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Changing Paradigms of Banking Sector

KEYWORDS

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ABSTRACT *Indian Banking sector is at this time passing through an exciting and challenging phase. Sooner than nationalization of banks, their activities were constrained to the urban areas and uncared for in the rural and semi-urban areas. The most important portion of the credit facilities was enjoyed by the large industries and big business houses. The priority sectors like agriculture, small scale industries are totally neglected. So the nationalization was necessitated. At the same time as a result of this, tremendous and rapid expansion was made in this field. By 1991, our financial system was saddled with an incompetent and financially unsound banking sector. In the year 1992 the banking sector reform package was introduced, based on the recommendations, which are proposed by the Naramimham committee. The Government has established rules to recapitalized public sector banks in order to give banks sufficient financial strength and to enable them to gain access to capital market. RBI permitted private entry in to the banking sectors, provided that new banks were well capitalized and technologically advanced and at the same time prohibited cross holding practices with industrial groups. Moreover banks are also permitted to do the non-traditional banking activities. In this background an attempt has*

Introduction

In 1991, the Indian economy went through various economic reforms Recognizing that the success of economic reforms was contingent on the success of financial sector reform as well, the Government initiated a fundamental banking sector reform package on 1992. The banking reform package was based on the recommendations proposed by the Narasimham Committee report that advocated a move to more market oriented banking system, which would operate in a environment of prudential regulation and transparent accounting, are of the primary motives behind the reforms.

The main objectives of the financial sector reform process on India initiated in the early 1990's have been to:

1. Remove financial repression that existed earlier.
2. Create an efficient product and profitable financial sector industry.
3. Enable price discovery, particularly by the market determination of interest rates that then helps in efficient allocation of resources.
4. Provide operational and functional autonomy to institutions.
5. Prepare the financial system for increasing international competition.
6. Open the external sector in a calibrated fashion.
7. Promote the maintenance of financial stability even in the face of domestic and external shocks.

Policy Reforms in the Banking Sector:

The nationalization of banking companies provides a rapid expansion and strong impetus growth in Indian Banks. However the state ownership had left its impact on the functioning of these banks. The post nationalization era witnessed the banking industry operation in a highly regulated environment culminating the non-commercial orientations, direct lending, and loan waiver and rising trend in non-performing assets. The Reserve Bank of India controlled these activities through its credit policies and regulation. As a result of state ownership, banks were able to conduct business with limited capital base, which was clearly in adequate compared to emerging international standards.

In this background, the financial liberalization and reforms took place in the later 1980's mainly taking in the form of interest rate deregulation prior to the period; almost all interest rates were administered and influenced by budgetary concerns and degree of concessionalities of directed loans. To preserve some profitability, interest rate margins were kept sufficiently large by keeping deposit rates low non-concessional lending rate high. Based on the report of the Chakravarty committee, coupon rates on government bonds were gradually increased to reflect demand and supply conditions.

Number of Banks and offices:

The number of offices of all scheduled commercial banks doubled from 29677 in 1980 to 76993 in 2011. This rapid increase in the number of bank offices is observed across the bank groups. However, the number of banks in the case of foreign bank group and domestic private sector bank group decreased from 42 in 2000 to 33 on 2011 and from 33 in 2000 to 21 in 2011, respectively. This fall in the number of banks is reflective of the consolidation process and mergers and acquisitions that are the order of the day.

Number of Scheduled commercial Banks

year	SBI		National-ised banks		Foreign Banks		Domestic Pvt Banks		Sch. Commercial Banks	
	No. of Banks	No. of Offices	No. of Banks	No. of Offices	No. of Banks	No. of Offices	No. of Banks	No. of Offices	No. of Banks	No. of Offices
1980	8	7745	20	18083	13	NA	34	3849	75	29677
1985	8	10568	20	25061	20	NA	32	4833	80	40462
1990	8	12074	20	29800	22	148	25	3961	75	45983
1995	8	12947	19	31817	27	157	32	4213	86	49134
2000	8	13589	19	33905	42	237	33	5437	101	53168
2005	8	13732	20	33879	29	251	28	6183	85	54045
2010	7	18114	20	43187	32	310	22	10387	81	71998
2011	7	18823	20	45850	33	319	21	12001	80	76993

Source: Offices of Commercial Banks in India 2007 to 2011, Statistics and information Management, RBI.,

Note: Number of banks and offices of the Nationalised bank group for the year 2005 onwards includes IDBI Ltd.,

