. This credit facility was supposed to be extended at considerably low rates. With nationalization there was all-around growth in branch network deposit, credit disbursement, assets & employment. In this process, profitability & competition has lost the front seat.

POST NATIONALIZATION PERIOD

Although nationalization of banks helped in the spread of banking to the rural and hitherto uncovered areas, the monopoly granted to the public sector and lack of competition led to overall inefficiency and low productivity. By 1991, the country's financial system was saddled with an inefficient and financially unsound banking sector. Some of the reasons for this were (i) high reserve requirements, (ii) administered interest rates, (iii) directed credit and (iv) lack of competition (v) political interference and corruption. As recommended by the Narasimhan Committee Report (1991) several reform measures were introduced which included reduction of reserve requirements, de-regulation of interest rates, introduction of prudential norms, strengthening of bank supervision and improving the competitiveness of the system, particularly by allowing entry of private sector banks. With a view to adopting the Basel Committee (1988) framework on capital adequacy norms, the Reserve Bank introduced a risk-weighted asset ratio system for banks in India as a capital adequacy measure in 1992. Banks were asked to maintain risk-weighted capital adequacy ratio initially at the lower level of 4 per cent, which was gradually increased to 9 per cent. Banks were also directed to identify problem loans on their balance sheets and make provisions for bad loans. The period 1992-97 laid the foundations for reform in the banking system (Rangarajan, 1998). The second Narasimhan Committee Report (1998) focused on issues like strengthening of the banking system, upgrading of technology and human resource development. The report laid emphasis on two aspects of banking regulation, viz., capital adequacy and asset classification and resolution of NPA-related problems. After adequate skills are developed, both at the banks and at the supervisory levels, some banks might be allowed to migrate to the internal rating based (IRB) approach (Reddy 2005). At present, banks in India are venturing into non-traditional areas and generating income through diversified activities other than the core banking activities. Strategic mergers and acquisitions were being explored and implemented. With this, the banking sector is currently on the threshold of an exciting phase.

In the early 1990s the then Narasimha Rao Government embarked on a policy of liberalizations and gave licenses to a small number of private banks, which came to be known as New Generation tech-savvy banks, which included banks such as UTI Bank(now re-named as Axis Bank), ICICI Bank ,HDFC Bank etc.. This move, along with the rapid growth in the economy of India, kick started the banking sector in India, which has seen rapid growth with strong contribution from banking industry.

OBJECTIVES OF THE STUDY

1. To study the performance of Commercial Banks in India during Post-Liberalization.
2. To compare the performance of Public sector, Private sector and Foreign banks in India.

ANALYSIS & DISCUSSION OF RESULTS

In order to analyze, evaluate and compare the performance of various banks, the following selective indicators are considered. These selective indicators are:

1) SHARE IN AGGREGATE DEPOSIT

In order to get the comprehensive view point of relative contribution of all the three sector of banks, their deposits from 1999 to 2007 are given in Table No 1.

TABLE 1 SHARE IN AGGREGATE DEPOSITS - BANK GROUP – WISE

(AS AT END MARCH)

	In percentage								
Years/Type of Bank	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Public Sector Banks	82.9	81.9	81.4	80.4	79.6	77.9	78.2	75	73.9
Old Private Sector banks	7.3	7.4	7	6.7	6.7	6.7	6.4	6	5.1
New Private Sector Banks	4	5.2	6	7.4	8.5	10.3	10.8	13.8	15.3
Foreign Banks	6.2	5.5	5.6	5.4	5.1	5.1	4.7	5.3	5.6

Source: Report on Trend & Progress of Banking in India, 2006-07

Perusal of Table1 depicts that share 2005of public sector banks in aggregate deposit was 82.9 percent in 1999 which was reduced to 79.6 percent in 2003; it was further declined to 73.9 percent in 2007 whereas the share of old private sector banks was just 7.3 percent in 1999 which was reduced to 6.7 percent in 2003 and it was further decreased to 5.1 percent. Share of new private sector banks was 4 percent in 1999 which was rose to 10.3 percent in 2004 and further increased to 15.3 in 2007. If we see the share of foreign sector banks, it was 6.2 percent in 1999 and declined to the lowest 2005 to 4.7 percent (2005) and further accelerated to 5.6 percent in 2007. From this data it is analyzed that though share of public sector banks data it is analyzed that though share of public sector banks is reducing aggregate deposits. The share of new private sector banks in aggregate deposits is increasing yet public sector banks are holding maximum share in aggregate.

2) DISTRIBUTION OF BRANCHES REGION WISE: The distribution of branches in various regional areas is given in Table No 2.

