Chapter-1

Introduction
1.1 INTRODUCTION

Finance is an essential requirement for every productive activity. Agriculture in India needs more attention as it provides livelihood for 65 percent of population and directly contributing 20 percent to the national income. It is obvious that the contribution of agriculture sector to the national income is not in line with the number of people engaged in that sector, which calls for an immediate attention for increasing the production and hence for a prosperous agricultural economy (Javir et al., 1998). Agriculture in India has always been away of life, rather than a business and has suffered from stagnation due to low productivity arising from inadequate investment. The emergence of green revolution in India by the late sixties has radically changed the character of Indian agriculture, as seen by a growing tendency among the farmers to replace the traditional farming practices with scientific and modern practices evident by increasing use of HYV seeds, fertilizers, pesticides, irrigation, machinery and equipment etc., medium and longterm investments for land improvement, irrigation etc. But, majority of farmers being small and marginal, they were unable to afford these investments from their own savings, as it has been rightly stated “the farmers in the under developed countries cannot expect their capital needs to come from savings, because their income from farm operations is barely sufficient to provide the minimum necessities of life” (Roy, 1994). This makes the farmers to go for borrowed funds to a large extent.

The rural credit system in the country has undergone radical changes in respect of focus, structure and approach overtime. Prior to the institutionalization of credit, the farmers where excessively dependent on the non-institutional credit sources especially an private money-lenders, who failed to provide the farmers the necessary and timely credit at
appropriate cost. In order to overcome the above hurdles and to supply the farmers with adequate and timely credit at appropriate costs, the institutionalization of credit was started with the establishment of cooperatives following the enactment of cooperative societies Act 1904, under which came the cooperative credit societies. Subsequently the nationalization of the banks was done for widening the role of commercial bank by urging them to open branches in the rural areas to meet credit needs of the rural people. Both the cooperatives and commercial banks have made substantial progress over the years in providing credit to agriculture which has been classified as a “priority sector” under the credit policy formulated by the Reserve Bank of India. The cooperative credit structure has two arms namely production credit (short-term credit structures) which comprises of Primary Agricultural Credit Societies (PACS) at the base level, District Central Cooperative Banks (DCCB) at the intermediate level and State Cooperative Banks (SCB) at the apex level and the investment credit (long-term credit structure) which comprises State Cooperative Agriculture and Rural Development Banks (SCARDB’S) which have a unitary structure with branches in some states or a federal structure supporting the Primary Cooperative Agriculture and Rural Development Banks (PCARDB’S) and their branches in other state. Commercial banks, another important constituent of the rural credit system have been extending all types of loans. Establishment of DCC Banks

The introduction of the cooperative credit societies Act in 1904 for providing production credit to farmers marked the beginning of the institutionalization of cooperative banking system in India. The act of 1904 was amended in 1912 to facilitate the establishment of central cooperative banks at the district level, thereby giving it a three tier federal
character. After the independence of the country, at the recommendations of the A.D. Gorwala committee (1954) one central cooperative bank for each district became dictum, particularly in the bigger states with a view to provide stability and facilitate emergence of a strong and powerful cooperative credit structure for the development of all cooperative activities at the district level. The establishment of central cooperative banks (DCCBs) at the district level was to serve as a link between the ultimate credit disbursing outlets, viz., Primary Agricultural Credit Societies (PACS) at the base level, District Central Cooperative Banks (DCCB) at the intermediate level and State Cooperative Banks (SCB) at the apex level. Until the nationalization of fourteen major commercial banks in 1969, DCCBs had the unique distinction of being the exclusive banking institution in the rural areas. Until the introduction of financial sector reforms in the country, in the wake of the Implementation of the recommendations of Narasimhan committee (1991), the issues related to operational efficiency and financial viability of the banking institutions in India were generally subsumed under the social banking/ target oriented banking norms. In fact, even after the introduction of reforms in the banking sector in 1992-93, the application of prudential and other disclosure norms were restricted largely to the commercial banks (PSBs) in India. The cooperative banking sector in general, was excluded from its implementation in the initial few years, mainly in few of the states sponsored and state patronized character of the cooperatives in India. Now that the prudential norms are also made applicable to the cooperative banking sector, it is necessary to review the performance of the DCCBs and assess their substantiability or prospects to cope with the new reforms generated norms. A strong network of DCC banks is a prerequisite for sound performance of the cooperative credit structure. DCC
banks not only provide the much-needed financial support to PACS, but also ensure the smooth flow of credit to various sectors in the district. They also ensure the strict implementation of the developmental schemes in the cooperative sector of the state and avoid the misuse of the funds by PACS or the select affluent sections of the rural society. Karnataka is a predominantly agricultural state with 10 agro-climatic zones facilitating the cultivation of a wide range of crops. The cropping activities in the state needed to be supported with timely and adequate farm credit. There are 4392 PACS in the state operating at the village level, catering to the credit needs of the farming community. These PACS are affiliated to 19 DCCBs, which shoulder the responsibility of strengthening the primary units by providing them an effective linkage with the apex cooperative bank at the state level. The economic viability and the overall efficiency of the primary units depend to a great extent on the viability of the central cooperative banks. A critical evaluation of the working of the central units can shed light on the limitations and drawbacks of these units, and help suggest ways to improve their functioning.

1.2. REVIEW OF LITERATURE
To devise the ways to evaluate the objectives of the study, it is necessary to have an idea of the methodology followed by the earlier related studies along with their findings. A review of literature connected with the working and performance of financial institutions in India and abroad was done, and is presented under the following heads.
In competitive industries, production units can be separated by some standard into those that perform relatively well and those that perform relatively poorly. Financial economists have done this separation by applying non-parametric and parametric frontier efficiency analysis. The
parametric approach includes stochastic frontier analysis, the free disposal hull, thick frontier and the distribution free approaches. While the nonparametric includes Data Envelopment Analysis (DEA), DEA is a linear programming based technique for measuring the relative efficiency of organizational units where the presence of multiple inputs and outputs makes comparisons difficult (Bauer 1990, Berger and Humphery 1997). All over the world, number of studies has applied DEA to the question of efficiency in banking but very little empirical research can be observed in case of India. Bhattacharayya et al. (1997) Saha and Ravishankar (1999), Avinandan et al. (2002), Kumbhakar and Sarkar (2004), Ram Mohan and Ray (2004), Inderjeet Singh and Pramod Kumar (2004) are among those few researchers who have examined performance of the Indian commercial banks. They have mainly considered the reform impact and different ownership groups e.g. Public, private and foreign. Though DEA is based on the pioneering work of Farrell (1957), Charnes Cooper and Rhodes (1978) developed technique. Several different mathematical programming DEA 4 models have been proposed in the literature (Charnes et al, 1994 Seiford and Thrall 1990). Charnes, Cooper and Rhodes (1978) proposed a model, which had an input orientation and assumed constant return to scale (CRS) commonly known as CCR model. Banker, Charnes and Cooper (1984) proposed a model considering variable return to scale (VRS) commonly known as BCC model. Reddy (1994) assessed the working of Malkanoor Cooperative Rural Bank considering the variables like share capital, reserve fund, deposits and borrowings for the period 1978-79 to 1992-93. The compound growth rates were calculated by fitting an exponential growth function. The study revealed that the growth rates were relatively higher for deposits, reserves and investments. Palleri (1998) employed compound
growth rate to evaluate the management of the credit distribution to agricultural sector by KCC Bank, Dharwad. The important indicators considered were amount of credit disbursed, amount of agricultural credit and non-agricultural credit, total deposits, number of beneficiaries, recovery performance and overdues. Javir et al. (1998) examined the advances extended by Thane Grameena Bank, Maharashtra for the period 1987 to 1995. The required data were collected from the annual reports of the bank for the above period. It was found that the outstanding advances had increased from Rs 0.82 lakhs to 178.38 lakhs during the period of 1987 to 1995 and the recovery position of the loan was found to be increasing. It was concluded that the bank had disbursed the credit to various sectors, various government schemes and social programme activities effectively.

Ramappa (1998) studied the extent of credit made available by Sree Anantha Grameena bank, Anathpur, its growth and recovery position of loans and found that it had made good progress in extending credit facilities from year to year. Further, the recovery performance was found to be better for non-agricultural sector compared to loans for allied activities. Dayanandan and Shashikumar (1999) undertook comparative analysis of DCBs in Kerala with the national level performance and revealed that the state level performance was behind the national level performance as regard to membership, own funds, borrowing loans advanced etc., where as deposits were slightly higher than the national level performance. But as long as there was no considerable decrease in rate of total loans overdue, profitability of the bank cannot be improved. Various researchers opined that, the major variables which have impact on performance of any credit institutions were deposits, membership, recovery, profit/loss etc., It was found the most of by the studies that
there was positive impact of credit on income and employment of borrowers.

Ramesh and Patil (1999) while explaining different analytical tools and techniques for measuring performance of co-operatives opined that co-operatives registered an excellent growth in all the selected variables. However, unstable profits, higher liquid assets, upward trend in over dues, decelerating trend in owned funds and regional imbalance in their distribution and growth were some of the major problems affecting badly the overall performance of co-operatives. Further it was revealed the important variables that determine the performance of the banks were share capital, loans, over dues profit and loss. There was a high growth in the aforesaid variables and mounting over dues was a common feature.

Saveeta (1999) studied the factors determining the profitability of public sector banks in India, by applying multiple Regression analysis. The study is confined to public sector banks comprising of state Bank of India (SBI) and its seven subsidiaries considering time series data from 1971-1995. For improving the profitability of banks, it was recommended that the priority sector advances need to be curtailed and the cost of funds should he reduced by mobilizing more of current and saving deposits. In short it was suggested to reduce costs at all levels which would improving the profitability of banks.

Devaraja (2000) examined the performance of the Horticultural Producers Cooperative Marketing and Processing Society Limited in Karnataka, India, during the period 1958-59 to 1995-96. Physical and financial indicators of performance such as membership, retail outlets, share capital, owned funds, total assets, long-term investments, fixed assets, working capital, total liabilities, and sales were analysed. Results showed
that there were substantial increases both in physical and financial indicators over the period of study.

Sarkar et al. (2001) examined the growth and functioning of Primary Agricultural Credit Societies in India during the period 1981-82 to 1995-96. The analysis revealed that the entire growth period could be broadly divided into 2 distinct phases with the period of truncation being 1989-90. The study revealed that although profits increased, the number of profit making societies had declined, mainly due to low borrowing membership, low business turnover and high level of overdues.

Aynew et al. (2002) analysed the loan delinquency, transaction/administrative cost and recovery performance of Primary Land Development Banks (PLDBs) and analyses the factors affecting the overdues in PLDBs in Haryana, India. They revealed that the amount of loan recovered by these banks in the state recorded a steady increase from Rs. 71.89 crores in 1988-89 to Rs.188.13 crores in 1997-98. The problem of chronic overdues seemed to be a serious case in these banks. The percentage of recovery to demand was the main significant factor influencing the overdues of long-term credit in the PLDBs over the study period.

Vivek et al. (2003) analysed the growth performance of all primary agricultural credit societies (PACS) in Haryana, India, based on secondary data for the years 1988/89-2000/01. Results revealed that the number of PACS increased from 2249 in 1998-99 to 2396 in 2000-01, with an annual growth rate of 0.52%. The total membership and the borrowing membership also increased over the study period.

Shekhar et al. (2003) used compound growth rates for selected physical and financial indicators of KDCCB for the period 1985-86 to1994-95. Among the physical indicators, the growth rates of number of branches
and number of employees were statistically significant, while those of beneficiaries covered and total number of employees were not. Among the financial indicators, the growth rates of total share capital, paid-up share capital, borrowings, deposits mobilized, investments, total liabilities, current assets, current liabilities, income, expenditure, and outstanding advances were statistically significant, but growth rates of authorized share capital, credit disbursed and recovery percentage were not significant.

Anonymous (2004) analysed the achievements in credit provision during 2003-04 by India's National Bank for Agriculture and Rural Development (NABARD). The year 2003-04 witnessed a 3.11% growth over the previous year with the aggregate financial support provided to various banks and state governments amounting to Rs. 23, 402.66 crore [1 crore = Rs. 10 million] compared to Rs. 22 696.01 crore in 2002-03.

Reddy (2006) examined total factor productivity and technical and scale efficiency changes in Regional Rural Banks by using data from 192 banks for the period 1996 to 2002. Rural banks showed significant economies of scale in terms of assets and number of branches under each bank. Total factor productivity growth of rural banks was higher in profitability than in service provision during liberalization. Overall, there was a convergence of efficiency of rural banks during the study period. Parent public sector banks have no influence on the efficiency and productivity growth of rural banks. There is a justification for opening new banks in low banking density regions as efficiency and productivity growth of rural banks in these areas are high. There is also a case for mergers and enlargement of the asset base and the number of branches under each bank.
Namasivayam (2006) examined the working performance of the Madurai District Central Co-operative Bank Ltd. The performance had been quite impressive in terms of deposit mobilization and credit deployment. He concluded that the success of the cooperative bank depends on effective manpower, planning and management.

Lakshmanan and Dharmendran (2007) examined the impact of NPAs on selected performance variables viz., net profit, Investments and legal expenses. The regression model was applied to analyse its impact on performance variables. The result showed that impact of NPAs on all the above performance variables of the bank was negative and insignificant at 5% level in all the equation. He concluded that efforts are required at RBI, NABARD and Bank level to control the management of NPAs and performance.

Hosamani (1995) used various ratios to evaluate the performance of Malaprabha Grameena Bank in Karnataka. Profitability ratios were negative (-43%) due to higher burden ratio (3.11%) compared to spread (2.96%). Pathania and Sharma (1997) studied the working of Himachal Pradesh State Cooperative Agricultural and Rural Development Bank, which lends money on a long–term basis for a variety of end users. The financial durability of the bank was measured and data were presented on the long–term financial strength, debt to equity ratio, fixed assets to net worth ratio, the short- term financial performance, and the current ratio. It was concluded that the financial position of the bank was not sound, with liabilities exceeding equity. Enugandula et al. (1998) used different financial ratios to evaluate performance of Karimnagar District co-operative central bank, Andhra Pradesh, and he concluded that the bank had not maintained a reasonable
level of solvency position and was unable to cover its medium and long time obligations. The credit deposit ratio declined which indicated a better deposit mobilization. The gross ratio for the study period was 108.8, which reflected a higher level of expenditure over the gross income leading to losses for the bank. The net worth decreased over the years and the net capital ratio was unity indicating that the assets of the bank were not sufficient to cover its liabilities.

Shekhar et al. (1999) employed financial ratio analysis for the Karimnagar District Central Cooperative Bank in Andhra Pradesh, India. Financial ratios relating to solvency, liquidity, profitability, efficiency and strength of the bank were analysed for the period 1985/86-1994/95.

Ramesh and Patil (1999) while explaining different analytical tools and techniques for measuring performance of co-operatives opined that, ratio analysis was one of the most significant internationally used techniques for evaluating the performance of an enterprise. He also said that in most of the studies on co-operatives, the ratios were found not satisfactory.

Siddhanti (1999) used various financial ratios to analyze financial performance of Indian Farmers Fertilizers Co-operative and opined that the current ratio of the institution between 1987-88 and 1997-98 was ranging from 2.62 to 2.52 as against the standard norm of 2:1. The debt equity ratio during the period was between 1.05 and 1.07 as against standard norm of 1:1.

Patil (2000) used various financial ratios to evaluate the performance of Primary Cooperative Agricultural and Rural Development Banks in Dharwad district of Karnataka. The study revealed that the current ratio was more than unity and acid-test ratio was less than unity, while the net worth and profitability ratios were negative for all the banks in all the periods except for PCARDB, Dharwad.
Aynew (2003) estimated the Loan delinquencies and unit transaction costs of the Haryana State Cooperative Apex Bank (India) using secondary data for the period 1988/89-1997/98. Unit transaction costs varied between Rs. 0.002 and 0.004 and the delinquency rate was negative during the first three years of the period studied. Financial ratio analysis revealed that the total liability to owned-fund ratio ranged between 8.16 and 12.53, indicating the bank's inability to cover its short-term and medium-term obligations.

Suhag (2003) examined the loan recovery performance, management costs (i.e., unit transaction/administrative cost), and financial ratios of cooperative credit banks in Haryana, India. The study was based on secondary data for the period 1988-89 to 1997-98. The credit deposit ratio was greater than unity throughout the study period, indicating a faster increase in the amount of loans advanced as compared to deposits mobilized. Chronic overdues ranged between 2.21 to 8.96% of the total overdues over the period of 10 years. The management cost increased from Rs. 12.86 crores in 1988-89 to Rs. 41.42 crores in 1997-98. Loan delinquency rate ranged between 0.83 and 34.7% during the period under study. It was highest during the year 1989-90 and lowest in 1996-97.

Deepak (2004) evaluated the financial viability of two primary agricultural cooperative societies (PACS) in Kolhapur district, Maharashtra, India, using data covering seven years after (1992-98) and seven years before (1985-91) the economic reforms. The two PACS selected represent class A and B societies, respectively. Results showed a reduction in the operational efficiency of the selected PACS during the post-reform period compared to the pre-reform period. The selected PACS showed a decline in their current liquidity ratio, rate of return on assets, return on owner's equity, and marginal efficiency of capital. They
also showed a higher dependency on lender's capital for their finances. This dependency was higher in the case of the class A society. Furthermore, although the class A society showed an improvement in its permanent capital, there was not much improvement in its net worth. It is concluded that the major reasons for the inefficient functioning of various PACS operating in Kolhapur district can be traced to the financial sector reforms introduced in the cooperative credit sector. Much of the rural finances extended through cooperatives are now going into investment rather than into loans to the farming sector.

Singhal (1998) considered two types of overdues – willful default and those beyond the control of borrower. The study suggested mechanisms for recovering overdues resulting from willful default. The study mentioned a need on the part of cooperatives to coordinate refinancing for borrowers with overdues beyond their control.

Gumaste et al. (1998) worked out cost of credit while studying the extent of borrowing, repayment and overdues of agricultural loans of farm facilities in Thane district of Maharashtra state. The overall total cost of credit per borrower was Rs 3053.76. The overall travelling expenses per borrower was Rs 13.98, expenditure incurred on certificate was Rs 11.19, loading and boarding expenses Rs 50.00 and overage interest paid by borrower was Rs 297.69. The lending norms for some of the sector were not mandatory. However, in the process of providing credit in the major components of cost were interest cost and noninterest cost.

Kulwantsingh and Singh (1998) studied the performance of the Himachal Pradesh cooperative banks. On the basis of certain indicators such as branch expansion, share capital, working capital, deposits mobilization, loan advancement and recovery, they concluded that the performance of the bank in terms of membership drive, share capital, deposit
mobilization and working capital had improved over a period five years. However, recovery performance was unsatisfactory and overdues had increased steadily. This was due to the after effects of loan waiver scheme. The per member and per branch performance of the bank revealed that there was significant growth in share capital, deposits, borrowings advances and profits.

Shiyani and Sima (1999) while comparing performance of credit institutions in promoting agricultural development in Gujarat opined that the total overdue of agricultural and allied activities in Gujarat was as high as Rs 421.52 crores. The situation of agricultural overdues in co-operative banks was warranted and needed immediate action as its proportion in the total overdue of all banks of Gujarat was more than 65%. Contrary to this, the shares of co-operative banks in total credit flow to the agricultural sector by all banks was only 36%. Dinabandhu (2002) studied the Pune District Central Cooperative Bank Ltd. (PDCC) in Maharashtra, India. He examined the impact of development action plans (DAPs) as a suitable mechanism through which the viability of rural financial institutions could be analysed and planned. The PDCCs resources, loan recovery performance, profitability, and productivity were examined. It was concluded that the bank's DAP has created some awareness in the bank. However, the increase in the bank's performance in all areas could not be totally attributed to the DAP.

Vivek et al. (2003) studied overdue loans in Primary Agricultural Credit Societies (PACS) in Punjab, India, during the period 1998-99 to 2000-01 based on secondary data. An increasing trend in the recovery of overdues was observed along with an increasing trend in the amount of overdues. Aynew (2003) in his study opined that the soundness and success of the whole cooperative credit structure to a large extent depended on the
immediate and timely recovery of loans. He studied the loan delinquency, transaction / administrative cost and recovery performance of Primary Land Development Banks (PLDBs) and analysed the factors affecting the overdues in PLDBs in Haryana, India. He revealed that the amount of loans recovered by these banks in the state recorded a steady increase from Rs. 71.89 crores in 1988-89 to Rs. 188.13 crores in 1997-98. The problem of chronic overdues seemed to be a serious case in these banks. The percentage of recovery to demand was the main significant factor influencing the overdues of long-term credit in the PLDBs over the study period.

Kulandaiswamy and Murugesan (2004) analysed the performance of primary agricultural cooperative credit societies (PACS) in India based on eight variables, namely, membership, share capital, working capital, loan disbursement, deposits, borrowings, demand and overdues. Of the 30 PACS studied, those showing good performance were only 7(23.3%), while 12 units (40%) revealed moderate performance and as much as 11 (36.7%) were found to be poor. The empirical evidence calls for appropriate policy interventions to correct the deficiency by such measures as recapitalization, amalgamation, bringing down the overdues, and improving the overall efficiency.

Natarajan (2007) analysed the series problem of service co-operative bank in Kerala is the same common lacunae of overdue. He opined that co-operatives have to get a reasonable profit. Therefore, it is high time that the SCBs in Kerala have to analyse their profitability of each of their activity, plan their funds efficiently and effectively utilize their work force to the maximum in order to get a reasonable profit and survive in their competitive environment otherwise the loss scenario will eat away the capital of the banks held up to liquidation.
Singh (1992) studied the random selection of 100 borrowers of dairy loans from the Bhojpur-Rohtas Gramin Bank in Bihar state, India. Discriminant function analysis was used to classify willful and non-willful defaulters on the basis of socioeconomic characteristics. 73 borrowers had defaulted. Of the total defaulters, 39 were willful and 34 non-willful defaulters. The results indicated that per capita expenditure on milk and milk products was the most important factor discriminating the non-willful defaulters from the willful defaulters. This was followed by expenditure as a proportion of total income, educational status and number of dairy animals. Predictive criteria on the basis of such factors could effectively be used in developing selective lending criteria to reduce the problem of overdues faced by lending institutions.

Reddy (1993) carried out discriminant analysis using variables which constituted different dimensions of the performance of co-operative agricultural and rural development banks (PCARDDBs) to classify the districts of Karnataka into relatively high and low performance districts. High performance districts were characterized with higher mean value (average of 15.63) with respect to all indicators as compared with low performing districts (average of 7.41). It was also seen that the contribution of these indicators to the distance between to the distance between the two groups was high with respect to working capital (49.69%), deposits (32.85%) and loan over due (26.49%).

Hosamani (1995) employed Discriminate between willful and non-willful defaulters for Malaprabha Grameena Bank, in Dharwad district Karnataka. The variables considered were education, family size, income level, family expenses and amount of over dues. Among these education and income levels were the two important characteristics, which
explained the major proportion of the variation in discriminating the willful and non-willful defaulters.

Sivaprakasam (1996) study was conducted a study with a sample of short-term agricultural credit defaulters of the Gandhigram Sarvodaya Cooperative Agricultural Bank in Dindigual Anna district, Tamil Nadu, India (n=160, 1993). The study examined, (1) socioeconomic and political characteristics of the defaulters. (2) causes for the failure in repayment of loans within the prescribed time. (3) attitudes of defaulters regarding repayment. (4) concessions expected by the defaulters for the immediate payment of dues. (5) agricultural credit needs of defaulters and the sources of credit and interest rates charged. Suggestions were offered for reducing the overdue position and strengthening agricultural credit cooperatives.

Pandey and Muralidharan (1997) in their study, used discriminant function to develop a criterion for classifying borrowers according to their willingness to repay the loans on the basis of differences in their socio-economic characteristics in Banda district of Uttar Pradesh. Literacy, percentage of income from sources other than the crop production, total income, operational size of holding and percentage of cash expenditure were the major characteristics which classified defaulters into willful and non-willful groups.

The variables considered were area of owned land, leased in land, area under HYV, quantity of plant protection measures, quantity of organic manure, amount of loan borrowed previous loan outstanding etc. They concluded that innovative attitude of farmers in terms of adoption of high yielding variety, plant protection measures and availability of short-term credit during the crop season were the important discriminating factors between fertilizer users and non-users.
Lekshmi *et al.* (1998) attempted to identify the characteristics responsible for default with particular reference to crop loans in Alappusha district of Kerala. For this, a two stage random sampling method was employed for sample selection with branches of the lead bank as primary units and borrowers as secondary units. Linear Discriminant function was the analytical tool employed for the study and concluded that market surplus, time of sowing and credit gap were the major characteristics which discriminated the borrowers of crop loan into defaulters and non-defaulters.

Pouchepparadjou (1998) used discriminant analysis was used to analyse the variables that discriminate defaulting farmer borrowers from non-defaulting farmer borrowers. The analysis uses data from a sample of 60 farmer borrowers (20 large, 20 small and 20 marginal) in Karaikal region, chosen from a list obtained from the lead bank in Pondicherry, India. The sample comprised an equal number of defaulters and non-defaulters. The discriminate function effectively discriminated the two groups. The percentage contribution of each of the ten variables in the discriminate function to the total variation was calculated. The two most important variables were the ratio of dependents to total family members (39.5%) and age (38), followed by cropping intensity (21.07%) and total income (8.89%). It was inferred that borrowers with high cropping intensity, high total income and higher gross farm income would generally be non-defaulters.

Krishna (2000) used discriminant function to discriminate the good and lower performing banks, based on their characteristics namely, employee per branch, income to expenditure ratio, credit deposit ratio and borrowings and their discriminating powers were 55.16, 12.70, 14.12, and 17.96 percent respectively towards the total discrimination.
Patil (2000) used Discriminant function to discriminate the defaulters into willful and non-willful defaulter based on four characteristics namely, education, size of the farm, income and family expenditure. Among these four important characteristics discriminating the two groups, expenditure and income were found to be contributing to the extent of 36.56 percent and 31.06 percent, respectively towards the total discrimination.

Vallabhan (2001) examined the default patterns in agricultural loans in Tiruchirappalli district, Tamil Nadu, India. Data were obtained from 90 farmer defaulters. The analysis shows that the predominant reason for default or overdue is the expectation of waiver of loan or interest by the borrowers. This is followed by the practice of diverting funds earmarked for agricultural purposes to other priorities; the prevailing low agricultural prices; and crop failure. Other findings of the study were default was more among educated agricultural loan borrowers than illiterate agricultural borrowers; the attitude of default was more among the borrowers who are in the age group of 35-50 years, and default was least among those who are 35 years of age and below and political affiliations of the borrowers had significant impact on their repayment pattern.

Debabrata (2002) examined the impact of the Arunachal Pradesh State Cooperative Apex Bank's loans on rural development in the Indian state. Data were obtained from 200 tribal beneficiaries drawn from 10 branches of the bank. It was observed that the loans provided by the bank played an important role in improving the economic conditions of the borrowers. The bank's financing had significantly contributed to an increase in the annual income of the borrowers and generated employment in various activities. It also enabled the borrowers to raise their living standards.
Ramappa (2003) used discriminant function to discriminate between loose milk buyer and packed milk buyer based on their characteristics namely, expenditure on milk and milk products, expenditure on non-food products and income group, which were found to have discriminating powers were 40.14, 39.84 and 20.02 percent, respectively towards the total discrimination.

Pandian et al. (2004) employed Linear near discriminant function analysis to identify the variables that are important in discriminating non-defaulters and defaulters. Educational level of the borrower-farmer, family size, political influence, amount of loan borrowed, repayment capacity, total income of the family, family consumption expenditure, land holding category, caste and total asset of the family were included for analysis. Data pertaining to the financial year 1999-2000 were collected from a sample of 120 borrower livestock farmers in Kanchipuram district, Tamil Nadu, India. The results of the classification of cases based on the score obtained by the discriminant function had shown that among the non-defaulters 71.9% were predicted correctly by the model, while among the defaulters 87.9% were identified correctly. In total, 80% of the original grouped cases were correctly classified by the model.

Mishra and Pattanaik, (2005) conducted a study based on data for the year 2001-02 collected from a sample of 80 households in Khurda block, Khurda district, Orissa, India. He examines:
(i) the sources of agricultural loans in the study area;
(ii) the extent of borrowing and the nature of the utilization of loans among different size groups of farms;
(iii) the extent of overdues and default among different categories of farmers
(iv) the factors associated with overdues among willful and non-willful defaulters

Satish (2005) studied the characteristics that distinguish commercial bank and cooperative sector borrowers. Data were collected in 2002 from a sample of 160 farm households (equally divided among bank and cooperative borrowers) in Punjab, India. The differences in characteristics are discussed in terms of land ownership, ownership of capital assets, farm expenditure, technology adoption, ownership of financial and other assets, and non-farm and subsidiary agricultural employment. It is revealed that cooperative borrowers were mainly small and marginal farmers with limited land and capital. Bank borrowers, on the other hand, are mainly commercial farmers who have larger land holdings and higher amounts of capital.

1.3 OBJECTIVES OF RESEARCH:

Every human activity should be directed towards the well being and upliftment of mankind. Development is said to have no meaning, unless it is able to improve the quality of life, this research study directed towards:

1) To Study Over all operations of Urban Co-Operative banks of Gujarat.

2) Explore the services and products offered by the banks to individual customers.

3) Understand the perception of the customers and the management with respect to services offered by banks.
4) Generate additional information to analyze the gap between the customer and management perceptions about the services offered by banks.
5) Conclude and enumerate the innovations required to reduce the gap and increase the customer base of banks.

1.4 RESEARCH METHODOLOGY

An engineer prepares a blueprint before he finally starts the construction of a building. An artist prepares a sketch and draw outline before he actually starts drawing the pictures. Similarly a research student is also required to plan well before he or she can start the work. Research design indicates the plan of action to be carried out in connection with the proposed research work.

The study aims to assimilate data about the various aspects of Retail banking services, to analyze the perceptions of the management and the customers regarding the services offered in Retail banking and to find out whether any gaps do exist between the services offered and the customer expectations. I have taken 6 Scheduled Urban Co-operative banks of Gujarat State.

A) The Kalupur Commercial Co-Operative Bank Ltd.
B) Rajkot Nagrik Sahakari Bank Ltd.
C) The Ahmedabad Mercentile Co-Operative Bank Ltd.
D) Mehasana Urban Co-Operative Bank Ltd.
E) The Surat People’s Co-Operative Bank Ltd.
F) Nutan Nagrik Sahakari Bank Ltd.
The criteria for selecting these banks were their deposit base. We have limited our Service Category to the core services in Retail Banking and a few specialized services.

The study is a mixture of Secondary and Primary data, with Questionnaires being our major instrument to collect primary data.

**Data Collection Source:**

The study required the understanding of the concept of Retail Banking and of the various products associated with it. The method used was that of secondary research and primary research. Under secondary research a detailed study was done from the various books, journals, magazines written on the subject of banking and retail banking to obtain the required information and to have a precise idea of the services of retail banking.

**Sampling Plan:**

Sampling Unit:

Sampling unit on Grade scale from 1 to 5 for each question.

**Sampling Technique:**

Filling up common questionnaires with 13 questions under consideration both by customers and the managers of the different retail banks.

**Sample Size:**

The sample size of the customers was 200 each from each of the six banks ie.1200 customers. The management sample size was restricted to 5 each, namely the Branch Manager from the six banks which are 30 managers.
**Theory of Gap:**

The gaps model positions the key concepts, strategies, and decisions in services marketing in a manner that begins with the customer and builds the organization’s tasks around what is needed to close the gap between customer expectations and perceptions.

The central focus of the gaps model is the customer gap, the difference between customer expectations and perceptions. Firms need to close this gap—between what customers expect and receive—in order to satisfy their customers and build long term relationships with them. To close this all important customer gap, the model suggests that four gaps—the provider gaps—need to be closed.

The following four provider gaps, shown below are the underlying causes behind the customer gap:

- Gap 1: Not knowing what customers expect.
- Gap 2: Not selecting the right service designs and standards.
- Gap 3: Not delivering to service standards.
- Gap 4: Not matching performance to promises.

**1.5 HYPOTHESIS:**

**H0:** There is Gap between management perception and customer perception in regard of the service provided by the bank.

**H1:** There is not a Gap between management perception and customer perception in regard of the service provided by the bank.
Chapter-2

Banking Sector in India
2.1 BANKING INDUSTRY IN INDIA

The Reserve Bank of India (RBI), as the central bank of the country, closely monitors developments in the whole financial sector. The banking sector is dominated by Scheduled Commercial Banks (SBCs). As at end March 2002, there were 296 Commercial banks operating in India. This included 27 Public Sector Banks (PSBs), 31 Private, 42 Foreign and 196 Regional Rural Banks. Also, there were 67 scheduled co-operative banks consisting of 51 scheduled urban cooperative banks and 16 scheduled state co-operative banks.

Scheduled commercial banks touched, on the deposit front, a growth of 14% as against 18% registered in the previous year. And on advances, the growth was 14.5% against 17.3% of the earlier year.

State Bank of India is still the largest bank in India with the market share of 20% ICICI and its two subsidiaries merged with ICICI Bank, leading creating the second largest bank in India with a balance sheet size of Rs. 1040 bn.

Higher provisioning norms, tighter asset classification norms, dispensing with the concept of ‘past due’ for recognition of NPAs, lowering of ceiling on exposure to a single borrower and group exposure etc., are among the measures in order to improve the banking sector.

A minimum stipulated Capital Adequacy Ratio (CAR) was introduced to strengthen the ability of banks to absorb losses and the ratio has subsequently been raised from 8% to 9%. It is proposed to hike the CAR to 12% by 2004 based on the Basle Committee recommendations.
Retail Banking is the new mantra in the banking sector. The home Loans alone account for nearly two-third of the total retail portfolio of the bank. According to one estimate, the retail segment is expected to grow at 30-40% in the coming years.

Net banking, phone banking, mobile banking, ATMs and bill payments are the new buzz words that banks are using to lure customers.

With a view to provide an institutional mechanism for sharing of information on borrowers / potential borrowers by banks and Financial Institutions, the Credit Information Bureau (India) Ltd. (CIBIL) was set up in August 2000. The Bureau provides a framework for collecting, processing and sharing credit information on borrowers of credit institutions. SBI and HDFC are the promoters of the CIBIL.

The RBI is now planning to transfer of its stakes in the SBI, NHB and National bank for Agricultural and Rural Development to the private players. Also, the Government has sought to lower its holding in PSBs to a minimum of 33% of total capital by allowing them to raise capital from the market. Banks are free to acquire shares, convertible debentures of corporate and units of equity oriented mutual funds, subject to a ceiling of 5% of the total outstanding advances (including commercial paper) as on March 31 of the previous year.

The finance ministry spelt out structure of the government-sponsored ARC called the Asset Reconstruction Company (India) Limited (ARCIL), this pilot project of the ministry would pave way for smoother functioning of the credit market in the country. The government will hold 49% stake and private players will hold the rest 51%- the majority being held by ICICI Bank (24.5%).
2.2 REFORMS IN THE BANKING SECTOR

The first phase of financial reforms resulted in the nationalization of 14 major banks in 1969 and resulted in a shift from Class banking to Mass banking. This in turn resulted in a significant growth in the geographical coverage of banks. Every bank has to earmark a minimum percentage of their Loan portfolio to sectors identified as “priority sectors”. The manufacturing sector also grew during the 1970s in protected environs and the banking sector was a critical source. The next wave of reforms saw the nationalization of 6 more commercial banks in 1980. Since then the number scheduled commercial banks increased four-fold and the number of banks branches increased eight-fold.

After the second phase of financial sector reforms and liberalization of the sector in the early nineties, the Public Sector Banks (PSB) s found it extremely difficult to complete with the new private sector banks and the foreign banks. The new private sector banks first made their appearance after the guidelines permitting them were issued in January 1993. Eight new private sector banks are presently in operation. These banks due to their late start have access to state-of-the-art technology, which in turn helps them to save on manpower costs and provide better services.

During the year 2000, the State Bank of India (SBI) and its 7 associates accounted for a 25% share in deposits and 28.1% share in credit. The 20 nationalized banks accounted for 53.5% of the deposits and 47.5% of credit during the same period. The share of foreign banks (numbering 42), regional rural banks and other scheduled commercial banks accounted for 5.7%, 3.9% and 12.2% respectively in deposits and 8.41%, 3.14% and 12.85% respectively in credit during the year 2000.
2.3 Classification of Banks

The Indian banking industry, which is governed by the Banking Regulation Act of India 1949 can be broadly classified into two major categories, non-scheduled banks and scheduled banks. Scheduled banks comprise commercial banks and the co-operative banks. In Terms of ownership, commercial banks can be further grouped into nationalized banks, the State Bank of India and its group banks, regional rural banks and private sector banks (the old / new domestic and foreign). These banks have over 67,000 branches spread across the country. The Indian banking industry is a mix of the public sector, private sector and foreign banks. The private sector banks are again spilt into old banks and new banks.

**Chart 2.1 Banking Systems in India**
Reserve bank of India (Controlling Authority)

- Development Financial institutions
- Banks
  - IFCI
  - IDBI
  - ICICI
  - NABARD
  - NHB
  - IRBI
  - EXIM Bank
  - SIDBI

- Commercial Banks
- Regional Rural Banks
- Land Development Banks
- Cooperative Banks

- Public Sector Banks
  - SBI Groups
  - Nationalized Banks

- Private Sector Banks
  - Indian Banks
  - Foreign Banks
2.4 GLOBAL AND LOCAL SCENARIO OF BANKING SECTOR

Recent time has witnessed the world economy develop serious difficulties in terms of lapse of banking & financial institutions and plunging demand. Prospects became very uncertain causing recession in major economies. However, amidst all this chaos India’s banking sector has been amongst the few to maintain resilience.

A progressively growing balance sheet, higher pace of credit expansion, expanding profitability and productivity akin to banks in developed markets, lower incidence of nonperforming assets and focus on financial inclusion have contributed to making Indian banking vibrant and strong. Indian banks have begun to revise their growth approach and re-evaluate the prospects on hand to keep the economy rolling. The way forward for the Indian banks is to innovate to take advantage of the new business opportunities and at the same time ensure continuous assessment of risks.

A rigorous evaluation of the health of commercial banks, recently undertaken by the Committee on Financial Sector Assessment (CFSA) also shows that the commercial banks are robust and versatile. The single-factor stress tests undertaken by the CFSA divulge that the banking system can endure considerable shocks arising from large possible changes in credit quality, interest rate and liquidity conditions. These stress tests for credit, market and liquidity risk show that Indian banks are by and large resilient.

Thus, it has become far more imperative to contemplate the role of the Banking Industry in fostering the long term growth of the economy. With the purview of economic stability and growth, greater attention is required on both political and regulatory commitment to long term
The pace of development for the Indian banking industry has been tremendous over the past decade. As the world reels from the global financial meltdown, India’s banking sector has been one of the very few to actually maintain resilience while continuing to provide growth opportunities, a feat unlikely to be matched by other developed markets around the world. FICCI conducted a survey on the Indian Banking Industry to assess the competitive advantage offered by the banking sector, as well as the policies and structures required to further stimulate the pace of growth.

The predicament of the banks in the developed countries owing to excessive leverage and lax regulatory system has time and again been compared with somewhat unscathed Indian Banking Sector. An attempt has been made to understand the general sentiment with regards to the performance, the challenges and the opportunities ahead for the Indian Banking Sector.

A majority of the respondents, almost 69% of them, felt that the Indian banking Industry was in a very good to excellent shape, with a further 25% feeling it was in good shape and only 6% of the respondents feeling that the performance of the industry was just average. In fact, an overwhelming majority (93.33%) of the respondents felt that the banking
industry compared with the best of the sectors of the economy, including pharmaceuticals, infrastructure, etc.

Most of the respondents were positive with regard to the growth rate attainable by the Indian banking industry for the year 2009-10 and 2014-15, with 53.33% of the view that growth would be between 15-20% for the year 2009-10 and greater than 20% for 2014-15.