Income Composition:

Income composition of scheduled commercial banks shows that across the different bank groups, interest income i.e., income from advances and investments are falling and the percentage of other incomes increasing. Other income inter alia includes income earned in the form of commission, exchange and brokerage and income from profit on sale of investments. In 1980, the share of interest income of all scheduled commercial banks was 89.0 per cent, which is decreased to 86.07 per cent in 2011. Other income on the other hand, increased from 11 per cent to 13.93 per cent for the same period. But it was 15.91 for the year 2010. This reflects

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upon the increasing reliance on non-interest income vis-à-vis interest income of commercial banks. This is a welcome trend as it may reduce the risks arising out of the sole dependency on interest as the source of income.

Bank group-wise interest and non-interest income shows that in the case of SBI and its Associates, interest income is slightly from 84.5 per cent in 1980 to 85.09 percent in 2011 and in the case of nationalized banks group, the same is declined from 91.4 per cent to 89.96 per cent. In the case of domestic private sector banks also, interest income declined from 90.3 per cent in 1990 to 82.37 per cent in 2011. It is evident from these figures that more than 80 per cent of the income still comes from interest income in the case public sector banks and domestic private sector banks, which indicates that these banks are seen to be dependent mainly on the traditional way of earning income even though there is a reduction in such dependence. In contrast, foreign banks are seen to be increasingly dependent upon non-interest sources of income. Non-interest income of foreign banks form about 27.78 per cent of their total income followed by domestic private sector banks 17.63 percent, SBI and its associates 14.91 per cent and nationalized banks 10.04 per cent.

Income Composition of Scheduled Commercial Banks

year	SBI		Nationalised banks		Foreign Banks		Domestic Pvt Banks		Sch. Commercial Banks	
	Interest	others	Interest	others	Interest	others	Interest	others	Interest	others
1980	84.5	15.5	91.4	8.6	-	-	-	-	89.0	11.0
1985	88.2	11.8	93.6	6.4	-	-	-	-	91.8	8.2
1990	89.1	10.9	91.9	8.1	82.8	17.2	90.3	9.7	90.3	9.7
1995	86.9	13.1	88.8	11.2	80.1	19.9	86.0	14.0	87.2	12.8
2000	85.8	14.2	88.4	11.6	79.2	20.8	83.9	16.1	86.2	13.8
2005	82.3	17.7	82.75	17.25	70.35	29.65	88.13	11.88	81.90	18.1
2010	84.19	15.8114.91	87.43	14.38	72.62	27.3827.78	80.42	19.58	84.09	15.91
2011	85.09		89.96	10.04	72.22		82.37	17.63	86.07	13.93

Source: Based on the data from annual accounts of respective group banks.

Expenditure Composition:

The expenditure composition of scheduled commercial banks indicates that the percentage of interest expenses to total expenses of all scheduled commercial banks increase from 66.3 per cent in 1980 to 70.82 per cent in 2011. Percentage of operating expenses to total expenses has decreased from 33.7 per cent in 1980 to 29.18 per cent in 2011. In case of all bank groups, similar trend is noticed except for foreign banks, where the interest expense has decreased from 64.6 per cent in 1990 to 45.83 per cent in 2011. Whereas, percentage of operating expenses to the total expenses of foreign banks increased from 35.4 per cent to 54.17 per cent.

Expenditure Composition of Scheduled Commercial Banks

year	SBI		Nationalised banks		Foreign Banks		Domestic Pvt Banks		Sch. Commercial Banks	
	Interest Expense	Operating	Interest Expense	Operating	Interest Expense	Operating	Interest Expense	Operating	Interest Expense	Operating
1980	64.3	35.7	67.4	32.6	-	-	-	-	66.3	33.7
1985	64.8	35.1	68.6	31.4	-	-	-	-	67.3	32.6
1990	69.0	31.0	71.4	28.6	64.6	35.4	62.8	37.2	69.9	30.1
1995	65.5	34.5	67.6	32.4	67.4	32.6	70.9	29.1	67.1	32.9
2000	70.6	29.4	71.4	28.6	65.8	34.2	78.0	22.0	71.5	28.5
2005	51.91	28.02	53.75	28.89	36.56	39.96	56.23	25.88	52.62	29.62
2010	72.44	27.56	78.13	21.87	44.60	55.40	69.31	30.7	73.17	26.83
2011	69.69	30.31	75.31	24.69	45.83	54.17	67.42	32.58	70.82	29.18

Source: Based on the data from annual accounts of respective group banks.