TABLE 2: BANK GROUP WISE REGIONAL DISTRIBUTION OF BRANCHES OF SCHEDULED COMMERCIAL BANKS IN PERCENTAGE

Type of bank/Region	Rural	Semi urban	Urban	Metropolitan
Public Sector Banks				
i) Nationalized Banks	36.4	21.3	21.4	20.9
ii) SBI Group	36.5	29.6	18.2	15.6
Old Private Sector Banks	18.6	32.8	28.1	20.6
New Private Sector Banks	5.2	22.2	33	39.6
Foreign Banks	Nil	0.7	16.1	83.2

Source: Report on Trend & Progress of Banking in India, 2006-07

Table 2 highlights that Public sector banks are not only having maximum share in aggregate deposits but these banks are also catering to rural India. In case of regional distribution of branches, nationalized banks and SBI group are having maximum branches i.e. 39.4 percent and 36.5 percent respectively in rural areas and old private sector banks are having only 18.6 percent and new private sector banks having 5.2 percent branches and foreign banks having no branch net work in rural areas.

3) BANK GROUP-WISE SHARE OF VARIOUS FINANCIAL INDICATORS

In consonance with the objective of enhancing efficiency and productivity of banks through greater competition, there has been a consistent decline in the share of public sector banks in total assets of commercial banks. Nevertheless, public sector banks appear to have responded to the new challenges of competition, as reflected in their increased share in the overall profit of the banking sector. This suggests that, with operational flexibility, public sector banks are competing relatively effectively with private sector and foreign banks. Shares of Indian private sector banks, especially new private sector banks established in the 1990s, in the total income and assets of the banking system have increased considerably since the mid-1990s.

TABLE 3: BANK GROUP-WISE SHARES: FINANCIAL INDICATORS

(PER CENT)

Item	1995-96	2000-01	2004-05	2005-06	2006-07
1	2	3	4	5	6
Public Sector Banks					
Income	82.5	78.4	75.6	72.4	68.4
Expenditure	84.2	78.9	75.8	73.0	68.9
Total Assets	84.4	79.5	74.4	72.3	70.5
Net Profit	-39.1@	67.4	73.3	67.3	64.6
Gross Profit	74.3	69.9	75.9	69.8	64.1
New Private Sector Banks					
Income	1.5	5.7	11.8	14.4	17.8
Expenditure	1.3	5.5	11.4	14.1	17.9
Total Assets	1.5	6.1	12.9	15.1	16.9
Net Profit	17.8	10.0	15.0	16.7	17.1
Gross Profit	2.5	6.9	10.7	13.8	16.7
Foreign Banks					
Income	9.4	9.1	7.0	8.0	9.0
Expenditure	8.3	8.8	6.6	7.4	8.3
Total Assets	7.9	7.9	6.8	7.2	8.0
Net Profit	79.8	14.8	9.7	12.5	14.7
Gross Profit	15.6	15.7	9.0	12.2	14.6

Source: Reserve Bank of India.

In Table 3, financial performance of various banks groups have been compared with selective indicators. These indicators were income, expenditure, total assets, net profit and gross profits. There was loss in case of public sector banks during 1995-96 i.e. 39.1 percent. In 2000-2001 share of profit of PSBs was 67.4 percent as compared to new private sector banks and foreign sector banks who were facing decline in net profits due to technological changes and other expenditures.

4) DISTRIBUTION OF SCHEDULED COMMERCIAL BANKS BY RATIO OF NET NPA'S TO NET ADVANCES

The measure of non performing asset helps to assess the efficiency in allocation of resources made by banks to productive sector. The problem of NPA's is arising either due to bad management by banks or due to external factors like unanticipated shocks, business cycle and natural calamities [Caprio and Klingebiel, 1996].

TABLE 4: DISTRIBUTION OF SCHEDULED COMMERCIAL BANKS BY RATIO OF NET NPAS TO NET ADVANCES

(NUMBER OF BANKS)

Bank Group	As at end-March				
	2003	2004	2005	2006	2007
1	2	3	4	5	6
Public Sector Banks	**27**	**27**	**28**	**28**	**28**
Up to 2 per cent	4	11	19	23	27
Above 2 and up to 5 per cent	14	13	7	5	1
Above 5 and up to 10 per cent	7	3	2	–	–
Above 10 per cent	2	–	–	–	–
Old Private Sector Banks	**20**	**20**	**20**	**20**	**17**
Up to 2 per cent	2	2	4	11	15
Above 2 and up to 5 per cent	4	9	12	7	1
Above 5 and up to 10 per cent	12	7	4	2	1
Above 10 per cent	2	2	–	–	–
New Private Sector Banks	**9**	**10**	**9**	**8**	**8**
Up to 2 per cent	2	4	5	6	7
Above 2 and up to 5 per cent	2	5	3	2	1
Above 5 and up to 10 per cent	4	–	1	–	–
Above 10 per cent	1	1	–	–	–