Chart 2.2 Projected Growth Rates for Banks

On being asked what is the major strength of the Indian banking industry, which makes it resilient in the current economic climate; 93.75% respondents feel the regulatory system to be the major strength, 75% economic growth, 68.75% relative insulation from external market, 56.25% credit quality, 25% technological advancement and 43.75% our risk assessment systems.
Change is the only constant feature in this dynamic world and banking is not an exception. The changes staring in the face of bankers relates to the fundamental way of banking—which is going through rapid transformation in the world of today. Adjust, adapt and change should be the key mantra. The major challenge faced by banks today is the ever rising customer expectation as well as risk management and maintaining growth rate. Following are the results of the biggest challenge faced by the banking industry as declared by our respondents (on a mode scale of 1 to 7 with 1 being the biggest challenge):

**Chart 2.3 Challenges to Banking Industry**

![Chart showing challenges faced by the banking industry]

- **Employee retention**
- **Making a global mark**
- **Consolidation**
- **Human Resource Management**
- **Maintaining the growth rate**
- **Risk Management**
- **Ever rising customer expectations**
They also asked their respondents to rate India on certain essential banking parameters (Regulatory Systems, Risk Assessment Systems, Technological System and Credit Quality) in comparison with other countries i.e. China, Japan, Brazil, Russia, Hong Kong, Singapore, UK and USA.

The recent financial crisis has drawn attention to under-regulation of banks (mainly investment banks) in the US. Though, the Indian story is quite different. Regulatory systems of Indian banks were rated better than China, Brazil, Russia, and UK; at par with Japan, Singapore and Hong Kong where as all our respondents feel that we are above par or at par with USA. On comparing the results with their previous survey where the respondents had rated Indian Regulatory system below par the US and UK system, they see that post the financial crisis Indian Banks are more confident on the Indian Regulatory Framework.

Chart 2.4 Regulatory Systems
The global meltdown started as a banking crisis triggered by the credit quality. Indian banks seem to have paced up in terms of Credit Quality. Credit quality of banks has been rated above par than China, Brazil, Russia, UK and USA but at par with Hong Kong and Singapore and 85.72% of the respondents feel that we are at least at par with Japan.

Chart 2.5 Credit Quality

As technology ingrains itself in all aspects of a bank’s functioning, the challenge lies in exploiting the potential for profiting from investments made in technology. A lot needs to be done on the technological front to keep in pace with the global economies, as is evident from the survey results. Technology systems of Indian banks have been rated more advanced than Brazil and Russia but below par with China, Japan, Hong Kong, Singapore, UK and USA. They find no change on introspection of their past surveys which also highlighted the need for Indian banks to pace up in adoption of advanced technology.
The idea of creating bigger banks to take on competition sounds attractive but one must realize even the biggest among Indian banks are small by global standards. The lack of global scale for Indian banks came into sharp focus during the recent financial crisis which saw several international banks reneging on their funding commitments to Indian companies, but local banks could not step into the breach because of balance sheet limitations.

In this light, 93.75% of all respondents to their survey are considering expanding their operations in the future. They further asked participants on the methods that they consider suitable to meet their expansion needs. They divide them into organic means of growth that comes out of an increase in the bank’s own business activity, and inorganic means that includes mergers or takeovers.
Chart 2.7 Organic Means

**ORGANIC MEANS**

- Direct Sales 14%
- New Representative office 22%
- New ventures 7%
- Upgrade offices 24%
- Branch expansion 33%

Chart 2.8 Inorganic Means

**INORGANIC MEANS**

- Subsidiaries 12%
- Strategic alliances 31%
- Joint Ventures 27%
- Buyout portfolios 9%
- M&A 21%
We see from the above graph that amongst organic means of expansion, branch expansion finds favor with banks while strategic alliances is the most popular inorganic method for banks considering scaling up their operations. On the other hand, new ventures and buyout portfolios are the least popular methods for bank expansion.

While there has been prior debate, they questioned banks on NBFCs and Industrial houses being established as banking institutions and find opinion to be marginally against the notion, with 35.71% in favour while 42.86% were against them being established as banks.

However, on further questioning, 57.14% of respondents feel that the above may be allowed but only if it is along with specific regulatory limitations. Banks felt that limitations regarding track record, ensuring adequate capitalization levels, a tiered license that enables new entrants to enter into specific areas of the business only after satisfactorily achieving set milestones for the prior stages, cap on promoter's holdings and wider public holding in addition to a common banking regulator on a level playing field are essential before they may set themselves up as banks.

2.5 Banking Activities

Over the last three decades, there has been a remarkable increase in the size, spread and scope of activities of banks in India. The business profile of banks has transformed dramatically to include non-traditional activities like merchant banking, mutual funds, new financial services and products and the human resource development. Their survey finds that within retail operations, banks rate product development and differentiation; innovation and customization; cost reduction; cross selling and technological up gradation as equally important to the growth of their
retail operations. Additionally a few respondents also find pro-active financial inclusion, credit discipline and income growth of individuals and customer orientation to be significant factors for their retail growth.

There is, at the same time, an urgent need for Indian banks to move beyond retail banking, and further grow and expand their fee-based operations, which has globally remained one of the key drivers of growth and profitability. In fact, over 80% of banks in their survey have only up to 15% of their total incomes constituted by fee-based income; and barely 13% have 20-30% of their total income constituted by fee-based income.

Out of avenues for non-interest income, we see that Banc assurance (85.71%) and FOREX Management (71.43%) remain most profitable for banks. Derivatives, understandably, remains the least profitable business opportunity for banks as the market for derivatives is still in its nascent stage in India.

There is nevertheless a visibly increased focus on fee based sources of income. 71% of banks in their survey saw an increase in their fee based income as a percentage of their total income for the FY 2008-09 as compared to FY 2007-08. Indian banks are fast realizing that fee-based sources of income have to be actively looked at as a basis for future growth, if the industry is to become a global force to reckon with.

**Financial Inclusion and Expansion of Banking Services**

Transition from class banking to mass banking and increased customer focus is drastically changing the landscape of Indian banking. Expansion of retail banking has a lot of potential as retail assets are just 22% of the
total banking assets and contribution of retail loans to GDP stands merely at 6% in India vis-à-vis 15% in China and 24% in Thailand. All banks in their survey weigh Cost effective credit delivery mechanisms (100%) as most important to the promotion of financial inclusion. This was followed by factors such as identifying needs and developing relevant financial products (75%), demographic knowledge and strong local relations (62.5%) and ensuring productive use and adequate returns on credit employed (43.75%) in decreasing levels of importance. In fact, India has an expanding middle class of 250 to 300 million people in need of varied banking services. While 60% of our population has access to banks, only 15% of them have loan accounts and an overwhelming 70% of farmers have no access to formal sources of credit, reflective of immense potential for the banking system. This is mirrored in the fact that while our survey finds no discernible shift in the lending pattern of banks across Tier 1, Tier 2 and Tier 3 cities over the last two years, 93% Indian Banking System: The Current State & Road Ahead Page | 20 participants still find rural markets to be a profitable avenue, with 53% of respondents finding it lucrative in spite of it being a difficult market. Cost of accessing markets has been the only sour note in the overall experience of our respondents in rural markets. At the same time, more than 81.25% of our respondents have a strategy in place to tap rural markets, with the remainder as yet undecided on their plan of action. Tie ups with microfinance institutions (MFIs)/SHG and introduction of innovative and customized products are considered most important to approaching rural markets according to respondents, more so as compared to internet kiosks, post offices and supply chain management techniques.
Additionally, 81.25% of respondents found branchless banking to be an effective and secure way of reaching out to rural markets, with mobile, biometric and handheld devices, equally popular amongst banks. Some respondents also found the Business Correspondents model to be an untapped model for financial inclusion.

As Indian financial markets mature over time, there is also a need for innovative instruments to deepen the market further. Suggestions ranged from micro saving and micro insurance initiatives, Cash deposit machines, warehouse receipts, to prepaid cash cards, derivatives, interest rate futures and credit default swaps as a means to further the financial inclusion and expansionary process.
Credit Flow and Industry

India Inc is completely dependent on the Banking System for meeting its funding requirement. One of the major complaints from the industry has in fact been high lending rates in spite of massive cuts in policy rates by the RBI. We asked the banks what they felt were major factors responsible for rigid prime lending rates.

None of the banks in their survey considered the cap on bank deposit rates to be one of the causes of inflexible lending rates. Due to long-term maturity, the trend seems to be changing. However, there are other factors which have led to the stickiness of lending rates such as wariness of corporate credit risk (33.33%), competition from government small savings schemes (26.67%). Benchmarking of SME and export loans against PLR (20.00%) on the other hand, do not seem to have as significant an influence over lending rates according to banks.

The great Indian industrial engine has nevertheless continued to hum its way through most of the year long crisis. We asked banks about the sectors that they consider to be most profitable in the coming years (Fig. 12). All respondents were confident in the infrastructure sector leading the profitability for the industry, followed by retail loans (73.33%) and others.
Chart 2.10 Sectors Profitable in the Coming Years

![Sectors Profitable in the Coming Years Chart]

Chart 2.11 Porter’s Five Force Model

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<tr>
<td>(2)</td>
<td><strong>Potential Entrants</strong> is high as development financial institutions as well as private and Foreign Banks have entered in a big way</td>
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<tr>
<td>(5)</td>
<td><strong>Organizing power of the supplier</strong> is high. With the new financial instruments they are asking higher return on the investments</td>
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<tr>
<td>(1)</td>
<td><strong>Rivalry among existing firms</strong> has increased with liberalization. New products and improved customer services is the focus.</td>
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<tr>
<td>(4)</td>
<td><strong>Bargaining power of buyers</strong> is high as corporate can raise funds easily due to high Competition.</td>
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<td>(3)</td>
<td><strong>The threat of substitute product</strong> is very high like credit unions and investment houses. There are other substitutes as well banks like mutual funds, stocks, government securities, debentures, gold, real estate etc.</td>
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1. **Rivalry among existing firms**

   With the process of liberalization, competition among the existing banks has increased. Each bank is coming up with new products to attract the customers and tailor made Loans are provided. The quality of services provided by banks has improved drastically.

2. **Potential Entrants**

   Previously the Development Financial Institutions mainly provided project finance and development activities. But they now entered into retail banking which has resulted into stiff competition among the exiting players.

3. **Threats from Substitutes**

   Competition from the non-banking financial sector is increasing rapidly. The threat of substitute product is very high like credit unions and in investment houses. There are other substitutes as well banks like mutual funds, stocks, government securities, debentures, gold, real estate etc.

4. **Bargaining Power of Buyers**

   Corporate can raise their funds through primary market or by issue of GDRs, FCCBs. As a result they have a higher bargaining power. Even in the case of personal finance, the buyers have a high bargaining power. This is mainly because of competition.
5. Bargaining Power of Suppliers

With the advent of new financial instruments providing a higher rate of returns to the investors, the investments in deposits is not growing in a phased manner. The suppliers demand a higher return for the investments.

6. Overall Analysis

The key issue is how banks can leverage their strengths to have a better future. Since the availability of funds is more and deployment of funds is less, banks should evolve new products and services to the customers. There should be a rational thinking in sanctioning Loans, which will bring down the NPAs. As there is a expected revival in the Indian economy Banks have a major role to play.

2.6 SWOT ANALYSIS OF BANKING SECTOR

The banking sector is also taken as a proxy for the economy as a whole. The performance of bank should therefore, reflect “Trends in the Indian Economy”. Due to the reforms in the financial sector, banking industry has changed drastically with the opportunities to the work with, new accounting standards new entrants and information technology. The deregulation of the interest rate, participation of banks in project financing has changed in the environment of banks.

The performance of banking industry is done through SWOT Analysis. It mainly helps to know the strengths and Weakness of the industry and to improve will be known through converting the opportunities into strengths. It also helps for the competitive environment among the banks.
a) STRENGTHS

1. Greater securities of Funds
Compared to other investment options banks since its inception has been a better avenue in terms of securities. Due to satisfactory implementation of RBI’s prudential norms banks have won public confidence over several years.

2. Banking network
After nationalization, banks have expanded their branches in the country, which has helped banks build large networks in the rural and urban areas. Private banks allowed to operate but they mainly concentrate in metropolis.

3. Large Customer Base
This is mainly attributed to the large network of the banking sector. Depositors in rural areas prefer banks because of the failure of the NBFCs.

4. Low Cost of Capital
Corporate prefers borrowing money from banks because of low cost of capital. Middle income people who want money for personal financing can look to banks as they offer at very low rates of interests. Consumer credit forms the major source of financing by banks.
b) WEAKNESS

1. Basel Committee

The banks need to comply with the norms of Basel committee but before that it is challenge for banks to implement the Basel committee standard, which are of international standard.

2. Powerful Unions

Nationalization of banks had a positive outcome in helping the Indian Economy as a whole. But this had also proved detrimental in the form of strong unions, which have a major influence in decision-making. They are against automation.

3. Priority Sector Lending

To uplift the society, priority sector lending was brought in during nationalization. This is good for the economy but banks have failed to manage the asset quality and their intentions were more towards fulfilling government norms. As a result lending was done for non-productive purposes.

4. High Non-Performing Assets

Non-Performing Assets (NPAs) have become a matter of concern in the banking industry. This is because reduced to meet the international
standards of change in the total outstanding advances, which has to be reduced to meet the international standards.

c) OPPORTUNITIES

1. Universal Banking
Banks have moved along the value chain to provide their customers more products and services, like home finance, Capital Markets, Bonds etc. Every Indian bank has an opportunity to become universal bank, which provides every financial service under one roof.

2. Differential Interest Rates
As RBI control over bank reduces, they will have greater flexibility to fix their own interest rates which depends on the profitability of the banks.

3. High Household Savings
Household savings has been increasing drastically. Investment in financial assets has also increased. Banks should use this opportunity for raising funds.

4. Untapped Foreign Markets
Many Indian banks have not sufficiently penetrated in foreign markets to generate satisfactory business therefore, it can be concluded clear opportunity exists in such markets.
5. **Interest Banking**
The advance in information technology has made banking easier. Business can effectively carried out through internet banking.

d) **THREATS**

1. **NBFCs, Capital Markets and Mutual funds**
There is a huge investment of household savings. The investments in NBFCs deposits, Capital Market Instruments and Mutual Funds are increasing. Normally these instruments offer better return to investors.

2. **Changes in the Government Policy**
The change in the government policy has proved to be a threat to the banking sector. Due to some major changes in policies related to deposits mobilization credit deployment, interest rates- the whole scenario of banking industry may change.

3. **Inflation**
The interest rates go down with a fall in inflation. Thus, the investors will shift his investments to the other profitable sectors.
4. Recession
Due to the recession in the business cycle the economy functions poorly and this has proved to be a threat to the banking sector. The market oriented economy and globalization has resulted into competition for market share. The spread in the banking sector is very narrow. To meet the competition the banks has to grow at a faster rates and reduce the overheads. They can introduce the new products and develop the existing services.

2.7 BANKING OPERATIONS
PERSONAL BANKING SERVICES
Personal banking is similar to retail banking. The essence is that the products and services of the bank are tailored to meet individual banking and ancillary needs, including everything from a checking account to investment advice. The different products available through personal banking include checking accounts, savings accounts, CDs, check cards with rewards, different types of loans, and personal lines of credit, credit cards, personal trust and private banking services, mortgage programs, investment management, discount brokerage, insurance services and advisory services. Insurance, investment advice, and wealth management are high end products offered in personal banking.

The most prominent feature in personal banking today is technology-enabled, customized products and services like anywhere banking, ATMs, and the delivery of services through channels like a telephone and the Internet. The idea is that the customer need not come to the branch for
their services and that everything should be delivered to the customer at his convenience. The bank will provide single window service, meaning that customers can visit one counter for any banking need.

Personal banking is quickly catching up in almost all the countries in the world and is expected to contribute significantly to the bank’s total revenue. Almost 15-20% of the customers contribute up to 90% of the banks business, so proper service to these customers will deepen the financial relationships.

Everyone with a personal bank account needs to be very cautious and pay close attention to all aspects of their account. People should promptly review their bank statement, avoid having to pay unnecessary fees and bank charges, avoid leaving discarded bank documents behind, avoid banking online in public places, and periodically change their password.

**DEPOSITS**

It is the taking of deposits and granting of loans that single out a bank. These are the core activities of a bank. Initially, all accounts are opened with a deposit of money by the customer and hence these accounts are called deposit accounts. Public deposits comprise the major proportion of a bank working funds which are used primarily to make loans and advances and to purchase securities. The banker solicits deposits from the members of the public belonging to different walks of life, engaged in numerous economic activities. The nature of banking facility sought by them, therefore, varies widely, e.g., some want to earn interest, some want their money to be safe; others use banking facilities for conducting
business. As a result, different types of accounts with various facilities and privileges are offered by banks to their customers. Banks accept various types of deposits, which are generally categorized as demand or time deposits.

**Demand deposits**: Demand deposits are those where customers expect to be able to withdraw money at anytime. These include savings deposits and deposits in current accounts.

**Saving deposits**: As saving accounts are meant to encourage saving habit, organizations whose purpose is profit are not allowed to open such accounts. Interest is paid on a half-yearly basis in these accounts. A minimum balance is stipulated by each bank. A balance amount above the minimum stipulated amount is eligible for a 3.5 per cent interest rate in India at present.

**Current deposits**: Since this account is to meet the transaction needs of the customer, there is no restriction on the number of transaction in the account or in the type of customers eligible to open these accounts. Account holders are not entitled to any interest from the bank.

**Time deposits**: These are also called as fixed deposits or term deposits. These are repayable after the expiry of a specified period varying from 7 days to 120 months. Any deposit which is not repayable on demand is a
time deposit. They are a genuine saving medium. The banker can utilize such amounts more profitably since he knows beforehand when this money will be demanded. As a result, a much higher rate of interest is offered to the customer on such deposits.

**Loans:**

The basic function of a commercial bank is to make loans and advances out of the money which comes to it from the public by way of deposits. Direct loans and advances are given to all types of persons, particularly to businessmen and investors against personal security, gold and silver and other movable and immovable assets. Banks, sometimes, also lend money at concessionary rates of interest to priority sector industries, small borrowers, students, disabled persons, etc.

**Commercial banks usually lend money in the following forms:**

**Cash credit:** A cash credit is an arrangement by which the banks agree to lend money up to a specified limit. The bank places a certain amount to the credit of the customer. The customer draws the money as and when he needs. Interest is charged only on the amount actually utilized by him and not on the limit granted. Cash credit is usually granted on a bond or certain other securities. This method of lending is very popular in India.
**Loans:** A loan is a specified amount which is sanctioned by the banker to the customer. It is granted for a fixed period, say six months, or a year. The specified amount is placed to the credit of the borrower. He can withdraw the amount in lump sum or draws cheques against this sum form any amount. Interest is charged on the full amount whether the borrower makes use of it or not. The rate of interest on it is lower than what is charged on cash credit. A loan is usually granted against the security of assets or the personal security of the borrower. It may be repayable in installments or in lump sum.

**Bank Overdraft:** Bank overdraft is granted when the customer has a current account in the bank. Under an overdraft arrangement, a depositor is allowed to draw by a cheque more than the deposited amount to his credit, but up to a specified limit. Interest is charged on the exact amount overdrawn by the customer. The rate of interest on it is always higher than that charged on the loans. This facility is given by banks on the security of some assets or on the personal security of the customer.

**Discounting of bills:** Banks may also give financial help to its customers by discounting their bills of exchange. The bank purchases them at their present worth. The bill is purchased by the bank at the face value less the interest at the current rate till the time when the bill falls due. This is known as discounting of bills. This is a form of lending to the business community. Discounting of bills facilitates modern business transactions in a large number.
The following types of loans can be availed from banks:

Home loans

Car loans

Education loans

Two Wheeler loans

Business Installment loans

Personal loans

**Investment:**

Investment banks help companies and governments raise money by issuing and selling securities in the capital markets (both equity and debt), as well as providing advice on transactions such as mergers and acquisitions. Until the late 1980s, the United States and Canada maintained a separation between investment banking and commercial banks. A majority of investment banks offer strategic advisory services for mergers, acquisitions, divestiture or other financial services for clients, such as the trading of derivatives, fixed income, foreign exchange, commodity, and equity securities. Trading securities for cash or securities (i.e., facilitating transactions, market-making), or the promotion of securities (i.e., underwriting, research, etc.) is referred to as the "sell side." Dealing with the pension funds, mutual funds, hedge funds, and the investing public who consume the products and services of
the sell-side in order to maximize their return on investment constitutes the "buy side". Many firms have buy and sell side components.

**Demat services:** Banks provide depository services where shares are held in dematerialized (demat) form. Demat is the process of converting the physical (paper) shares into electronic form. With demat trading; customers won’t need to worry about forgery and duplicate or stolen share certificates. Apart from safety, transaction costs are significantly lesser too. Under demat trading, every security has a ISIN (International Security Identification Number) that uniquely identifies that particular security, and provides a convenient form of ID. The salient features of a demat account are:

- Holding statement every 3 months, showing current portfolio of shares.
- Overdraft available against demat shares through AssetLink upto 90 per cent of the value of select scrips.
- No account opening charges and no minimum balance requirements.
- No stamp duty on transfers and immediate transfers possible.
- Just 3-4 weeks to dematerialize shares, immediate transfer on buying.
- A total of 10 sale transactions per month may be free of cost for each demat account. Further, banks will receive new issues, rights and bonus issues in demat form on behalf of the customer. Interest rates for loans against demat shares are lower than the rates for loans against physical scrips.
Cards:

Credit cards: A credit is an instrument which provides instantaneous credit facility to its holder-usually between 30 and 45 days. A credit card is made of plastic. It is a payment device that can be used in local, national and sometimes even in international markets, during travel, at ATMs, etc. for purchase of all kinds of goods such as households, consumer durables and services like hotels, airways, railways, and so on. The credit card reduces the need for the customer to hold money balances at any given time. Having a bank account is not a prerequisite for issuing a credit card. Each credit card holder is given a credit limit on his credit card.

Debit cards: Like a credit card a debit card too is a payment mechanism which allows the holder to make purchases without making any immediate cash payment. A debit card can be used in any merchant outlet that is linked with the customer’s bank for making payment. At the time of making payment through a debit card, the amount is instantly debited to the customer’s account. It is like a blank cheque, so it must be used carefully. There are no chances of the debit card user to fall into the debt trap. There are no transaction costs and no question of late fee payment in the use of debit card. Bankers also avoid the risk of bad debts.
Insurance:

In Financial sense:

The term insurance may be defined in the financial sense as: A social device providing financial compensation for the consequences of adversity, the payments being made from the accumulated contributions of all parties participating in the arrangement. The essence of insurance thus, is collective bearing of risks as it involves pooling of risk.

In Legal sense:

The contract of insurance may be defined as: A contract under which the insurer (insurance company) in consideration of a sum of money paid (premium) by the insured (the person whose risk is insured) agrees to: (i). make good the loss suffered by the insured against a specific risk (for which the insurance is effected), or; (ii).To pay a prefixed amount to the insured or his/her beneficiaries on the happening of a specified event. Thus, insurance is a contract between the insurer and the insured requiring all the essentials of a valid contract according to the law of contracts. The instrument containing the contract of insurance is called a policy.

Bank assurance is the distribution of insurance products through the bank’s distribution channel whereby, along with a complete range of banking and investment products and services, insurance products are also offered through the vast network of banking services. Thus, it is in the nature of a partnership between an insurance company and a banking
institution through which an attempt is made to exploit synergies between both the insurance companies and banks.

Government of India, through its notification dated August 3, 2000, has recognized insurance as a permissible form of banking business under the provisions of the Banking Regulation Act, business under the provisions of the Banking Regulation Act, 1949. The RBI too has recognized bank assurance, allowing banks with prior permission to offer physical infrastructure to insurance companies within the premises of some selected branches. Some of the bank assurance alliances in India include the following:

**Table 2.1 Insurance By Banks**

<table>
<thead>
<tr>
<th>Insurance Company</th>
<th>Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>HDFC Standard Life Insurance Co. Ltd.</td>
<td>Union Bank Of India</td>
</tr>
<tr>
<td>ICICI Prudential Life Insurance Co. Ltd.</td>
<td>Lord Krishna Bank, ICICI Bank, Bank of India, Citibank, Allahabad Bank, Federal Bank, South Indian Bank, Punjab and Maharashtra Cooperative Bank</td>
</tr>
<tr>
<td>Insurance Company</td>
<td>Bank</td>
</tr>
<tr>
<td>-----------------------------------------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>Life Insurance Corporation of India</td>
<td>Corporation Bank, Indian Oversean Bank, Centurion Bank( Centurian Bank Of Punjab), Satara District Central Cooperative Bank, Janata Urban Cooperative Bank, Yeotmal Mahil Sahkari Bank, Vijaya Bank, Oriental Bank Of Commerce</td>
</tr>
<tr>
<td>Metlife India Insurance Co. Ltd.</td>
<td>Karnataka Bank, Dhanalakshami Bank, J&amp;K Bank</td>
</tr>
<tr>
<td>SBI Life Insurance Co. Ltd.</td>
<td>State Bank Of India</td>
</tr>
<tr>
<td>Bajaj Allianz General Insurance Co. Ltd.</td>
<td>Karur Vysya Bank and Lord Krishna Bank</td>
</tr>
<tr>
<td>National Insurance Co. Ltd.</td>
<td>City Union Bank</td>
</tr>
<tr>
<td>Royal Sundaram General Insurance Company</td>
<td>Standard Chartered Bank, ABN AMRO Bank, Citibank, Amex and Repco Bank</td>
</tr>
<tr>
<td>United India Insurance Co. Ltd.</td>
<td>South Indian Bank</td>
</tr>
</tbody>
</table>

**Online services:** On-line banking or internet banking is the ability to use one’s personal computer to communicate with one’s bank. It is an outgrowth of PC banking. PC banking enables customers to execute bank transactions from their personal computer via a modem through financial software of the bank. Internet banking has become a strategic necessity for most commercial banks. It is being used as a distribution channel to build up customer contracts in a systematic way in order to inform, counsel and sell products and services.
All banks, which propose to offer internet services, should obtain prior approval from RBI. Only those banks which are licensed and supervised in India and have a physical presence in India will be permitted to offer internet banking products to residents of India. Thus, both banks and virtual banks incorporated outside the country and having no physical presence in India will not, for the present, be permitted to offer internet banking services to Indian residents.

A number of routine issues which are simple in nature but time-consuming can be handled through the internet, e.g., customer’s request for opening an account, balance enquiries, FD renewals, request for cheque-books, foreign exchange rates, on-line bill payment, stop payment request, request for debit cards, transfer of funds on-line and monthly statement be e-mail. No staff intervention is required in all these cases and the bank can provide all these services to their customers at a fraction of the cost. Internet banking not only ensures saving in the salary of the staff, but also enhances the bank’s ability to increase their customer base without having to invest in exorbitantly priced real estate for opening more physical branches. According to some estimates, the cost per transaction over the internet is one-eighth of the cost to the bank if performed through branch banking.

Internet banking provides anywhere and anytime banking as services are provided round the clock; worldwide connectivity as it transcends geographical boundaries; easy access to recent and historical data; direct customer control of international movement of funds; greater processing speed and accuracy. However, there are certain limitations of internet
banking also- it pre-supposes computer literate customers who can develop trust in this technology which is not always the case especially in a country like India. The fear of hacking is very real in people’s minds so the risk management of the system of the banks poses new challenges.

**NRI banking:**

To meet the specific needs of non-resident Indians related to their remittances, savings, earnings, investments and repatriation, the Government of India introduced in 1970 Non-Resident (External) Account Rules which are governed by the Exchange Control Regulations. **NRI accounts** are maintained by banks which hold authorised dealers' licences from the Reserve Bank of India. Some cooperative and commercial banks have also been specifically permitted to maintain NRI accounts in rupees even though they are not authorised dealers. The financial budget for 2007-08 extends NRI accounts to regional rural banks (RRBs) as well. This would boost remittances from NRIs particularly in Bihar, Kerala, Uttar Pradesh and Gujarat where a large number of persons from rural areas from these states are employed overseas.

**Banking Laws for NRIs** allow for accounts with authorised dealers to be maintained in Indian rupees and in foreign currency.

Bank Accounts:

The Foreign Exchange Management Act, 1999 determines the laws regulating foreign exchange and enlists the various deposit schemes
available to Non-Resident Indians. The types of deposit schemes made available to NRIs are:

a) FCNR (B) - Foreign Currency (Non-Resident) Account (Banks) Scheme for all NRIs

b) NRE Account - Non-Resident (External) Rupee Account for all NRIs

c) NRO Account - Non-Resident Ordinary Rupee Account Scheme.

All NRIs can open such accounts, with the exception of individuals residing in Pakistan and Bangladesh, who require special permission from the RBI. Joint accounts of two or more non-residents and nomination facility are permitted.

Bank Accounts:

NRE Savings Account:

The Non-Resident External Account (NRE) is the perfect choice for NRIs wishing to route investments on a repatriable basis. An NRI is permitted to transfer the funds held in the NRE Account as well as the interest earned on it. Maintained in Rupee, this Savings Account requires one to keep an average quarterly balance of Rs.10,000 only. NREs have the choice to open this account jointly with other NRIs. They can transfer their funds out of India whenever they want. What’s more, the funds in the account and the interest earned are both exempt from taxes.

NRO Savings Account:

NRIs can enjoy a host of advantages with the NRO Savings Account. They can repatriate the interest earned after payment of applicable taxes. If they have any investments made in Indian Rupee, they also get the advantage to route these out of India.
NRE Fixed Deposit:

An NRE Fixed Deposit is a fixed deposit maintained in Indian Rupee. It can be fully repatriated at any time.

NRO Fixed Deposit:

An NRO Fixed Deposit is a fixed deposit that is maintained in Indian Rupee by NRIs.

FCNR (Foreign Currency Non-Resident) Deposit:

The NRIs can earn Indian Interest Rates on their Foreign Currency Non-Resident Deposit.

RFC Fixed Deposit:

An RFC Fixed Deposit allows returning Indians to hold their deposit in any one of the four currencies (US Dollar, Pound Sterling, Euro, Japanese Yen). They can convert their deposit into Indian Rupees as and when required.

RFC Savings Account:

An RFC Savings Account allows NRIs to hold their deposit in any one of four currencies (US Dollar, Pound Sterling, Euro, Japanese Yen). They can convert the deposit into Indian Rupees as and when required.

While the FCNR(B) is a term deposit only, the NRE and NRO accounts can be operated as either savings, current, recurring or fixed deposit accounts. As for interest rates, FCNR(B) and NRE are subject to a cap, and should not exceed the LIBOR/swap rates. In the case of NRO accounts, rates are determined by the banks. The interest rates, currently at 3.5% apply to a period of 1 to 3 years.
The total NRE/ FCNR deposits during 2006-2007, as per RBI statistics, are USD 37,751 million and are expected to grow with regional rural banks also mopping up funds. Banks are expected to offer lucrative interest rates to bolster NRI funds.

**Money Transfer:**

Many banks provide simple and convenient, online remittance facility to India. NRI’s can remit funds from USA, UK, Singapore, Germany, France, Italy, etc. The money can be sent to accounts at all the branches of the banks across India. Demand draft delivery can also be done to all locations across India. The benefits of this facility are: it is completely online; there are no transaction charges; superior exchange rates can be availed; email updates are available and personalized messages can also be sent. Online donations can also be made to a host of charitable institutions.

**Investments and Insurance:**

Mutual Funds: Mutual Funds pool the money of several investors to invest in equity or debt markets. Mutual Funds could be Equity Funds, Debt Funds or Balanced Funds. Funds are selected on quantitative parameters like volatility, FAMA Model, risk adjusted returns and rolling return, coupled with a qualitative analysis of fund performance and investment styles through regular interactions/due diligence processes with fund managers. The bank will help to determine the investment profile, which in turn, will help choose the type of investments that suits customer the best.
Insurance: NRIs can avail a world of choice in insurance. They can also avail of Life-Insurance plans.

Portfolio Investment Scheme: Portfolio Investment Scheme (PIS) is a scheme through which NRIs who want to deal in shares in the secondary market can route their transactions. No matter which part of the world the NRIs are in, they can trade on recognized Indian Stock Exchanges under the Portfolio Investment Scheme (PIS).

Online Investment Services on NRE/NRO Savings Account:

Investment Services Account (ISA): The online facility of the banks allows the NRIs to enjoy the comfort of investing in Mutual Funds in India from their home/office abroad. The NRIs can open an Investment Services Account by signing up a onetime agreement with the bank to invest in Mutual Fund Schemes. No additional login/password/validations are required at the time of login. The customer can log on to the bank’s website using the Customer Id and Net Banking Password and access their investment services account.

Loans:

Home Loans: Attractive Home Loans can be availed at attractive rates meant exclusively for NRIs. The banks help them to realize their dreams.

Loans Against Securities: NRIs can get an overdraft against their securities such as Equity Shares, Mutual Fund Units, GOI Relief Bonds and LIC Policies, while still retaining ownership.

Loans Against Deposits:

Foreign Currency Loans: The NRIs can avail of the Foreign Currency Loans with the FCNR Deposit as Collateral. They can retain the FCNR
Deposit even as you meet their financial needs overseas. They can utilize the loan amount for any purpose whatsoever except investing in India.

Indian Rupee Loans (INR Loans): The NRIs enjoy a high rate of interest along with the liquidity of a Savings Account by opting for a Super Saver Account. They can avail of an overdraft facility of up to 90% of the value of their fixed deposit or Rs. 20 lac, whichever is lower and get the best of both the worlds.

Corporate Banking

Cash Management Services (CMS):- Cash Management is the process of optimizing receivable and payables while ensuring predictability in the cash flows. Efficient Cash Management is about getting funds in time, quick transfers, quick realization of local and outstation cheques, easy disbursements, account reconciliation, controlled processes and customized MIS. Thus Cash Management Services (CMS) eliminates the inherent delays of a funds transfer mechanism, thus enhancing liquidity and ensuring optimum planning and utilization of funds. Bank Cash Management Services include the following basic components:

1. Collection or Receivables Management
2. Payment or Payables Management

Benefits of Cash Management Services:

- **Financial**
  Collection & Disbursement products enable business to reduce the interest cost on their borrowings by getting access to your funds faster there-by reducing the borrowings. Additionally, it helps
business to improve the liquidity position by realizing cheques earlier, there-by improving the Balance Sheet and Financial Ratios.

- **Operational**
  Banking and Treasury functions can be managed with far less number of people as most of the funds and liquidity management functions get outsourced to the bank and in addition business will require lesser manpower for performing various payment related activities.

- **Control**
  The Bank’s CMS products allows business to maintain better control over the various Banking and Treasury related activities, improve speed and ease of reconciliation and reduces the risk of fraud.

**Trade services:**

International trade is a risky business. Exporters and importers may be thousands of miles apart. The banks at both ends of the trade transaction have to safeguard the interests of these distant business partners. Effective support through payment instruments such as letters of credit, bills of exchange, and documentary collections is a prerequisite to the unobstructed flow of goods and services.

**Trade way:**

Trade Way is designed to be an international banking gateway for India related trade business. With Trade Way the Bank is the customer’s single point contact for India related documentary collections.
With addition of Trade Way to its spectrum of financial services the Banks truly offer the customer the ultimate banking experience. As a hub for multi-banking transactions, banks make all Documentary Collection Process smoother, faster, cost effective and most importantly – more efficient. Optimizing every business opportunity for the client.

Benefits

- Single point of contact for all the India bound collections.
- Efficient Document Handling and Payment Collection Services
- Cost / Time Advantages through economies of scale
- Online status enquiry facility.
- Leveraging the Bank’s extensive domestic network and area coverage
- Specialized processing team with expertise in Trade Services.

Forex Online:

Getting right rates at the right time is the key factor for determining profitability in forex transactions. To serve this purpose, Forex online offers instant rates that enhance client’s decision-making capability to maximize their gains. Client gets to book rates and view deal tickets online and all they need to do is ‘login’. One can transact from anywhere through the internet. No calling up the bank now, just keep the Forex online page open till one gets the best rate and book it the moment one gets it.
It is completely safe with firewalls, filtering routers and a multi layered security architecture to protect from unauthorized access.

**Forex online Features**

- Real time platform with competitive forex rates
- Transaction in a secure network
- Instantaneous deal number and deal ticket generation
- No need to call up Branch/dealer for rates
- Archival and online retrieval of past transactions

**Process of registration**

The FXOnline application form along with a Board resolution / Partnership letter / Sole proprietorship letter / HUF letter in the specified format should be handed over to the Solution Manager, or to FX Channels team.

The forms should be dispatched to the Web Channel Team at the following address.

FXOnline / FX-On-Call, Secondary dealing room, 2nd Floor, North Tower, ICICI Bank towers, Bandra Kurla Complex, Bandra (E), Mumbai 400051.

1. Once the form is received by us User ID & Passwords are dispatched to the clients.
• 1st level password through E mail - View rate facility
• 2nd level password through courier - transaction password.

2. User ID & Passwords are activated on receipt of acknowledgment from you

SME SERVICES

A squeeze on interest margins, a nudge from the central bank and an opportunity to expand their credit portfolio towards a new and relatively unexplored direction, and led most banks to take a focus on the small and medium enterprise (SME) sector. According to a recent survey commissioned by Citibank, the small businesses and professionals community in India is estimated at more than 3 million. As a result, this sector is the focus of attention among banks.

With so much to work with, most banks now have special cells in place to target this sector. In addition to providing the usual loans and working capital assistance, banks are now going the extra mile to empower their SME clients.

But nothing works like a nudge from the Finance Minister himself. P Chidambaram has asked the State Bank of India (SBI) to increase its share of lending to this sector. “The bank should also use its vast branch network to increase lending to the SME sector as it helps in generating employment and also addresses the issue of balanced regional development,” he said.

SBI on its part has already taken an initiative in this direction. Through its Project Uptech, has taken a cluster financing approach, where the units from similar industry are identified for process improvement. This means
that units, which come forward to adopt innovations, get financial assistance for upgradation costs.

ICICI Bank, the country's second largest bank, has introduced a simplified loan product, an unsecured loan upto Rs 25 lakh for the SME sector.

Oriental Bank of Commerce (OBC) is in the process of setting up a specialised cell for the SME sector.

Though, these are recent initiative, almost all banks now have a special package for this sector. The foreign banks don’t want to be left behind either. Most of them want to target the neglected segment of potential customers as many of these businesses get only transactional banking services, because of their size and relatively low cash flow requirements.

Standard Chartered Bank has taken a lead in this direction. It is offering this service through a separate business unit called Standard Chartered Investment & Loans Ltd (SCILL), currently present in 16 cities. The bank has drawn up a road map to extend SCILL’s network to 60 cities by the end of this fiscal.

HSBC, which has become an aggressive player in the Indian market, is not far behind. HSBC is offering this mass-banking service through its 21 branches in 16 cities across the country. The minimum income level required for getting a loan from HSBC is just Rs 3,500 per month for salaried employees and Rs 10,000 per year for the self-employed.

Despite its extensive research, Citibank is a later entrant in this business, and has announced its initiative only recently. Understandably, risk management for this sector is a huge issue with banks. CRISIL has
stepped in to provide a rating service for the SME sector. According to this rating programme, SMEs would be rated on a scale of one to eight, with scale one indicating the highest credit quality and the scale eight, hinting at default possibilities. The ratings assigned to SMEs would also function as a self-improvement tool for them. To top all initiatives, SBI, ICICI Bank and Standard Chartered Bank, have agreed to join hands with the Small Industries Development Bank of India (SIDBI) to float a rating agency for the SME segment. The rating agency, Small and Medium Enterprises Rating Agency (SMERA), will rate the company’s overall strength, unlike most rating agencies whose core business are to rate debt instruments. With planning, government encouragement and dedicated rating services, banks can tap the potential of this sector in the coming years.

Other Banking Services

ATM:

An automated teller machine or automatic teller machine (ATM) is a computerized telecommunications device that provides a financial institution’s customers a secure method of performing financial transactions in a public space without a human clerk or bank teller. For using an ATM, a customer requires an ATM card. Initially an ATM card worked on various principles including radiation and low-coercivity magnetism that was wiped by the cards reader to make fraud more difficult. However, most modern ATM card are made up of plastic with a magnetic stripe or a plastic smart card with a chip. Customer has a special card number that is referred to as a PIN (personal identification number)
usually of four or more digits. The customer has to insert the card in the machine and quote the PIN number. Initially ATMs were used for withdrawing or depositing cash. However, they provide many other services. A consumer can use an ATM for: deposits/withdrawals of cash; making balance enquiry; obtaining an account statement for previous limited transactions; inter account transfer of funds (restricted to accounts of the same customer at same or different centers); making utility payment of bills, e.g., electricity, telephone, etc.; requisition of cheque books.