A further break-up of operating expenses reveals that wages, as percentage of operating expenses of public sector banks is around 45 per cent. The percentage of wages on total expense it was 19.15 for 2006-07 and decreased to 14.79 in 2009-10, but the same is increased to 17.27 in 2010-11. These are symptoms of under employment. This situation calls for more apt and pragmatic human resource policies and proper man power planning for the future. The wages of all scheduled banks are stood as 58.44 per cent in 2011.The wages of foreign banks increased from 25.9 per cent in 1990 to 43.03 per cent of their operating expenses in 2011.

In case of domestic private sector banks group, wages as percentage of operating expenses was 73.5 per cent in 1990 and the same is decreased drastically to 44.62 per cent. This goes to indicate that banks in the private sector both foreign and domestic are spending for other business boosting measures like image building, software development etc.

Priority Sector Advances:

Priority sector advances of scheduled commercial banks showed some marginal decline from 35 per cent in 1980 to 30.32 per cent in 2009. This declining trend is observed in the case of all bank groups except for foreign banks. In the case of foreign banks, priority sector advances increased over the years since the banking sector reforms started. Of the total advances, nationalized banks advanced loans to priority sectors to the extent of 30.85 per cent and State Bank group to the extent of 28.69 per cent in 2009.

Percentage of Priority Sector Advances to Total Advances

Year	SBI & its Associates	Nationalised Banks	Foreign Banks	Domestic Pvt. Banks	All scheduled Comm. Banks
1980	36.0	38.4	7.9	28.9	35.0
1995	31.1	33.6	20.7	27.0	31.3
2000	32.3	34.1	21.4	26.6	31.5
2001	32.2	333.9	21.1	24.5	31.0
2002	31.4	34.1	21.6	16.9	29.2
2003	31.2	36.2	21.9	22.2	31.1
2004	33.2	38.6	23.2	26.9	33.7
2005	32.33	35.50	25.8	25.74	32.20
2009	28.69	30.85	31.20	30.76	30.32

Source: Based on the data from annual accounts of respective group banks, Trends and Position of Indian Banking,

RBI

Note: Priority Sector Advances to total advances is available in the official website of RBI is only up-to 2009.

Such loans were low with respect to domestic private sector banks group at 30.76 per cent foreign banks at 31.2 per cent. A target of 40 per cent of net bank credit has been stipulated for lending to the priority sector by foreign bank groups at present. However, the data presented here is the percentages of priority sector lending to gross bank credit.

Non-Performing assets (NPA's):

The measure of non-performing assets helps us to assess the efficiency in the allocation of resources made by banks to productive sectors. The problem of NPA does arise either due to bad management by banks or due to external factors like unanticipated shocks, business cycle and natural calamities. Several studies have underscored the role of banks lending policy and

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terms of credit, which include cost, maturity and collateral in influencing the movement of non-performing assets of banks.

Bank Group-wise NPA's of Scheduled Commercial Banks

year	SBI		Foreign Banks		Domestic Pvt Banks		Sch. Commercial Banks	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
1980	16.0	8.2	6.4	2.2	8.7	5.3	14.4	7.3
2000	14.0	7.4	7.0	2.4	8.2	5.4	12.7	6.8
2001	12.4	6.7	6.8	1.8	8.4	5.4	11.4	6.2
2002	11.1	5.8	5.4	1.9	9.6	5.7	10.4	5.5
2003	9.4	4.5	5.3	1.8	8.1	5.0	8.8	4.4
2004	7.8	3.0	4.6	1.5	5.8	2.8	7.2	2.9
2005	5.4	2.1	2.9	0.9	3.9	2.2	4.9	2.0
2010	2.7	1.5	4.29	1.82	2.74	1.03	2.39	1.12
2011	3.12	1.49	2.54	0.67	2.45	0.56	2.35	0.97

Source: Handbook of Statistics on Indian Economy and Report on Trend and Progress of Banking in India

The ratio of gross non-performing assets (NPA's) to gross advances of all scheduled commercial banks decreased from 14.4 percent in 1980 to 2.35 per cent in 2011. Bank group-wise analysis shows that across the bank groups there has been a significant reduction in the gross non-performing assets. With respect to SBI group NPA's have decreased from 16.0 per cent in 1980 to 3.12 per cent in 2011. In the case of foreign banks group, gross NPA as percentage to gross advances, which was the lowest among all the groups at 6.4 per cent in 1980. With regard to domestic private sector banks groups, gross NPA's decreased from 8.7 per cent to 2.45 per cent during the same period. The ratio of net NPA's to net advances of different bank groups also exhibited similar declining trends during the period from 1980 to 2010. The net NPA's of all scheduled commercial banks declined from 7.3 per cent in 1980 to 0.97 per cent in 2011

The decline in NPA's is more evidenced across bank groups especially since 2003 except in foreign banks. This reflects on the positive impact of the measures taken by the RBI towards NPA reduction and specifically due to the enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, ensuring speedier recovery without intervention of courts or tribunal.