Foreign Banks	**36**	**33**	**31**	**29**	**29**
Up to 2 per cent	19	22	23	25	27
Above 2 and up to 5 per cent	3	2	2	–	1
Above 5 and up to 10 per cent	6	3	2	–	–
Above 10 per cent	8	6	4	4	1
– : Nil/Negligible.					

Source: Report on Trend & Progress of Banking in India, 2006-07

In Table 4, the ratio of gross performing assets (NPA's) decreased of all scheduled commercial banks. Banks group wise analysis shows that in 2003 NPA's of only 4 public sector banks was up to 2 percent and in 2005, NPA's of 19 banks was up to 2 percent and this number increased to 27 banks in 2007. Different banks groups also exhibited similar declining trends in NPA's.

5) CAPITAL ADEQUACY RATIO – BANK GROUP-WISE

TABLE 5: CAPITAL ADEQUACY RATIO – BANK GROUP-WISE

(AS AT END-MARCH 2006)

(PER CENT)

Bank Group	2000	2001	2002	2003	2004	2005	2006	2007
1	2	3	4	5	6	7	8	9
Scheduled Commercial Banks	11.1	11.4	12.0	12.7	12.9	12.8	12.3	12.3
Public Sector Banks	10.7	11.2	11.8	12.6	13.2	12.9	12.2	12.4
Nationalized Banks	10.1	10.2	10.9	12.2	13.1	13.2	12.3	12.4
SBI Group	11.6	12.7	13.3	13.4	13.4	12.4	11.9	12.3
Old Private Sector Banks	12.4	11.9	12.5	12.8	13.7	12.5	11.7	12.1
New Private Sector Banks	13.4	11.5	12.3	11.3	10.2	12.1	12.6	12.0
Foreign Banks	11.9	12.6	12.9	15.2	15.0	14.0	13.0	12.4
Source: Based on off-site returns submitted by banks.								

In Table 5 The Capital Adequacy Ratio (CAR) of various banks, which represents risk at the adjusted capital ratio to the risk weighted adjusted assets, has improved considerably in the past reform years. CAR of public sector banks which 10.7 percent was less than industry norm i.e. 11.1 percent in 2000 and increased than industry norms on 2004, 2005 and 2007, whereas CAR pf new private sector was declining and there was increase in CAR of foreign banks from 2000 to 2003 and decreasing trend in CAR after 2003.

CONCLUSION

Banking in India is generally fairly mature in terms of supply, product range and reach-even though reach in rural India still remains a challenge for the private sector and foreign banks. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. The Reserve Bank of India is an autonomous body, with minimal pressure from the government. The stated policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate-and this has mostly been true.

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. One may also expect Mergers & Acquisitions, takeovers, and asset sales.

Public sector banks in India were mainly concerned with providing finance to weaker section of society, development of priority sectors and providing credit under differential rate of interest scheme.

Before liberalization, public sector banks were working under the guidance of govt. for achievement of social objective .Their motive wasn't earning profits but achieving social targets. Liberalization has changed the Indian banking industry especially Public sector banks.

“Competition has been infused into the financial system principally through deregulation in interest of rates, granting of functional autonomy to banks and allowing greater participation of public sector and foreign banks”-- Report on trend and progress of banking in India 2003-04, Mumbai.

Before liberalization there was a monopoly of public sector banks after reforms on 1991, the entry of many foreign players have been permitted. Post liberalization demand PSB to compete with well diversified and resource rich foreign banks and to provide fine funded services and unique products to suit customers need. Public sector banks have already sacrificed a lot of their profits for achievement of social objectives. Due to cut throat competition and technology, the public sector banks are thinking to improve productivity and profitability which is essential to survive in a globalised economy. All

these require inner strength and control over costs, new techniques of managing various branches , motivating people, proper consideration for innovation, better system and procedures, fixing adequate and reasonable norms and creation of team spirit in bank management.

The future of public sector banks would be based on their capability to continuously build good quality assets in an increasingly competitive environment and maintaining capital adequacy and stringent prudential norms. Consolidation and competition may be key factors impacting the nationalized banks in the future. Due to reforms, it have been felt that not only increase in profits but also reduction in non-profit assets (NPA's) of banks.

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