**Mobile Banking**

Mobile banking (also known as M-Banking, mbanking, SMS Banking etc.) is a term used for performing balance checks, account transactions, payments etc. via a mobile device such as a mobile phone. Mobile banking today (2007) is most often performed via SMS or the Mobile Internet but can also use special programs called clients downloaded to the mobile device."Mobile Banking refers to provision and availment of banking- and financial services with the help of mobile telecommunication devices. The scope of offered services may include facilities to conduct bank and stock market transactions, to administer accounts and to access customised information."

**Demand Draft** is a written order for making payments. It is also called in short form as DD (Demand Draft). The person making payments is called drawee and the recipient is called payee. The bank providing the service is called drawer.
Demand draft can be of two types, Sight Draft or Time Drafts.

Sight drafts allows money transfer only when proper documents are produced on sight. While time drafts allows money transfer after the specified time (a future date).

**Locker/Safe-vault**

Most banks offer safe deposit lockers in branches, though at some places there is a long waiting list before you finally get one. The rates and fees for a locker differ from bank to bank. But regardless of whether it is a private sector or public sector bank you have to have an account with the bank to apply for the facility. Also, fees will vary depending on the size of the locker, usually banks have three sizes - small, medium and large.

Private sector banks like ICICI Bank and HDFC Bank do not charge a one-time deposit in addition to the annual fees like most public sector banks do. The only criterion for obtaining a locker in a private sector bank is that one should have a satisfactorily maintained bank account with a steady minimum balance. The lockers are allocated on the basis of a first-come-first-serve basis or availability. ICICI Bank, for instance, charges Rs.1,800 annually for the smaller locker size and Rs.4,000 for the large locker. This includes the rent, stamp and admission fee.

Public sector banks, however, charge a much lower annual fee. But availability of lockers being a key issue, they charge a deposit which is sometimes as high as Rs.50,000 – Rs.100,000 depending on the waiting list. Like State Bank Of India's branch in Bandra, which charges Rs.50,000 as a deposit, that can be paid in installments over a period of time. The annual fee is Rs.500. Similarly, Indian Bank charges Rs.10,000
as a deposit and Rs.600 annually for a medium sized locker. Indian Bank calculates the deposit such that the interest earned on it matches the annual fee charged for the locker facility.

**Core banking** is a general term used to describe the services provided by a group of networked bank branches. Bank customers may access their funds and other simple transactions from any of the member branch offices.

Core Banking is normally defined as the business conducted by a banking institution with its retail and small business customers. Many banks treat the retail customers as their core banking customers, and have a separate line of business to manage small businesses. Larger businesses are managed via the Corporate Banking division of the institution. Core banking basically is depositing and lending of money.

Normal core banking functions will include deposit accounts, loans, mortgages and payments. Banks make these services available across multiple channels like ATMs, Internet banking, and branches.

**Core Banking Solutions**

Core Banking Solutions is new jargon frequently used in banking circles. The advancement in technology especially internet and information technology has led to new way of doing business in banking. The technologies have cut down time, working simultaneously on different issues and increased efficiency. The platform where communication technology and information technology are merged to suit core needs of banking is known as Core Banking Solutions. Here computer software is
developed to perform core operations of banking like recording of transactions, passbook maintenance, interest calculations on loans and deposits, customer records, balance of payments and withdrawal are done. This software is installed at different branches of bank and then interconnected by means of communication lines like telephones, satellite, internet etc. It allows the user (customers) to operate accounts from any branch if it has installed core banking solutions. This new platform has changed the way banks are working. Now many advanced features like regulatory requirements and other specialised services like share (stock) trading are being provided. Core banking solutions are very helpful to SME industries.

In countries such as India and Hong Kong that were a part of the British empire, it is only recently that core banking has caught on. This is mainly due to the restrictions by the UK government on free movement of money throughout the region. Also, the IT infrastructure necessary for such services did not exist in these countries until recently. After Britain chose to give these countries their freedom, the economies of these countries went through a drastic change - thus the demand for such services increased and the need to meet such demand were met with today's technologies. Most of the nationalized banks in India for example: State Bank of India, Punjab National Bank, Allahabad Bank, HDFC and ICICI Bank today supports core banking. As of 2007, many Cooperative banks in India such as REPCO Bank, Jain Urban Cooperative Bank, Kangra Central Cooperative Bank, Udaipur Urban Cooperative Bank, Kollam District Cooperative Bank, Kerala State Cooperative Bank and Panchsheel Mercantile Cooperative Bank have started to use and offer centralized Core Banking too. The Four standard software tools used are
Intellect Suite from POLARIS, Flexcube from iFlex Solutions, Finacle from Infosys and B@ncs from TATA Consultancy Services.

In countries such as Japan, core banking is still in its early stages. Although having autonomous reign over their currency for over half a century, the consumers themselves do not see much use for such services - low demand, thus less services. It is only within the last decade that banks started placing ATMs outside the bank premises. Many of the bank services must be done in person at the account holder's registered branch. Japanese banks rely heavily on paperwork and physical evidence, thus rendering core banking impractical.
Chapter-3
Conceptual Framework of Co-Operative Banks and Urban Co-operative Banks
3.1 Urban Co-operative Banks

Urban Co-operative Banks (UCBs) are an important part of the financial system in India. It is, therefore, necessary that the UCBs emerge as a sound and healthy network of jointly owned, democratically controlled, and ethically managed banking institutions providing need based quality banking services, essentially to the middle and lower middle classes and marginalized sections of the society. This document sets out the broad approach and strategies that need to be adopted to actualize this vision.

1. Background

The urban cooperative banking system has witnessed phenomenal growth during the last one and a half decades. From 1307 urban cooperative banks (UCBs) in 1991, the number of UCBs has risen to 2105 in the year 2004. Deposits have increased by over 1100 percent from Rs. 8600 crore to over Rs.100, 000 crore, while advances have risen from Rs. 7800 crore to over Rs.65,000 i.e. by 733 percent during the above 15-year period. This growth path has been possible mainly on account of the enabling policy environment in the Post 1991 period, which encouraged setting up of new urban cooperative banks. Further, the deregulation of interest rates, as available to commercial banks, enabled the UCBs to mobilize vast deposits, which, together with the liberal licensing policy propelled the growth of UCBs in terms of numbers as also in size. This significant growth in business, which has come about in a competitive environment was largely due to the efforts and the ability of the sector to harness resources from the small depositors.
Thus, while the sector has shown spectacular growth during the last decade exhibiting substantial potential for sustained growth, there are certain infirmities in the sector that have manifested in the form of weakness of some of the entities resulting in erosion of public confidence and causing concern to the regulators as also to the sector at large. There is, thus, a need to harness the benefit of rapid growth and mitigate the risk to which individual banks and the system are exposed by providing a regulatory and supervisory framework that will address the problems of the sector as also the shortcomings of dual control.

2. Objective

In the light of above, the broad objectives of the document can be set out as under: -

i. To rationalize the existing regulatory and supervisory approach keeping in view the heterogeneous character of entities in the sector

ii. To facilitate a focused and continuous system of supervision through enhanced use of technology.

iii. To enhance professionalism and improve the quality of governance in UCBs by providing training for skill up-gradation as also by including large depositors in the decision making process / management of banks.
iv. To put in place a mechanism that addresses the problems of dual control, given the present legal framework, and the time consuming process in bringing requisite legislative changes

v. To put in place a consultative arrangement for identifying weak but potentially viable entities in the sector and provide a framework for their being nurtured back to health including, if necessary, through a process of consolidation

vi. To identify the unviable entities in the sector and provide an exit path for such entities.

3. The Operating Environment

Urban cooperative banks form a heterogeneous group in terms of geographical spread, area of operation, size or even in terms of individual performance. As such, development of the urban cooperative banking institutions into safe and vibrant entities requires the small banks in the group to be insulated from systemic shocks by emphasizing their cooperative character. Further, the weak banks may have to be strengthened as a group, through a process of consolidation that may entail mergers/amalgamations of viable entities and exit of the unviable ones, if there are no other options available. It is also felt that it is necessary to set up a
supervisory system that is based on an in-depth analysis of the heterogeneous character of the urban cooperative banks and one that is in tandem with the policy of strengthening the sector.

4. **Structures and Spread of UCBs**

In terms of geographical spread, UCBs are unevenly distributed across the states. Five states viz., Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu account for 1523 out of 1924 banks that presently comprise the sector. Further, the UCBs in these states account for approximately 82% of the deposits and advances of the sector as may be seen from the table below:

**Table 3.1 Deposits & Advances**

<table>
<thead>
<tr>
<th>Name of the State</th>
<th>No of banks in operation</th>
<th>% to total no. of banks</th>
<th>Deposits (Rupees in lakhs)</th>
<th>% of deposits to total deposits</th>
<th>Advances (Rupees in lakhs)</th>
<th>% of advances to total advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maharashtra</td>
<td>639</td>
<td>26.68</td>
<td>60,72,498</td>
<td>55.08</td>
<td>37,42,401.2</td>
<td>55.09</td>
</tr>
<tr>
<td>Gujarat</td>
<td>321</td>
<td>15.24</td>
<td>16,27,946</td>
<td>14.77</td>
<td>9,71,287.03</td>
<td>14.28</td>
</tr>
<tr>
<td>Karnataka</td>
<td>300</td>
<td>14.25</td>
<td>8,35,274</td>
<td>7.58</td>
<td>5,37,186.7</td>
<td>7.91</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>132</td>
<td>6.27</td>
<td>3,10,521</td>
<td>2.82</td>
<td>2,12,113.28</td>
<td>3.12</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>131</td>
<td>6.22</td>
<td>2,11,324</td>
<td>1.92</td>
<td>1,37,888.23</td>
<td>2.03</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,523</strong></td>
<td><strong>2,106</strong></td>
<td><strong>90,57,563</strong></td>
<td><strong>82.15</strong></td>
<td><strong>55,99,876.5</strong></td>
<td><strong>82.44</strong></td>
</tr>
</tbody>
</table>

For all UCBs in the country, the total Deposits are Rs. 1,10,25,642 lakhs and total Advances are Rs. 67,93,017 lakhs.
5. **Regulatory Environment**

The urban co-operative banks are regulated and supervised by State Registrars of Co-operative Societies, Central Registrar of Co-operative Societies in case of Multi-state co-operative banks and by Reserve Bank. The Registrars of Co-operative Societies of the States exercise powers under the respective Co-operative Societies Act of the States in regard to incorporation, registration, management, amalgamation, reconstruction or liquidation. In case of the urban co-operative banks having multi-state presence, the Central Registrar of Co-operative Societies, New Delhi, exercises such powers. The banking related functions, such as issue of license to start new banks / branches, matters relating to interest rates, loan policies, investments, prudential exposure norms etc. are regulated and supervised by the Reserve Bank of India under the provisions of the Banking Regulation Act, 1949(AACS). Various Committees in the past, which went into working of the UCBs, have found that the multiplicity of command centers and the absence of clear-cut demarcation between the functions of State Governments and the Reserve Bank have been the most vexatious problems of urban cooperative banking movement. This duality of command is largely responsible for most of the difficulties in implementing regulatory measures with the required speed and urgency and impedes effective supervision.
6. **Strategy**

6.1 **State Specific Approach**

The strategy to deal with the UCBs may need to be state specific, one that involves the concerned State Government, RBI and the UCBs operating in the state. A State level Task Force on Co-operative Urban Banks (TAFCUB) comprising the Regional Director (RD) of the RBI for the concerned state, Registrar of Cooperative Societies, an official from Central Office of Urban Banks Department (UBD), in-charge of UBD of the concerned Regional Office of RBI and a representative each from NAFCUB and the State Federation of the UCBs, could be set up, in each of the 5 states with high concentration of UCBs and in a few other states having, say, more than 50 banks to explore viable state specific solutions, including, on the future set up of the existing unlicensed banks whose license applications are pending with the RBI. Similar approaches may be considered for other states in a second phase after assessing the working of the state specific approach in the five states and in states with more than 50 UCBs. However, if any state prefers to adopt the approach in the first phase itself, RBI could consider the proposal appropriately.

The Regional Director (RD) of the RBI and RCS of the concerned state could be the Chairman and co-chairman of TAFCUB, respectively. Each TAFCUB could identify the weak but viable (non-scheduled) UCBs in the respective states and frame a time bound programme for revival of such entities. It would identify the nature and extent of funds required to be infused, the changes in management where necessary and suggest periodical milestones to be achieved. The RBI would closely monitor the progress made by the bank vis-à-vis the revival plan and initiate
appropriate action, in case of non-achievement of the targets, as per the plan. Further, UCBs which are not found viable by the TAFCUB, could be required to exit from banking business either through merger with strong banks, if such merger makes economic sense to the acquiring bank, or through voluntary conversion into a cooperative society by paying off the non-member deposits and withdrawing from the payment system and if there is not other viable option they could even be taken into liquidation by the Registrar at the behest of the RBI. The proposed terms of reference of TAFCUB is given in Appendix.

The guidelines on merger and amalgamations (M&A) of UCBs have been issued vide our circular UBD.No.(PCB)Cir.36/09.169.00/2004-05 dated February 2, 2005. These guidelines provide that Reserve Bank of India may consider proposals for merger and amalgamation in the following circumstances:

(i) When the networth of the acquired bank is positive and the acquirer bank assures to protect entire deposits of all the depositors of the acquired bank.

(ii) When the networth of acquired bank is negative and the acquirer bank on its own assures to protect deposits of all the depositors of the acquired bank.

(iii) When the networth of the acquired bank is negative and the acquirer bank assures to protect the deposits of all the depositors of the acquired bank with financial support from the State Government extended upfront as part of the process of merger.
In all cases of merger/amalgamation the financial parameters of the acquirer bank, post merger, should conform to the prescribed minimum prudential and regulatory requirement for urban co-operative banks and the realizable value of assets has to be assessed through a process of due diligence. TAFCUB shall make suitable recommendations on M&A based on the above guidelines.

6.2 Memorandum of Understanding with State Governments
As per provisions of the State Cooperative Societies Act as also the BR Act 1949 (AACS), the Reserve Bank is not empowered to take action against the management of an urban cooperative bank, in case of need, as in respect of commercial banks. It may be useful to have a working arrangement in the form of Memorandum of Understanding (MOU) between the RBI and the State Government/CRCS to ensure that the difficulties caused by dual control are suitably addressed through such MOU/s. The State Governments may, through the MOU, agree to take immediate action on requisitions of RBI for supersession of the Board of Directors, appointment of liquidators, initiating action for removal of CEO/Chairman of a bank, enhancing quality of HR and IT resources in the banks on the lines required by RBI, work to raise the standards of corporate Governance by putting in place certain minimum fit and proper criteria for members to be eligible for seeking election for the post of director, institute special audit by Chartered Accountants, the cost of which may be borne by the RBI, and furnish reports of the findings within a given time frame, introduce long form audit reports for conducting statutory audit, modify its audit rating models to bring it on par with the gradation system of RBI, conduct statutory audit only through external Chartered Accountants in respect of banks with deposits.
over a specified minimum level etc. The draft MOU is given in Annexure –I. The TAFCUBs would be set up in states that sign the MOUs with the RBI. In respect of the states that sign the MOU but do not fulfill the commitments therein, the TAFCUB would cease to function and RBI would be at liberty to initiate appropriate corrective action.

7. **Proposed Operating Framework**

The entities in the sector display a high degree of heterogeneity in terms of their deposit/asset base, area of operations and nature of business. A system of differentiated regulatory and supervisory regime as opposed to a ‘one size fits all” approach may be more appropriate, keeping in view the vastly differentiated entities comprising the sector. The broad principles governing RBI regulation over UCBs could largely follow the principles as under:

A. **Unit Banks (Simplified regulatory regime)**

Unit banks, in particular, the smaller among them, essentially capture the basic concept and spirit of cooperative banking since they function from a single office/branch and cater to the clientele in and around their place of business. As such, they have a natural ability to relate to the customer, have the local feel and flavour and consequently modulate their business strategy to meet the local aspirations. Since small unit banks with deposits below, say, Rs.50 crore epitomise the basic tenets of cooperative banking, less stringent regulations could be considered for such banks. For example, CRAR could be replaced by the simpler form of minimum capital requirement viz. Net Owned Funds to NDTL ratio which is easier to compute for the small banks while serving the purpose adequately. At the same time, keeping in view their ability to assess and absorb risks,
appropriate limitations like a lower level of single and group exposure limit could be prescribed for these banks to contain their concentration risk. Similarly, the exposure by such banks to sensitive sector should be checked, as these banks lack the wherewithal, in terms of expertise, technology and financial strength to sustain exposure to capital market / real estate etc. As such, keeping in view the nature and size of their operations, appropriate relaxations like a lower prescribed minimum investment in G-Sec (in view of their inability to access market) and restrictions necessary to insulate them from systemic shocks may be introduced for such banks. Ideally the unit banks should work within a small geographical area and accordingly the Unit banks to be eligible for the simplified regulatory regime shall conform to this requirement by rolling back their business in far off locations. The suggested simplified regulatory prescriptions are given in Annexure - II.

B. **All Banks (other than unit banks with deposits less than Rs. 50 crore)**

Regulatory prescriptions, as applicable to commercial banks should be applicable in all respects to banks falling in this category. However, for these banks the extant relaxations for UCBs could remain in force for the period already prescribed. Further, it is suggested that as a matter of principle, there should not be any unscheduled Multi State Bank. This could be operationalised through the Central Registrar of Cooperative Societies, which could ensure that a bank is scheduled before it is granted registration under the Multi State Co-operative Societies Act. In order to ensure that all scheduled banks are also, as far as possible, strong enough
to support themselves and a few smaller UCBs around them, the RBI could prescribe appropriate norms for scheduling of cooperative banks. Further, banks in this category which comply with the prescribed regulatory requirements can be extended facilities and privileges as are presently available to the commercial banks of comparable size.

The existing scheduled banks, both under Multi State and State Cooperative Societies Act, which do not meet the prescribed criteria and do not comply with the prudential and regulatory regimen akin to that of commercial banks, could be excluded from the second schedule to the RBI Act through a time bound corrective action framework. As a corollary, the existing non-scheduled Multi State Banks could also be required to close their branches/withdraw from any business outside the principal State of their activity.

8. **Supervision**

The number of unit banks with deposits under Rs. 50 crore constitute 33 percent of UCBs and account for less than 6 percent of deposits of the sector. These banks, limited by their size / type of operations, pose lower systemic risks and could be supervised by a combination of simplified off-site surveillance system of the RBI and on-site audit by the state governments. Based on these reports, Reserve Bank of India, at its discretion, could conduct inspection of such banks, which, however would not be normally covered under its regular schedule of inspection. The increased dependence on off-site surveillance of RBI and on-site supervision by RCS in respect of the small unit banks would provide
increased flexibility to the RBI to deploy its supervisory resources to the larger and more risky banks.

9. Developmental Role of RBI

The Reserve Bank may have to provide assistance to the UCBs, more particularly the smaller ones, in improving their skill levels. Since the College of Agricultural Banking is already providing training facilities to the UCBs, this institution could be used as the forum for doing so. Keeping in view the financial implications for banks, for providing quality training, the cost of training programmes could be largely subsidised by the Reserve Bank for the Unit banks falling under Tier I.

The Reserve Bank has been encouraging the UCBs to invest in government securities by stipulating that a portion of the SLR investments are held in the form of these securities. There is an inherent advantage in holding a part of the SLR investments in G-Secs as otherwise the banks are required to keep their entire SLR in higher tier co-operative banks, the financial position of which may itself be uncertain. At the same time it would be necessary to ensure that the UCBs are not put to any difficulty in buying and selling the securities. To address this issue Reserve Bank may, through its Regional Directors, liaise with the network of Primary Dealers to put in place an appropriate arrangement in this regard.

Every authority concerned with Co-operative sector will have to play its part in ensuring that the aspirations of the Urban Co-operative Banking sector are nurtured in a manner that depositor interest and the public
interest at large is protected. The role of RBI could, thus, be to frame a regulatory and supervisory regime that is multi-layered to capture the heterogeneity of the sector and implement policies that would provide adequate elbowroom for the sector to grow in a non-disruptive manner. The State and Central Governments could recognize that the UCBs are not just co-operative societies but they are essentially banking entities whose management structure is that of a co-operative. They should recognize the systemic impact that inefficient functioning of the entities in the sector could have. Consequently, it would be in the interest of the sector if they support, facilitate and empower the RBI to put in place mechanisms and systems that would enable these UCBs to perform their banking functions in a manner that is in the overall interest of the depositor and the public at large.

3.2 Tiered Regulatory Regime

UCBs may be classified into the following two tiers of regulatory regime:

a) Tier I:

   Unit Banks with deposits upto Rs. 50 crore

b) Tier II

   All other Banks

To determine the deposit base, the fortnightly average of the NDTL reported in the statutory returns in the preceding accounting year may be reckoned so that a stable and reliable basis is adopted.
The prudential norms recommended for banks falling under different Tiers are as under:

(I) Tier I Banks i.e. Unit Banks with deposits less than Rs.50 crore

(i) Asset classification norms:

To identify NPAs on the basis of 180 day delinquency norm for three more years commencing March 31 2005 but build up adequate provisions in the BDDR over the next three years such that they would be able to transit to 90 day NPA norm by March 31 2008. Since the 90 day norm for asset classification came into force effective March 31 2004, revised asset classification norm should not result in any write back of provisions and the new norm would be applicable for identification of NPAs in 2005 and onwards.

   Note: Extant instructions would apply for agricultural loans.

(ii) Provisioning norms:

The provisioning norms will be as under for another three years:

   Sub standard : 10%
   Doubtful (up to one year) : 100% of unsecured portion plus 20% of secured portion
   Doubtful (one to three years) : 100% of unsecured portion plus 30% of secured portion
   Doubtful for more than 3 years: 100% of unsecured portion plus 50% of secured portion
   Loss : 100%.
Note: i) A Sub standard account will be classified as doubtful after 18 months.

ii) All the above provisioning norms will apply for another 3 years. Consequently implementation of the instructions requiring classification of substandard account into doubtful category after 12 months instead of 18 months and 100 % provisioning for doubtful assets of over 3 years would be deferred by another three years. As such the banks should build up adequate provisions over this period to facilitate smooth transition.

(iii) Norms for Investment:

(iii.i) SLR: The minimum SLR holding in Government and other approved securities as a percentage of NDTL for non scheduled UCBs is presently 15 % for banks with NDTL of over Rs. 25 crores and 10% for the remaining non scheduled UCBs. It is observed that the smaller banks, particularly those operating in rural, semi-urban centers, find it difficult to make investments in G-Sec due to lack of access to the markets. In order to meet SLR requirements, these banks often have to purchase G-Sec at a price that is higher than prevailing market rates, as they do not have the wherewithal to obtain information on current market price of these securities, like access to PDO-NDS platform etc.

While efforts will be made to enable access to securities’ market through Primary Dealers, in the interregnum,
these banks could be exempted from compulsory investment in G-Sec to the extent of the deposits kept by them in SBI, Associates and Nationalised banks.

(iii.ii) Non-SLR:  Present limit of 10% of total investments would continue.

(iv) Borrowings:  Not to exceed 2% of deposits

(v) Capital Adequacy:

At present all UCBs are required to comply with 9% CRAR akin to commercial banks. For easier understanding and simplification, it is suggested that CRAR in respect of Tier I banks may be replaced with a Net Owned funds to NDTL ratio. It is proposed that a NDTL to NOF ratio of 15 could be prescribed.

(vi) Exposure Norms:

10% of capital funds or Rs.40 lakhs, which ever is lower for individual borrower and 20% or Rs.80 lakhs, which ever is lower, for group, would be applicable in order to contain concentration risk for the Tier I banks.

Off-Balance sheet exposure not to exceed 2 percent of NDTL.
(vii) Sensitive Sector Exposure:

Tier I banks should not be allowed to take any direct exposure to real estate, builders or to the capital market. However, loan for individual housing may still be extended by these banks upto the present limit of Rs.15 lakh per individual borrower.

(viii) Audit:

Concurrent audit should be compulsory for all banks. Statutory audit should be done using Long Form Audit Report. Statutory audit of banks with deposit base of over Rs 25 crore should be entrusted to chartered accountants.

TIER - II (All other banks):

For all banks, other than unit banks with deposits upto Rs.50 crore, all regulations as applicable to commercial banks should be applied. However, for these banks the extant relaxations for UCBs could remain in force for the period already prescribed. Further, facilities and opportunities available to commercial banks should, as far as possible, be also made available to such banks to enable them to grow and compete with commercial banks. Banks that do not comply with the regulations should either reduce their operations to qualify for the relaxed regulations applicable for unit banks with deposits less than Rs.50 crore or may be required to convert into cooperative societies.
FINANCIAL REGULATION AND SUPERVISION

The blurring of the distinction between financial intermediaries under the combined effect of domestic and cross-border integration, innovations in instruments and processes, advances in technology and the massive volumes of capital intermediated by the financial system has necessitated a pro-active strengthening of the regulatory and supervisory framework. Recent international experience has highlighted the critical role played by the regulatory and supervisory system in ensuring the stability of the financial system. This has made the upgradation and refinement of the regulatory and supervisory function of the Reserve Bank a concurrent priority. The approach of the Reserve Bank in this context has been to pursue a progressive upgrading of prudential norms and benchmarking of these norms against international best practices, although there has been a strong emphasis on adapting these standards to the country-specific situation.

This Section presents an overview of the regulatory and supervisory policy initiatives undertaken in 2003-04 to intensify and broaden the ongoing process of financial sector reforms. It reviews the measures initiated during the year to strengthen the financial sector with a view to calibrating the approach to a new supervisory regime compatible with the Basel II process. An overview of various measures initiated to enhance the co-ordination with other regulatory agencies, to strengthen the transparency and corporate governance practices and to improve customer service is also presented. The performance of various intermediaries - commercial banks, co-operative banks, financial
institutions and non-bank financial companies - is evaluated in terms of key financial and prudential indicators.

REGULATORY FRAMEWORK FOR THE INDIAN FINANCIAL SYSTEM

The Reserve Bank regulates commercial and urban co-operative banks, development finance institutions (DFIs) and non-banking financial companies (NBFCs). There are 293 commercial banks (289 scheduled and 4 non-scheduled), 1,926 urban co-operative banks (UCBs), 9 DFIs and 13,671 NBFCs (of which 584 NBFCs are permitted to accept/hold public deposits). In addition, the Reserve Bank is also the regulator in respect of State and district central co-operative banks [(the supervision is vested with the National Bank for Agriculture and Rural Development (NABARD)]. Life insurance companies and mutual funds are regulated by the Insurance Regulatory and Development Authority (IRDA) and the Securities and Exchange Board of India (SEBI), respectively.

The main objective of regulation and supervision has been to maintain confidence in the financial system by enhancing its soundness and efficiency. For this purpose, the Reserve Bank evaluates system-wide risks and promotes sound business and financial practices. It also conducts analyses of institution-wise risks to detect deficiencies in their operations, if any, in a timely manner and ensures that institution-specific problems do not spread to the system as a whole. The Board for Financial Supervision (BFS), constituted as a Committee of the Central Board of the Reserve Bank in November 1994 and headed by the Governor with a Deputy Governor as Vice Chairperson and other Deputy Governors and
four Directors of the Central Board as members, held 12 meetings during the period July 2003 to June 2004. During this period, it examined 105 inspection reports. While State and district co-operative banks are supervised by the NABARD, certain problem cases are reviewed by the BFS. The Reserve Bank closely monitors these banks to enforce regulatory provisions and takes corrective action in respect of problem banks.

REGULATORY AND SUPERVISORY INITIATIVES

As the financial sector matures and becomes more complex, the process of deregulation must continue, but in such a manner that all types of financial institutions are strengthened and financial stability of the overall system is safeguarded. As deregulation gathers momentum, the emphasis of regulatory practice has to shift towards effective monitoring and implementation of regulations. To ensure this shift in regulatory practice, corporate governance within financial institutions must be strengthened and internal systems must be developed. Furthermore, as financial institutions expand and grow more complex, it is also necessary to ensure that the quality of service to customers is focused upon and improved.

Various issues which received regulatory attention during the year included ownership and governance in banks, further progress towards international best practices in prudential norms with country-specific adaptation, greater deregulation and rationalisation of banking policies, compliance with Know Your Customer (KYC) norms, strengthening the financial system for global integration in the light of the ongoing liberalisation of the capital account, greater inter-regulatory co-ordination
and the drive for improving the quality of public services rendered by banks. In the evolution and implementation of policy, a consultative approach continues to be followed through formal institutional structures such as the BFS, the newly-formed Standing Committee on Financial Regulation, the Technical Committee on Money and Government Securities Markets and also through specific working groups and committees as well as formal and informal consultations with the regulated entities, external experts and professionals.

Scheduled Commercial Banks

Ownership and Governance of Banks

Corporate governance has assumed crucial significance for ensuring the stability and soundness of the financial system in recent years. The ongoing debate is focused on shareholders’ rights and shareholder influence on corporate behaviour in respect of banks. Furthermore, in order to protect the interests of depositors and integrity of the financial system, it is necessary that owners and managers of banks are persons of sound integrity. Keeping these considerations in view, the Reserve Bank initiated several measures to enhance transparency and strengthen corporate governance practices in the financial sector in India.

The Reserve Bank provided guidelines for acknowledgment for transfer of shares of private sector banks in February 2004. The guidelines set out the factors that would be taken into account by the Reserve Bank for permitting acquisition of 5 per cent or more of the paid-up capital of banks. Due diligence would be intensified at higher threshold levels, keeping in view the desirability of diversified ownership and public interest. It was also decided that an independent advisory committee will
make appropriate recommendations to the Reserve Bank for dealing with such applications.

In pursuance of the discussions held at the BFS for ensuring that suitable persons are appointed as directors in private sector banks, the Reserve Bank advised banks in June 2004 that they should undertake due diligence to ensure that persons appointed as directors satisfy ‘fit and proper’ criteria upfront. Also, such persons should be required to sign a deed of covenant undertaking to follow good governance principles.

The BFS formulated a draft comprehensive policy framework with regard to ownership of and governance in private sector banks and placed it in the public domain on July 2, 2004 for wider consultation and feedback before it is finalised. The draft policy framework envisages diversified ownership and restrictions on cross holding by banks.

In terms of the existing legal framework, mergers between banking companies and non-banking companies do not require specific approval by the Reserve Bank. As such mergers could involve significant changes in ownership and control of banks with implications for depositor interest, the Reserve Bank advised banks in June 2004 that banks should obtain prior approval of the Reserve Bank for any merger with a non-banking financial company.

In order to minimise cross holding of equity and other instruments eligible for capital status within the financial system, banks/DFIs were advised in July 2004 to restrict their investments in these instruments issued by other entities in the financial system to 10 per cent of the investing bank’s capital funds. Furthermore, the equity holding in any other bank / DFI is required to be restricted to 5 per cent of the capital of
the investee bank. Banks/DFIs are required to indicate to the Reserve Bank the time frame for reducing the equity holding where such holding exceeds 5 per cent.

**Strengthening Prudential Norms**

Banks were advised to ensure that the building up of the Investment Fluctuation Reserve (IFR) to 5 per cent of their investments in ‘Held for Trading’ (HFT) and ‘Available for Sale’ (AFS) categories is achieved earlier, though they have time up to March 2006. In order to ensure that the internationally accepted norms for capital charge for market risk under Basel I are adopted, banks were also advised in June 2004 to maintain an explicit capital charge for market risks on the lines of the standardised duration method prescribed under the 1996 Amendment to the Capital Accord issued by the Basel Committee on Banking Supervision (BCBS). This would apply to the trading portfolio by March 2005 and to the AFS category by March 2006.

**Ownership and Governance in Private Sector Banks - Draft Guidelines**

The objective of the draft guidelines issued by the Reserve Bank in July 2004 is to have a regulatory road map for ownership and governance in private sector banks in the interests of the depositors and financial stability. The underlying thread of the draft guidelines is to ensure that the ultimate ownership and control of banks is well diversified, banks are owned and managed by 'fit and proper' persons/entities and well capitalised and that the processes are transparent and fair. Several countries, both developed and developing, have regulatory stipulations and clearance for significant shareholding and control. The threshold
level may vary from country to country and can also involve more stringent conditions for higher thresholds.

The draft guidelines allow for a level of shareholding of a single entity or a group of related entities beyond 10 per cent with the prior approval of the Reserve Bank. Such approval will be governed by the principles enunciated in the February 2004 guidelines. Apart from more intensive due diligence at higher levels of shareholding, the February 2004 guidelines require public interest objectives to be served for shareholding beyond 30 per cent. Where the ownership of a bank is by a corporate entity, diversified ownership of that corporate entity will be considered among other factors. The draft guidelines do not cover foreign bank investment in Indian banks, which will be released separately, consistent with the policy in the Government press note of March 2004 to allow only one form of operational presence for foreign banks in India.

In order to minimise vulnerability due to small size, the guidelines provide for increasing the net owned funds to Rs.300 crore for all private sector banks within a reasonable period. Cross holding beyond 5 per cent is sought to be discouraged and where such holding exceeds five per cent, the objective is to reduce it to 5 per cent. Promoters with existing shareholding beyond 10 per cent will be required to indicate the timetable for reduction - the requests would be considered on the basis of the underlying principles of 'fit and proper' governance and public interest. As a matter of desirable practice, not more than one member of a family or close relative or associate should be on the board. Based on the feedback received, a second draft of the guidelines would be prepared and put in the public domain.
Banks were advised to examine the soundness of their risk management systems and draw up a road map by end-December 2004 for migration to Basel II. They were also advised to review the progress made there under at quarterly intervals. The Reserve Bank is closely monitoring the progress made by banks in this direction.

In terms of the earlier guidelines, all eligible direct agricultural advances would become NPA when interest and/or instalment of principal remains unpaid, after it has become due for two harvest seasons, not exceeding two half years. In the case of long duration crops, the prescription of “not exceeding two half-years” was considered to be inadequate. In order to align the repayment dates with crop seasons, with effect from September 30, 2004 a loan granted for a short duration crop (i.e., with a crop season less than one year) would be treated as a non-performing asset (NPA), if the instalment of principal or interest thereon remains overdue for two crop seasons. A loan granted for a long duration crop (i.e., with a crop season beyond one year) would be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

Banks were advised to increase the provisioning on the secured portion of doubtful assets which have remained in that category for over three years from 50 to 100 per cent. In the case of existing assets in this category, a time period of three years is allowed. It is expected that this will facilitate speedy resolution of doubtful assets including through transfer to asset reconstruction companies (ARCs).

The Reserve Bank’s guidelines on country risk management issued in February 2003 require banks to maintain provisions on a graded scale relating to the level of risk in respect of countries to which they have net
funded exposure of two per cent or more of total assets. With effect from the year ending March 31, 2005 the coverage would be enlarged to include countries to which a bank has net funded exposure of one per cent or more of its total assets.

As banks have been putting in place risk management systems and considering the requirement of banks to cater to the evolving requirements of their clientele, the Reserve Bank permitted banks to consider enhancement of the exposure up to a further 5 per cent of capital funds to 20 per cent of capital funds for a single borrower and 45 per cent of capital funds for group borrowers. The additional limits to be sanctioned are subject to approval by banks’ boards and the borrower consenting to the banks making appropriate disclosures in their annual reports.

The reporting mechanism for cases of wilful default by banks/DFIs was strengthened in July 2003. Decisions to classify borrowers as wilful defaulters were entrusted to a committee of senior functionaries headed by an Executive Director. The decision to declare a borrower as a wilful defaulter should be supported by sufficient evidence vis-à-vis the Reserve Bank’s guidelines. Banks/DFIs should create a grievance redressal mechanism, headed by the Chairman and Managing Director, for allowing representation by borrowers who have been wrongly classified as wilful defaulters.

**Resolution of NPAs**

During the year, the Reserve Bank strengthened the existing mechanisms for NPA management and initiated some new measures to strengthen the efforts of banks to recover their dues.
A recent addition to the menu of options available to banks for resolving NPAs is the establishment of ARCs. In terms of the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 the Reserve Bank prescribed guidelines for the formation and functioning of securitisation companies (SC) and reconstruction companies (RC). Guidelines were also provided to banks/DFIs to facilitate sale of NPAs to SCs/RCs. One ARC, viz., Asset Reconstruction Company of India Ltd. (ARCIL) was set up during 2003-04. Banks and financial institutions sold assets aggregating Rs.7,099 crore to ARCIL.

Corporate debt restructuring offers an avenue for reorganising the indebtedness of viable entities without reference to the Board for Industrial and Financial Reconstruction (BIFR), debt recovery tribunals (DRTs) and other legal proceedings. The process of corporate debt restructuring gained momentum during 2003-04 after revised guidelines were provided by the Reserve Bank in June 2004 (Table 10.1). The major beneficiaries were iron and steel, refinery, fertilisers and telecommunication sectors which accounted for more than two-thirds of the total value of assets restructured.

In pursuance of the recommendations of the Working Group to review the existing provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (Chairman: Shri S. N. Aggarwal), the Central Government amended substantially the
Table 3.2 Progress under Corporate Debt Restructuring Scheme
(Amount in Rupees crore)

<table>
<thead>
<tr>
<th>Item</th>
<th>No. of cases</th>
<th>Amount involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cases referred to CDR forum</td>
<td>135</td>
<td>72,139</td>
</tr>
<tr>
<td>Final schemes approved</td>
<td>94</td>
<td>64,017</td>
</tr>
<tr>
<td>Rejected</td>
<td>30</td>
<td>5,445</td>
</tr>
<tr>
<td>Pending</td>
<td>11</td>
<td>2,677</td>
</tr>
</tbody>
</table>

Debt Recovery Tribunal (Procedure) Rules in 2003, especially Rules 7 and 10 relating to application fee and plural remedies, respectively. A Working Group was also set up for reviewing and streamlining the functioning of DRTs. Out of 61,301 cases (involving Rs. 88,876 crore) filed with DRTs by banks as on December 31, 2003, 25,510 cases (involving Rs.23,273 crore) were adjudicated with recovery amounting to Rs.6,874 crore.

A scheme for settlement of chronic NPAs up to Rs.10 crore in public sector banks was introduced in January 2003 to give one more opportunity to borrowers for settlement of their outstanding dues. As on March 31, 2004, 2,12,370 cases amounting to Rs.1,977 crore were decided by banks and recovery was effected in 1,80,117 cases aggregating Rs.1,095 crore.

The SARFAESI Act, 2002, *inter alia*, provides for enforcement of security interest for realisation of dues without the intervention of courts or tribunals. In April 2004, the Supreme Court upheld the right of banks and financial institutions to attach and sell assets of the defaulting companies and the borrower’s right to appeal. It struck down the
provisions contained in Section 17 (2) of the SARFAESI Act requiring the defaulting borrower to pre-deposit 75 per cent of the liability in case the borrower wants to appeal against the order of the attachment of the assets. The Union Budget, 2004-05 has proposed to amend the relevant provisions of the Act to appropriately address the Supreme Court’s concerns regarding a fair deal to borrowers while ensuring that the recovery process is not delayed or hampered. Up to December 31, 2003 27 public sector banks issued 49,169 notices involving an amount of Rs.16,318 crore. An amount of Rs.1,037 crore from 16,490 cases was recovered.

**Inter-Regulatory Co-ordination and Co-operation**

The Reserve Bank announced in November 2003 that it would set up a monitoring system in respect of systemically important financial intermediaries (SIFIs), including (i) a reporting system for SIFIs on financial matters of common interest to the Reserve Bank, the SEBI and the IRDA; (ii) the reporting of intragroup transactions of SIFIs; and (iii) the exchange of relevant information among the Reserve Bank, the SEBI and the IRDA. A Working Group (Chairperson : Smt. Shyamala Gopinath) was set up by the Reserve Bank in December 2003 with representation from the SEBI and the IRDA to recommend a framework for monitoring financial conglomerates. The Working Group, which submitted its report in June 2004, recommended the introduction of a framework for the complementary supervision of financial conglomerates.

The High Level Co-ordination Committee on Financial and Capital Markets (HLCCFCM), set up in 1992 with the Governor of the Reserve Bank as its Chairman and Finance Secretary, Government of India and the
Chairman, SEBI as its members (subsequently, the Chairman, IRDA was also made a member), constituted three Standing Technical Committees in order to provide a more focused inter-agency forum for sharing of information and intelligence. These Committees meet at regular intervals. Reports detailing the outcome of the meetings are presented before the HLCCFCM for its information and any further directions.

The responsibilities of the Technical Committee on RBI Regulated Entities include reviewing exposure of the Reserve Bank regulated entities to the capital market on an ongoing basis in the light of market developments. In case a policy issue of wider interest requires inter-agency co-ordination, it also decides whether the case should be referred to the RBI-SEBI Technical Committee of the HLCCFCM.