Composition of NPA's of Public Sector Banks

year	SBI & its Associates			Nationalised Banks		
	Priority sector	Non-Priority Sector	Public Sector	Priority sector	Non-Priority Sector	Public Sector
1980	52.5	41.4	6.1	48.7	49.2	2.0
2000	45.2	51.9	2.8	44.1	54.5	1.5
2001	44.2	49.8	6.0	46.2	52.3	1.5
2002	47.0	50.4	2.6	45.7	53.1	1.2
2003	47.5	49.4	3.1	47.1	51.3	1.6
2004	47.1	51.5	1.5	47.7	51.1	1.1
2005	47.4	51.5	1.1	48.4	50.7	0.9
2010	50.10	48.72	1.12	56.13	43.09	0.79
2011	55.32	44.66	0.02	59.84	39.52	0.64

Source: Various issues of report of Banks in India, and Trends and Position of Indian Banks, RBI.

The composition of NPA's of public sector banks bringing to light certain interesting aspects. It is observed that in 1980 for SBI group, the share of NPA's was 52.5 per cent for the priority sector, 41.4 per cent for the non-priority sector, and 6.1 per cent for the public sector. These percentages were 55.32 per cent, 44.66 per cent and 0.02 per cent, respectively in 2011. Similarly in the case of nationalized banks also, the NPA composition for non-priority sector has decreased, whereas, that for priority sector and public sector, there is a marginal increase. This shows that not only advances to the priority sector are going non-performing, but more than that, non-priority sector lending is the area where the bankers need to cautiously examine the possibilities of loans becoming non-performing. Here the question of moral hazard, adverse selection and credit rationing come to the fore. These issues are to be addressed face on. This also goes to explode the commonly held myth that the problem of NPA's is caused mainly due to the credit allocation to priority sectors.

Conclusion

Strengthening financial system has been one of the central issue facing emerging markets and developing economics. This is because the financial systems serve as important channel for achieving economic growth through the mobilization of financial saving, putting them to productive use and transforming various risks. In India the financial sectors reforms were initiated in the year 1991, these reforms tends to significant favorable changes in India's highly regulated banking sectors. The financial sector reforms have had a moderately positive impact on reducing the concentration of the banking sector an end improving performance.

The study is made with the available datum in the published reports of RBI and only selected parameters are considered for the analysis. The empirical estimation showed the progress of commercial banking activities in India. At the time of nationalization the number of commercial banks were 73 and percentage of deposit were 15.5. But as at close March 2010 it stood at 165 and 86.6 respectively. Generally this shows the rapid expansion in the level of banking activities and deposit mobilization, but at the same time this also depicts that there is a decrease in the number of banks from 2000 to 2011 to the extent of nearly 130 banks.

Across the bank groups, there has been a significant reduction in the non-performing assets (NPA). The composition of NPA of public sector banks interestingly reveals that NPA's connected to non-priority sector has increased, whereas, NPAs relating to priority sector advances exhibited a decline. This goes to explode the commonly held myth that the problem of NPA's is caused mainly due to the credit allocation made to priority sectors.

The share of non-interest income in the total income has been increasing across the different bank groups. This is a welcome trend as it may reduce the risks arising out of the sole dependency on interest as the source of income.

Wages as a percentage of operating expenses of public sector banks is more that 45 per cent. This situation possibly calls for more apt and pragmatic human resource policies and proper manpower planning for the future of these banks. Banks in the private sector both foreign and domestic, however, have reduced their wage component in the operating expenses and are spending more for other business boosting measures like image building, software development etc.

The above results suggest that the current structure of our banking sector is marching towards the success for facing the market competition and taking the bank activities from mass banking to better banking. But it is the duty of the policy makers to concentrate in priority sector advances, promotion of banking activities in the rural areas which helps the real needy persons who are in the grass root of our economy.

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