**Opening up of the Financial Sector**

In terms of the agreement arrived at under the *aegis* of the World Trade Organization (WTO), India is committed to permitting the opening of 12 new branches by foreign banks per year in the country. Thirty two foreign banks now operate 217 branches in India. During 2003-04, permission was granted to 5 foreign banks to open 18 branches. Three foreign banks, *viz.*, Toronto Dominion Bank, Overseas Chinese Banking Corporation Ltd. and Bank Muscat (SAOG) shut down their branches in India. There was a worldwide merger of Credit Lyonnais and Credit Agricole Indosuez into CALYON Bank, which resulted in the merger of their operations in India as well. In addition to opening of branches, foreign banks can open representative offices which cannot do any banking business. During the year, Everest Bank Ltd., Nepal was permitted to open a representative office in New Delhi and with West LB AG, Germany closing down its
representative office, the number of operating representative offices stands at 26.

Indian banks continued to expand their presence overseas. During the year, ICICI Bank opened representative offices in Dubai (UAE) and Shanghai (China), while IndusInd Bank set up offices in Dubai (UAE) and London (UK) and Punjab National Bank opened an office in London (UK). The number of Indian banks with overseas operations increased by one to 10, although the number of branches remained at 93. The number of representative offices increased by four to 22. The total number of subsidiaries set up by Indian banks stood at 16.

During 2003-04, ten banks were given ‘in principle’ approval to open 14 overseas banking units (OBUs) in Special Economic Zones (SEZs). Of these, six banks, viz., State Bank of India, Bank of Baroda, Union Bank of India, ICICI Bank and Punjab National Bank have begun operations in the Santa Cruz Electronics Export Processing Zone, Mumbai and Canara Bank in NOIDA, Uttar Pradesh.

**Working Group on Monitoring of Financial Conglomerates**

The major recommendations of the Working Group on Financial Conglomerates comprise:

- Identifying financial conglomerates for focused regulatory oversight; capturing intra-group transactions and exposures amongst ‘group entities’ within the identified financial conglomerates and large exposures of the group to outside counter parties; identifying a designated entity within each group to furnish group data to the
principal regulator for the group; and formalising a mechanism for inter-regulatory exchange of information.

- Segments under the jurisdiction of the Reserve Bank, the SEBI, the IRDA, and the NHB should be subjected to complementary regulation. The framework could later be extended to the segment covered by the Pension Fund Regulatory and Development Authority.

- The new reporting framework should track: (i) any unusual movement in respect of intra-group transactions manifested in major markets; (ii) build-up of any disproportionate exposure (both fund based and non-fund based) of any entity to other group entities; (iii) any group-level concentration of exposure to various financial market segments and outside counter parties; and (iv) direct/indirect cross-linkages amongst group entities.

- Individual intra-group transactions beyond threshold levels (Rs.1 crore for fund based transactions and Rs.10 crore for others) should be included in the reporting format, supplemented by exposure ceilings in respect of intragroup exposures.

**Towards More Deregulation**

As a part of the move towards greater deregulation, banks fulfilling certain minimum criteria regarding CRAR and net NPAs have been given the discretion to pay dividend without the prior approval of the Reserve Bank, provided the dividend payout ratio does not exceed 33.3 per cent. Banks which do not meet the minimum criteria or which seek a higher payout ratio are required to obtain the prior approval of the Reserve Bank. Foreign banks operating in India were advised that they
may remit net profits/surplus (net of tax) arising out of their Indian operations on a quarterly basis, without the prior approval of the Reserve Bank. This is conditional on (i) audit of the accounts on a quarterly basis, (ii) appropriate transfers to statutory reserves as per Section 11(2)(b)(ii) and other relevant provisions of the Banking Regulation (BR) Act, 1949, and (iii) compliance with the directions issued by the Reserve Bank.

Banks were not allowed to assume unsecured exposures by way of guarantees and advances beyond a prescribed ceiling in terms of the Reserve Bank’s guidelines prescribed in 1967. In view of the ongoing shift towards financing borrowers based on estimated cash flows rather than on collateral and in recognition of the availability of financial assistance through credit substitutes, viz., commercial paper, bonds and debentures, the restriction on unsecured exposures was withdrawn. Banks’ boards are allowed to formulate their own policies on unsecured exposures. The unsecured exposures would, however, attract a higher provisioning of 20 per cent when they become sub-standard.

Effective September 22, 2003 banks are not required to obtain prior approval of the Reserve Bank for engaging in insurance agency business or referral arrangement without any risk participation, subject to their complying with the prescribed conditions. Banks intending to set up insurance joint ventures with equity contribution on a risk participation basis or making investments in insurance companies for providing infrastructure and services support would still require prior approval of the Reserve Bank.
Towards Greater Transparency

In recent years, banks have turned out to be the major investors in bonds issued on a private placement basis. In view of the fact that issuance of such bonds lacked transparency, banks were advised in November 2003 to restrict their fresh investments in unlisted securities to 10 per cent of their overall non-SLR portfolio. A time period was also prescribed for getting the existing outstanding bonds listed. Simultaneously, the SEBI also prescribed guidelines requiring all debt issuances, including private placements, to be rated and listed within a specified time period.

With a view to aligning standards adopted by the Indian banking system with global standards, the Reserve Bank issued detailed guidelines relating to several Accounting Standards (AS) in March 2003. In April 2004, guidelines for compliance with three more standards, viz., AS 24 (discontinuing operations), AS 26 (intangible assets) and AS 28 (impairment of assets) were issued. Banks are required to ensure that there are no qualifications by the auditors in their financial statements for non-compliance with any of the accounting standards.

The Credit Information Bureau (India) Ltd. (CIBIL) took over from the Reserve Bank the responsibility of disseminating the information on suit-filed accounts at banks/FIs in India in respect of defaulters and wilful defaulters with effect from March 31, 2003. The Reserve Bank issued instructions to banks/DFIs to obtain the consent of all their borrowers - not only defaulters - for dissemination of credit information to enable CIBIL to compile and disseminate comprehensive credit information.
Preserving the Integrity of the Banking System

Preventing misuse of the financial system and preserving its integrity is vital for orderly development of the financial system. Prevention of frauds and implementation of Anti Money Laundering (AML) measures are two important aspects of the efforts being made by the Reserve Bank to prevent misuse of the financial system by criminals whose transactions threaten the stability of financial transactions worldwide.

In 2002, banks were advised to follow certain KYC norms while opening accounts, with specific focus on verification and identity. These norms were also required to be applied to the existing accounts in a given time frame. With a view to adopting a risk-based approach and to mitigate the inconvenience to the common man, banks were advised to apply the new KYC norms only to those accounts where the annual credit or debit summation were Rs.10 lakh or more or where the transactions in the account was of a suspicious nature.

Improving Customer Service

The Reserve Bank set up a Committee on Procedures and Performance Audit on Public Services (Chairman : Shri S.S.Tarapore) to advise it on improving the quality of such services. Banks were asked to constitute similar ad hoc committees to undertake procedures and performance audit on public services rendered by them and co-ordinate with the Tarapore Committee. Based on the reports of the Committee on personal transactions of individuals in foreign exchange, government transactions, banking operations and currency management, a number of guidelines have been issued with a view to improving the customer service rendered by banks and the Reserve Bank.
The Reserve Bank provided detailed operational guidelines for banks for the process of takeover of bank branches in rural and semi-urban centres. Due publicity is required to be given to the constituents of the branch concerned by the existing bank as well as of the bank taking over. In cases where the rural branch being taken over is the only one functioning in the village/town, the bank taking over would not be permitted to merge it with any of its existing branches in rural/semi-urban areas (with service area obligation).

**Technology Upgradation / Training**

The Reserve Bank has been emphasising the need to harness the developments in information technology in the business of banking (Box X.3).

**Strengthening the Consultative Process**

The relationship between the Reserve Bank and market participants has continued to evolve over a period through the expansion and reinforcement of the consultative processes. A Standing Technical Advisory Committee on Financial Regulation was set up during the year on the lines of the Reserve Bank’s Technical Advisory Committee on Money and Government Securities Market. The Committee would advise the Reserve Bank on regulations covering banks, non-bank financial institutions and other market participants on an ongoing basis, in addition to the existing channels of consultation. The Committee, constituted with Smt. K. J. Udeshi, Deputy Governor as the Chairperson, comprises experts drawn from academia, financial markets, banks, non-bank financial institutions and credit rating agencies. During the year, the Committee’s views were sought on a wide range of topical regulatory
issue, including (i) issuance of long-term bonds by banks; (ii) adequacy of present prudential credit exposure ceilings; (iii) review of prudential norms in respect of unsecured exposures; (iv) norms for declaration of dividend by public and private sector banks; and (v) review of the calendar of reviews placed before the boards of banks.

With a view to reinforcing this consultative process further and making the regulatory guidelines more user-friendly, a Users’ Consultative Panel was constituted comprising representatives of the Indian Banks’ Association (IBA), public sector, private sector and foreign banks and market participants. The panel provides feedback on regulatory instructions at the formulation stage to avoid ambiguities and operational glitches.

**Supervisory Initiatives**

Keeping in view the emerging scenario under the Basel II accord and the need to use supervisory resources more productively, a beginning towards risk-based supervision (RBS) of banks was made. The Risk-Based Supervision Manual (RBS Manual), customising the international best practices to Indian conditions, was finalised during the year. A pilot study of eight banks was taken up during the year, which was later extended to 15 additional banks. Extensive training was imparted to the Reserve Bank’s supervision staff as also to the risk managers of various banks across the country. The review of the current methodology, based on the first pilot study, is under examination. 10.46 The scheme of Prompt Corrective Action (PCA), indicating ‘structured’ and ‘discretionary’ actions to be initiated by the Reserve Bank against banks
Computerisation of Banks - Aligning Technology Plan with Business Strategy

The Reserve Bank sponsored a study by the National Institute of Bank Management (NIBM), Pune to assess the computerisation in the banking system with a view to suggesting a broad methodology with which banks could smoothly integrate their technology plan with their business objectives. The report suggested a business-technology model termed as 'Enterprise Maturity Model' (EMM). It has five layers with defined business objectives at each layer starting with 'increasing operational efficiency' and leading up to higher strategic objectives such as 'maximising wealth and stakeholder value'. While every individual bank will need to chart its own course in integrating its business and technology plans, the NIBM report serves as a benchmark for banks to review the direction of their progress. The Reserve Bank advised banks which have not adopted core banking solutions to identify the level at which they are in the Enterprise Maturity Model and accordingly chart their future course of action with the approval of their boards which had hit the trigger points under the PCA framework, was introduced in 2002-03. Since the scheme was introduced on an experimental basis, banks that could potentially attract the provisions of the PCA framework were informed of the possible corrective action required to be taken in case the same were made applicable to them.

Frauds in banks reflect in most cases failure of well laid down systems and procedures, and the boards and the top management in banks need to view frauds with utmost seriousness. With a view to ensuring prompt reporting of frauds, a software package for fraud reporting and monitoring system was developed and supplied to all commercial banks.
They were also advised to constitute a special board-level committee for monitoring and follow-up of cases of frauds involving Rs. one crore and above exclusively, while the audit committee of the board may continue to monitor all the cases of frauds in general.

A separate Fraud Monitoring Cell has been set up at the Reserve Bank to pay focused attention to the monitoring and follow-up of frauds in commercial banks, co-operative banks, financial institutions, NBFCs, local area banks and regional rural banks.

On an application by the Reserve Bank, the Central Government issued an Order of Moratorium in respect of Global Trust Bank (GTB) on July 24, 2004 in public interest, in the interest of depositors and the banking system. Keeping in view the need to minimise the period of moratorium, the available options and the synergies of strategic advantages in merging with Oriental Bank of Commerce (OBC), the Reserve Bank prepared a draft scheme of amalgamation of GTB with OBC and announced it on July 26, 2004 soon after both the banks, which are listed, had notified the information to the stock exchanges. After due sanction from the Central Government, the scheme came into force with effect from August 14, 2004 from which date customers, including depositors of GTB, were able to operate their accounts as customers of OBC.

The BFS took several steps to streamline the long outstanding entries under inter-branch accounts, balancing of books, reconciliation of inter-bank accounts (including *nostro* accounts) and clearing differences, especially in respect of public sector banks. While institution-specific action, as advised by the BFS, was taken, the time period allowed for reconciliation of accounts was also reduced from one year to six months.
with effect from March 31, 2004. On account of the initiatives taken by the BFS, the amount of outstanding entries under inter-branch accounts declined steadily.

**Co-operative Banks**

Membership of co-operative credit institutions comprises largely lower and middle-income sections of society. UCBs are supervised by the Reserve Bank, while district central co-operative banks (DCCBs) and state co-operative banks are supervised by the NABARD. Both are regulated by the State Governments in respect of certain types of functions. In addition, multi-State UCBs are regulated by the Central Government. UCBs are concentrated in five states, *viz.*, Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu which account for 79 per cent of the urban co-operative banking sector and 90 per cent of deposit resources. The focus of supervision of urban co-operative banks by the Reserve Bank has been on strengthening the prudential norms, resolving the issue of dual control, addressing the lack of professionalism, use of unscientific loan policy and increasing incidence of financial weakness.

A system of gradation of UCBs, based on critical financial parameters, *viz.*, capital adequacy, net non-performing advances and profitability was introduced as a framework for initiating prompt corrective action. The gradation is communicated to problem banks to enable them to formulate action plans for corrective action. The content and structure of off-site surveillance returns were modified and the revised returns came into effect from the quarter ended March 2004. The period for recognition of
loan impairment was reduced from 180 days to 90 days with effect from March 31, 2004 in line with the international best practice and to ensure greater transparency. Gold loans and small loans up to Rs. one lakh, however, continue to be governed by the 180-day impairment norm. The Registrars of Co-operative Societies of all States were advised to issue suitable instructions enabling UCBs to take recourse to the SARFAESI Act for recovery of NPAs. UCBs were also advised to build up Investment Fluctuation Reserves (IFR) out of realised gains on sale of investments of a minimum of 5 per cent of the investment portfolio within a period of 5 years, subject to available net profit, in order to mitigate interest rate risk.

**Off-site Surveillance System for UCBs**

The system of off-site surveillance, introduced in April 2001 under Section 27 (2) of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies), requires scheduled urban co-operative banks to submit returns to the Reserve Bank on a quarterly basis. The content and structure of OSS returns was modified to enlarge the breadth and depth of information obtained while reducing the volume of data submission. Seven quarterly returns (submitted from April 2004) and one annual return have been prescribed to obtain information on areas of supervisory concern, and at the same time, to strengthen MIS systems within the scheduled UCBs and sensitise their managements about the prudential concerns of the supervisory authority. The OSS is proposed to be extended to non-scheduled UCBs with a deposit base of Rs.100 crore and above and thereafter to other UCBs. A project is underway for development of software for UCBs that would assist them in preparation
and submission of all the regulatory and supervisory returns including OSS returns in an electronic format.

It was observed by the BFS that some of the large UCBs are facing serious problems with regard to solvency and liquidity. The State Governments concerned were advised to infuse capital funds to ensure that the banks attain the minimum CRAR level.

In pursuance of the recommendations of the Joint Parliamentary Committee (JPC) on Stock Market Scam and Matters relating thereto, a complete ban was imposed on granting of loans and advances to the directors and their relatives or the concerns in which they are interested, with effect from October 1, 2003. Only UCBs with strong financials are allowed to declare dividend.

The Reserve Bank is concerned with the existence of a large number of financially weak UCBs, some of which are unlicensed. As some UCBs have faced problems of liquidity and solvency in recent years, a scheme of reconstruction was approved by the Reserve Bank in respect of two scheduled UCBs in exceptional circumstances which, \textit{inter alia}, require payment of insured deposits by the DICGC. However, the Reconstruction Scheme has not yielded the desired results. Therefore, in the light of experience gained, the Reserve Bank decided that it would only consider a scheme of reconstruction which envisages recapitalisation by the stakeholders, \textit{viz.}, the shareholders/co-operative institutions/Government to the extent of achieving the prescribed capital adequacy norms, without infusion of liquidity through settlement of insurance claims by the Deposit Insurance and Credit Guarantee Corporation (DICGC).
Furthermore, the scheme should lay a clear road map for reducing the NPA level to a tolerable limit within the stipulated time frame.

In order to examine new applications for licence by proposed UCBs, the Reserve Bank constituted a Screening Committee consisting of eminent experts. In the light of experience gained, the policy of licensing co-operative banks was revised and it was decided to consider applications for licence of UCBs only after a comprehensive policy, including an appropriate legal and regulatory framework for the sector, is put in place and a policy for improving the financial health of the urban co-operative banking sector is formulated.

Scheduled UCBs with a minimum net worth of Rs.100 crore and complying with the exposure norms and connected lending were allowed to act as corporate agents for undertaking insurance business without risk participation, after obtaining the approval of the Reserve Bank.

The Central Government had enacted a Multi-State Co-operative Societies (MSCS) Act, 2002 by repealing the MSCS Act, 1984. The MSCS Act, 2002 does not contain provisions empowering the Reserve Bank on matters relating to supersession of boards of UCBs, which is one of the pre-requisites for banks to have deposit insurance cover of the DICGC in terms of Section 2(gg) of the DICGC Act, 1961. Therefore, deposits of UCBs registered under the MSCS Act, 2002 lose insurance cover of the DICGC.

The Supreme Court, in its judgement in a case relating to the Apex Urban Co-operative Bank of Maharashtra and Goa Limited, Mumbai in October 2003 ruled that the UCBs registered under the MSCS Act, 2002 do not fall within the meaning of ‘primary co-operative bank’ as defined under
the Banking Regulation Act, 1949. In order to rectify the deficiencies, the Reserve Bank has suggested to the Government amendments in the BR Act, 1949 and the DICGC Act, 1961 with the objective of bringing all UCBs registered under the MSCS Act, 2002 under the BR Act, 1949 and extend deposit insurance cover of the DICGC.

In 2003-04, licence applications of two DCCBs were rejected by the Reserve Bank in view of their precarious financial position. Besides, show cause notices were issued to 3 DCCBs as to why their licence applications should not be rejected. As on June 30, 2004 seven DCCBs were placed under the Reserve Bank’s directions prohibiting them from granting any loans and advances and/or accepting fresh deposits.

**Development Finance Institutions (DFIs)**

With the change in the operating environment, DFIs have been facing difficulties in sustaining their operations. Several policy initiatives have been taken to facilitate the process of transition of DFIs opting for conversion into banks through a series of measures aimed at financial restructuring, provision of regulatory relaxation for restructured investments of creditor banks or providing Government support, transfer of stressed assets of DFIs to asset reconstruction companies/asset management trusts for managing the NPA level and harmonisation of prudential norms between banks and DFIs.

A Working Group on DFIs (Chairman: Shri N. Sadasivan) was set up by the Reserve Bank. The Working Group, which submitted its Report in May 2004, has suggested a road map for development financing and the future role of DFIs.
Strengthening of Prudential Norms

DFIs were advised that, with effect from end-March 2006, an asset should be classified as non-performing if the interest and/or instalment of principal remain overdue for more than 90 days. DFIs would have the option to phase out the additional provisioning required for moving over to the 90-day income recognition norm over a period of three years beginning from the year ending March 31, 2006, subject to at least one fourth of the additional provisioning being made in each year. Guidelines provided to banks to prevent the slippage of accounts in the ‘sub-standard’ category to the ‘doubtful’ category were extended to DFIs as well. They were advised to place the guidelines before their boards of directors and take appropriate actions for implementing the recommended measures. As in the case of banks, “special mention” accounts,

Report of the Working Group on Development Financial Institutions

The major recommendations of the Group are set out below:

• Banks may be encouraged to extend high risk project finance with suitable Government support.

• As a market-driven business model of any DFI is inherently unsustainable, a detailed social cost benefit analysis should identify activities which require development financing. The rest of the DFIs must convert to either a bank or a NBFC, as recommended by the Narasimham Committee.

• Concessions in the form of according “approved investment” status to paper issued and a lower risk weight of 20 per cent allowed for
exposure by banks, DFIs, NBFCs and RNBCs should be withdrawn for public financial institutions, as many of them have become financially weak and act without any assurance of Government support.

- DFIs which convert into banks could be accorded certain exemptions/relaxations for a period of 3-5 years after conversion.
- Regulation of DFIs should ensure that overall systemic stability is not endangered.
- The Reserve Bank should continue to regulate the Exim Bank, NABARD, SIDBI and NHB which would continue to function as DFIs. As there is a scope for conflict of interest, the Reserve Bank may divest its ownership in NABARD and NHB.
- The Reserve Bank may ensure that the standards of regulation and/or supervision exercised by NHB (in case of Housing Finance Companies), SIDBI (SFCs and SIDCs) and NABARD (state co-operative banks, district central co-operative banks and RRBs) are broadly at par with those maintained by the Reserve Bank.
- DFIs which have been constituted as companies and are performing developmental roles should be classified as a new category of NBFCs called ‘Development Financial Companies’ (DFCs) and subjected to uniform regulation. Considering the nature of business of development financing, DFCs may be permitted to maintain 9 per cent CRAR as against 15 per cent prescribed for NBFCs in general.
- Public deposit mobilisation by RNBCs should be capped at 16 times the net owned fund (NOF) as an initial measure and finally to the level for other NBFCs in five years. This should be accompanied by
deregulation in the quantitative restrictions (alongside more stringent quality criteria) on the asset side.

In December 1998, DFIs were advised that their investments in the bonds/debentures of certain Public Financial Institutions (PFIs) would attract a uniform risk weight of 20 per cent. In the Annual Policy Statement for the year 2004-05, it was announced that with effect from April 1, 2005 exposures to all PFIs will attract a risk weight of 100 per cent. In terms of the guidelines provided in January 2004, FIs must not, *inter alia*, invest in unrated debt securities or in debt securities of original maturity of less than one year other than CP and CDs, effective April 1, 2004. All fresh investments in debt securities are required to be made only in listed debt securities.

**Transformation into Banks**

During 2003-04, the Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003 was passed by the Parliament and received assent of the President of India on December 30, 2003. In terms of the provisions of the Act, the undertaking of Industrial Development Bank of India (IDBI) would vest in the company named Industrial Development Bank of India Limited, which has to be incorporated as a Company under the Companies Act, 1956. On the ‘Appointed Date’, the new company would assume all assets and liabilities of IDBI. In this regard, the Government of India has already approved the IDBI’s proposal to set up a Stressed Asset Stabilisation Fund (SASF) wherein stressed assets of IDBI amounting to Rs.9,000 crore would be transferred to the SASF against transfer of an equivalent amount of 20-year maturity
bonds issued by the Central Government in favour of the SASF on cash/fisc neutral basis.

The Board of Directors of the IFCI Limited approved, in principle, a merger with a bank. The Central Government has already decided to take over certain liabilities of the IFCI and correspondingly the Reserve Bank has provided certain regulatory relaxations for restructured liabilities of the IFCI.

While sending the inspection reports of the IDBI, the IFCI and Industrial Investment Bank of India (IIBI) Limited, action was taken on the various directives given by the BFS that included conveying the concerns on IIBI to the Government.

**Consolidated Accounting and Consolidated Supervision**

Guidelines on consolidated accounting and consolidated supervision, which were prescribed for banks, were extended to DFIs as well, effective April 1, 2003 (July 1, 2003 in the case of the NHB). They comprise three components in the supervisory framework, *viz.*, (i) consolidated financial statements (CFS); (ii) consolidated prudential returns (CPR); and (iii) application of prudential regulations such as capital adequacy, large exposures and liquidity gaps on group-wide basis in addition to the solo prudential norms applicable to the parent DFIs/subsidiaries. The publication of the CFS as per the Accounting Standard (AS) 21 of the Institute of Chartered Accountants of India (ICAI) is mandatory for the listed FIs in terms of the Listing Agreement with the Stock Exchanges. The Reserve Bank’s guidelines sought to make such publication mandatory even for the non-listed DFIs from the financial year beginning April 1, 2003.
Non-Banking Financial Companies (NBFCs)

The policy initiatives in respect of NBFCs related to measures for protecting depositors, aligning interest rates offered by NBFCs with those of banks in respect of NRI deposits on a repatriable basis, issuance of KYC guidelines and allowing diversification into insurance business.

The maximum rate of interest that NBFCs (including Nidhi companies and Chit Fund companies) could pay on their public deposits was reduced from 12.5 per cent per annum to 11.0 per cent per annum with effect from March 4, 2003 in line with the general softening of interest rates. Similarly, the minimum rate of interest payable by the Residuary Non-Banking Companies (RNBCs) was reduced from 4 per cent per annum to 3.5 per cent per annum on daily deposit schemes and from 6 per cent per annum to 5 per cent per annum on other types of deposits. The rate of interest which NBFCs and Miscellaneous Non-Banking Companies (MNBCs) could pay on NRI deposits was also aligned with that payable by scheduled commercial banks on such deposits. It was clarified that NBFCs were not allowed to accept such deposits for a period less than one year (with a maximum period of three years).

NBFCs were allowed to take up insurance agency business for a fee on a non-risk participation basis without the approval of the Reserve Bank, subject to certain conditions. NBFCs intending to set up joint ventures in insurance with equity contribution on a risk participation basis or making investments in the insurance companies would continue to obtain prior approval as envisaged in the guidelines issued on June 9, 2000.
The KYC guidelines, akin to those issued for commercial banks, were prescribed for NBFCs, including MNBCs (Chit Fund Companies) and RNBCs in January 2004.

The inspection policy of NBFCs was revised in July 2003 to increase the frequency. Inspections of 460 deposit taking companies and 385 non-deposit taking companies as also scrutiny and ad hoc scrutiny of books of accounts of 568 companies were carried out. Important findings of inspection and scrutiny reports were placed before the BFS.

An Internal Group in the Reserve Bank examined the scope of providing insurance cover to depositors of NBFCs on a suggestion made by the Joint Parliamentary Committee (JPC) on Stock Market Scam and Matters Relating Thereto. The Group did not favour extending deposit insurance to NBFCs in view of high risks and inadequate compliance with the regulatory and supervisory framework. These recommendations were endorsed by an external group.

The Reserve Bank issued final guidelines and directions to Securitisation Companies and Reconstruction Companies on April 23, 2003 relating to registration, owned funds, permissible business, operational structure for giving effect to the business of securitisation and asset reconstruction, deployment of surplus funds, internal control system, prudential norms and disclosure requirements. In order to ensure that the size of capital has some relationship to the value of assets acquired by the securitisation company or reconstruction company, the Reserve Bank in March 2004 issued a notification whereby the minimum owned funds for commencing the business of securitisation or asset reconstruction has been stipulated at an amount not less than 15 per cent of the total financial assets acquired.
or to be acquired by the securitisation company or reconstruction company on an aggregate basis or Rs.100 crore, whichever is lower. This stipulation is irrespective of whether the assets are transferred to a trust set up for the purpose of securitisation or not. However, the provisions relating to maintaining a capital adequacy ratio which shall not be less than 15 per cent of the total risk weighted assets of the securitisation company or reconstruction company on an ongoing basis, shall continue to be applicable.

In June 2004, the Reserve Bank rationalised the investment pattern of RNBCs for imparting greater liquidity and safety to their investments, enhancing the protection available to the depositors and reducing the overall systemic risk.

**Residuary Non-Banking Companies (RNBCs)**

A Residuary Non-Banking Company (RNBC) is a non-banking financial company which, as its principal business, is engaged in collecting deposits under any scheme or arrangement and cannot be placed in any one of the defined categories of NBFC, *i.e.*, leasing company, hire purchase finance company, loan company or investment company. At present, there are four companies registered under Section 45 IA of the RBI Act, 1934 which operate as RNBCs. Aggregate deposits of these companies stood at Rs.15,062 crore as on March 31, 2003, constituting 74.9 per cent of aggregate deposits of all NBFCs. Two large RNBCs account for deposits aggregating Rs.15,058 crore, constituting 99.9 per cent of the deposits with all RNBCs and 77.3 per cent of public deposits of all NBFCs.
RNBCs are required to invest not less than 80 per cent of the aggregate liabilities to the depositors (ALD) in the manner prescribed by the Reserve Bank which include Government securities, Government guaranteed bonds, fixed deposits with scheduled commercial banks, debentures of public financial institutions, commercial paper (CP) issued by companies and units of mutual funds, within certain limits.

The Reserve Bank recently reviewed the current regulations relating to investments by RNBCs. Modifications include stipulation of minimum rating, exposure norms and an increase in investment in government securities as set out below:

- RNBCs should invest only in (i) the fixed deposits and CDs of scheduled commercial banks; and (ii) CDs of specified financial institutions provided such CDs are rated not less than AA+ or its equivalent by an approved credit rating agency, with exposure to a scheduled commercial bank not exceeding 1 per cent of the aggregate deposit liabilities of the bank as on March 31 of the previous accounting year and exposure to any one specified DFI not exceeding 1 per cent of the ALD.

- RNBCs should invest in the Central and State Government securities issued by the Governments in the course of their market borrowing programme an amount which shall not be less than 15 per cent of the outstanding ALD.

- Investment in debt securities should be confined to those having minimum AA+ or equivalent grade rating and listed in any one of the stock exchanges.
• The investment in units of mutual funds should be in only debt-oriented mutual funds, subject to the aggregate investment in mutual funds not exceeding 10 per cent and in any one mutual fund not exceeding 2 per cent of ALD.

• Effective April 1, 2005, RNBCs will be permitted to invest, as per their discretion, only 10 per cent of the ALD as at the second preceding quarter or up to their net owned funds (NOF), whichever is lower. Effective April 1, 2006 the discretionary investment limit would stand abolished.

The Reserve Bank directed that the NBFCs which were granted Certificates of Registration (CoR) in the non-public deposit taking category should meet the minimum capital requirements of Rs.200 lakh to be eligible to apply to the Reserve Bank for accepting public deposits. Accordingly, NBFCs registered in the non-deposit taking category were advised to ensure compliance with this requirement before applying to the Reserve Bank for approval to accept public deposits.

During the year under review, the Reserve Bank cancelled CoR of twenty NBFCs for reasons other than conversion from category ‘A’ (deposit accepting NBFCs) to category ‘B’ (non-deposit accepting NBFCs). The Reserve Bank launched prosecution proceedings against 63 companies so far and winding up petitions have been filed with the courts in respect of 71 companies.
MACRO-PRUDENTIAL INDICATORS REVIEW

Macro-prudential indicators (MPIs), which comprise both aggregated micro-prudential indicators of the health of individual financial institutions (FIs) and macroeconomic variables associated with financial system soundness, are a useful tool to assess the health and stability of the financial system. The Reserve Bank has been compiling MPIs from March 2000 onwards. Over the last few years, the compilation exercise has been refined in consonance with the methodology given by the International Monetary Fund (IMF). In the Annual Policy Statement for 2004-05, it was indicated that the salient features of the MPI review would be published on an annual basis. Accordingly, the MPI review for the year 2003-04 is set out below.

Capital Adequacy

The capital position of financial intermediaries was generally above the minimum requirement (Table 10.2). The core capital ratio of banks showed some decline during 2003-04. The Capital to Risk-weighted Assets Ratio (CRAR) of the majority of banks as also major bank groups was well above the regulatory stipulation, except for two banks (Tables 10.3 and 10.4). This should enable the meeting of requirements relating to the capital charge for market risk and provisioning for doubtful assets as announced in the Policy Statement. Tier I capital of scheduled UCBs also recorded an improvement, in absolute terms, partly because of the liquidation of two banks with negative net worth, inclusion of one bank in the scheduled category and the attainment of 9 per cent CRAR level by some banks.
In the case of DFIs, although the aggregated CRAR was high, the erosion of capital of two large Government-owned DFIs due to the high level of NPAs resulted in negative CRAR in respect of these institutions.

Table 3.3 Key Financial Indicators of Scheduled UCBs

(Amount in Rupees crore)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>March 2004</th>
<th>March 2003</th>
<th>Percentage variation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Scheduled UCBs</td>
<td>55</td>
<td>56</td>
<td></td>
</tr>
<tr>
<td>Paid up capital</td>
<td>707</td>
<td>608</td>
<td>16.1</td>
</tr>
<tr>
<td>Reserves (excluding loan loss provisions)</td>
<td>2,488</td>
<td>2,195</td>
<td>13.4</td>
</tr>
<tr>
<td>Tier I capital</td>
<td>297</td>
<td>-10</td>
<td></td>
</tr>
<tr>
<td>Tier II capital</td>
<td>529</td>
<td>434</td>
<td>21.7</td>
</tr>
<tr>
<td>Deposits</td>
<td>39,305</td>
<td>36,024</td>
<td>9.1</td>
</tr>
<tr>
<td>Investment in Government and other approved securities</td>
<td>13,954</td>
<td>10,806</td>
<td>29.1</td>
</tr>
<tr>
<td>Loans and Advances</td>
<td>23,962</td>
<td>22,941</td>
<td>4.5</td>
</tr>
<tr>
<td>Gross NPAs</td>
<td>6,892</td>
<td>6,927</td>
<td>-0.5</td>
</tr>
<tr>
<td>Net NPAs</td>
<td>3,509</td>
<td>3,827</td>
<td>-8.3</td>
</tr>
<tr>
<td>Net Profit#</td>
<td>497</td>
<td>354</td>
<td>40.4</td>
</tr>
<tr>
<td>Net Loss*</td>
<td>101</td>
<td>326</td>
<td>-69.1</td>
</tr>
<tr>
<td>Accumulated Losses</td>
<td>2,320</td>
<td>2,276</td>
<td>2.0</td>
</tr>
</tbody>
</table>

Memo items: Ratios (in per cent)

Gross NPAs as percentage of gross advances 28.8 30.2
Net NPAs as percentage of net advances 17.1 19.3

# : Relates to 47 banks in March 2003 and 50 banks in March 2004.
* : Relates to 9 banks in March 2003 and 5 banks in March 2004.
Note : Data as on March 31, 2004
A large concentration of credit in a few sectors is an indicator of vulnerability since the lending institutions are exposed to the heightened credit risk, especially in the downturn phase of the business cycle. Data on sector-wise deployment of gross bank credit by 48 major banks showed that the share of food credit declined. The share of credit to the priority sector remained more or less unchanged up to September 2002 before increasing gradually.

The growth in the housing and retail sectors. Industry-wise data showed a steady increase in share of credit to infrastructure industries. The share of engineering industries, however, declined steadily.

The asset quality of DFIs as a group has been deteriorating due to very high NPA ratios in respect of two DFIs. NPA ratios were low in respect of NBFCs.

**Earnings and Profitability Indicators**

The earnings and profitability indicators for the financial system as a whole were positive, except in the case of DFIs. The return on total assets (ROA) in respect of DFIs was negative, reflecting persistent losses combined with limited recourse to low cost funds. Although the ROA of the PDs declined marginally due to increased volatility in securities market, it was still high. The ROA of scheduled commercial banks has been improving steadily even after making substantial provisions. Continued higher income from securities trading, profits from foreign exchange operations and decline in interest expenses are some of the reasons for the buoyancy in banks’ profitability. The return on equity
(ROE) of the commercial banking system remained high which augurs well for their efforts towards raising capital from the market. The operating costs of banks witnessed an increase during April-September 2003, due to increases in staff costs and other operating expenses as a percentage to income. However, the cost income  

Table 3.4 Operational Results of Scheduled Commercial Banks - Key Ratios

(Percent)

<table>
<thead>
<tr>
<th>Ratio to Total Assets</th>
<th>2003-04</th>
<th>2002-03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings before Provisions and Taxes (EBPT)</td>
<td>2.70</td>
<td>2.43</td>
</tr>
<tr>
<td>Profit after Tax</td>
<td>1.18</td>
<td>1.01</td>
</tr>
<tr>
<td>Total Income</td>
<td>9.48</td>
<td>10.29</td>
</tr>
<tr>
<td>Interest Income</td>
<td>7.41</td>
<td>8.39</td>
</tr>
<tr>
<td>Non-Interest Income</td>
<td>2.07</td>
<td>1.91</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>6.76</td>
<td>7.86</td>
</tr>
<tr>
<td>Interest Expenses</td>
<td>4.52</td>
<td>5.59</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>2.24</td>
<td>2.27</td>
</tr>
<tr>
<td>Provisions and Contingencies</td>
<td>1.53</td>
<td>1.42</td>
</tr>
</tbody>
</table>

Ratio (ratio of operating expenses to total income net of interest expended) declined, reflecting improved efficiency. While containment of such costs is imperative to sustaining improved profitability, the impending wage revision in the financial sector may put pressure on its operating costs in the near future.
A sharp improvement in the commercial banks’ bottomline was due, in large part, to the treasury profits which were fuelled by the decline in interest rates and profit-booking on sale of Government securities. These sources of profits may not be sustained in the future. Banks’ earning capacity would increasingly depend on other sources such as interest earned from lending operations and fee-based business.

**Sensitivity to Market Risk**

**Interest Rate Risk**

Given the significant share of investments in Government securities in the assets of commercial banks, the interest rate sensitivity of their balance sheets is critical. The Reserve Bank, therefore, conducts periodic sensitivity analyses of banks’ balance sheets.

**Currency Risk**

An appreciation in the rupee *vis-à-vis* the US dollar, combined with soft global interest rates during 2003-04, led to increased recourse to external commercial borrowings as also increased borrowings in foreign currency from the domestic banks. The foreign currency positions of importers and other corporates going in for such borrowings have, however, remained largely unhedged. Banks have, therefore, been sensitised to the need to assess the foreign currency risk of their borrowers spilling over to the credit risk.
Commodity Risk

Banks in India generally do not trade in commodities. Certain banks have, however, been allowed to trade in precious metals and in gold derivatives subject to fulfilment of certain prudential norms. The exposure of the banking system to precious metals is insignificant and is not a cause of systemic concern.

Equity Risk

Banks’ exposure to the capital market at 1.8 per cent of total advances at end-March 2004 was well below the stipulated ceiling of 5 per cent. Some new private sector banks have exposures close to the limit prescribed.

Liquidity

The ratio of liquid assets to total assets of banks declined to 42.6 per cent at end-March 2004 from 44.2 per cent at end-September 2003. This was indicative of the increased credit offtake from the banking system during the last half year.

MPIs also include key indicators of the global economic outlook, prospects for the domestic economy, financial markets, corporate profitability and credit offtake. These have been covered extensively elsewhere in the Report. Besides, exposure of banks to retail credit has also assumed considerable significance as an MPI, which is covered in Section III.
To sum up, the response of the financial sector to the Reserve Bank’s initiatives has been encouraging. This has resulted in improvement in key banking parameters, especially in increased capital adequacy and reduced net NPA ratios. The improved macroeconomic outlook and the pick-up in industrial activity have also resulted in an improved credit offtake. The financial sector has acquired greater strength, efficiency and stability. The performance of the banking sector is noteworthy considering the legacy of past NPAs and progressive tightening of prudential norms. Overall rigidity in lending rates as well as inadequacy in quality of service to some sections continue to be matters of concern.

Outlook

The process of financial liberalisation has exposed financial institutions to a wide range of market risks than before. This has necessitated an ongoing restructuring of the regulatory framework, adaptation to the changing landscape of the financial system and a continuous sharpening of the focus of monitoring. Furthermore, recent events have brought issues relating to corporate governance and internal control systems to the centre-stage of the responsibility for financial stability. It also calls for watchfulness among all stakeholders.

The Reserve Bank would continue to strengthen its supervisory initiatives. Risk-based supervision and the PCA framework would be strengthened further. Consolidated supervision would be complemented by a supervisory framework for financial conglomerates. Regulators and regulated entities would have to enhance their risk detection and management systems in order to prepare themselves for the eventual
adoption of the new capital adequacy norms under the Basel II process. The improvement in the asset quality in spite of the adoption of the 90-day delinquency norm is indeed a noteworthy development. The Reserve Bank would continue to ensure a sustained reduction in the non-performing assets to levels comparable with those of industrial countries and even below.

3.3 REPORT OF THE HIGH POWER COMMITTEE ON URBAN COOPERATIVE BANKS

1. The Reserve Bank of India appointed this Committee in May 1999 under the Chairmanship of Shri K. Madhava Rao, Ex-Chief Secretary, Government of Andhra Pradesh to review the performance of Urban Cooperative Banks (UCBs) and suggest necessary measures to strengthen this sector. The terms of reference of the Committee are (i) to evolve objective criteria to determine the need and potential for organising urban cooperative banks; review the existing entry point norms and examine the relevance of special dispensation for less/least developed areas etc., ii) to review the existing policy pertaining to branch licensing and area of operation of urban cooperative banks, iii) to consider measures for determining the future set up of weak/unlicensed banks, iv) to examine the feasibility of introducing capital adequacy norms for urban cooperative banks, v) to examine the need for conversion of cooperative credit societies into primary cooperative banks and vi) to suggest necessary legislative amendments to B.R. Act and Cooperative Societies Acts of various states for strengthening the urban banking movement. (Paras 1.2 & 1.3)
2. The Committee feels that there are 5 broad objectives before it. These are (i) to preserve the cooperative character of UCBs, (ii) to protect the depositors’ interest (iii) to reduce the systemic risks to the financial system, (iv) to put in place strong regulatory norms at the entry level so as to sustain the operational efficiency of UCBs in a competitive environment and evolve measures to strengthen the existing UCB structure particularly in the context of ever increasing number of weak banks and (v) to align urban banking sector with the other segments of banking sector in the context of application of prudential norms in toto and removing the irritants of dual control regime. (Para 1.4)

**Genesis and Architecture of UCBs:**

3. The urban cooperative banks have contributed significantly to the well being of low income groups of the urban and semi urban populace. Perhaps, the urban cooperative movement in India, was the first ever attempt at micro credit dispensation in semi urban and urban areas. The UCBs and other cooperative banks were essentially governed by the State Governments under the provisions of their respective Cooperative Societies Acts. But with the increasing demand for introduction of deposit insurance to cooperative banks, it was felt necessary to bring them under the purview of the Banking Regulation Act, 1949 (B.R.Act). The urban cooperative banks were, therefore, brought under the purview of B.R. Act, effective from 1 March 1966. With this, UCBs were subjected to dual command by RBI exercising control over their banking related functions and State
Governments exercising supervision over their managerial, administrative and other matters. (Para 2.1 & 2.11)

4. The deposit resources of UCBs rose from a meagre sum of Rs.153 crores as at the end of financial year 1966-67 (UCBs were brought under the purview of B.R.Act with effect from 1 March 1966) to Rs.50,544 crores as at the end of 31 March, 1999. The number of UCBs had also gone up from 1106 to 1936 during the corresponding period. Heterogeneity is a striking characteristic feature of UCB structure. Gujarat, Maharashtra, Karnataka, Tamil Nadu and Andhra Pradesh alone account for 78.9% of urban cooperative banks and over 75 per cent of their deposit resources. Notwithstanding the phenomenal progress registered by UCBs, today they are facing five major problems (i) dual control, (ii) inadequate legal framework to regulate UCBs compared to the powers RBI has been vested with to regulate commercial banks, (iii) increasing incidence of weakness, (iv) low level of professionalism and (v) apprehensions about the credentials of promoters of some new UCBs. The Committee has attempted to address these issues in this report. (Paras 2.22, 2.23 & 2.25)

**Licensing Policy of New Urban Cooperative Banks**

5. The Committee has examined the feasibility of evolving certain objective criteria for determining the need for urban cooperative banks and assessing the potential of a proposed UCB in a given area. The Committee feels that in a fairly deregulated regime neither it is feasible for the regulator to evolve certain objective criteria for
assessing the need for an UCB in a given area nor does it have the wherewithal to do it. Certain conceptual tools like ‘existence of credit gap’ and the Average Population Per Bank Office (APPBO) are not effective in determining the need for an urban bank in a given locale specific. It, therefore, recommends that the regulator should prescribe the twin criteria i.e., a strong startup capital and requisite norms for promoters eligibility. These two norms will suffice at the entry level for the new UCB. As regards the viability of an entity, it should be left to the judgement of the promoters. The Committee, therefore, recommends that the existing quantitative criteria of viability standards should be dispensed with and they should be replaced by qualitative norms like CRAR, tolerance limit of NPAs and operational efficiency. (Paras 3.7 & 3.38)

6. The twin functions of start-up capital are (i) to meet the initial infrastructure cost and (ii) to provide cushion against the erosion of bank’s assets. Viewed in this context, the existing Entry Point Norms (EPNs) are low. The Committee also feels that EPNs for UCBs should be on par with peer groups like Local Area Banks (LABs) and Regional Rural Banks (RRBs) whose clientele and area of operation are broadly similar to UCBs. The Committee also feels that the existing low EPNs is one of the major causes for weakness of UCBs. The Committee, therefore, agrees with the views of Narasimham Committee Report on Banking Sector Reforms that the existing EPNs are rather low. Accordingly, the Committee recommends the following 5 grades of increased EPNs compared to the existing 3 grades.
### Table 3.5  Entry point norms for UCBs other than unit banks

<table>
<thead>
<tr>
<th>Category of Centre</th>
<th>Capital (Rs. in crores)</th>
<th>Membership (Nos.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>- population over 15 lakhs</td>
<td>5.00</td>
</tr>
<tr>
<td>B</td>
<td>- population over 10 lakhs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>but not exceeding 15 lakhs</td>
<td>2.50</td>
</tr>
<tr>
<td>C</td>
<td>- population over 5 lakhs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>but not exceeding 10 lakhs</td>
<td>2.00</td>
</tr>
<tr>
<td>D</td>
<td>- population over 2 lakhs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>but not exceeding 5 lakhs</td>
<td>1.00</td>
</tr>
<tr>
<td>E</td>
<td>- population not exceeding</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2 lakhs</td>
<td>0.50</td>
</tr>
</tbody>
</table>

(Para 3.18)

7. If promoters desire to set up unit banks (1 branch bank), the above entry point capital norms require reduction. The Committee, therefore, recommends that banks which intend to start only unit banking, should be given 50% relaxation in the entry point norms applicable to the particular centre as under.
Table 3.6  Entry Point Norms for unit banks

<table>
<thead>
<tr>
<th>Category of Centre</th>
<th>Capital (Rs. in crores)</th>
<th>Membership Nos.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>2.5</td>
<td>3000</td>
</tr>
<tr>
<td>B</td>
<td>1.25</td>
<td>2500</td>
</tr>
<tr>
<td>C</td>
<td>1.00</td>
<td>2000</td>
</tr>
<tr>
<td>D</td>
<td>0.50</td>
<td>1500</td>
</tr>
<tr>
<td>E</td>
<td>0.25</td>
<td>1000</td>
</tr>
</tbody>
</table>

However, if any UCB intends to open additional branches, it has to comply with the entry point capital prescribed for the banks as indicated in the Table A. (Para 3.19)

8. The Committee has examined the desirability of continuance of special dispensation i.e., relaxation in entry point norms for certain categories of banks organised in less/least developed areas and banks set up exclusively for women and SCs/STs. There is some merit in the argument of the critics of special dispensation that, urban banks being financial entities, any relaxation in entry point norms would lead to proliferation of weak banks. But in view of constitutional provision for reservation for SCs/STs and the state policy of empowerment of women, the Committee recommends continuation of the relaxations in EPNs to the above categories of banks for a period of 5 years and, thereafter, the RBI should review the policy. (Para 3.32)
9. Good corporate governance is critical to efficient functioning of an entity and more so for a banking entity. The Committee feels that irrespective of the size of the operations, banks need to run on professional lines and UCBs are no exception to this rule. It, therefore, suggests that at least 2 directors with suitable banking experience or relevant professional background should be present on the Boards of UCBs and the promoters should not be defaulters to any financial institution or banks and should not have any association with chitfund / NBFCs / cooperative bank or commercial bank in the capacity of Director on the Board of Directors. (Para 3.25)

Branch Licensing Policy and Area of Operation

10. The Committee while, broadly agreeing with the existing branch licensing policy, recommends a few changes in the policy particularly with reference to dispensing with viability standards as a prerequisite for issue of branch licences. Although UCBs are functioning in a compact area, any restriction on their expansion will hamper their growth. The Committee, recommends that RBI should extend to the UCBs the same freedom and discipline as is applicable to commercial banks in opening branches. If an UCB complies with the following broad norms viz., (a) it should not have been in default of any of the provisions of the B.R.Act or RBI Act or Directives issued by RBI from time to time, (b) its capital adequacy is not lower than the minimum required level, (c) it must have fully complied with the provisioning norms specified by RBI,
(d) its net NPAs are not more than 10%, (e) it has made profits in the last two years and (f) its priority sector advances are not less than 60% of the total loans and advances. The Committee recommends that every UCB must submit to the RBI an Annual Action Plan (AAP). Scheduled UCBs which satisfy the eligibility criteria be given freedom to open new branches under the AAP. Non-scheduled UCB should continue to obtain prior approval of RBI after complying the eligibility criteria. The Committee also recommends that non-scheduled UCBs should not open more than 10% of their existing branches subject to a minimum of one branch, in any given year. No UCB can open more than 2 branches on its inception or within a period of 2 years thereafter. Scheduled UCBs may be permitted to open mobile and satellite offices subject to compliance with guidelines. (Para 4.15)

11. Though urban cooperative banks were initially conceived to be small entities confining their area of operation to small towns and municipal limits of cities, over a period of time some of them have started expanding to the entire state and in some cases beyond their respective states of registration. The opponents of expansion of area of operation of UCBs argue that UCBs would lose their cooperative character and structure which give them their identity viz. local feel, compact area of operation and mutual help, if they indiscriminately expand their area of operation. Proponents of expansion of area of operation, on the other hand, argue that expansion of area of operation does not necessarily dilute the cooperative character
because the clientele of UCBs having common interest belonging to common ethnic group, may spread over different parts of the state or more than one state. When some Cooperative Banks of Europe have nation-wide and worldwide presence, restricting UCBs operations to districts of their registration would place artificial barriers on their growth. (Para 4.22)

12. The Committee, therefore, recommends that (a) new UCBs can extend their area of operation to the entire district of their registration and adjoining districts, (b) when an UCB desires to open a branch in a district in a state other than the district in which it is registered, it must have a net worth which is not less than the entry point norms prescribed for the highest category centre in that state and (c) if an UCB desires to open a branch in a state other than the state in which it is registered, it must have a net worth of not less than Rs.50 crores (which is 50% of the minimum requirement for a new private sector bank). (Para 4.23)

**Policy on Weak and Unlicensed Banks**

13. Existence of large number of unlicensed banks has become a cause of concern for regulators. As on 30 September 1999, as many as 181 banks are still unlicensed entities. Of these, 97 banks continue to be unlicensed for over 3 decades. Existence of such large number of unlicensed banks over 3 decades places the RBI in a state of "regulatory discomfiture". (Para 5.1)
14. The main reason for proliferation of unlicensed banks is on account of statute induced expansion. Under the provisions of Section 5 (ccv), a primary credit society whose paid up capital and reserves attain the level of Rs. 1 lakh and whose main objective is to carry on banking business automatically secures urban banking status. The Committee, therefore, recommends that in order to choke this automatic route of transformation into UCBs, this Section of B.R.Act, needs to be amended. Many of the unlicensed banks were not given licences due to non-compliance with entry point capital norms, non compliance with the provisions of B.R.Act, 1949 (AACS) and RBI Act, high level of NPAs and unsatisfactory operating results etc. The Committee, expresses its concern about RBI allowing so many unlicensed banks to continue to operate for so long a period. It, therefore, recommends that (a) ubcs which are brought under the purview of B.R.Act, 1949 (AACS) in 1966, should be either given licences by RBI if they comply with the norms prescribed by it by 31 March 2002, or their application for licences be rejected. b) primary cooperative societies which were converted into UCBs after 1 March 1966, and remained unlicensed should be given licences or their application for licence rejected by 31 March 2002 or within 5 years from the date of their conversion into ucbs whichever is later and (c) for all primary credit societies which apply for licence in future, the licence should be granted or rejected within a period of 6 months from the date of application and pending grant of licence, such societies must not be permitted to carry on banking business. (Paras 5.2, 5.3 & 5.6)
15. RBI should also make its policy of licensing of unlicensed banks more transparent and precise. The Committee, therefore, recommends that if an unlicensed bank (a) attains minimum level of CRAR prescribed by the regulator, (b) its net NPAs are not in excess of 10%, (c) it has made profits during each of the last 3 years and (d) it has complied with the statutory framework of B. R. Act / Directives issued by RBI, it should be licensed. (Para 5.6)

16. Increasing incidence of sickness in UCBs has become a constant cause of concern for RBI. As at the end of 31 March 1999, as many as 293 banks have been classified as weak. Of these, 112 do not comply with even the minimum capital requirement of Rs.1 lakh prescribed under section 11 of B.R.Act, 1949 (AACS). The Committee feels that (a) inadequate entry point capital, (b) lack of professionalism and politicisation of management, (c) absence of compliance of prudential norms, (d) absence of system for timely identification of weakness and (e) dual control over UCBs are some of the major attributary factors for sickness in UCBs. (Paras 5.7 & 5.10)

17. Though there are institutional mechanisms like State Level Rehabilitation Review Committee (SLRRC) and Bank Level Rehabilitation Review Committee (BLRRC) to review the performance of weak banks, the progress has not been quite satisfactory. Besides, the existing parameters for classifying weak banks, in the opinion of the Committee, suffer from several defects.
There should be a system to flash early warning signals to detect the incipient sickness so that financial position of a bank may not further deteriorate. The Committee, therefore, believes that there should be separate criteria for identification of weak and sick banks and recommends the following objective criteria. (Para 5.28)

Table 3.7 Identification of Sick & Weak Banks

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Weak bank</th>
<th>Sick bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>CRAR</td>
<td>Less than 75%</td>
<td>Less than of 50% of minimum prescription, or</td>
</tr>
<tr>
<td>Net NPA</td>
<td>10% or more but less than 15% of loans and advances</td>
<td>15% or more of outstanding as advances on 31 March, or outstanding as on 31 March, or</td>
</tr>
<tr>
<td>History of Losses</td>
<td>Showing net losses in operation for the last three consecutive financial years</td>
<td>Showing net losses in operation for the last three consecutive financial years</td>
</tr>
</tbody>
</table>

18. The Committee also feels that BLRRCs have not achieved much and it recommends dismantling the same. It, however, recommends that SLRRCs should continue. (Para 5.28)
19. The Committee also recommends that once an UCB is classified as a sick bank, action may be taken under the provisions of Section 45 of the B.R.Act, 1949 to place it under moratorium. During the period under moratorium it must, however, reconstruct or amalgamate with another UCB and if this is not possible, the bank’s licence to carry on banking business must be withdrawn. (Para 5.28)

20. If, however, RBI feels that even without reconstruction or amalgamation a sick UCB can be rehabilitated and it should be allowed to continue to operate, then it would be necessary for RBI to ensure that bank’s CRAR is not allowed to deteriorate below the ratio which exists when it is identified as a sick UCB. The Committee, therefore recommends that RBI/GOI create a Rehabilitation Fund which would be used as subordinated debt for the purpose of maintaining the CRAR of sick UCBs at the level which existed when it is declared sick. If the rehabilitation scheme succeeds the loan amount would be returned to the Rehabilitation Fund. Since, CRAR is not applicable to UCBs, it is not feasible to compute exact quantum of the Fund. Assuming the minimum networth needed to be maintained for the sick UCBs would be equivalent to 4% of its loans and advances portfolio, and considering that only some of the sick UCBs with positive networth would be considered as capable of rehabilitation, the size of the Fund is estimated at around Rs.40 crores. (Para 5.28)
Application of CRAR to UCBs

21. In the opinion of the Committee, the continued financial stability of UCBs cannot be ensured unless they are subjected to the discipline of maintenance of prescribed minimum capital to risk assets ratio (CRAR). While a quick review of 50 (other than weak banks) UCBs showed that 76% had reached the minimum CRAR prescribed for commercial banks, the Committee realises that it may be difficult for all UCBs to immediately comply if a minimum norm is made applicable to the whole UCB sector. (Paras 6.4 & 6.5)

22. It has been represented to the Committee that the ability of UCBs to raise additional capital to meet CRAR norms is limited (a) by their inability to make public issue of capital, (b) the fact that members can reduce their capital and (c) particularly by the quantitative ceiling imposed by the State Cooperative Societies Acts, and Multi-State Cooperative Societies Act,1984, on the number of shares an individual can hold. The Committee is in favour of removing these quantitative restrictions but is in favour of imposing a percentage ceiling whereby no single individual can hold more than 5% of the share capital of an UCB. (Para 6.8)

23. The Committee is also in favour of UCBs being subjected to CRAR discipline in a phased manner with initially a lower CRAR norms being prescribed for non-scheduled UCBs as compared to scheduled UCB. The following norms are, therefore, recommended.
### Table 3.8  Recommended Norms

<table>
<thead>
<tr>
<th>Date</th>
<th>Scheduled (UCBs)</th>
<th>Non-Scheduled (UCBs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>31st March 2001</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>31st March 2002</td>
<td>9%</td>
<td>7%</td>
</tr>
<tr>
<td>31st March 2003</td>
<td>As applicable to Commercial banks</td>
<td>9%</td>
</tr>
<tr>
<td>31st March 2004</td>
<td>- do -</td>
<td>As Applicable to Commercial banks</td>
</tr>
</tbody>
</table>

(Para 6.14)

24. Until an UCB attain the specified CRAR norms, the Committee recommends that it should be required to transfer not less than 50% of its net profits to the Reserve Fund and there should be a ceiling of 20% on the percentage of dividend it can distribute to its members. (Para 6.14)

Conversion of Cooperative Credit Societies into UCBs:

25. RBI had been pursuing the policy of allowing cooperative credit societies as defined in secn. 5 (ccii) of B.R. Act, (AACS) to convert themselves into urban cooperative banks, provided that they attain
entry point norms prescribed by RBI. But it has been suggested that allowing conversion of credit societies into UCBs in over banked areas might tantamount to back door entry into the Urban Banking fold. (Para 7.6)

26. The Committee, however, believes that denying the benefit of conversion of cooperative credit societies which have a good track record of profits, which comply with entry point norms prescribed by RBI and have already been serving certain sections of a given area, while allowing new urban cooperative banks whose promoters’ antecedents are untested, would be an unfair policy stance. It, therefore, recommends that such of the credit societies whose networth is not less than the entry point capital prescribed for new banks in that given centre, which have been posting profits during each of the last 3 years, which have earned "A" audit rating and whose methods of operation are not detrimental to the interests of the depositors may be allowed to convert themselves into UCBs. (Para 7.11)

Legislative Reforms in Central and States Statutes

27. Application of certain provisions of B.R. Act, 1949 to urban cooperative banks in 1966, inaugurated regime of dual control. The dual control has become a very serious problem affecting the functioning of the urban cooperative banking sector. After interaction with urban cooperative banks and their federations,
The Committee is convinced that dual control regime is perhaps one of the most vexatious problems of urban cooperative banking movement. The Committee is of the view that duality in command, per se, is not the issue but it is the absence of clear cut demarcation between the functions of the State Government and the Reserve Bank of India that has been responsible for the irritants thrown up by the dual control regime. (Paras 8.1 to 8.3)

28. Branch licensing, expansion of area of operation, fixing interest rates on deposits and advances, audit, and investments are essentially banking related functions. The Registrars of Cooperative Societies of many States continue to exercise their powers over these areas under the mistaken impression that they can do so under the general provision of Cooperative Societies Act which empowers them to exercise general supervision and control. The Committee, therefore, strongly feels that the State Acts should be amended so as to categorise the banking related functions and the functions of the State Governments separately. The Committee feels that areas relating to investment, prudential norms, branch licensing, remission of debts, change of management should exclusively come under the realm of banking related functions and RBI should be the sole regulatory authority. Registrar of Cooperative Societies of the State concerned should confine his activities to registration, approval and amendments to by-laws, election to management committees,

29. The Committee is conscious that in a competitive federal polity, the State Governments may be reluctant to carry out these amendments to the Acts. It, therefore, recommends that unless necessary amendments are made to the respective State Act and Multi State Cooperative Societies Act as suggested above, RBI may not licence any new banks, nor allow the branch expansion of the existing banks in a State which does not carry out these amendments. Pending amendments to State Cooperative Societies Acts, UCBs will have the freedom to register under the amended Multi-State Cooperative Societies Act. (Para 8.14)

30. With a view to contain the growth of weak banks, the Committee suggests amendments under section 5(ccv) of B.R. Act (AACS) so as to arrest automatic transformation of primary cooperative credit societies into urban cooperative banks. Similarly section 5(ccvi) also needs to be amended to delete the word "primary" and Primary Cooperative Banks should be known as Urban Cooperative Banks. UCBs must also to be allowed to admit any cooperative society, other than a cooperative credit society or a cooperative bank, as their members. It also recommends amending Section 7 from
stopping primary credit societies using the words "bank", "banker" etc. Besides, Section 30 of B.R. Act with regard to appointment of auditors should also be made applicable to UCBs. The Committee feels that RBI should be vested with powers to remove Directors, CEO of a bank and recommends that Section 36AA of B.R. Act, 1949 [As Applicable to Banking Companies (AABC)] may be extended to UCBs. RBI should also be vested with powers in regard to moratorium of UCBs on the lines of Section 45(4) to 45(15) of B.R. Act (AABC). The Committee also suggests amendments to B.R. Act (AACS) so as to make the format of Balance Sheet be in consonance with Schedule III of B.R. Act (AABC). (Para 8.21 to 8.34)

Other Related Issues

31 During its interaction with the State Government officials, bankers and federations certain related issues which are outside the scope of the terms of reference but have an important bearing on the functioning of UCBs were brought before the Committee. One of them relates to reduction in the target set for priority sector advances. The Committee feels that urban cooperative banks are essentially required to cater to the needs of low/middle income groups. Bringing down the targets of priority sector advances will go against the stated objective. Besides, of over 1400 reporting urban cooperative banks on 31 March 1998, 84.1% have attained the target in deploying over 60% of their advances to priority sector. The Committee is, therefore, not inclined to agree for reduction in the existing priority sector targets for UCBs. (Paras 9.20 and 9.21)
32. The Committee, during its visits to various centres, was told by UCBs that there is need for larger currency chest facility as many a time, RBI offices and scheduled commercial banks, who are maintaining currency chests, either do not entertain them nor the surplus cash is accepted for deposits. The Committee feels that this is a genuine grievance and requests RBI to increase the currency chests facilities by allowing other scheduled commercial banks as well as scheduled urban cooperative banks to open currency chests by giving incentives to meet the initial and the recurring expenditure. (Para 9.11)

33. Under provisions of section 24 of the B.R. Act, urban cooperative banks are required to invest their SLR funds either in approved securities or with DCCBs/SCBs. Many representatives of urban cooperative banks have expressed their concern over the financial health of DCCBs and felt that they should be given an opportunity to invest their funds with scheduled urban cooperative banks and scheduled commercial banks. While there is some merit in this representation, the Committee is also aware of the impact of adoption of such a policy on the viability of DCCBs/SCBs in the event of flight of deposits from DCCBs/SCBs to other banks. It, therefore, suggests that RBI may examine this request in the light of recommendations to be submitted by Task Force under the Chairmanship of Shri Jagdish Capoor, Deputy Governor, Reserve Bank of India, to suggest suitable package for cooperative banks. (Paras 9.14, 9.15 & 9.16)
34. One member (Dr. Sawai Singh Sisodia) suggested a different Entry Point prescription. Another member, (Dr. Mukund L. Abhyankar) is unable to agree with our recommendation on non-voting shares and prescribing a ceiling on individual share holding in UCBs. Another member, (Shri Subhash S. Lalla) is unable to agree with our recommendations on (1) the area of operation being taken out of the purview of RCS, (2) allowing UCBs to park SLR funds in commercial banks, (3) deleting the word "primary" from the B.R. Act and (4) on dual control. (Paras 3.21, 6.8, 8.14, 8.22 & 9.22)
Chapter-4

Urban Co-Operative Banks in Gujarat
4.1 HISTORY OF URBAN COOPERATIVE BANKS

The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. These banks were traditionally centered on communities, localities work place groups. They essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably. The origins of the urban cooperative banking movement in India can be traced to the close of nineteenth century when, inspired by the success of the experiments related to the cooperative movement in Britain and the cooperative credit movement in Germany such societies were set up in India. Cooperative societies are based on the principles of cooperation, - mutual help, democratic decision making and open membership. Cooperatives represented a new and alternative approach to organisation as against proprietary firms, partnership firms and joint stock companies which represent the dominant form of commercial organisation.

The first known mutual aid society in India was probably the “Anyonya Sahakari Mandali” organized in the erstwhile princely State of Baroda in 1889 under the guidance of Vithal Laxman also known as Bhausaheb Kavthekar. Urban co-operative credit societies, in their formative phase came to be organised on a community basis to meet the consumption oriented credit needs of their members. Salary earners societies inculcating habits of thrift and self help played a significant role in popularising the movement, especially amongst the middle class as well as organized labour. From its origins then to today, the thrust of UCBs, historically, has been to mobilise savings.
from the middle and low income urban groups and purvey credit to their members - many of which belonged to weaker sections.

The enactment of Cooperative Credit Societies Act, 1904, however, gave the real impetus to the movement. The first urban cooperative credit society was registered in Canjeevaram (Kanjivaram) in the erstwhile Madras province in October, 1904. Amongst the prominent credit societies were the Pioneer Urban in Bombay (November 11, 1905), the No.1 Military Accounts Mutual Help Co-operative Credit Society in Poona (January 9, 1906). Cosmos in Poona (January 18, 1906), Gokak Urban (February 15, 1906) and Belgaum Pioneer (February 23, 1906) in the Belgaum district, the Kanakavli-Math Co-operative Credit Society and the Varavade Weavers Urban Credit Society (March 13, 1906) in the South Ratnagiri (now Sindhudurg) district. The most prominent amongst the early credit societies was the Bombay Urban Co-operative Credit Society, sponsored by Vithaldas Thackersey and Lallubhai Samaldas established on January 23, 1906. The Cooperative Credit Societies Act, 1904 was amended in 1912, with a view to broad basing it to enable organisation of non-credit societies. The Maclagan Committee of 1915 was appointed to review their performance and suggest measures for strengthening them. The committee observed that such institutions were eminently suited to cater to the needs of the lower and middle income strata of society and would inculcate the principles of banking amongst the middle classes. The committee also felt that the urban cooperative credit movement was more viable than agricultural credit societies. The recommendations of the Committee went a long way in establishing the urban cooperative credit movement in its own right. In the present day context, it is of interest to recall that during the
banking crisis of 1913-14, when no fewer than 57 joint stock banks collapsed, there was a flight of deposits from joint stock banks to cooperative urban banks. Maclagan Committee chronicled this event thus: As a matter of fact, the crisis had a contrary effect, and in most provinces, there was a movement to withdraw deposits from non-cooperatives and place them in cooperative institutions, the distinction between two classes of security being well appreciated and a preference being given to the latter owing partly to the local character and publicity of cooperative institutions but mainly, we think, to the connection of Government with Cooperative movement. The constitutional reforms which led to the passing of the Government of India Act in 1919 transferred the subject of Cooperation from Government of India to the Provincial Governments.

The Government of Bombay passed the first State Cooperative Societies Act in 1925 which not only gave the movement its size and shape but was a pace setter of cooperative activities and stressed the basic concept of thrift, self help and mutual aid. Other States followed. This marked the beginning of the second phase in the history of Cooperative Credit Institutions. There was the general realization that urban banks have an important role to play in economic construction. This was asserted by a host of committees. The Indian Central Banking Enquiry Committee (1931) felt that urban banks have a duty to help the small business and middle class people. The Mehta-Bhansali Committee (1939), recommended that those societies which had fulfilled the criteria of banking should be allowed to work as banks and recommended an Association for these banks. The Co-operative Planning Committee (1946) went on record to say that urban banks have been the best agencies for small people in
whom Joint stock banks are not generally interested. The Rural Banking Enquiry Committee (1950), impressed by the low cost of establishment and operations recommended the establishment of such banks even in places smaller than taluka towns.

The first study of Urban Co-operative Banks was taken up by RBI in the year 1958-59. The Report published in 1961 acknowledged the widespread and financially sound framework of urban co-operative banks; emphasized the need to establish primary urban cooperative banks in new centers and suggested that State Governments lend active support to their development. In 1963, Varde Committee recommended that such banks should be organised at all Urban Centers with a population of 1 lakh or more and not by any single community or caste. The committee introduced the concept of minimum capital requirement and the criteria of population for defining the urban centre where UCBs were incorporated.

However, concerns regarding the professionalism of urban cooperative banks gave rise to the view that they should be better regulated. Large cooperative banks with paid-up share capital and reserves of Rs.1 lakh were brought under the preview of the Banking Regulation Act 1949 with effect from 1st March, 1966 and within the ambit of the Reserve Banks supervision. This marked the beginning of an era of duality of control over these banks. Banking related functions (viz. licensing, area of operations, interest rates etc.) were to be governed by RBI and registration, management, audit and liquidation, etc. governed by State Governments as per the provisions of respective State Acts. In 1968, UCBS were extended the benefits of Deposit Insurance. Towards the late 1960s there was much debate regarding the promotion of the small scale industries. UCBs came to be seen as important players in this
context. The Working Group on Industrial Financing through Co-operative Banks, (1968 known as Damry Group) attempted to broaden the scope of activities of urban co-operative banks by recommending that these banks should finance the small and cottage industries. This was reiterated by the Banking Commission (1969).

The Madhavdas Committee (1979) evaluated the role played by urban co-operative banks in greater details and drew a roadmap for their future role recommending support from RBI and Government in the establishment of such banks in backward areas and prescribing viability standards. The Haste Working Group (1981) desired better utilisation of banks' surplus funds and that the percentage of the Cash Reserve Ratio (CRR) & the Statutory Liquidity Ratio (SLR) of these banks should be brought at par with commercial banks, in a phased manner. While the Marathe Committee (1992) redefined the viability norms and ushered in the era of liberalization, the MadhavaRao Committee (1999) focused on consolidation, control of sickness, better professional standards in urban co-operative banks and sought to align the urban banking movement with commercial banks. A feature of the urban banking movement has been its heterogeneous character and its uneven geographical spread with most banks concentrated in the states of Gujarat, Karnataka, Maharashtra, and Tamil Nadu. While most banks are unit banks without any branch network, some of the large banks have established their presence in many states when at their behest multi-state banking was allowed in 1985. Some of these banks are also Authorized Dealers in Foreign Exchange.
**Recent Developments**

Over the years, primary (urban) cooperative banks have registered a significant growth in number, size and volume of business handled. As on 31st March, 2003 there were 2,104 UCBs of which 56 were scheduled banks. About 79 percent of these are located in five states, - Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. Recently the problems faced by a few large UCBs have highlighted some of the difficulties these banks face and policy endeavours are geared to consolidating and strengthening this sector and improving governance.

The Urban Banks Department of the Reserve Bank of India is vested with the responsibility of regulating and supervising primary (urban) cooperative banks, which are popularly known as Urban Cooperative Banks (UCBs).

While overseeing the activities of 1926 primary (urban) cooperative banks, the Urban Banks Department performs three main functions regulatory, supervisory and developmental. The Department performs these functions through its 17 regional offices.

**I. Regulatory Functions**

(i) Licensing of New Primary (Urban) Cooperative Banks

For commencing banking business, a primary (urban) cooperative bank, as in the case of commercial bank, is required to obtain a licence from the Reserve Bank of India, under the provisions of Section 22 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies).

(ii) Licensing of Existing Primary (Urban) Co-operative Banks
In terms of sub-section (2) of Section 22 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies), the primary (urban) cooperative banks existing in the country as on March 1, 1966, (when some banking laws were applied to UCBs), were required to apply to the Reserve Bank of India. They were given three months to obtain a licence to carry on banking business. Similarly, a primary credit society which becomes a primary (urban) cooperative bank by virtue of its share capital and reserves reaching Rs. one lakh (Rs.1,00,000) and above was to apply to the Reserve Bank of India for a licence within three months from the date on which its share capital and reserves reach Rs. one lakh. The existing unlicensed primary (urban) cooperative banks can carry on banking business till they are refused a licence by the Reserve Bank of India.

(iii) Branch Licensing
Under the provisions of Section 23 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies), primary (urban) cooperative banks are required to obtain permission from the Reserve Bank of India for opening branches.

(iv) Statutory Provisions
The regulatory functions of Urban Banks Department relate to monitoring compliance with the provisions of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies) by urban cooperative banks. These provisions include:

a. Minimum Share Capital
Under the provisions of Section 11 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies), no primary (urban) cooperative bank can commence or carry on banking business if the real
or exchangeable value of its paid-up capital and reserves is less than Rs. one lakh.

b. Maintenance of CRR and SLR As in the case of commercial banks, primary (urban) cooperative banks are also required to maintain certain amount of cash reserve and liquid assets. The scheduled primary (urban) cooperative banks are required to maintain with the Reserve Bank of India an average daily balance, the amount of which should not be less than 5 per cent of their net demand and time liabilities in India in terms of Section 42 of the Reserve Bank of India Act, 1934. Non-scheduled (urban) cooperative banks, under the provision of Section 18 of Banking Regulation Act, 1949 (As Applicable to Cooperative Societies) should maintain a sum equivalent to at least 3 per cent of their total demand and time liabilities in India on day-to-day basis. For scheduled cooperative banks, CRR is required to be maintained in accounts with Reserve Bank of India, whereas for non-scheduled cooperative banks, it can be maintained by way of either cash with themselves or in the form of balances in a current account with the Reserve Bank of India or the state co-operative bank of the state concerned or the central cooperative bank of the district concerned or by way of net balances in current accounts with public sector banks. In addition to the cash reserve, every primary (urban) cooperative bank (scheduled/non-scheduled) is required to maintain liquid assets in the form of cash, gold or unencumbered approved securities which should not be less than 25 per cent of the total of its demand and time liabilities in accordance with the provisions of Section 24 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies). Out of the prescribed SLR, the UCBs have been advised to maintain a certain amount in the form of SLR Securities.
II Supervisory function:
Ensure that the UCBs conduct their affairs in the interests of the depositors and also comply with the regulatory framework prescribed by the Reserve Bank of India, the department undertakes on site inspection of these banks with frequency ranging from one to two years depending upon the financial condition / status of banks. The thrust of supervision is to ensure that banks' affairs are not conducted in a manner detrimental to the depositors' interest and also to assess the solvency of the bank, its liabilities, besides examining the banks compliance with the existing regulatory framework. The department also undertakes off-site surveillance of scheduled banks and non-scheduled banks with a deposit base of Rs 100 crore and above based on a set of quarterly and annual returns.

III Development Function:
With a view to extending institutional credit support to tiny and cottage units, the Reserve Bank of India grants refinance facilities to urban cooperative banks under the provisions of Section 17 of the Reserve Bank of India Act, 1934. The refinance is given at the Bank Rate. Training is imparted to the middle and top management of urban cooperative banks through College of Agricultural Banking, Pune. The international co-operative alliance has in 1925 adopted the beautiful seven-colour pattern of the rainbow horizontal strips as its international flag, the flag of co-operation, progress and peace. The flag has seven colours. They are violet, indigo, blue, green, yellow, orange and red. Rainbow is regarded as an auspicious omen, Farmers see the rainbow and
start ploughing their fields, They read in it the message about rains to come, It is thus a symbol of hope a harbinger peace.

Men see co-operation in its multi-colour patterned, each colour blending with the other to make one harmonious. Whole an ultimately all-pervading harmony & unity in diversity.

The seven hues of the rainbow when blended together reunite to present pure unstained white effulgence. Thus it stands for purity truth and righteousness.

It symbolizes the aims and idea of the co-operative movement like the rainbow co-operation brings hope to the depressed achieves harmony among diverse interest and offers the promise of an ultimate and universe peace.

Co-operative by their own efforts inspired by a sense of fraternity, equity and love of the past and creates a new economic system, a system in which capital plays the role of servant instead of master, the object of production is organized self-help instead of profit and human dignity is given the pride of place for achieving a more equitable and efficient economy better social adjustment and a more balanced system of democracy.

Co-operatives are based on the values of self-responsibility, democracy, equality and solidarity. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and carrying for others.
Unlike commercial banks, which are occupied in the helping, the industrial and commercial sectors of the economy, the co-operative Banks on the other hand provide credit and other associated facilities to the rural and agricultural sectors.

In World, Co-operative activity was stated in December 1844 in Britan. Social development is the sole aim of co-operative activity. Co-operative societies came in to begin when the co-operative societies Act-1904, was enacted. A co-operative society is the society of voluntary and organized group of individuals. The movement was started with the aim of providing farmer funds with low rate of interest. So that, exploitation by the village money lenders in hindered.

Under the Banking Regulation Act of 1904, co-operative banks have been brought under the control of Reserve Bank Of India (RBI).

In India, co-operative activity was started in 1889.the noble ideals like unity, similarity, honesty, loyalty and mutual co-operation etc. are the base of Co-operative activity.

In India, co-operative society Act was enacted in 1904. In 1909, Jambusar Urban co-operative Bank was first established under this act. Then in 1925, new co-operative society Act was come. Before then there was seven co-operative Banks in the Gujarat.

The activity of urban co-operative Banking was to extraordinary developed in the latter half 20th century. There is two reason of this. Banking regulation Act 1949 was apply to the co-operative Bank in 1966. At that time there was only 400 Urban co-operative Bank in the whole country. Then in 1969, nationalization of 14 large business banks
was become in the country. Today in our country, there are about 1400 urban co-operative Bank providing service in area of villages and cities.

**Principles of Co-operative Bank:**

The basic principles of co-operation are as follows:

1) **Voluntary and open Membership:**

Co-operatives Banks are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2) **Democratic Member Control:**

Co-operative Banks are democratic organizations controlled by their members, who actively participate in setting their policies and making decision, men and women serving as elected. Member representatives are accountable to the membership. In primary co-operatives members have equal voting right (one member, one vote) and co-operative at other levels are organized in a democratic manner.

3) **Member Economic Participation:**

Members Contribute equitably to and democratically control the capital of their co-operative. At least part of the capital is usually the common properly of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as condition of membership.
Members allocated surpluses for any of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible, benefiting members in proportions to their transactions with the co-operative, and supporting other activities approved by the membership.

4) Autonomy and Independence:

Co-operatives Banks are autonomous, self-help organizations controlled by their members. If they either into agreements with other organizations, includes governments to raise capital from external sources, they do so in terms that ensure democratic control by their members and maintain their co-operative autonomy.

5) Education, Training and Information:

Co-operatives Banks provide Education and Training for their members, elected representatives, managers and employees so that they can contribute effectively to the development of their Co-operatives. They inform the general public—particularly young people and opinion leaders—about the nature and benefit of Co-operation.

6) Co-operation among Co-operatives:

Co-operatives Banks serve their members most effectively and strengthen the Co-operative movement by working together through local, national, regional and international structures.
7) Concern for community:
  Co-operative works for the sustainable development of their communities through policies approved by their members.

4.2 BANKING SECTOR IN GUJARAT

The Banking Regulation Act 1949 defines banking as accepting the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, and order otherwise. The essential function of a bank is to provide services related to the storing of value and the extending credit. The evolution of banking dates back to the earliest writing, and continues in the present where a bank is a financial institution that provides banking and other financial services. Currently the term bank is generally understood an institution that holds a banking license. Banking licenses are granted by financial supervision authorities and provide rights to conduct the most fundamental banking services such as accepting deposits and making loans. There are also financial institutions that provide certain banking services without meeting the legal definition of a bank, a so called non-bank. Banks are a subset of the financial services industry.

The word bank is derived from the Italian “banca” which is derived from German and means bench. The terms bankrupt and "broke" are similarly derived from banca rottia, which refers to an out of business bank, having its bench physically broken. Money lenders in Northern Italy originally did business in open areas, or big open rooms, with each lender working from his own bench or table.
Typically, a bank generates profits from transaction fees on financial services or the interest spread on resources it holds in trust for clients while paying them interest on the asset.

**TYPES OF BANKS:**

There are several different types of banks including:

- **Central banks** usually control monetary policy and may be the lender of last resort in the event of a crisis. They are often charged with controlling the money supply, including printing paper money. Examples of central banks are the European Central Bank and the US Federal Reserve Bank.

- **Investment banks** underwrite stock and bond issues and advice on mergers. Examples of investment banks are Goldman Sachs of the USA or Nomura Securities of Japan.

- **Merchant banks** were traditionally banks which engaged in trade financing. The modern definition, however, refers to banks which provide capital to firms in the form of shares rather than loans. Unlike Venture capital firms, they tend not to invest in new companies.

- **Private Banks** manage the assets of the very rich. An example of a private bank is the Union Bank of Switzerland.

- **Savings banks** write mortgages exclusively.

- **Offshore banks** are banks located in jurisdictions with low taxation and regulation, such as Switzerland or the Channel Islands. Many offshore banks are essentially private banks.

- **Commercial banks** primarily lend to businesses (corporate banking)
Retail banks primarily lend to individuals. An example of a retail bank is Washington Mutual of the USA.

Universal banks engage in several of these activities. For example, Citigroup, a large American bank, is involved in commercial and retail lending; it owns a merchant bank (Citicorp Merchant Bank Limited) and an investment bank (Salomon Smith Barney); it operates a private bank (Citigroup Private Bank); finally, its subsidiaries in tax-havens offer offshore banking services to customers in other countries.

Banking in India has its origin as early as the Vedic period. It is believed that the transition from money lending to banking must have occurred even before Manu, the great Hindu Jurist, who has devoted a section of his work to deposits and advances and laid down rules relating to rates of interest.

During the Mogul period, the indigenous bankers played a very important role in lending money and financing foreign trade and commerce. During the days of the East India Company, it was the turn of the agency houses to carry on the banking business.

The General Bank of India was the first Joint Stock Bank to be established in the year 1786. The others which followed were the Bank of Hindustan and the Bengal Bank. The Bank of Hindustan is reported to have continued till 1906 while the other two failed in the meantime.

In the first half of the 19th century the East India Company established three banks; the Bank of Bengal in 1809, the Bank of Bombay in 1840 and the Bank of Madras in 1843. These three banks also known as Presidency Banks, were independent units and functioned well.
These three banks were amalgamated in 1920 and a new bank, the Imperial Bank of India was established on 27th January 1921. With the passing of the State Bank of India Act in 1955 the undertaking of the Imperial Bank of India was taken over by the newly constituted State Bank of India.

The Reserve Bank which is the Central Bank was created in 1935 by passing Reserve Bank of India Act 1934. In the wake of the Swadeshi Movement, a number of banks with Indian management were established in the country namely, Punjab National Bank Ltd, Bank of India Ltd, Canara Bank Ltd, Indian Bank Ltd, the Bank of Baroda Ltd, the Central Bank of India Ltd. On July 19, 1969, 14 major banks of the country were nationalized and in 15th April 1980 six more commercial private sector banks were also taken over by the government.

Today the commercial banking system in India may be distinguished into:

**Public Sector Banks**
- State Bank of India and its associate banks called the State Bank group
- 20 nationalized banks
- Regional Rural Banks mainly sponsored by Public Sector Banks

**Private Sector Banks**
- Old generation private banks
- New generation private banks
Foreign banks in India
Scheduled Co-operative Banks
Non-scheduled Banks

Co-Operative Sector

The co-operative banking sector has been developed in the country to supplement the village money lender:

- State Co-operative Banks
- Central Co-operative Banks
- Primary Agriculture Credit Societies
- Land Development Banks
- Urban Co-operative Banks
- Primary Agricultural Development Banks
- Primary Land Development Banks
- State Land Development Banks

Development Banks

- Industrial Finance Corporation of India (IFCI)
- Industrial Development Bank of India (IDBI)
- Industrial Credit and Investment Corporation of India (ICICI)
- Industrial Investment Bank of India (IIBI)
- Small Industries Development Bank of India (SIDBI)
- SCICI Ltd.
- National Bank for Agriculture and Rural Development (NABARD)
- Export Import Bank of India
- National Housing Bank
STATUS OF INDIAN BANKING INDUSTRY

It is useful to note some telling facts about the status of the Indian banking industry juxtaposed with other countries, recognizing the differences between the developed and the emerging economies.

First, the structure of the industry: In the world’s top 1000 banks, there are many more large and medium-sized domestic banks from the developed countries than from the emerging economies. Illustratively, according to The Banker 2004, out of the top 1000 banks globally, over 200 are located in USA, just above 100 in Japan, over 80 in Germany, over 40 in Spain and around 40 in the UK. Even China has as many as 16 banks within the top 1000, out of which, as many as 14 are in the top 500. India, on the other hand, had 20 banks within the top 1000 out of which only 6 were within the top 500 banks. This is perhaps reflective of differences in size of economies and of the financial sectors.

Second, the share of bank assets in the aggregate financial sector assets: In most emerging markets, banking sector assets comprise well over 80 per cent of total financial sector assets, whereas these figures are much lower in the developed economies. Furthermore, deposits as a share of total bank liabilities have declined since 1990 in many developed countries, while in developing countries public deposits continue to be dominant in banks. In India, the share of banking assets in total financial sector assets is around 75 per cent, as of end-March 2004. There is, no doubt, merit in recognizing the importance of diversification in the institutional and instrument-specific aspects of financial intermediation in the interests of wider choice, competition and stability.
Third, internationalization of banking operations: The foreign controlled banking assets, as a proportion of total domestic banking assets, increased significantly in several European countries (Austria, Ireland, Spain, Germany and Nordic countries), but increases have been fairly small in some others (UK and Switzerland). Amongst the emerging economies, while there was marked increase of foreign-controlled ownership in several Latin American economies, the increase has, at best, been modest in the Asian economies. Available evidence seems to indicate some correlation between the extent of liberalization of capital account in the emerging markets and the share of assets controlled by foreign banks. As per the evidence available, the foreign banks in India, which are present in the form of branches, seem to enjoy greater freedom in their operations, including retail banking, in the country on par with domestic banks, as compared with most of the other developing countries. Furthermore, the profitability of their operations in India is considerably higher than that of the domestically-owned banks and, in fact, is higher than the foreign banks’ operations in most other developing countries. India continues to grant branch licenses more liberally than the commitments made to the WTO.

Fourth, the share of state-owned banks in total banking sector assets: Emerging economies, with predominantly Government-owned banks, tend to have much higher state-ownership of banks compared to their developed counterparts. While many emerging countries chose to privatize their public sector banking industry after a process of absorption of the overhang problems by the Government, we have
encouraged state-run banks to diversify ownership by inducting private share capital through public offerings rather than by strategic sales and still absorb the overhang problems.

A noteworthy feature of banking reforms in India is the growth of newly licensed private sector banks, some of which have attained globally best standards in terms of technology, services and sophistication. In many respects related to performance, these domestically promoted banks have surpassed branches of foreign banks in India, and could be a role model for other banks. The Reserve Bank of India (RBI) is India's central bank. Though the banking industry is currently dominated by public sector banks, numerous private and foreign banks exist. India's government-owned banks dominate the market. Their performance has been mixed, with a few being consistently profitable. Several public sector banks are being restructured, and in some the government either already has or will reduce its ownership.

**Private and foreign banks**

The RBI has granted operating approval to a few privately owned domestic banks; of these many commenced banking business. Foreign banks operate more than 150 branches in India. The entry of foreign banks is based on reciprocity, economic and political bilateral relations. An inter-departmental committee approves applications for entry and expansion.
**Capital adequacy norm**

Foreign banks were required to achieve an 8 percent capital adequacy norm by March 1993, while Indian banks with overseas branches had until March 1995 to meet that target. All other banks had to do so by March 1996. The banking sector is to be used as a model for opening up of India's insurance sector to private domestic and foreign participants, while keeping the national insurance companies in operation.

**Banking**

India has an extensive banking network, in both urban and rural areas. All large Indian banks are nationalized, and all Indian financial institutions are in the public sector.

**RBI banking**

The Reserve Bank of India is the central banking institution. It is the sole authority for issuing bank notes and the supervisory body for banking operations in India. It supervises and administers exchange control and banking regulations, and administers the government's monetary policy. It is also responsible for granting licenses for new bank branches. 25 foreign banks operate in India with full banking licenses. Several licenses for private banks have been approved. Despite fairly broad banking coverage nationwide, the financial system remains inaccessible to the poorest people in India.
Indian banking system

The banking system has three tiers. These are the scheduled commercial banks; the regional rural banks which operate in rural areas not covered by the scheduled banks; and the cooperative and special purpose rural banks.

Scheduled and non scheduled banks

There are approximately 80 scheduled commercial banks, Indian and foreign; almost 200 regional rural banks; more than 350 central cooperative banks, 20 land development banks; and a number of primary agricultural credit societies. In terms of business, the public sector banks, namely the State Bank of India and the nationalized banks, dominate the banking sector.

Local financing

All sources of local financing are available to foreign-participation companies incorporated in India, regardless of the extent of foreign participation. Under foreign exchange regulations, foreigners and non-residents, including foreign companies, require the permission of the Reserve Bank of India to borrow from a person or company resident in India.

Regulations on foreign banks

Foreign banks in India are subject to the same regulations as scheduled banks. They are permitted to accept deposits and provide credit in accordance with the banking laws and
RBI regulations. Currently about 25 foreign banks are licensed to operate in India. Foreign bank branches in India finance trade through their global networks.

**RBI restrictions**
The Reserve Bank of India lays down restrictions on bank lending and other activities with large companies. These restrictions, popularly known as "consortium guidelines" seem to have outlived their usefulness, because they hinder the availability of credit to the non-food sector and at the same time do not foster competition between banks.

**Indian vs. foreign banks**
Most Indian banks are well behind foreign banks in the areas of customer funds transfer and clearing systems. They are hugely over-staffed and are unlikely to be able to compete with the new private banks that are now entering the market. While these new banks and foreign banks still face restrictions in their activities, they are well-capitalized, use modern equipment and attract high-caliber employees.

**Need to Ponder**
Debates on India's slowdown focus on the manufacturing sector which is dangerously misleading: one of the biggest areas of worry about India's economic slowdown is being ignored - the systemic flaw of India's banking sector. Stories about the real health of Indian banks get less publicised because banks are still overwhelmingly owned, controlled and directed by the government, i.e., the ministry of finance (MoF). Banks have no effective mouthpiece either.
Grey future

One more reason being the opacity of the Reserve Bank of India. This does not mean a forecast of doom for the Indian banking sector the kind that has washed out south east Asia. And also not because Indian banks are healthy. We still have no clue about the real non-performing assets of financial institutions and banks. Many banks are now listed. That puts additional responsibility of sharing information. It is now clear that it was the financial sector that caused the sensational meltdown of some Asian nations. India is not Thailand, Indonesia and Korea. Borrowed investment in property in India is low and property prices have already fallen, letting out steam gently. Our micro-meltdown has already been happening.

Still, there are several other worries about the banking sector, mainly confusion over ownership and control. Sometime soon India will be forced to apply the norms of developed countries and many banks (including some of the biggest) will show very poor return ratios and dozens of banks will be bankrupt. When that happens the two popular reasons to defend bad banks will disappear. These are: one, to save face in the remote hope of that fortunes will `revive' and two, some banks are too big to be allowed to fail, fearing social upheaval.

India is one of the fastest growing economies in the world. Evidence from across the world suggests that a sound and evolved banking system is required for sustained economic development. India has a better banking system in place vis a vis other developing countries, but there are several issues that need to be ironed out.
The challenges that the banking sector in India faces are:

- **INTEREST RATE RISK:**
  Interest rate risk can be defined as exposure of bank's net interest income to adverse movements in interest rates. A bank's balance sheet consists mainly of rupee assets and liabilities. Any movement in domestic interest rate is the main source of interest rate risk.
  Now as yields go up (with the rise in inflation, bond yields go up and bond prices fall as the debt market starts factoring a possible interest rate hike), the banks will have to set aside funds to mark to market their investment.
  This will make it difficult to show huge profits from treasury operations. This concern becomes much stronger because a substantial percentage of bank deposits remain invested in government bonds.

- **INTEREST RATES AND NON-PERFORMING ASSETS:**
  The best indicator of the health of the banking industry in a country is its level of NPAs. Given this fact, Indian banks seem to be better placed than they were in the past. A few banks have even managed to reduce their net NPAs to less than one percent (before the merger of Global Trust Bank into Oriental Bank of Commerce, OBC was a zero NPA bank). But as the bond yields start to rise the chances are the net NPAs will also start to go up. This will happen because the banks have been making huge provisions against the money they made on their bond portfolios in a scenario where bond yields were falling.
COMPETITION IN RETAIL BANKING:
The entry of new generation private sector banks has changed the entire scenario. Earlier the household savings went into banks and the banks then lent out money to corporates. Now they need to sell banking. The retail segment, which was earlier ignored, is now the most important of the lot, with the banks jumping over one another to give out loans. The consumer has never been so lucky with so many banks offering so many products to choose from. With supply far exceeding demand it has been a race to the bottom, with the banks undercutting one another. A lot of foreign banks have already burnt their fingers in the retail game and have now decided to get out of a few retail segments completely.

THE URGE TO MERGE:
In the recent past there has been a lot of talk about Indian Banks lacking in scale and size. The State Bank of India is the only bank from India to make it to the list of Top 100 banks, globally. Most of the PSBs are either looking to pick up a smaller bank or waiting to be picked up by a larger bank.

The central government also seems to be game about the issue and is seen to be encouraging PSBs to merge or acquire other banks. Global evidence seems to suggest that even though there is great enthusiasm when companies merge or get acquired, majority of the mergers/acquisitions do not really work.
So in the zeal to merge with or acquire another bank the PSBs should not let their common sense take a back seat. Before a merger is carried out cultural issues should be looked into. A bank based primarily out of North India might want to acquire a bank based primarily out of South India to increase its geographical presence but their cultures might be very different. So the integration process might become very difficult. Technological compatibility is another issue that needs to be looked into in details before any merger or acquisition is carried out. The banks must not just merge because everybody around them is merging. As Keynes wrote, "Worldly wisdom teaches us that it's better for reputation to fail conventionally than succeed unconventionally". Banks should avoid falling into this trap.

- IMPACT OF BASEL-II NORMS:

Banking is a commodity business. The margins on the products that banks offer to its customers are extremely thin vis a vis other businesses. As a result, for banks to earn an adequate return of equity and compete for capital along with other industries, they need to be highly leveraged. The primary function of the bank's capital is to absorb any losses a bank suffers (which can be written off against bank's capital). Norms set in the Swiss town of Basel determine the ground rules for the way banks around the world account for loans they give out. These rules were formulated by the Bank for International Settlements in 1988.

Essentially, these rules tell the banks how much capital the banks should have to cover up for the risk that their loans might go bad. The rules set in 1988 led the banks to differentiate among the customers it
lent out money to. Different weight age was given to various forms of assets, with zero percentage weightings being given to cash, deposits with the central bank/govt.etc, and 100 per cent weighting to claims on private sector, fixed assets, real estate etc. The summation of these assets gave us the risk-weighted assets. Against these risk weighted assets the banks had to maintain a (Tier I + Tier II) capital of 9 per cent i.e. every Rs100 of risk assets had to be backed by Rs 9 of Tier I + Tier II capital. To put it simply the banks had to maintain a capital adequacy ratio of 9 per cent.

The problem with these rules is that they do not distinguish within a category i.e. all lending to private sector is assigned a 100 per cent risk weighting, be it a company with the best credit rating or company which is in the doldrums and has a very low credit rating. This is not an efficient use of capital. The company with the best credit rating is more likely to repay the loan Vis a Vis the company with a low credit rating. So the bank should be setting aside a far lesser amount of capital against the risk of a company with the best credit rating defaulting Vis a Vis the company with a low credit rating. With the BASEL-II norms the bank can decide on the amount of capital to set aside depending on the credit rating of the company.

Credit risk is not the only type of risk that banks face. These days the operational risks that banks face are huge. The various risks that come under operational risk are competition risk, technology risk, casualty risk, crime risk etc. The original BASEL rules did not take into account the operational risks. As per the BASEL-II norms, banks will have to set aside 15 per cent of net income to protect themselves against operational risks.
So to be ready for the new BASEL rules the banks will have to set aside more capital because the new rules could lead to capital adequacy ratios of the banks falling. How the banks plan to go about meeting these requirements is something that remains to be seen. A few banks are planning initial public offerings to have enough capital on their books to meet these new norms.

IN CLOSING:
Over the last few years, the falling interest rates, gave banks very little incentive to lend to projects, as the return did not compensate them for the risk involved. This led to the banks getting into the retail segment big time. It also led to a lot of banks playing it safe and putting in most of the deposits they collected into government bonds. Now with the bond party over and the bond yields starting to go up, the banks will have to concentrate on their core function of lending. The banking sector in India needs to tackle these challenges successfully to keep growing and strengthen the Indian financial system.
Furthermore, the interference of the central government with the functioning of PSBs should stop. A fresh autonomy package for public sector banks is in offing. The package seeks to provide a high degree of freedom to PSBs on operational matters. This seems to be the right way to go for PSBs. The growth of the banking sector will be one of the most important inputs that shall go into making sure that India progresses and becomes a global economic super power.
CHALLENGES AHEAD
Following highlights some thoughts on certain areas which have a key bearing on the ability of Indian banks to remain competitive and enhance soundness. Needless to state, these are more in the nature of random thoughts, rather than any structured thinking, and are meant to invite discussion.

First, **cost management.** Cost containment is a key to sustainability of bank profits as well as their long-term viability. To highlight this point, we take recourse to some figures. In 2003, operating costs of banks as a proportion of total average assets in the UK were 2.12 per cent, for those in Switzerland they were 2.03 per cent, and less than 2 per cent in major European economies like Sweden, Austria, Germany and France. In India, however, in 2003, operating costs as proportion of total assets of scheduled commercial banks stood at 2.24 per cent. The tasks ahead are thus clear and within reach.

Second, **recovery management.** This is a key to the stability of the banking sector. There should be no hesitation in stating that Indian banks have done a remarkable job in containment of non-performing loans (NPL) considering the overhang issues and overall difficult environment. Let me add that for 2004, the net NPL ratio for the Indian scheduled commercial banks at 2.9 per cent is ample testimony to the impressive efforts being made by our banking system. In fact, recovery management is also linked to the banks’ interest margins. We must recognize that cost and recovery management supported by enabling legal framework hold the key to future health and
competitiveness of the Indian banks. No doubt, improving recovery-management in India is an area requiring expeditious and effective actions in legal, institutional and judicial processes.

Third, **technological intensity** of banking: This is one area where perhaps India needs to do significant ‘catching up’, notwithstanding the rapid strides made over the last.

Some available figures indicate that in late 1999, the percentage of customers using online banking was less than 1 per cent in India, compared with anywhere between 6-30 per cent in developed economies like US, UK, Germany, Finland and Sweden. Even in Latin America, these figures are much higher than for India. While admittedly the numbers for India are likely to be much higher at present than these figures suggest, so would be the case for these other economies as well. The issue, therefore, remains what has been the extent of ‘catching up’ by India on this score? In fact, this seems somewhat intriguing: India happens to be a world leader in information technology, but its usage by our banking system is somewhat muted. It is wise for Indian banks to exploit this globally state-of-art expertise, domestically available, to their fullest advantage.

Fourth, **risk management**. Banking in modern economies is all about risk management. The successful negotiation and implementation of Basel II Accord is likely to lead to an even sharper focus on the risk measurement and risk management at the institutional level. Thankfully, the Basel Committee has, through its various publications, provided useful guidelines on managing the various facets of risk. The
institution of sound risk management practices would be an important pillar for staying ahead of the competition. Banks can, on their part, formulate ‘early warning indicators’ suited to their own requirements, business profile and risk appetite in order to better monitor and manage risks.

Fifth, governance. The recent irregularities involving accounting firms in the US have amply demonstrated the importance of good corporate governance practices. The quality of corporate governance in the banks becomes critical as competition intensifies, banks strive to retain their client base, and regulators move out of controls and micro-regulation. As already mentioned, banks are special in emerging markets since they take a leading role in development of other financial intermediaries and of financial markets, apart from having a large recourse to public deposits. No doubt, there is nothing like an ‘optimal’ level of governance for one to be satisfied with. The objective should be to continuously strive for excellence. The RBI has, on its part, made significant efforts to improve governance practices in banks, drawing upon international best practices. It is heartening to note that corporate governance presently finds explicit mention in the annual reports of several banks. The improved corporate governance practice would also provide an opportunity to accord greater freedom to the banks’ boards and move away from micro regulation to macro management. Banks in India are custodians of depositors’ monies, monies of the millions of depositors who are seeking safe avenues for their hard earned savings, and hence, banks must accept and perform an effective fiduciary role. In this light, improvement in policy-framework, regulatory regime, market-

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perceptions, and indeed, popular sentiments relating to governance in banks need to be on the top of the agenda – to serve our society’s needs and realities while being in harmony with the global perspective.

RETAIL BANKING

Retail banking is typical mass-market banking where individual customers use local branches of larger commercial banks. Services offered include: savings and checking accounts, mortgages, personal loans, debit cards, credit cards, and so forth. This is very different from wholesale banking.

RETAIL BANKING IN INDIA:

India is poised to become the world's fourth largest economy in the span of two decades. Economic prosperity is providing many in this populous nation with real purchasing power; it simply is an opportunity that cannot be overlooked by global banks. Despite its appeal, India remains a developing economy. Thus, global banks seeking a presence or expansion in India must craft a business strategy that considers the country's attendant challenges: long-established competitors; rudimentary infrastructure; dynamic political environment; restrictive regulations; and developing country operational risks.
These challenges should be weighed against the potential gains from entering the marketplace, as well as the likely cost of doing nothing. Extensive research conducted by the IBM Institute for Business Value pinpointed four of the most promising product areas for global banks entering the Indian market: housing loans, automobile loans, small and medium enterprise (SME) banking and personal financial services. However, recognizing the growth opportunities is only the beginning. Global banks targeting India as a source of new growth will have to do much more than just "show up" - success will lie in the details of execution.

With one of the most under penetrated retail lending markets in Asia-Pacific, India offers great potential. India's mortgage debt in 2002 totaled only 2 percent of gross domestic product (GDP), compared to 7 percent of Thailand's GDP, 8 percent of GDP in China and much higher proportions in other parts of the region: Malaysia (28 percent), South Korea (30 percent) and Hong Kong (52 percent). While India remains characterized by extreme wealth and poverty, a middle class is beginning to emerge, with absolute demand for products and services on the rise. To seize this opportunity, new market entrants must exploit specific market niches and leverage best-in-class capabilities while addressing the unique challenges of the Indian banking environment.

During the last decade, India has emerged as one of the biggest and fastest growing economies in the world. The strengthening economy in India has been fueled by the convergence of several key influences: liberalization policies of the government, growth of key economic
sectors, development of an English-speaking, well-educated work force and the emergence of a middle class population.

**More liberal economic policies: Opening the marketplace**

India's debt crisis in the early 1990s forced the government to radically reform its economic policies. The resulting liberalization program opened the market for foreign investment, fostered domestic competition and spawned an era of privatization. In the 10 years after 1992, India's economy grew at an average rate of 6.8 percent. During April to June 2004, the economy continued to show its strength and grew by 7.4 percent.

Foreign direct investment (FDI) grew more than twenty-fold, from just under US$0.13 billion in 1992 to almost US$2.86 billion in 2003. Meanwhile, privatization accelerated between 2000 and 2002, when 13 state-owned companies were sold, while the Indian government recently raised another US$3.41 billion by selling off stakes in six state-owned firms. Since foreign investment and access to external markets remain critical to the growth of the country - and specifically, it's banking system - reform-minded institutional and foreign investors are monitoring the early words and actions of the new administration that took control in May 2004, uncertain whether its predecessor's liberalization program will continue.

**Booming businesses: Services, agriculture and manufacturing**

Domestic industries have prospered from the development of India's capital markets and the increased foreign trade and investment across sectors. The rapidly expanding services sector (including telecommunications and information technology), has benefited from government spending and explosive demand for IT and IT-enabled
services (ITES), such as call centers and back-office administration. Agriculture and core industries (such as steel, cement and automobiles) are expected to remain strong over time because of affordable consumer credit and the robust economy. In addition, infrastructure spending is expected to be very strong - fueled by big-ticket projects involving national highway systems, establishment of privatized airports, and the modernization of ports and telecommunication networks. An estimated US$440 billion is expected to be spent in public and private projects over the next five years.

A growing labor force: English-speaking with IT savvy Global investors are attracted to India because of the growing number of well-educated, English-speaking workers who are comfortable working in information technology. India's IT work force will be augmented by a booming population of engineering students. The number of engineering students admitted at the university level rose in 2004 to 341,649 from 310,590 in 2003. Furthermore, India's labor pool also serves as an expanding customer base for retail bank products and services.

The emerging middle class: Managing "new money"
The development of India's economy is boosting overall consumer purchasing power. The percentage of middle to high income Indian households is expected to continue rising. The younger, more educated population not only wields increasing purchasing power, but it is more comfortable than previous generations with acquiring personal debt
A view of India's banking industry

India's banking industry is one of the major beneficiaries of the country's ascendant economic power. Improving consumer purchasing power, coupled with more liberal attitudes toward personal debt, is fueling India's explosive banking segment. Global banks should be encouraged further by the relatively under penetrated status of the country's various retail lending segments. The retail market for mortgages, credit cards, automobile loans and other consumer loans is expected to jump from its 1999 total of US$9.7 billion to US$36.7 billion in 2004 (see Figure 3). Even with this strong performance, significant opportunities for continued retail lending growth remain as retail lending figures lag India's regional peers.

Unlike most rapidly-expanding, emerging markets, India's banking sector has exhibited financial stability and a trend toward improved governance under the management of its central bank, the Reserve Bank of India (RBI). One challenge the RBI had to contend with was the legacy of policy-directed, corporate lending by the state-owned banks that had produced high levels of non-performing assets (NPAs). Through structural reform, remedial legislative actions, and favorable returns from the fixed income Treasury Markets, Indian banks have cut gross NPA levels from 15.7 percent in 1997 to 8.8 percent in 2003. Fortunately, new entrants to the market are not subjected to the same mandatory lending requirements as domestic banks and can therefore "cherry-pick" the most desirable clients, allowing them to lower their own risk of NPAs through more rigorous risk management strategies.

Global banks in India: Gaining a foothold

The competitive environment in India presents both challenges and opportunities to global banks seeking market entry. Entrenched
domestic competitors and restrictive equity ownership ceilings imposed by the government create obstacles for banks establishing a foothold in India. Primary challenges include tough competition and government ceilings on foreign equity ownership. Opportunities exist because global banks often have technological advantages, well-honed, efficient processes and appealing products and services.

For the most part, global banks must execute on an organic growth strategy to expand their footprint in India. Merger and acquisition activity in the banking sector remains limited by government regulation. This is difficult news for global banks that have relied on acquisitions as a market entry or expansion strategy. Unless the government shifts its posture on foreign equity ownership, global banks will have to rely on organic growth to expand their presence in India.

Crafting an India-specific retail banking strategy
As global banks have experienced in the past, successfully competing in India requires substantially more consideration than merely choosing the right market to target. It warrants a well-crafted strategy that addresses the numerous risks and challenges specific to India's developing economy. The confluence of rapid economic development, elevated consumer purchasing power levels and an underserved retail banking population position India as a potential growth region for the 21st Century. However, India's banking history has also seen global banks failing to establish a profitable operation in the country.

Success will truly lie in the details of execution.
REASONS FOR THE CHANGE OVER FROM CORPORATE BANKING TO RETAIL BANKING:

- The financial sector reforms undertaken by the Government since the year 1991 have accelerated the process of disintermediation which has encouraged blue chip corporate to access cheaper funds to meet their working capital requirements directly from investors in India and abroad through capital market instruments and external Commercial Borrowings route thus by-passing Banks in the process. The deregulation of markets and interest rates has lead to cut throat competition among Banks for corporate loans making them to lend even at PLR or sub PLR and offer other valued services at comparatively cheaper rates to big and high value corporate. In the process, most of the banks have experienced substantial reduction in interest spreads and drain on their profitability.

- The introduction of stringent Asset Classification, Income Recognition and provisioning norms has resulted in growing menace of NPAs in corporate loans which has affected the asset quality, profitability and capital adequacy of banks adversely. The risks involved in corporate loans are very high as corporate have to keep all their eggs in one basket. The risks involved in retail Banking advances are comparatively less and well diversified as loan amounts are relatively small ranging from Rs. 5000 to Rs. 100 lace and repayable normally in short period of 3-5 years except housing loans (where repayment period is long up to 15 years in some cases) and from fixed source of income like salaries.
Whereas corporate loans give average return of just 0.5 to 1.5 percent only, the retail advances offer attractive interest spread of 3 to 4 percent, because retail borrowers are less interest rate sensitive than the Corporate. Another reason for large interest spreads on retail advances is that the retail customers are too fragmented to bargain effectively.

While corporate loans are subject to ups and downs in trade frequently, retail loans are comparatively independent of recession and continue to deliver even during the sluggish phase of economy.

Retail Banking gives a lot of stability and public image to banks as compared to corporate banking.

The housing loans, which form the major chunk of retail lending and where NPAs are the least, carry risk weight of just 50% for capital adequacy purposes. This is likely to come down further as new Basel Capital Accord or (Basel II) norms are put in place from the year 2006. This offers added incentive to banks for lending to this retail segment as against corporate lending where capital consumption is higher.

The greater amount of consumerism in the country with upswing in income levels of burgeoning middle class, which has propensity to consume to raise their standard of living, is enlarging the retail markets. This market is growing 250 percent per year and boosting the demand for credit from households. The potential is huge as present penetration level is just over 2 percent in the country. Given the easy liquidity scenario in the country the growth rate in this sector is likely to go up manifold in the years come. This offers great potential for banks to enlarge their loan books.
The Indian mindset is also changing and consumers prefer to improve their quality of life even if it means borrowing for facilities like housing, consumer goods vehicles and vacationing etc. Borrowing and lending is no longer considered a taboo. The peer pressure and demonstration effect is further pushing up demand for housing loans, consumer products and automobiles. The profiles of customers are fast changing from conservative dodos to fashionable peacocks. All these developments give big push to Retail Banking activities.

Retail Banking clients are generally loyal and tend not to change from one Bank to another very often.

Large numbers of Retail clients facilitate marketing, mass selling and ability to categorize/select clients using scoring system and data mining. Banks can cut costs and achieve economies of scale and improve their bottom-line by robust growth in retail business volume.

Through product innovations and competitive pricing strategies Banks can foster business relationship with customers to retain the existing clients and attract new ones.

Innovative products like asset securitization can open new vistas in sustaining optimal capital adequacy and asset liability management for banks.

Retail Banking offers opportunities to banks to cross sell other retail products like credit card, insurance, mutual fund products and demate facilities etc. to depositors and investors.
RETAIL BANKING PRODUCTS AND SERVICES

⇒ **Deposits:**
There are many products in retail banking like F.D., Savings A/c, Current A/c, Recurring A/c, NRI A/c, Corporate Salary A/c, Free Demat A/c, Kid’s A/c, Senior Citizen Scheme, Cheque Facilities, Overdraft Facilities, Free Demand Draft Facilities, Locker Facilities, Cash Credit Facilities, etc. They are listed and explained as follows:

⇒ **Fixed Deposit:**
The deposit with the bank for a period, which is specified at the time of making the deposit is known as fixed deposit. Such deposits are also known as F.D or term deposit. A F.D is repayable on the expiry of a specified period. The rate of interest and other terms and conditions on which the banks accepted F.D were regulated by the R.B.I. in section 21 and 35A of the Banking Regulation Act 1949.

Each bank has prescribed their own rate of interest and has also permitted higher rates on deposits above a specified amount. R.B.I has also permitted the banks to formulate F.D. schemes specially meant for senior citizen with higher interest than normal.

⇒ **Savings A/c:**
Saving bank A/c is meant for the people who wish to save a part of their current income to meet their future needs and they can also earn in interest on their savings. The rate of interest payable on by the banks on deposits maintained in savings account is prescribed by R.B.I. The bank should not open a saving account in the name of:
1. Govt. Department.
2. Municipal Corporation
3. Panchayat Samities
4. State housing Boards
5. Water and Sewerage Boards

Nowadays the fixed deposit is also linked with a saving account. Whenever there is excess of balance in saving a/c it will automatically transfer into Fixed deposit and if there is shortfall of funds in savings a/c, by issuing cheque the money is transferred from fixed deposit to saving a/c. Different banks give different names to this product.

⇒ **Current A/c:**
A current A/c is an active and running account, which may be operated upon any number of times during a working day. There is no restriction on the number and the amount of withdrawals from a current account. Current account suit the requirements of big businessmen, joint stock companies, institutions, public authorities and public corporation etc.

⇒ **Recurring Deposit:**
A variant of the saving bank a/c is the recurring deposit or cumulative deposit a/c introduced by banks in recent years. Here, a depositor is required to deposit an amount chosen by him. The rate of interest on the recurring deposit account is higher than as compared to the interest on the saving a/c. Banks open such accounts for periods ranging from 1 to 10 years. TDS is not applicable to this type of deposit. The recurring deposit account can be opened by any number of persons, more than
one person jointly or severally, by a guardian in the name of a minor and even by a minor.

⇒ NRI Account:
NRI accounts are maintained by banks in rupees as well as in foreign currency. Four types of Rupee account can be open in the names of NRI.

1. Non Resident Rupee Ordinary Account (NRO)
2. Non Résident External Account (NRE)
3. Non Resident (Non Repatriable Deposit Scheme) (NRNR)
4. Non Resident (special) Rupee Account Scheme (NRSR)

Apart from this, foreign currency account is the account in foreign currency. The account can be open normally in US dollar, Pound Sterling, Euro. The accounts of NRIs are Indian millennium deposit, Resident foreign currency, housing finance scheme for NRI investment schemes.

⇒ Corporate Salary Account:
Corporate Salary a/c is a new product by certain private sector banks, foreign banks and recently by some public sector banks also. Under this account salary is deposited in the account of the employees by debiting the account of employer. The only thing required is the account number of the employees and the amount to be paid them as salary. In certain cases the minimum balance required is zero. All other facilities available in savings a/c is also available in corporate salary a/c.
⇓ **Demat Account:**
Dematerialization is a process by which physical share certificates / securities are taking back by the company or registrar and destroyed ultimately. An equivalent number of shares are credited electronically to customers depository account. Just like saving/current account with a bank one can open a securities account with the depository through a depository participant (DP).

⇓ **Kid’s Account: ( Minor Account )**
Children are invited as customer by certain banks. Under this, Account is opened in the name of kids by parents or guardians. The features of kid’s account are free personalized cheque book which can be used as a gift cheque, internet banking, investment services etc.

⇓ **Senior Citizenship Scheme:**
Senior citizens can open an account and on that account they can get interest rate somewhat more than the normal rate of interest. This is due to some social responsibilities of banks towards aged persons whose earning are mainly on the interest rate.

⇓ **Loans and Advances:**
The main business of the banking company is lending of funds to the constituents, mainly traders, business and industrial enterprises. The major portion of a bank’s funds is employed by way of loans and advances, which is the most profitable employment of its funds.
There are three main principles of bank lending that have been followed by the commercial banks and they are safety, liquidity, and profitability.

Banks grant loans for different periods like short term, medium term, and long term and also for different purpose.

- **Personal Loans:**
  This is one of the major loans provided by the banks to the individuals. There the borrower can use for his/her personal purpose. This may be related to his/her business purpose. The amount of loan is depended on the income of the borrower and his/her capacity to repay the loan.

- **Housing Loans:**
  NHB is the wholly own subsidiary of the RBI which control and regulate whole industry as per the guidance and information, home loan’s rates is going to be cheaper so that infrastructure sector gets motivation for development home loans rate is decline up to 7.5% EMI at declining rate so that it becomes cheaper. The purpose of loan to purchase, extension, renovation, and land development.

- **Education Loans:**
  Loans are given for education in country as well as abroad.

- **Vehicle Loans:**
  Loans are given for purchase of scooter, auto-rickshaw, car, bikes etc. The market size of auto finance is RS 7500 cr. Low interest rates,
increasing income levels of people are the factors for growth in this sector. Even for second hand car finance is available.

Professional Loans:
Loans are given to doctor, C.A, Architect, Engineer or Management Consultant. Here the loan repayment is normally done in the form of equated monthly.

Consumer Durable Loans:
Under this, loans are given for acquisition of T.V, Cellphones, A.C, Washing Machines, Fridge and other items.

Loans against Shares and Securities:
Finance against shares is given by banks for different uses. Now a days finance against shares are given mostly in demat shares. A margin of 50% is normally accepted by the bank on market value. For these loans the documents required are normally DP notes, letter of continuing security, pledge form, power of attorney. This loan can be used for business or personal purpose.

Services Provided By the Banks:
Credit Cards:
A credit card is an instrument, which provides immediate credit facilities to its holder to avail a variety of goods and services at the merchant outlets. It is made of plastic and hence popularly called as Plastic Money.
Such cards are issued by bank to persons with minimum income ranging between RS 50000 and RS 100000 per annum. And are accepted by a variety of business establishments which are notified by the card issuing bank.

Some banks insist on the cardholder being their customers while others do not.

Few banks do not charge any fee for issuing credit cards while others impose an initial enrollment fee and annual fee also.

If the amount is not paid within the time duration the bank charges a flat interest of 2.5%.

Leading Indian Banks such as: SBI, BOB, Canara Bank, ICICI, HDFC and a few foreign banks like CITIBANK, Standard Chartered etc are the important issuers of credit card in India.

⇒ **Debit Cards:**
It is a new product introduced in India by Citibank a few years ago in association with MasterCard.
A debit card facilitates purchases or payments by the cardholder.
It debits money from the a/c of the cardholder during a transaction. This implies that the cardholder can spend only if his account permits.

⇒ **Net Banking:**
This facilitates the customers to do all their banking operations from their home by using the internet facility.
With Net Banking one can carry out all banking and shopping transactions safely and with total confidentiality.

With Net Banking one can easily perform various functions:

1. Check Account Balance
2. Download Account Statement
3. Request for a stop payment of a cheque.
5. Make a FD/TDS enquiry.
6. Access DEMAT a/c
7. Transfer funds.
8. Facilitate bill Payments.
9. Open a FD

⇒ **Mobile Banking:**

To avail the mobile banking, one needs to have a savings, current and FD a/c and mobile connection.

Using mobile banking facility one can –

1. Check Balance
2. Check last three transactions.
3. Request for a statement
5. Enquire on a cheque status.
6. Instruct stock cheque payment.
7. View FD details.
8. Transfer funds.
⇒ **Phone Banking:**
It helps to conduct a wide range of banking transactions from the comfort of one’s home or office.

Using phone banking facility one can

1. Check Balance
2. Check last three transactions.
4. Transfer funds.
5. Enquire on a cheque status, and much more.

⇒ **Anywhere Banking:**
One can operate his roaming current a/c at one centre at any other designated of a particular across any other centre.

One can deposit or withdraw cash from any branch of a particular bank all over the country up to a prescribed limit. One can also transfer funds.

⇒ **Automated Teller Machines (ATM):**
ATM features user-friendly graphic screens with easy to follow instructions. The ATMs interact with customers in their local language for increased convenience.

Following are the features available on ATMs which can be accessed from anywhere at anytime:

1. Cash Withdrawal
2. Cash Deposit
3. Balance Enquiry
4. Mini A/c Statements
5. Cheque Book Request
6. Transaction at various merchant establishments.
Smart Card:
The smart card, a latest additional to the world of banking and information technology has emerged as the largest volume driven end-product in the world due to its data portability, security and convenience. Smart Card is similar in size to today’s plastic payment card; it has a memory chip embedded in it. The chip stores electronic data and programmes that are protected by advanced security features. When coupled with a reader, the smart card has the processing power to serve many different applications.
To ensure the confidentiality of all banking service, smart cards have mechanisms offering a high degree of security. These mechanisms are based on private and public key cryptography combined with a digital certificate, one of the most advanced security techniques currently available.

SOME ASPECTS OF RETAIL BANKING
Impact of Retail Banking:

- The major impact of retail Banking is that, the customers have become the Emperors – the fulcrum of all Banking activities, both on the asset side and the liabilities front.
- The Non-Banking finance companies which have hitherto been thriving on retail business due to high risk and high returns thereon have been dislodged from their profit munching citadel
- Retail Banking is transforming banks into one stop financial super markets.
- The share of retail loans is fast increasing in the loan books of banks.
Banks can foster lasting business relationship with customers and retain the existing customers and attract new ones. There is a rise in their service as well.

Banks can cut costs and achieve economies of scale and improve their revenues and profits by robust growth in retail business. Reduction in costs offers a win situation both for banks and the customers.

It has affected the interface of banking system through different delivery mechanism

It is not that banks are sharing the same pie of retail business, the pie itself is growing exponentially. Retail Banking has fuelled a considerable quantum of purchasing power through a slew of retail products.

4.3 Introduction to Selected Urban Co-Operative Banks of Gujarat

For analysis of operating efficiency of urban co-operative banks of Gujarat, I have selected following 6 scheduled urban co-operative banks of Gujarat.

A) The Kalupur Commercial Co-Operative Bank Ltd.
B) Rajkot Nagrik Sahakari Bank Ltd.
C) The Ahmedabad Mercentile Co-Operative Banld Ltd.
D) Mehasana Urban Co-Operative Bank Ltd.
E) The Surat People’s Co-Operative Bank Ltd.
F) Nutan Nagrik Sahakari Bank Ltd.
A) The Kalupur Commercial Co-Operative Bank Ltd.

The phenomenal growth of the urban co-operative banks in Gujarat as well as in Maharashtra has been witnessed particularly after the nationalization of major commercial banks in the year 1969. Immediately after nationalization, small traders and small scale industrial units in big cities and some urban places experienced difficulties in obtaining timely and adequate credit facilities. They felt the need of having a bank which could cater to their needs. With this objective in mind the Ahmedabad Grain Merchants' Association promoted this bank under the leadership of late Shri Baldevbhai Dosabhai Patel. The Kalupur Bank was registered on 9.10.1970 and started functioning from 5.12.1970 in just 250 sq.ft. area in the premises belonging to the association, under the able and dynamic leadership of late Shri Baldevbhai Dosabhai Patel along with his team of dedicated members on the Board or Directors. Shri B.D.Patel rendered the services as the Chairman continuously and uninterruptedly till he left for heavenly abode on 12.07.1997.

Vikram cooperative Bank Ltd., Ahmedabad became sick in 1982. Reserve Bank of India and co-operative Department of Gujarat State first handed over the administration of this bank to Kalupur Bank and in 1991 the bank was amalgamated with Kalupur Bank. The objective behind this action was to set an example in cooperative banking sector and to protect the interest of its depositors/shareholders by handing over its management or by amalgamation with a sound and well
managed bank and thus to instill confidence of the public in cooperative banking sector. Thereafter three small and weak urban co-op Banks, viz The Standard co-op bank ltd. Ahmedabad, The Royal co-op bank ltd. Ahmedabad and The Tapi Co-op Bank, Surat based were merged with Kalupur Bank wef 04-10-2005, 03-03-2006 and 02-02-2007 respectively. Reserve Bank of India accorded the status of a "Scheduled Bank" effective from 1st September 1988 which is an outstanding achievement. The bank enjoys competitive advantage over its other counterparts on account of this achievement.

The bank was registered under Multi-State cooperative societies Act, 1984 with effect from 8th September 1995. It opened up new vistas to expand its business in the Municipal limits of Greater Mumbai of Maharashtra. At present bank's branch is operating at Kalbadevi, Mumbai. The Bank has a network of 38 branches of which 4 are functioning in neighbouring urban towns viz. Bavla, Bareja, Sanand and Gandhinagar in Ahmedabad district. The Bank has opened branches in Anand, Vadodara, Kambhat and Surat. The Kalbadevi - Mumbai branch is the first branch opened out of the Gujarat state.

GUIDING PRINCIPLES

- To ensure customer confidence and satisfaction.
- To enhance the bank's net worth.
- To offer maximum dividend to its members.
• To provide best available input to its employees through training.
• To contribute to the social cause.
• To contribute to the progress of the country.
• To respect laws of the land.

Kalupur bank is committed to maintain the leadership position in all parameters and thrive to give best customer satisfaction by efficient, quick and courteous customer service.

B) Rajkot Nagrik Sahakari Bank Ltd.

Rajkot Nagarik Sahakari Bank is a leading Co-Operative Bank in Gujarat State, India. Bank was established on 5th October 1953 With a small Capital Of Rs. 4890 and Membership of 59 persons under the leadership of Late Keshavlal Amrutlal Parekh as a Chairman, and Late Janmashankar Antani as a M.D. Bank has made tremendous & real progress, Bank became pride of saurashtra region & achieved new heights in banking as well as Co.Operative sector under the leadership of former Chairman Late Shri Arvindbhai Maniar.

During past years bank has played vital & leading role for the development of industries, business & Economy of Rajkot City, Development and nursing of Co-operative movement in the Saurashtra region of Gujarat State. Bank was the first co-operative institute to start functioning in the erstwhile state of Saurashtra. Bank was inaugurated by "SAHAKAR MAHARSHI"late Shri Vainkunthbhai Metha.

Bank has developed in manifolds with the time. Membership (Share Holder) of bank is counting towards 2,50,000 which is a record by itself & provides an example of how a mass movement can be turned into the
instrument for social upliftment. To day Bank has more than 7,20,000 + deposit accounts with a deposit base of 1141.60 + Crores, And 40000 + Establishments / Individuals enjoy the facility of Rs 760.42+ Crores of Advances.

Since inception bank was guided by the people with foresight & vision, Which Includes the names Like Shri Keshubhai Patel, Shri Vajubhai Vala, Shri Shashikant Mehta, Shri Vasantbhai Khokhani, Shri Pravinbhai Maniyar, Shri Shivlalbhai Vekaria etc.

Being in the service sector, with a vision of current & future trends, Bank started automation & modernization way back in 1987 and by 1995 all the Branches were computerized.

Bank is Enjoying the SCHEDULE BANK Status Since 1989. In year 2001 Bank was registered UNDER MULTI-STATE CO-OPERATIVE SOCIETY ACT. With this Bank has opened a Branch In Mumbai, Economic Capital of India and become MULTI-STATE SCHEDULE CO-OPERATIVE BANK.

Rajkot Nagarik Sahakari Bank’s aim is to provide a WORLD-CLASS Banking facility to the common people of the society at a economical rate, so as to be a preferred provider of the banking services in the area where bank operates and to achieve a healthy growth in profit, which will be partly used for the benefit of society and for upliftment of masses & the general growth of co-operative movement. The bank is committed to the highest level of ethical standards, professional integrity and regulatory compliances. Our bank’s business philosophy is based on following core values, Operational Excellence, Customer Focus and Upliftment through Co-Operation.
C) The Ahmedabad Mercantile Co-Operative Bank Ltd.
The Ahmedabad Mercantile Co-op. Bank Ltd., Established in the year 1966, popularly known as "AMCO BANK" started its banking activity under the leadership of Shri Mohanbhai C. Patel with one branch at Relief Road, Ahmedabad in Gujarat State, India. Expansion accelerated, and branch after branch was added to the family of branches of the Bank, creating a group of 25 branches, all are operating in their own fully air-conditioned premises. With opening of a branch in Mumbai, in Maharashtra, the Bank attained the Multi State Co-op. Society status. The Bank acquired Scheduled Bank status in 1996.
The birth and the spectacular growth of the Bank in a comparatively a small span of 40 years can mainly be attributed to the desire to cater the needs of the business community in general and small traders in particular, encouraging the community to save and channelise these savings for productive purposes leading to economic progress and prosperity of the community. With the passage of time and with gaining of strength and stability, the Bank spread its wings to other areas such as financing of Small Scale Industries, large industries, professionals, individuals for consumer durables, vehicles etc. as also acceptance of deposits from Non-Resident Indians. Our motto is "CUSTOMER CARE" and thereby total customer satisfaction and our goal is to BETTER to BEST.

• The salient features which helped bank in acquiring a unique position amongst the co-operative banks in Ahmedabad are
  • Service with Smile- Fast & Accurate
  • Total Mechanisation- Computerisation & Upgradation
  • Speedy clearing of instruments between Mumbai & Ahmedabad
- Free remittance facility between Ahmedabad & Mumbai through issue of D.D. at par
- Introduction of services like customer terminal, single window service and telebanking
- Acceptance of NRE deposits
- Attractive interest rates on term deposits and most competitive interest rates on advances. Special rates for schematic lending.
- Issue of out-station drafts & collection of cheques/ bills through agency arrangements with country's leading Banks
- Assured safety of deposits
- Funds Transfer To and Fro through RTGS and NEFT on same day to any centre
- Utility bill pay Service Through bill Desk
- Life and General Insurance arrangement with Bajaj Alliance
- All branches equipped with CCTV to arrest unwanted incidence

The Bank is ably managed by an elected Board of Directors with the active support of Executives and staff compliment of around 98 Officers, 131 Clerks and 73 other employees.

The Management and Staff of the Bank has earned a reputation for their unstinted and transparent administration and caring service.

D) Mehasana Urban Co-Operative Bank Ltd.
Mehasana Urban Co-Operative bank Ltd. Established on 23rd October, 1983, registered under Co Operative Society Act 1961 Registration No. 20052 The RBI License No. DB/UBD GJ 357 P dt. 28/09/1983 The Bank started with one branch at Mehsana with Share Capital of Rs. 15.00 lacs,
made continuous Progress as on 31/03/2010 paid up share capital is Rs. 33.19 crore. The Bank was given status of Scheduled Bank by Reserve Bank of India in the year 2000. At present The Bank is providing better customer service through its 25 & one extension counters at Ganpat University, Kherva and Branches at various centers in the state of Gujarat. Bank is having its Spacious and attractive own Premises of 14 Branches, reaming premises on lease hold base. The Business growth of the bank is very tremendous and growth rate graph is on high level every year by year with shows the figures given here under. Internet has revolutionized the way online users can avail services like internet banking from anywhere, anytime without physical presence. Mehsana Urban Co Operative Bank Ltd has been delivering electronic services to its customers and businesses remotely since last couple of years. Though increased world-wide acceptance of internet as a delivery channel for providing services and products creates new business opportunities, it also gives an opportunity for fraudsters to use internet as medium to commit frauds. It is important for online users to be aware of such frauds and protect themselves against them.

E) The Surat People’s Co-Operative Bank Ltd.
With the advent of the 20th century, Co-operative Movement started in India. Late Raosaheb Varundavan Jadav - a visionary dreamt of establishing Co-operative Bank. This Dream turned into reality in the name of The Surat Peoples Co-operative Bank Ltd. The Surat People’s Co-operative Bank Ltd was established in 1922 at Surat. Bank was registered on 10th March, 1922 and started functioning from 21st April, 1922. The Bank was first registered Urban Co-Operative Bank in India and became Scheduled Bank on 1st September, 1988.
The Bank is serving since last 87 years to the people of Surat. The bank is having network of 21 branches, 19 in Surat and 1 branch at Vapi and 1 branch at Navsari.

- The Bank is the "First Registered Urban Co-operative Bank" of India.
- All Branches Connected in CBS.
- Among the first 13 Co-operative Banks in September 1988 to get the "Scheduled Bank" Status.
- The bank commenced "Total Branch Automation" in 1992-93.
- The Bank introduced "SMS Banking Facility" and "View Account Terminal" (VAT) facility at all branches for better customer service.
- Bank started its own "Training Centre" for providing training to its employees.
- The first Bank to provide the "Depository Participant Services" in South Gujarat.
- Only coop bank of South Gujarat to have direct connectivity to RBI server for RTGS/NEFT facility.
- Only bank to have direct connectivity with RBI server to have NECS facility.
- Only Bank to give RTGS/NEFT facility on STP basis - straight through processing.

F) Nutan Nagrik Sahakari Bank Ltd.

Nutan Nagarik Sahakari Bank Limited was established in Ahmedabad on 4th October, 1971 under the Chairmanship of Late Shri Atmaram Bhogilal Sutaria and Managing Directorship of Late Shri Kalyanbhai P. Fadia. The Bank started functioning in very small rented premises at Maskati market in the area of about 15 X 16 feet.
The Bank got Banking License No. UBD GJ 627 P on 30th October, 1986.
Nutan Nagarik Sahakari Bank Limited has 18 Branches in Ahmedabad City. The Administrative Office of the Bank and most of the branches are functioning in beautiful buildings owned by the Bank. All the branches are situated in very prominent business or residential areas of Ahmedabad. Ten branches of the Bank is having Safe Deposit Vault facility. All branches are provided with modern and comfortable furniture, latest office equipments, computers and fax machines so that customers can conduct their business in pleasant and comfortable surroundings. The Bank has started core banking services since March, 2008. The Board of Directors of the Bank includes very prominent businessmen, industrialists, social workers and leading citizens. The chairman, Vice-Chairmen and all Board of Directors are giving honorary services to the bank. Customers of the Bank includes Manufacturers, Wholesalers, traders and retailers dealing in textiles, chemicals, machine tools, plastics , cars, papers, computers, jewelers etc. Advances against cars and trucks are given to large number of customers. Professionals such as doctors, lawyers, chartered accountants, engineers etc. receive loans for buying premises for their clinics, office, equipments, computers etc. Women entrepreneurs receive special encouragement from the Bank for starting small business or industry. The Bank gives loan against gold ornaments also.
• Gujarat State Co.op. Union had organized competition in the year 1995-96 for best performance during the year 1994-95. Our Bank had secured the shield as a winner of first Prize.

• The Bank has introduced – “Apurva Nutan Yojana”, the services of inter branch cheque encashment. Respected Deputy Governor of Reserve Bank of India – Shri D.R.Mehta inaugurated this unique service called “Apurva Nutan Yojana” on 2nd July, 1994.

• The Bank has constructed a traffic police booth on 27th August, 1996 at Lal Darwaja, Ahmedabad as a part of its Silver Jubilee Year.

• “Puraskar Yojna: The Bank is awarding the meritorious students under the “Nutan Nagarik Sahakari Bank Puraskar Yojna” every year. The students are eligible for merit certificate and cash award of Rs. 500/-.

• Bright Students who have secured first 10 positions in Ahmedabad in SSCE and HSC Board. Children of Depositors / Members who have secured minimum 70 % marks in SSCE and 60 % in HSC Board / Graduation.
• They have to apply in prescribed format within specified time limit. In each category, first ten students, as per merit list, are eligible for cash award. A large number of shareholders and customers enthusiastically take part in every function. The Bank is also encouraging young children who have achieved some goal in various kind of sports
Chapter-5
Study on Operational Efficiency of Urban Co-Operative Banks of Gujarat
5.1 THEORY OF GAP

CUSTOMER SERVICE

Customer Service is the service provided in support of a company’s core products. Customer Service most often includes answering questions, taking orders, dealing with billing issues, handling complaints, and perhaps scheduling maintenance or repairs. Customer Service can occur on site, or it can occur over the phone or via the internet. Many companies operate customer service call centers, often staffed around the clock. Typically there is no charge for customer service. Quality customer service is essential to building customer relationships. It should not, however, be confused with the services provided for sale by a company. Services tend to be more intangible than manufactured products. There is a growing market for services and increasing dominance of services in economies worldwide.

There are generally two types of customer expectations. The highest can be termed as desired service: the level of service the customer hopes to receive. The threshold level of acceptable service which the customers will accept is adequate service.

Yet there is hard evidence that consumers perceive lower quality of service overall and are less satisfied.

Possible reasons might be:

⇒ With more companies offering tiered service based on the calculated profitability of different market segments, many customers are in fact getting less service than they have in past.
Increasing use by companies of self-service and technology-based service is perceived as less service because no human interaction or human personalization is provided.

Technology-based services (Automated Voice Systems, Internet-Based Services, and Technology Kiosks) are hard to implement, and there are many failures and poorly designed systems in place.

Customer expectations are higher because of the excellent service they receive from some companies. Thus they expect the same from all and are frequently disappointed.

Organizations have cut costs to the extent that they are too lean and are too understaffed to provide quality service.

The intensely competitive job market results in less skilled people working in frontline service jobs; talented workers soon get promoted or leave for better opportunities.

Many companies give lip service to customer focus and service quality; but they fail to provide the training, compensation, and support needed to actually deliver quality service.

Delivering consistent, high-quality service is not easy, yet many companies promise it.

The gaps model positions the key concepts, strategies, and decisions in services marketing in a manner that begins with the customer and builds the organization’s tasks around what is needed to close the gap between customer expectations and perceptions.

The central focus of the gaps model is the customer gap, the difference between customer expectations and perceptions. Firms need
to close this gap—between what customers expect and receive—in order to satisfy their customers and build long-term relationships with them. To close this all important customer gap, the model suggests that four gaps—the provider gaps—need to be closed.

The following four provider gaps, shown below are the underlying causes behind the customer gap:

▷ Gap 1: Not knowing what customers expect.
▷ Gap 2: Not selecting the right service designs and standards.
▷ Gap 3: Not delivering to service standards.
▷ Gap 4: Not matching performance to promises.

**Chart 5.1 Theory of Gap**
The key points for each gap can be summarized as follows:

**Gap 1: Not knowing what customers expect:**

- Inadequate marketing research orientation
- Lack of upward communication
- Insufficient relationship focus
- Inadequate service recovery

**Gap 2: Not selecting the right service designs and standards.**

- Poor service design
- Absence of customer-driven standard
- Inappropriate physical evidence and service scope

**Gap 3: Not delivering to service standards.**

- Deficient in human resource policies
- Customers who do not fulfills roles
- Problems with service intermediaries
- Failure to match supply and demand

**Gap 4: Not matching performance to promises.**

- Lack of integrated services marketing communication
- Ineffective management of customer expectation
- Over promising
- Inadequate horizontal communication
5.2 DATA ANALYSIS

Q-1. On a scale of 1-5 how do you rate the courtesy levels of your bank’s Personnel/Staff?

**Table 5.1 Comparison (Que.1)**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading Given By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>3</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>4</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>

**Table 5.2 Percentage Break up Que.1 (as per Management)**

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>34</td>
<td>50</td>
<td>16</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Chart 5.2 Percentage Break up Que.1 (as per Management)

Table 5.3 Percentage Break up Que.1 (as per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>7</td>
<td>60</td>
<td>34</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
**Interpretation**

There is a gap that exists between the management and the customer perception regarding the courtesy levels of the staff. The proportion of management that rates the courtesy aspect as “excellent” is very high but very few number of customers thinks this aspect to be excellent. Majority of them feels it to be between “very good” and “good.”

It is almost in all banks that this Gap exists except for one bank that is MUCB bank, this is because management may feel that the employees courtesy level is high but when asked to the customer they feel it a little lower than the management. This is because sometimes customers may be victimized from rude type of behavior of employee due to some internal factors.

Q-2.Rate as to how well informed/knowledgeable you feel the bank staff is in Answering/solving your questions/queries?

**Table 5.4 Comparison (Que.2)**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading Given By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>3</td>
<td>RNSB</td>
<td>3</td>
</tr>
<tr>
<td>AMCO</td>
<td>4</td>
<td>AMCO</td>
<td>5</td>
</tr>
<tr>
<td>MUCB</td>
<td>3</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>
Table 5.5 Percentage Break up Que.2 (as per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>0</td>
<td>66</td>
<td>34</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.4 Percentage Break up Que.2 (as per Management)

Table 5.6 Percentage Break up Que.2 (as per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>20</td>
<td>34</td>
<td>36</td>
<td>10</td>
<td>0</td>
</tr>
</tbody>
</table>
Interpretation

The management perceives the knowledge aspect of its employees to be between very good and average. While few customers perceive it to be excellent, few as very good, good and average.

In this particular question customer of private bank has given high grade as far as knowledge of the staff is concerned, while the gap lies in public sector bank and sort of in foreign banks this is because sometimes customer also failed to understand what the employee is trying to convey, due to this reason gap is existing.
Q-3. Rate the aspect as to how fast the personnel are in responding/attending to you?

**Table 5.7 Comparison (Que.3)**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading by customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>3</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>4</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>4</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>5</td>
<td>NNSB</td>
<td>2</td>
</tr>
</tbody>
</table>

**Table 5.8 Percentage Break up Que.3 (as per Management)**

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50</td>
<td>34</td>
<td>16</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Chart 5.6 Percentage Break up Que.3 (as per Management)**

![Chart showing percentage break up of fast/speedy response of bank employees](chart.png)
Table 5.9 Percentage Break up Que.3 (as per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>6</td>
<td>56</td>
<td>24</td>
<td>14</td>
<td>0</td>
</tr>
</tbody>
</table>

Interpretation

The proportion of management that rates the speedy response aspect as excellent is quite high as compared to the customers who are very few. The customers perceive it to be between very good, good and average.

Customer perceive that bank management is not responding fast in many cases while management of the banks told that they have to follow the standardize procedure in various types of queries of the customer, which may take some time which leads to slow response from bank management side.
Q-4 (a) How do you rate your bank with regards to the “Transaction time” taken for cash withdrawal/deposits?

Table 5.10 Comparison (Que.4-a)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading by customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>4</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>3</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>5</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>3</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>4</td>
</tr>
</tbody>
</table>

Table 5.11 Percentage Break up Que.4-a (as per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50</td>
<td>50</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Chart 5.8 Percentage Break up Que.4-a (as per Management)

Table 5.12 Percentage Break up Que.4-a (as per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>16</td>
<td>54</td>
<td>24</td>
<td>6</td>
<td>6</td>
</tr>
</tbody>
</table>

Chart 5.9 Percentage Break up Que.4-a (as per Customers)
Interpretation

The management rates the transaction time taken for cash withdrawals/deposits to be between excellent and very good. But the customers rate it to be very few for excellent, a sizeable amount for very good, few for good and a very few of them for average.

Due to introduction of new core banking technology transaction time has reduced significantly though some of the customers surveyed have said that banks are taking too much time, this is because some customer are in hurry and bank cannot entertain his / her issue or some times the amount of customer that visit bank at a certain time is very large hence transaction time automatically increases.

Q-4 (b) Rate the bank with regards to the transaction time taken to issue DD/Cheque/Statements?

Table 5.13 Comparison (Que. 4-b)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>3</td>
<td>RNSB</td>
<td>4</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>5</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>2</td>
</tr>
</tbody>
</table>
Table 5.14 Percentage Break Up Que.4-b (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50</td>
<td>34</td>
<td>16</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 5.10 Percentage Break Up Que.4-b (As Per Management)

Table 5.15 Percentage Break Up Que.4-b (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>14</td>
<td>50</td>
<td>16</td>
<td>16</td>
<td>4</td>
</tr>
</tbody>
</table>

Table 5.11 Percentage Break Up Que.4-b (As Per Customers)
**Interpretation**

The management rates the transaction time taken for dd/cheques/statements to be excellent and very good. But the customers rate it as – very few for excellent, high proportion for very good an equal amount for good and average and a few of them as poor.

Almost each and every bank takes some required time for issuing demand draft/ cheque / statement due to their routine checking and clearance due to this more customer rate as very good not as excellent.

Q-5. Rate how hassle frees it was/is for you to open an account with the bank?

**Table 5.16 Comparison(que.5)**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading by customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>4</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>3</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>5</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>3</td>
<td>NNSB</td>
<td>2</td>
</tr>
</tbody>
</table>
Table 5.17 Percentage Break Up Que.5 (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>34</td>
<td>50</td>
<td>16</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 5.12 Percentage Break up Que.5 (As Per Management)

![Bar chart showing the percentage of ratings for hassle-free account opening as per manager.]

Table 5.18 Percentage Break Up Que.5 (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>15</td>
<td>50</td>
<td>15</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>
Interpretation

The management rates the hassle free account opening as- a sizeable amount for excellent, a large amount for very good, a few say it’s good. The customers rate it as- a few say it is excellent and good, a very high proportion say it is very good, still few say its average and poor.

Now a days it is less hassle free to opening an account in any bank due to lowering of the paper work and fast and transparent practices by the banks , still there lies a gap due to documentation and signature and some other aspects due to which customer rate it somehow low as compared to management.
Q-6. How do you rate your bank’s product or service innovation in the past two years?

Table 5.19 Comparison (Que.6)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading by customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>4</td>
</tr>
<tr>
<td>RNSB</td>
<td>5</td>
<td>RNSB</td>
<td>4</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>3</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 5.20 Percentage Break up Que.6 (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50</td>
<td>50</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.14 Percentage Break up Que.6 (As Per Management)
Table 5.21 Percentage Break up Que.6 (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>6</td>
<td>50</td>
<td>32</td>
<td>12</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.15 Percentage Break up Que.6 (As Per Customers)

Interpretation

The management rates the product or service innovation as – a high number between excellent and very good. The customers rate it as- a few say it is excellent, a high amount say it is very good, a sizable amount says its good and very few say it is average.

Management perceive that it has takes steps in innovating services and products but actually customer feel other way that bank is less innovative in terms of services and product offered by them.
Q-7 How do you rate your bank regarding its promptness in keeping you informed of deposit rates /service charges?

Table 5.22 Comparison (Que.7)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading Given By Managers</th>
<th>Banks</th>
<th>Average Grading by Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>3</td>
<td>KCCB</td>
<td>2</td>
</tr>
<tr>
<td>RNSB</td>
<td>3</td>
<td>RNSB</td>
<td>1</td>
</tr>
<tr>
<td>AMCO</td>
<td>4</td>
<td>AMCO</td>
<td>3</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>2</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>2</td>
</tr>
</tbody>
</table>

Table 5.23 Percentage Break up Que.7 (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>33</td>
<td>34</td>
<td>33</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.16 Percentage Break up Que.7 (As Per Management)
Table 5.24 Percentage Break up Que.7 (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>4</td>
<td>20</td>
<td>26</td>
<td>40</td>
<td>10</td>
</tr>
</tbody>
</table>

Chart 5.17 Percentage Break up Que.7 (As Per Customers)

**Interpretation**

The management rates its promptness in keeping the customers informed of service or deposit rates as a sizeable and almost equal amount say it is excellent, very good and good. The customers rate it as very few for excellent, few for very good, good, and a high amount as average and a few as poor.

Informing about current interest rates and other new policies that RBI introduced bank fails highly, customer rates this particular parameter very low hardly banks takes steps in informing this type of aspect to
customers. Customer faces this problem at the time of investments because they have planned according to old interest rates while new ones are in effect.

Q-8 (a) Rate how positive or negative the bank is in entertaining your grievances.

**Table 5.25 Comparison (Que.8-a)**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>3</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>4</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>3</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>2</td>
</tr>
</tbody>
</table>

**Table 5.26 Percentage Break Up Que.8-a (As Per Customers)**

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>5</td>
<td>26</td>
<td>40</td>
<td>25</td>
<td>4</td>
</tr>
</tbody>
</table>
Interpretation

The customers rate Responses to grievance as – a very few for excellent, poor, few for very good, average and a very high for good.

Customer of public sector bank and foreign banks give very low rating as far as their response to grievances are concerned because employee sometime ignore their complaints . This situation is good in private sector banks.
Q-8(b) How do you rate your banks grievance redressal system?

Table 5.27 Comparison (Que.8-b)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>5</td>
<td>RNSB</td>
<td>3</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>4</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>4</td>
</tr>
</tbody>
</table>

Table 5.28 Percentage Break Up Que.8-b (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>17</td>
<td>83</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.19 Percentage Break Up Que.8-b (As Per Management)
Table 5.29 Percentage Break Up Que.8-b (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>3</td>
<td>23</td>
<td>46</td>
<td>24</td>
<td>4</td>
</tr>
</tbody>
</table>

Chart 5.20 Percentage Break Up Que.8-b (As Per Customers)

Interpretation

The management rates its grievance redressal system as – a few rate it as excellent, a very high proportion as very good. The customers rate it as – a very few for excellent, few for very good, average and a very high proportion for good and very few for poor.

Grievance redressal system of some is good as compared to other banks as private and foreign banks are more keen in customer service they tend to give good services to maintain the relation with the banks.
Q-9. How do you rate your bank/branch facility in terms of the comfort facilities it offers with reference to?

- Seating Arrangements
- Restroom
- Ac
- Drinking water

Table 5.30 Comparison (Que.9)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>2</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>3</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>5</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 5.31 Percentage Break Up Que.9 (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50</td>
<td>34</td>
<td>16</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Chart 5.21 Percentage Break Up Que.9 (As Per Management)

Table 5.32 Percentage Break Up Que.9 (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>4</td>
<td>53</td>
<td>20</td>
<td>20</td>
<td>3</td>
</tr>
</tbody>
</table>

Chart 5.22 Percentage Break Up Que.9 (As Per Customers)
Interpretation

The management rates its infrastructure as- a very high as excellent, a sizeable amount as very good and a few as good. Customers rate it as a very few as excellent, poor, a very high proportion as very good, and a few as good and average. Comfort facility in some banks is good as compared to the other sector banks.

Q-10. How do you rate the quality of ATM services provided by the bank?

Table 5.33 Comparison (Que.10)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>5</td>
<td>KCCB</td>
<td>5</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>4</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>3</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>3</td>
</tr>
<tr>
<td>NNSB</td>
<td>5</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 5.34 Percentage Break Up Que.10 (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50</td>
<td>50</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Table 5.35 Percentage Break Up Que.10 (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>24</td>
<td>36</td>
<td>16</td>
<td>20</td>
<td>4</td>
</tr>
</tbody>
</table>

Chart 5.24 Percentage Break Up Que.10 (As Per Customers)
Interpretation

The management rates its ATM services as – a very high and equal number as excellent and very good. Customers rate it as few as excellent, a high as very good, a few as good, average and very few as poor.

There lies a gap in few banks as far as ATM service is concern this is because sometimes ATMs are out of its service like availability of cash, technical problems. Overall ATM service is match with customer expectation.

Q-11(a) How do you rate the Debit card services offered by your bank?

Table 5.36 Comparison (Que.11-a)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>4</td>
</tr>
<tr>
<td>RNSB</td>
<td>5</td>
<td>RNSB</td>
<td>4</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>5</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>5</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 5.37 Percentage Break Up Que.11-a (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>66</td>
<td>34</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Chart 5.25 Percentage Break Up Que.11-a (As Per Management)

![Chart showing percentage break up of Debit card Services as per management.]

Table 5.38 Percentage Break Up Que.11-a (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>11</td>
<td>46</td>
<td>36</td>
<td>7</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.26 Percentage Break Up Que.11-a (As Per Customers)

![Chart showing percentage break up of Debit card Services as per customer.]

259
Interpretation

The management rates its Debit card services as- a very high as excellent and few as very good. Customers rate it as – a few as excellent, a high amount of them as very good, a sizeable amount as good and very few as average.

As far as debit card service is concerned few banks has more or less it exist with little gap due to their hidden charges sometimes debit card not accepted for shopping due to this reason customer given less rating.

Q-11 (b) How do you rate the Credit card services offered by your bank?

Table 5.39 Comparison (Que. 11-b)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>4</td>
</tr>
<tr>
<td>RNSB</td>
<td>4</td>
<td>RNSB</td>
<td>3</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>3</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>5</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>5</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 5.40 Percentage Break Up Que.11-b (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>0</td>
<td>66</td>
<td>17</td>
<td>17</td>
<td>0</td>
</tr>
</tbody>
</table>
Chart 5.27 Percentage Break Up Que.11-b (As Per Management)

Table 5.41 Percentage Break Up Que.11-b (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>0</td>
<td>50</td>
<td>27</td>
<td>17</td>
<td>6</td>
</tr>
</tbody>
</table>

Chart 5.28 Percentage Break Up Que.11-b (As Per Customers)
Interpretation

Both the management and the customers rate the credit card services as same except in a few cases. That is a very high amount of them as very good and a few as good and average.

There is high gap that exists as far as credit card service of the bank is concern in most of the banks this is because customer do not read all the required information regarding time duration, payment option etc. hence sometime banks charge some amount which customer may not be actually aware about that charges. Due to this reason customer expectation are not matching with the management.

Q-12 (a) Rate your bank as to how fast you feel it is in processing and disbursing loans.

Table 5.42 Comparison (Que.12-a)

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>4</td>
</tr>
<tr>
<td>RNSB</td>
<td>5</td>
<td>RNSB</td>
<td>4</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>5</td>
</tr>
<tr>
<td>MUCB</td>
<td>5</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>5</td>
<td>NNSB</td>
<td>3</td>
</tr>
</tbody>
</table>
Table 5.43 Percentage Break Up Que.12-a (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>50</td>
<td>34</td>
<td>16</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.29 Percentage Break Up Que.12-a (As Per Management)

Table 5.44 Percentage Break Up Que.12-a (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>6</td>
<td>46</td>
<td>36</td>
<td>7</td>
<td>5</td>
</tr>
</tbody>
</table>

Chart 5.30 Percentage Break Up Que.12-a (As Per Customers)
**Interpretation**

The management rates its speed in processing /disbursing loans as – a very few percentage say it is excellent, a high percent say it is very good and a few say it is good. The customers rate it as – a very few percent as excellent, a very high as very good, a high percentage as good, a few as poor and very few as poor.

In disbursing and processing loans banks have to follow very strict steps hence it may take time and force management to ask more questions and investigate more about customer ability to repay the loan which customer sometime feels useless ,thus the gap is existing in this case.

Q-12 (b) Rate the interest rates currently being offered

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>4</td>
<td>KCCB</td>
<td>4</td>
</tr>
<tr>
<td>RNSB</td>
<td>2</td>
<td>RNSB</td>
<td>2</td>
</tr>
<tr>
<td>AMCO</td>
<td>3</td>
<td>AMCO</td>
<td>3</td>
</tr>
<tr>
<td>MUCB</td>
<td>4</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>4</td>
<td>NNSB</td>
<td>4</td>
</tr>
</tbody>
</table>
Table 5.46 Percentage Break Up Que.12-b (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>17</td>
<td>67</td>
<td>0</td>
<td>16</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.31 Percentage Break Up Que.12-b (As Per Management)

Table 5.47 Percentage Break Up Que.12-b (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>3</td>
<td>56</td>
<td>41</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.32 Percentage Break Up Que.12-b (As Per Customers)
**Interpretation**

The management rates its interest rates as – a very high percentage as very good and a few as excellent and average. The customers rate it as- A very few as excellent, a very high as very good and a high amount as good.

Interest rates offered by the banks are generally fixed by the central bank that is Reserve Bank of India which varies by very little percent in different banks hence mostly customer agrees with the management, so management perception almost matching with the customer expectation.

Q-13 (a) Do bank uses the phone/net banking facility offered?

If ‘Yes’ (a) proceed to 13 (b). If ‘No’ specify the reason.

**Table 5.48 Comparison (Que.13-a)**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading By Managers</th>
<th>Banks</th>
<th>Average Grading By Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>Yes</td>
<td>KCCB</td>
<td>No</td>
</tr>
<tr>
<td>RNSB</td>
<td>Yes</td>
<td>RNSB</td>
<td>No</td>
</tr>
<tr>
<td>AMCO</td>
<td>Yes</td>
<td>AMCO</td>
<td>Yes</td>
</tr>
<tr>
<td>MUCB</td>
<td>Yes</td>
<td>MUCB</td>
<td>Yes</td>
</tr>
<tr>
<td>SPCB</td>
<td>Yes</td>
<td>SPCB</td>
<td>No</td>
</tr>
<tr>
<td>NNSB</td>
<td>Yes</td>
<td>NNSB</td>
<td>No</td>
</tr>
</tbody>
</table>
Table 5.49 Percentage Break Up Que.13-a (As Per Management)

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.33 Percentage Break Up Que.13-a (As Per Management)

Table 5.50 Percentage Break Up Que.13-a (As Per Customers)

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>56</td>
<td>64</td>
</tr>
</tbody>
</table>

Chart 5.34 Percentage Break Up Que.13-a (As Per Customers)
Interpretation

All the management agreed to providing the facilities of phone/net banking. But not all customers agreed to be using this facility. A high amount of them refused when asked whether they were using this facility, a sizeable about were using it.

In this case management of all the banks providing the facility of phone banking and net banking but more number of customers are not agreeing with that because they are not aware about the service and those are aware have little knowledge about using this facilities.

Q-13 (b) Rate the quality of the phone/net banking facility offered by your bank

**Able 5.51 Comparison (Que.13-b)**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Average Grading Given By Managers</th>
<th>Banks</th>
<th>Average Grading Given</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCCB</td>
<td>3</td>
<td>KCCB</td>
<td>3</td>
</tr>
<tr>
<td>RNSB</td>
<td>2</td>
<td>RNSB</td>
<td>2</td>
</tr>
<tr>
<td>AMCO</td>
<td>5</td>
<td>AMCO</td>
<td>4</td>
</tr>
<tr>
<td>MUCB</td>
<td>4</td>
<td>MUCB</td>
<td>4</td>
</tr>
<tr>
<td>SPCB</td>
<td>4</td>
<td>SPCB</td>
<td>4</td>
</tr>
<tr>
<td>NNSB</td>
<td>5</td>
<td>NNSB</td>
<td>4</td>
</tr>
</tbody>
</table>
Table 5.52 Percentage Break Up Que.13-b (As Per Management)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>33</td>
<td>33</td>
<td>17</td>
<td>17</td>
<td>0</td>
</tr>
</tbody>
</table>

Chart 5.35 Percentage Break Up Que.13-b (As Per Management)

Table 5.53 Percentage Break Up Que.13-b (As Per Customers)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Excellent</th>
<th>Very Good</th>
<th>Good</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>0</td>
<td>71</td>
<td>21</td>
<td>8</td>
<td>0</td>
</tr>
</tbody>
</table>
**Interpretation**

The management rated its quality of phone/net banking facility as – a very high as excellent, very good and a few as good and average. The customers rated it as- very high percent as very good, few as good and very few as average.

Those customers who are using this facilities have given rating mostly same as the rating given by the bank management reason is that those customer using this facilities are taking utmost benefit out of it hence they agrees with the service provided by the banks expect for few banks.
**CALCULATION OF HYPOTHESIS:**

<table>
<thead>
<tr>
<th>Managers</th>
<th>Customers</th>
<th>Plus</th>
<th>Minus</th>
<th>Zero's</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>3</td>
<td>+</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>3</td>
<td>+</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>4</td>
<td>+</td>
<td>-</td>
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</tr>
<tr>
<td>4</td>
<td>4</td>
<td>+</td>
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<tr>
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<td>+</td>
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<td>3</td>
<td>+</td>
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<tr>
<td>4</td>
<td>4</td>
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HYPOTHESIS:

**H₀**: There is Gap between management perception and customer perception in regard of the service provided by the bank.

**H₁**: There is not a Gap between management perception and customer perception in regard of the service provided by the bank.

**H₀**: $P = 0.5$

**H₀**: $P \neq 0.5$

**PH₀**: Hypothesized proportion of the population that feels Gap

**PH₁**: Hypothesized proportion of the population that feels no Gap
p Bar: Proportion of success in the sample 0.92

q Bar: Proportion of failure in the sample 0.08

n = 39

\[ Z = \frac{\hat{p} - p}{\sqrt{\frac{p \cdot q}{n}}} \]

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⇒ Z tabulated at 0.05 level of significance = ± 1.96

⇒ Conclusion: There is a Gap between management perception and customer perception in regard of the service provided by the bank.
Chapter-6

Conclusion
6.1 FINDINGS OF THE STUDY

⇒ Except MUCB bank in all other banks there is a Gap existing in the employee’s courtesy level. This is type 1 Gap :( Not knowing what customers expect.) Each might have occurred due to lack of inward communication and insufficient relationship focus mostly by the employee and sometimes by the customers.

⇒ The staff’s level of being informed and knowledgeable is seen to be high in private sector banks as compare to the public sector bank., but still there seems to be a huge gap of Type 4 ( Not matching performance to promises) & Type 1 (Not knowing what customers expect) between the bank management perceptions & customers perceptions; where in it could be a result of ineffective management of customers expectations or it could be due to lack of communications as some of the customers also lack the knowledge of understanding.

⇒ The figures show that except in KCCB & NNSB Bank the speed at which personnel work is very good. The gap between the management and the customer’s perceptions is mostly because some customers feel that bank management is not responding fast but the management says it has to follow the standardized procedures in various types of queries, hence the slow response. This is basically Type 3 Gap (Not delivering to the service standards) where in the reason could be failure to match supply & demand and the problems with service intermediaries.

⇒ Due to introduction of new core banking technology transaction time has reduced significantly, still some of the customers during the survey complained of long transaction time. This is because of
Type 3 Gap (Not delivering to the service standards) where some customer do not fulfill their roles i.e. they are in a hurry to have their work done with high expectations towards management and sometimes this also results due to management's failure to match supply and demand.

⇒ Today it is hassle free to open an account in most of the banks due to lowering of the paperwork and fast and transparent practices. But still there exists a gap between the management and customers' perceptions in few banks, like in public sector banks the services are poorly designed & in some private banks like the NNSB target very rich client to be their customers that have very high income capacities thus the rest of the common customers feel that the amounts to open an new account is very high and a complex set of documentations are also needed like income proof, proof of any other deposits else were etc.

⇒ Management perceives that they have introduced enough innovating services and products in past 2 years but customer are not entirely satisfied. Hence it is seen that there is Type 1 Gap (Not knowing what customers expect) which is existing, where in inadequate marketing research & orientation is not done matching the customers' expectations.

⇒ Contradicting the management's promise the customers feels that banks are not keeping the customers well informed about the changing deposit & service charge rates. Such a gap is result of Type 4 Gap where in inadequate horizontal communications & ineffective management of customer expectations is experienced.
In case of entertaining the grievances of the customers and the grievance redressal systems is concerned there is a huge gap between the customers & banks perceptions. This could be due to Type 4 & 3 Gap where in banks are deficient in human resources policies, their over promising nature about the services and ineffective management of customers expectations is experienced.

The management and the customer’s perceptions are matching to some extents in the case of comfort facility provided by the banks. It is observed that public sector banks tend to ignore these services where as private banks think that providing such facilities will make a positive impact on customers.

In the case of ATM service there is little gap because of technological advancements, today most of the ATM centers can be shared by customers of all banks. But were debit /credit card service is concerned there is huge gap due to the hidden costs that are imposed on customers by some of the banks.

In disbursing and processing loans banks have to follow very strict steps hence time taken is more due to which a huge Gap is observed by customers.

Phone/net banking are new facilities hence little gap is observed in perceptions.
6.2 RECOMMENDATION

⇒ Proper training about the various products of the banks should be provided and proper follow should be taken to increase the knowledge of employee.

⇒ Transaction time can be reduced by increasing people or adding new branches.

⇒ Transparency at the time of account opening from both the sides will make account opening process smooth.

⇒ Government banks should timely update about the account and also new services.

⇒ The functioning of the complaint department should be fast and to the customer’s expectation.

⇒ Transparency in charges and transaction is lacking in credit card and debit card services.

⇒ Reduction in time period of loan processing and disbursing

⇒ Awareness and uses of phone and net banking should increase to decrease the rush at the bank.

6.3 EMERGING ECONOMIC SCENE

The financial system is the lifeline of the economy. The changes in the economy get mirrored in the performance of the financial system, more so of the banking industry. The Committee, therefore felt, it would be desirable to look at the direction of growth of the economy while drawing the emerging contours of the financial system. The “India Vision 2020" prepared by the Planning Commission, Government of India, is an important document, which is likely to guide the policy makers, in the
years to come. The Committee has taken into consideration the economic profile drawn in India Vision 2020 document while attempting to visualise the future landscape of banking Industry.

India Vision 2020 envisages improving the ranking of India from the present 11th to 4th among 207 countries given in the World Development Report in terms of the Gross Domestic Product (GDP). It also envisages moving the country from a low-income nation to an upper middle-income country. To achieve this objective, the India Vision aims to have an annual growth in the GDP of 8.5 per cent to 9 per cent over the next 20 years. Economic development of this magnitude would see quadrupling of real per capita income. When compared with the average growth in GDP of 4-6% in the recent past, this is an ambitious target. This would call for considerable investments in the infrastructure and meeting the funding requirements of a high magnitude would be a challenge to the banking and financial system.

India Vision 2020 sees a nation of 1.3 billion people who are better educated, healthier, and more prosperous. Urban India would encompass 40% of the population as against 28% now. With more urban conglomerations coming up, only 40% of population would be engaged in agricultural sector as against nearly two thirds of people depending on this sector for livelihood. Share of agriculture in the GDP will come down to 6% (down from 28%). Services sector would assume greater prominence in our economy. The shift in demographic profile and composition of GDP are significant for strategy planners in the banking sector.
Small and Medium Enterprises (SME) sector would emerge as a major contributor to employment generation in the country. Small Scale sector had received policy support from the Government in the past considering the employment generation and favourable capital-output ratio. This segment had, however, remained vulnerable in many ways. Globalization and opening up of the economy to international competition has added to the woes of this sector making bankers wary of supporting the sector. It is expected that the SME sector will emerge as a vibrant sector, contributing significantly to the GDP growth and exports.

India’s share in International trade has remained well below 1%. Being not an export led economy (exports remaining below 15% of the GDP), we have remained rather insulated from global economic shocks. This profile will undergo a change, as we plan for 8-9% growth in GDP. Planning Commission report visualizes a more globalised economy. Our international trade is expected to constitute 35% of the GDP.

In short, the Vision of India in 2020 is of a nation bustling with energy, entrepreneurship and innovation. In other words, we hope to see a market-driven, productive and highly competitive economy. To realize the above objective, we need a financial system, which is inherently strong, functionally diverse and displays efficiency and flexibility. The banking system is, by far, the most dominant segment of the financial sector, accounting for as it does, over 80% of the funds flowing through the financial sector. It should, therefore, be our endeavor to develop a more resilient, competitive and dynamic financial system with best practices that supports and contributes positively to the growth of the economy.
The ability of the financial system in its present structure to make available investible resources to the potential investors in the forms and tenors that will be required by them in the coming years, that is, as equity, long term debt and medium and short-term debt would be critical to the achievement of plan objectives. The gap in demand and supply of resources in different segments of the financial markets has to be met and for this, smooth flow of funds between various types of financial institutions and instruments would need to be facilitated.

Government’s policy documents list investment in infrastructure as a major area which needs to be focused. Financing of infrastructure projects is a specialized activity and would continue to be of critical importance in the future. After all, a sound and efficient infrastructure is a sine qua non for sustainable economic development.

Infrastructure services have generally been provided by the public sector all over the world in the past as these services have an element of public good in them. In the recent past, this picture has changed and private financing of infrastructure has made substantial progress. This shift towards greater role of commercial funding in infrastructure projects is expected to become more prominent in coming years. The role of the Government would become more and more of that of a facilitator and the development of infrastructure would really become an exercise in public-private partnership. ‘India Infrastructure Report’ (Rakesh Mohan Committee - 1996) placed financing of infrastructure as a major responsibility of banks and financial institutions in the years to come. The report estimated the funding requirements of various sectors in the infrastructure area at Rs 12,00,000 crore by the year 2005-06. Since the estimated availability of financing from Indian financial institutions and
banks was expected at only Rs 1,20,000 crore, a large gap is left which needs to be filled through bilateral/multilateral/government funding.

It has been observed globally that project finance to developing economies flows in where there is relatively stable macro-economic environment. These include regulatory reforms and opening of market to competition and private investment. Liberalized financial markets, promoting and deepening of domestic markets, wider use of risk management tools and other financial derivative products, improved legal framework, accounting and disclosure standards etc are some of the other aspects which would impact commercial funding of infrastructure projects.

The India Vision document of Planning Commission envisages Foreign Direct Investments (FDI) to contribute 35% (21% now) to gross capital formation of the country by 2020. Government has announced a policy to encourage greater flow of FDI into the banking sector. The recent amendment bill introduced in Parliament to remove the 10% ceiling on the voting rights of shareholders of banking companies is a move in this direction. The working group expects this to have an impact on the capital structure of the banks in India in the coming years.

Consequent to opening up of the economy for greater trade and investment relations with the outside world, which is imperative if the growth projections of India Vision 2020 were to materialize, we expect the banking Industry’s business also to be driven by forces of globalization. This may be further accentuated with the realisation of full convertibility of the rupee on capital account and consequent free flow of capital across the borders. An increase in the income levels of the people
would naturally lead to changes in the spending pattern also. This could result in larger investments in the areas like entertainment and leisure, education, healthcare etc and naturally, these would attract greater participation of the banking system.

On the basis of the projection made by the Draft 10\textsuperscript{th} Five Year Plan on relevant macro indicators such as GDP and extending the trend for a further period of three years, it is estimated that GDP at current market prices during 2009-10 would be Rs.61,40,000 crore. Taking into account the on-going reform measures, expected Basel II needs, and financial dis-intermediation, the pace of expansion in the balance sheets of banks is likely to decelerate. Thus total assets of all scheduled commercial banks by end March 2010 may be taken as Rs.40,90,000 crore as a working estimate. At that level, the annual composite rate of growth in total assets of Scheduled Commercial Banks would be about 13.4 per cent to be over 2002-03 as compared to 16.7 per cent between 1994-95 and 2002-03. It will form about 65 per cent of GDP at current market prices as compared to 67 per cent in 2002-03.

On the liability side, there may be large augmentation to capital base. Reserves are likely to increase substantially. Banks will relay more on borrowed funds. Hence, the pace of accretion to deposits may slow down.

On the asset side, the pace of growth in both advances and investment may slacken. However, under advances, the share of bills may increase. Similarly, under investment, the share of ‘others’ may increase.
6.4 FUTURE LANDSCAPE OF INDIAN BANKING

Liberalization and de-regulation process started in 1991-92 has made a sea change in the banking system. From a totally regulated environment, we have gradually moved into a market driven competitive system. Our move towards global benchmarks has been, by and large, calibrated and regulator driven. The pace of changes gained momentum in the last few years. Globalization would gain greater speed in the coming years particularly on account of expected opening up of financial services under WTO. Four trends change the banking industry world over, viz. 1) Consolidation of players through mergers and acquisitions, 2) Globalisation of operations, 3) Development of new technology and 4) Universalisation of banking. With technology acting as a catalyst, we expect to see great changes in the banking scene in the coming years. The Committee has attempted to visualize the financial world 5-10 years from now. The picture that emerged is somewhat as discussed below. It entails emergence of an integrated and diversified financial system. The move towards universal banking has already begun. This will gather further momentum bringing non-banking financial institutions also, into an integrated financial system.

The traditional banking functions would give way to a system geared to meet all the financial needs of the customer. We could see emergence of highly varied financial products, which are tailored to meet specific needs of the customers in the retail as well as corporate segments. The advent of new technologies could see the emergence of new financial players doing financial intermediation. For example, we could see utility service providers offering say, bill payment services or supermarkets or retailers
doing basic lending operations. The conventional definition of banking might undergo changes.

The competitive environment in the banking sector is likely to result in individual players working out differentiated strategies based on their strengths and market niches. For example, some players might emerge as specialists in mortgage products, credit cards etc. whereas some could choose to concentrate on particular segments of business system, while outsourcing all other functions. Some other banks may concentrate on SME segments or high net worth individuals by providing specially tailored services beyond traditional banking offerings to satisfy the needs of customers they understand better than a more generalist competitor.

International trade is an area where India’s presence is expected to show appreciable increase. Presently, Indian share in the global trade is just about 0.8%. The long term projections for growth in international trade is placed at an average of 6% per annum. With the growth in IT sector and other IT Enabled Services, there is tremendous potential for business opportunities. Keeping in view the GDP growth forecast under India Vision 2020, Indian exports can be expected to grow at a sustainable rate of 15% per annum in the period ending with 2010. This again will offer enormous scope to Banks in India to increase their forex business and international presence. Globalization would provide opportunities for Indian corporate entities to expand their business in other countries. Banks in India wanting to increase their international presence could naturally be expected to follow these corporates and other trade flows in and out of India.
Retail lending will receive greater focus. Banks would compete with one another to provide full range of financial services to this segment. Banks would use multiple delivery channels to suit the requirements and tastes of customers. While some customers might value relationship banking (conventional branch banking), others might prefer convenience banking (e-banking).

One of the concerns is quality of bank lending. Most significant challenge before banks is the maintenance of rigorous credit standards, especially in an environment of increased competition for new and existing clients. Experience has shown us that the worst loans are often made in the best of times. Compensation through trading gains is not going to support the banks forever. Large-scale efforts are needed to upgrade skills in credit risk measuring, controlling and monitoring as also revamp operating procedures. Credit evaluation may have to shift from cash flow based analysis to “borrower account behaviour”, so that the state of readiness of Indian banks for Basle II regime improves.

Corporate lending is already undergoing changes. The emphasis in future would be towards more of fee based services rather than lending operations. Banks will compete with each other to provide value added services to their customers.

Structure and ownership pattern would undergo changes. There would be greater presence of international players in the Indian financial system. Similarly, some of the Indian banks would become global players. Government is taking steps to reduce its holdings in Public sector banks to 33%. However the indications are that their PSB character may still be retained.
Mergers and acquisitions would gather momentum as managements will strive to meet the expectations of stakeholders. This could see the emergence of 4-5 world class Indian Banks. As Banks seek niche areas, we could see emergence of some national banks of global scale and a number of regional players.

Corporate governance in banks and financial institutions would assume greater importance in the coming years and this will be reflected in the composition of the Boards of Banks.

Concept of social lending would undergo a change. Rather than being seen as directed lending such lending would be business driven. With SME sector expected to play a greater role in the economy, Banks will give greater overall focus in this area. Changes could be expected in the delivery channels used for lending to small borrowers and agriculturalists and unorganized sectors (micro credit). Use of intermediaries or franchise agents could emerge as means to reduce transaction costs.

Technology as an enabler is separately discussed in the report. It would not be out of place, however, to state that most of the changes in the landscape of financial sector discussed above would be technology driven. In the ultimate analysis, successful institutions will be those which continue to leverage the advancements in technology in re-engineering processes and delivery modes and offering state-of-the-art products and services providing complete financial solutions for different types of customers.

Human Resources Development would be another key factor defining the characteristics of a successful banking institution. Employing and retaining skilled workers and specialists, re-training the existing
workforce and promoting a culture of continuous learning would be a challenge for the banking institutions.

6.5 CHANGES IN THE STRUCTURE OF BANKS

The financial sector reforms ushered in the year 1991 have been well calibrated and timed to ensure a smooth transition of the system from a highly regulated regime to a market economy. The first phase of reforms focused on modification in the policy framework, improvement in financial health through introduction of various prudential norms and creation of a competitive environment. The second phase of reforms started in the latter half of 90s, targeted strengthening the foundation of banking system, streamlining procedures, upgrading technology and human resources development and further structural changes. The financial sector reforms carried out so far have made the balance sheets of banks look healthier and helped them move towards achieving global benchmarks in terms of prudential norms and best practices.

Under the existing Basel Capital Accord, allocation of capital follows a one-size-fit-all approach. This would be replaced by a risk based approach to capital allocation. While regulatory minimum capital requirements would still continue to be relevant and an integral part of the three pillar approach under Basel II, the emphasis is on risk based approach relying on external ratings as well as internal rating of each asset and capital charge accordingly. The internal risk based approach would need substantial investments in technology and development of MIS tools. For a rating tool for internal assessment to be effective, past data for 3 to 5 years would be required and as such, Indian banking
system will have to build up the capabilities for a smooth migration to the new method.

Another aspect which is included in Basel II accord is a provision for capital allocation for operational risk. This is a new parameter and even internationally evaluation tools are not yet fully developed. This would be another area where banking system will have to reckon additional capital needs and functioning of its processes.

The financial sector reforms have brought in the much needed competition in the market place. The competition to the existing banks came mainly from the techno-savvy private sector banks. In the coming years, we expect to see greater flow of foreign capital to come into the Indian banking sector. Opening up of banking sector to global players would see banks facing global competition.

Technology is expected to be the main facilitator of change in the financial sector. Implementation of technology solutions involves huge capital outlay. Besides the heavy investment costs, technology applications also have a high degree of obsolescence. Banks will need to look for ways to optimize resources for technology applications. In this regard, global partnerships on technology and skills sharing may help.

The pressure on capital structure is expected to trigger a phase of consolidation in the banking industry. Banks could achieve consolidation through different ways. Mergers and acquisitions could be one way to achieve this. In the past, mergers were initiated by regulators to protect the interests of depositors of weak banks. In recent years, market led mergers between private banks have taken place. It is expected that this process would gain momentum in the coming years. Mergers between
Public sector banks or public sector banks and private banks could be the next logical thing / development to happen as market players tend to consolidate their position to remain in competition.

Consolidation could take place through strategic alliances / partnerships. Besides helping banks to achieve economy of scale in operations and augment capital base, consolidation could help market players in other ways also to strengthen their competitiveness. The advantage could be in achieving better segmentation in the market. Strategic alliances and collaborative approach, as an alternative to mergers and acquisitions, could be attempted to reduce transaction costs through outsourcing, leverage synergies in operations and avoid problems related to cultural integration. If consolidation is taken too far, it could lead to misuse of dominant market positions. Rapid expansion in foreign markets without sufficient knowledge of local economic conditions could increase vulnerability of individual banks.

Public Sector Banks had, in the past, relied on Government support for capital augmentation. However, with the Government making a conscious decision to reduce its holding in Banks, most Banks have approached the capital market for raising resources. This process could gain further momentum when the government holding gets reduced to 33% or below. It is expected that pressures of market forces would be the determining factor for the consolidation in the structure of these banks. If the process of consolidation through mergers and acquisitions gains momentum, we could see the emergence of a few large Indian banks with international character. There could be some large national banks and several local level banks.
Opening up of the financial sector from 2005, under WTO, would see a number of Global banks taking large stakes and control over banking entities in the country. They would bring with them capital, technology and management skills. This will increase the competitive spirit in the system leading to greater efficiencies. Government policy to allow greater FDI in banking and the move to amend Banking Regulation Act to remove the existing 10% cap on voting rights of shareholders are pointers to these developments.

The cooperative banks have played a crucial part in the development of the economy. The primary agricultural societies which concentrate on short-term credit and rural investment credit institutions supported by District / State level cooperative banks have played a crucial role in the credit delivery in rural areas. The Urban Cooperative Banks have found their own niche in urban centres. These institutions in the cooperative sector need urgent capital infusion to remain as sound financial entities. Cooperative sector comes under State jurisdiction while commercial banking operations are regulated by the Reserve Bank of India. The duality in control had weakened the supervisory set up for these institutions. It is expected that certain amendments to the Banking Regulation Act introduced recently in the Parliament with the objective of strengthening the regulatory powers of the Reserve Bank of India would pave the way for strengthening of cooperative / financial institutions. It is expected that these banks would upgrade skills of their staff and improve the systems and procedures to compete with commercial bank entities.

Consolidation would take place not only in the structure of the banks, but also in the case of services. For instance, some banks would like to shed their non-core business portfolios to others. This could see the emergence
of niche players in different functional areas and business segments such as housing, cards, mutual funds, insurance, sharing of their infrastructure including ATM Network, etc.

Rationalization of a very large network of branches, which at present has rendered the system cost ineffective and deficient in service would take place. Most of the banks would have adopted core-banking solutions in a fully networked environment. Back office functions would be taken away from branches to a centralized place. While brick and mortar branches would continue to be relevant in the Indian scenario, the real growth driver for cost cutting would be virtual branches viz., ATMs, Internet Banking, mobile banking, kiosks etc., which can be manned by a few persons and run on 24 x 7 basis to harness the real potential of these technological utilities, there will be strategic alliances / partnership amongst banks and this phenomenon has already set in.

As we move along, the concept of branch banking will undergo changes. Banks will find that many of the functions could be outsourced more profitably without compromising on the quality of service. Specialized agencies could come forward to undertake Marketing and delivery functions on behalf of banks. This could see banking products being sold outside the four walls of a branch. Banks would then concentrate on developing new products and earning fee based income.

The composition of bank staff will change. As total computerization will render a part of the workforce surplus, banks will go for a rightsizing exercise. Some may resort to another round of VRS to shed excess flab while some other may go for re-deployment to strengthen marketing arms. With greater use of technology and outsourcing of services in
different areas, the manpower recruitment will mostly be in specialized areas and technology applications. With commitment shifting from the organization to the profession, we could see greater lateral movement of banking personnel. Training and skill development will, however, continue to be key HR functions. With the age profile of staff undergoing changes, banks will have to focus on leadership development and succession planning. Knowledge management will become a critical issue.

Management structure of banks will also undergo drastic changes in the coming years. Instead of the present pyramid structure, the banks will move towards reduction in tiers to ultimately settle for a flat structure. Product-wise segmentation will facilitate speedier decision-making.

**6.6 PRODUCT INNOVATION AND PROCESS RE-ENGINEERING**

With increased competition in the banking Industry, the net interest margin of banks has come down over the last one decade. Liberalization with Globalization will see the spreads narrowing further to 1-1.5% as in the case of banks operating in developed countries. Banks will look for fee-based income to fill the gap in interest income. Product innovations and process re-engineering will be the order of the day. The changes will be motivated by the desire to meet the customer requirements and to reduce the cost and improve the efficiency of service. All banks will therefore go for rejuvenating their costing and pricing to segregate profitable and non-profitable business. Service charges will be decided taking into account the costing and what the traffic can bear. From the
earlier $\text{revenue} = \text{cost} + \text{profit}$ equation i.e., customers are charged to cover the costs incurred and the profits expected, most banks have already moved into the $\text{profit} = \text{revenue} - \text{cost}$ equation. This has been reflected in the fact that with cost of services staying nearly equal across banks, the banks with better cost control are able to achieve higher profits whereas the banks with high overheads due to under-utilisation of resources, un-remunerative branch network etc., either incurred losses or made profits not commensurate with the capital employed. The new paradigm in the coming years will be $\text{cost} = \text{revenue} - \text{profit}$.

As banks strive to provide value added services to customers, the market will see the emergence of strong investment and merchant banking entities. Product innovation and creating brand equity for specialized products will decide the market share and volumes. New products on the liabilities side such as forex linked deposits, investment-linked deposits, etc. are likely to be introduced, as investors with varied risk profiles will look for better yields. There will be more and more of tie-ups between banks, corporate clients and their retail outlets to share a common platform to shore up revenue through increased volumes.

Banks will increasingly act as risk managers to corporate and other entities by offering a variety of risk management products like options, swaps and other aspects of financial management in a multi currency scenario. Banks will play an active role in the development of derivative products and will offer a variety of hedge products to the corporate sector and other investors. For example, Derivatives in emerging futures market for commodities would be an area offering opportunities for banks. As the integration of markets takes place internationally, sophistication in trading and specialized exchanges for commodities will
expand. As these changes take place, banking will play a major role in providing financial support to such exchanges, facilitating settlement systems and enabling wider participation.

Bancassurance is catching up and Banks / Financial Institutions have started entering insurance business. From mere offering of insurance products through network of bank branches, the business is likely to expand through self-designed insurance products after necessary legislative changes. This could lead to a spurt in fee-based income of the banks.

Similarly, Banks will look analytically into various processes and practices as these exist today and may make appropriate changes therein to cut costs and delays. Outsourcing and adoption of BPOs will become more and more relevant, especially when Banks go in for larger volumes of retail business. However, by increasing outsourcing of operations through service providers, banks are making themselves vulnerable to problems faced by these providers. Banks should therefore outsource only those functions that are not strategic to banks’ business. For instance, in the wake of implementation of 90 days’ delinquency norms for classification of assets, some banks may think of engaging external agencies for recovery of their dues and in NPA management.

Banks will take on competition in the front end and seek co-operation in the back end, as in the case of networking of ATMs. This type of co-opetition will become the order of the day as Banks seek to enlarge their customer base and at the same time to realize cost reduction and greater efficiency.
6.7 TECHNOLOGY IN BANKING

Technology will bring fundamental shift in the functioning of banks. It would not only help them bring improvements in their internal functioning but also enable them to provide better customer service. Technology will break all boundaries and encourage cross border banking business. Banks would have to undertake extensive Business Process Re-Engineering and tackle issues like a) how best to deliver products and services to customers b) designing an appropriate organizational model to fully capture the benefits of technology and business process changes brought about. c) how to exploit technology for deriving economies of scale and how to create cost efficiencies, and d) how to create a customer - centric operation model.

Entry of ATMs has changed the profile of front offices in bank branches. Customers no longer need to visit branches for their day to day banking transactions like cash deposits, withdrawals, cheque collection, balance enquiry etc. E-banking and Internet banking have opened new avenues in “convenience banking”. Internet banking has also led to reduction in transaction costs for banks to about a tenth of branch banking.

Technology solutions would make flow of information much faster, more accurate and enable quicker analysis of data received. This would make the decision making process faster and more efficient. For the Banks, this would also enable development of appraisal and monitoring tools which would make credit management much more effective. The result would be a definite reduction in transaction costs, the benefits of which would be shared between banks and customers.
While application of technology would help banks reduce their operating costs in the long run, the initial investments would be sizeable. IT spent by banking and financial services industry in USA is approximately 7% of the revenue as against around 1% by Indian Banks. With greater use of technology solutions, we expect IT spending of Indian banking system to go up significantly.

One area where the banking system can reduce the investment costs in technology applications is by sharing of facilities. We are already seeing banks coming together to share ATM Networks. Similarly, in the coming years, we expect to see banks and FIs coming together to share facilities in the area of payment and settlement, back office processing, data warehousing, etc. While dealing with technology, banks will have to deal with attendant operational risks. This would be a critical area the Bank management will have to deal with in future.

Payment and Settlement system is the backbone of any financial market place.

The present Payment and Settlement systems such as Structured Financial Messaging System (SFMS), Centralised Funds Management System (CFMS), Centralised Funds Transfer System (CFTS) and Real Time Gross Settlement System (RTGS) will undergo further fine-tuning to meet international standards. Needless to add, necessary security checks and controls will have to be in place. In this regard, Institutions such as IDRBT will have a greater role to play.
6.8 RISK MANAGEMENT

Risk is inherent in any commercial activity and banking is no exception to this rule. Rising global competition, increasing deregulation, introduction of innovative products and delivery channels have pushed risk management to the forefront of today’s financial landscape. Ability to gauge the risks and take appropriate position will be the key to success. It can be said that risk takers will survive, effective risk managers will prosper and risk averse are likely to perish. In the regulated banking environment, banks had to primarily deal with credit or default risk. As we move into a perfect market economy, we have to deal with a whole range of market related risks like exchange risks, interest rate risk, etc. Operational risk, which had always existed in the system, would become more pronounced in the coming days as we have technology as a new factor in today’s banking. Traditional risk management techniques become obsolete with the growth of derivatives and off-balance sheet operations, coupled with diversifications. The expansion in E-banking will lead to continuous vigilance and revisions of regulations.

Building up a proper risk management structure would be crucial for the banks in the future. Banks would find the need to develop technology based risk management tools. The complex mathematical models programmed into risk engines would provide the foundation of limit management, risk analysis, computation of risk-adjusted return on capital and active management of banks’ risk portfolio. Measurement of risk exposure is essential for implementing hedging strategies.

Under Basel II accord, capital allocation will be based on the risk inherent in the asset. The implementation of Basel II accord will also
strengthen the regulatory review process and, with passage of time, the review process will be more and more sophisticated. Besides regulatory requirements, capital allocation would also be determined by the market forces. External users of financial information will demand better inputs to make investment decisions. More detailed and more frequent reporting of risk positions to banks’ shareholders will be the order of the day. There will be an increase in the growth of consulting services such as data providers, risk advisory bureaus and risk reviewers. These reviews will be intended to provide comfort to the bank managements and regulators as to the soundness of internal risk management systems.

Risk management functions will be fully centralized and independent from the business profit centres. The risk management process will be fully integrated into the business process. Risk return will be assessed for new business opportunities and incorporated into the designs of the new products. All risks – credit, market and operational and so on will be combined, reported and managed on an integrated basis. The demand for Risk Adjusted Returns on Capital (RAROC) based performance measures will increase. RAROC will be used to drive pricing, performance measurement, portfolio management and capital management.

Risk management has to trickle down from the Corporate Office to branches or operating units. As the audit and supervision shifts to a risk based approach rather than transaction orientation, the risk awareness levels of line functionaries also will have to increase. Technology related risks will be another area where the operating staff will have to be more vigilant in the coming days.
Banks will also have to deal with issues relating to Reputational Risk as they will need to maintain a high degree of public confidence for raising capital and other resources. Risks to reputation could arise on account of operational lapses, opaqueness in operations and shortcomings in services. Systems and internal controls would be crucial to ensure that this risk is managed well.

The legal environment is likely to be more complex in the years to come. Innovative financial products implemented on computers, new risk management software, user interfaces etc., may become patentable. For some banks, this could offer the potential for realizing commercial gains through licensing.

Advances in risk management (risk measurement) will lead to transformation in capital and balance sheet management. Dynamic economic capital management will be a powerful competitive weapon. The challenge will be to put all these capabilities together to create, sustain and maximise shareholders’ wealth. The bank of the future has to be a total-risk-enabled enterprise, which addresses the concerns of various stakeholders’ effectively.

Risk management is an area the banks can gain by cooperation and sharing of experience among themselves. Common facilities could be considered for development of risk measurement and mitigation tools and also for training of staff at various levels. Needless to add, with the establishment of best risk management systems and implementation of prudential norms of accounting and asset classification, the quality of assets in commercial banks will improve on the one hand and at the same time, there will be adequate cover through provisioning for impaired
loans. As a result, the NPA levels are expected to come down significantly.

6.9 REGULATORY AND LEGAL ENVIRONMENT

The advent of liberalization and globalization has seen a lot of changes in the focus of Reserve Bank of India as a regulator of the banking industry. De-regulation of interest rates and moving away from issuing operational prescriptions have been important changes. The focus has clearly shifted from micro monitoring to macro management. Supervisory role is also shifting more towards off-site surveillance rather than on-site inspections. The focus of inspection is also shifting from transaction-based exercise to risk-based supervision. In a totally de-regulated and globalised banking scenario, a strong regulatory framework would be needed. The role of regulator would be critical for:

a) ensuring soundness of the system by fixing benchmark standards for capital adequacy and prudential norms for key performance parameters.

b) adoption of best practices especially in areas like risk-management, provisioning, disclosures, credit delivery, etc.

c) adoption of good corporate governance practices.

d) creation of an institutional framework to protect the interest of depositors.

e) regulating the entry and exit of banks including cross-border institutions.
Further, the expected integration of various intermediaries in the financial system would add a new dimension to the role of regulators. Also as the co-operative banks are expected to come under the direct regulatory control of RBI as against the dual control system in vogue, regulation and supervision of these institutions will get a new direction.

Some of these issues are addressed in the recent amendment Bill to the Banking Regulation Act introduced in the Parliament.

The integration of various financial services would need a number of legislative changes to be brought about for the system to remain contemporary and competitive. The need for changes in the legislative framework has been felt in several areas and steps have been taken in respect of many of these issues, such as,

i) abolition of SICA / BIFR setup and formation of a National Company Law Tribunal to take up industrial re-construction.

ii) enabling legislation for sharing of credit information about borrowers among lending institutions.

Integration of the financial system would change the way we look at banking functions. The present definition of banking under Banking Regulation Act would require changes, if banking institutions and non-banking entities are to merge into a unified financial system

While the recent enactments like amendments to Debt Recovery Tribunal (DRT) procedures and passage of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) have helped to improve the climate for recovery of bank dues, their impact is yet to be felt at the ground level. It would be
necessary to give further teeth to the legislations, to ensure that recovery of dues by creditors is possible within a reasonable time. The procedure for winding up of companies and sale of assets will also have to be streamlined.

In the recent past, Corporate Debt Restructuring has evolved as an effective voluntary mechanism. This has helped the banking system to take timely corrective actions when borrowing corporates face difficulties. With the borrowers gaining confidence in the mechanism, it is expected that CDR setup would gain more prominence making NPA management somewhat easier. It is expected that the issue of giving statutory backing for CDR system will be debated in times to come.

In the emerging banking and financial environment there would be an increased need for self-regulation. This is all the more relevant in the context of the stated policy of RBI to move away from micro-management issues. Development of best practices in various areas of banks’ working would evolve through self-regulation rather than based on regulatory prescriptions.

Role of Indian Banks’ Association would become more pronounced as a self regulatory body. Development of benchmarks on risk management, corporate governance, disclosures, accounting practices, valuation of assets, customer charter, Lenders’ Liability, etc. would be areas where IBA would be required to play a more proactive role. The Association would also be required to act as a lobbyist for getting necessary legislative enactments and changes in regulatory guidelines.
HR practices and training needs of the banking personnel would assume greater importance in the coming days. Here again, common benchmarks could be evolved.

Talking about shared services, creation of common database and conducting research on contemporary issues to assess anticipated changes in the business profile and market conditions would be areas where organizations like Indian Banks’ Association are expected to play a greater role.

Evolution of Corporate Governance being adopted by banks, particularly those who have gone public, will have to meet global standards over a period of time. In future, Corporate Governance will guide the way Banks are to be run. Good Corporate Governance is not a straight jacketed formula or process; there are many ways of achieving it as international comparisons demonstrate, provided the following three basic principles are followed:

a) Management should be free to drive the enterprise forward with the minimum interference and maximum motivation.

b) Management should be accountable for the effective and efficient use of this freedom. There are two levels of accountability – of management to the Board and of the Board to the Shareholders. The main task is to ensure the continued competence of management, for without adequate and effective drive, any business is doomed to decline. As stated by J.Wolfensohn, President, World Bank – “Corporate governance is about promoting corporate fairness, transparency and accountability”.

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c) In order to enlist the confidence of the global investors and international market players, the banks will have to adopt the best global practices of financial accounting and reporting. This would essentially involve adoption of judgmental factors in the classification of assets, based on Banks’ estimation of the future cash flows and existing environmental factors, besides strengthening the capital base accordingly.

When we talk about adoption of International accounting practices and reporting formats it is relevant to look at where we stand and the way ahead. Accounting practices being followed in India are as per Accounting Standards set by the Institute of Chartered Accountants of India (ICAI). Companies are required to follow disclosure norms set under the Companies Act and SEBI guidelines relating to listed entities. Both in respect of Accounting Practices and disclosures, banks in India are guided by the Reserve bank of India guidelines issued from time to time. Now these are, by and large, in line with the Accounting Standards of ICAI and other regulatory bodies. It is pertinent to note that Accounting Standards of ICAI are based on International Accounting Standards (IAS) being followed in a large number of countries. Considering that US forms 40% of the financial markets in the world compliance with USGAAP has assumed greater importance in recent times. Many Indian banks desirous of raising resources in the US market have adopted accounting practices under USGAAP and we expect more and more Indian Financial entities to move in this direction in the coming years.
There are certain areas of differences in the approach under the two main international accounting standards being followed globally. Of late, there have been moves for convergence of accounting standards under IAS and USGAAP and this requires the standard setters to agree on a single, high-quality answer. Discussions in the accounting circles indicate that convergence of various international accounting standards into a single global standard would take place by 2007.

In the Indian context, one issue which is likely to be discussed in the coming years is the need for a common accounting standard for financial entities. While a separate standard is available for financial entities under IAS, ICAI has not so far come out with an Indian version in view of the fact that banks, etc. are governed by RBI guidelines. It is understood that ICAI is seized of the matter. It is expected that banks would migrate to global accounting standards smoothly in the light of these developments, although it would mean greater disclosure and tighter norms.

6.10  RURAL AND SOCIAL BANKING ISSUES

Since the second half of 1960s, commercial banks have been playing an important role in the socio-economic transformation of rural India. Besides actively implementing Government sponsored lending schemes, Banks have been providing direct and indirect finance to support economic activities. Mandatory lending to the priority sectors has been an important feature of Indian banking. The Narasimham committee had recommended for doing away with the present system of directed lending to priority sectors in line with liberalization in the financial system. The recommendations were, however, not accepted by the Government. In the
prevailing political climate in the country any drastic change in the policy in this regard appears unlikely.

The banking system is expected to reorient its approach to rural lending. “Going Rural” could be the new market mantra. Rural market comprises 74% of the population, 41% of Middle class and 58% of disposable income. Consumer growth is taking place at a fast pace in 17113 villages with a population of more than 5000. Of these, 9989 villages are in 7 States, namely Andhra Pradesh, Bihar, Kerala, Maharashtra, Tamilnadu, Uttar Pradesh and West Bengal. Banks’ approach to the rural lending will be guided mainly by commercial considerations in future.

Commercial Banks, Co-operatives and Regional Rural Banks are the three major segments of rural financial sector in India. Rural financial system, in future has a challenging task of facing the drastic changes taking place in the banking sector, especially in the wake of economic liberalization. There is an urgent need for rural financial system to enlarge their role functions and range of services offered so as to emerge as "one stop destination for all types of credit requirements of people in rural/semi-urban centers.

Barring commercial banks, the other rural financial institutions have a weak structural base and the issue of their strengthening requires to be taken up on priority. Co-operatives will have to be made viable by infusion of capital. Bringing all cooperative institutions under the regulatory control of RBI would help in better control and supervision over the functioning of these institutions. Similarly Regional Rural banks (RRBs) as a group need to be made structurally stronger. It would be desirable if NABARD takes the initiative to consolidate all the RRBs into a strong rural development entity.
Small Scale Industries have, over the last five decades, emerged as a major contributor to the economy, both in terms of employment generation and share in manufactured output and exports. SSIs account for 95% of the industrial units and contribute about 40% of the value addition in the manufacturing sector. There are more than 32 lac units spread all over the country producing over 7500 items and providing employment to more than 178 lac persons. The employment generation potential and favourable capital-output ratio would make small scale sector remain important for policy planners.

Removal of quantitative restrictions on a large number of items under the WTO and opening up of Indian market to greater international competition have thrown both challenges and opportunities for the SSI sector. Low capital base and weak management structure make these units vulnerable to external shocks, more easily. However the units which can adopt to the changing environment and show imagination in their business strategy will thrive in the new environment.

Instead of following the narrow definition of SSI, based on the investment in fixed assets, there is a move to look at Small and Medium Enterprises (SME) as a group for policy thrust and encouragement. For SMEs, banks should explore the option of E-banking channels to develop web-based relationship banking models, which are customer-driven and more cost-effective. Government is already considering legislation for the development of SME sector to facilitate its orderly growth.

In the next ten years, SME sector will emerge more competitive and efficient and knowledge-based industries are likely to acquire greater prominence. SMEs will be dominating in industry segments such as Pharmaceuticals, Information Technology and Biotechnology. With
SME sector emerging as a vibrant sector of the Indian economy, flow of credit to this sector would go up significantly. Banks will have to sharpen their skills for meeting the financial needs of this segment. Some of the Banks may emerge as niche players in handling SME finance. Flow of credit to this Sector will be guided purely by commercial considerations as Banks will find SMEs as an attractive business proposition.

6.11 HUMAN RESOURCES MANAGEMENT

The key to the success of any organization lies in how efficiently the organization manages its’ human resources. The principle applies equally and perhaps more aptly to service institutions like banks. The issue is all the more relevant to the public sector banks who are striving hard to keep pace with the technological changes and meet the challenges of globalization.

In order to meet the global standards and to remain competitive, banks will have to recruit specialists in various fields such as Treasury Management, Credit, Risk Management, IT related services, HRM, etc. in keeping with the segmentation and product innovation. As a complementary measure, fast track merit and performance based promotion from within would have to be institutionalized to inject dynamism and youthfulness in the workforce.

To institutionalize talent management, the first priority for the banking industry would be to spot, recognize and nurture the talent from within. Secondly, the industry has to attract the best talent from the market to maintain the required competitive edge vis-a-vis global players. However, the issue of critical importance is how talent is integrated and sustained in
the banks. Therefore, a proper system of talent management has to be put in place by all the banks.

As the entire Indian banking industry is witnessing a paradigm shift in systems, processes, strategies, it would warrant creation of new competencies and capabilities on an on-going basis for which an environment of continuous learning would have to be created so as to enhance knowledge and skills.

Another important ingredient of HR management is reward and compensation which at present do not have any linkage to skills and performance. A system of reward and compensation that attracts, recognizes and retains the talent, and which is commensurate with performance is an urgent need of the industry.

An equally important issue relevant to HRM is to create a conducive working environment in which the bankers can take commercial decisions judiciously and, at the same time, without fear. This calls for a re-look into the vigilance system as it exists today, and perhaps there is a need to keep the banking industry out of the CVC. The Banks’ Boards may be allowed to have their own system of appropriate checks and balances as well as accountability.

### 6.12 ACTION POINTS

1. Banks will have to adopt global standards in capital adequacy, income recognition and provisioning norms.

2. Risk management setup in Banks will need to be strengthened. Benchmark standards could be evolved.
3. Payment and settlement system will have to be strengthened to ensure transfer of funds on real time basis eliminating risks associated with transactions and settlement process.

4. Regulatory set-up will have to be strengthened, in line with the requirements of a market-led integrated financial system.

5. Banks will have to adopt best global practices, systems and procedures.

6. Banks may have to evaluate on an ongoing basis, internally, the need to effect structural changes in the organisation. This will include capital restructuring through mergers / acquisitions and other measures in the best business interests. IBA and NABARD may have to play a suitable role in this regard.

7. There should be constant and continual upgradation of technology in the Banks, benefiting both the customer and the bank. Banks may enter into partnership among themselves for reaping maximum benefits, through consultations and coordination with reputed IT companies.

8. The skills of bank staff should be upgraded continuously through training. In this regard, the banks may have to relook at the existing training modules and effect necessary changes,
wherever required. Seminars and conferences on all relevant and emerging issues should be encouraged.

9. Banks will have to set up Research and Market Intelligence units within the organization, so as to remain innovative, to ensure customer satisfaction and to keep abreast of market developments. Banks will have to interact constantly with the industry bodies, trade associations, farming community, academic / research institutions and initiate studies, pilot projects, etc. for evolving better financial models.

10. Industry level initiatives will have to be taken, may be at IBA level, to speed up reform measures in legal and regulatory environment.
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