CHAPTER - 1
INTRODUCTORY

1. Introduction:
The financial sector plays a crucial role in mobilising community’s savings and channelising them into effective investment in the country. The Government intervention in this sector is harmful for resource mobilisation and resource allocation as low interest rates discourage savings and distort the choice of investment avenues (McKinnon and Shaw, 1973). The liberalisation measures therefore, would eliminate these distortions and lead to sustain economic growth of the country. The economy gains momentum in its structural aspects from a vibrant and competitive financial system. The Indian financial system has attained commendable height in promoting financial inter-mediation in the economy, accelerating the pace of growth of financial savings, extending credit support to vital sector; agriculture, industry of the economy, providing liquidity and payment services to the real sector of the economy, catering credit requirement of all sections of the economy: household, industry, govt., weaker section of the society and so on.

Financial sector comprising of financial institutions, instruments and markets which act as a conduit for transfer of financial resources from savers to borrowers. The financial system is concerned about money, credit and finance that are intimately related to somewhat different from each other. Financial institutions are business organisations that act as mobilisers and depositories of savings and as purveyors of credit. They also provide various financial services to the community in respect of their dealings i.e. financial assets such as deposits, loans, securities and so on. Financial markets are the arrangements that provide facilities for buying and selling of financial claims and services. The corporations, financial institutions, individuals and Government trade in financial products in these markets either directly or through brokers and dealers on organised exchanges or off-exchanges (Bhole, 1999).

Financial institutions are divided into banking and non-banking institutions. The banking institution have quite a few things in common with the non-banking ones, but

their distinguishing character lies in the fact that unlike other institutions, they participate in the economy’s payment mechanism, i.e. they provide transactions services, their deposits, liabilities constitute a major part of the national money supply, and they can as a whole, create deposits or credit, which is money. Banks, subject to legal reserve requirements, can advance credit by creating claims against themselves, while other institutions can lend only out of resources put at their disposal by the savers. Sayers (1964)\(^3\) has aptly has distinguished the former as ‘creators’ of credit, and the latter as mere ‘purveyors’ of credit.

Financial institutions are also classified as intermediaries and non-intermediaries. Intermediaries intermediate between savers and investors; they lend money as well as mobilise savings; their liabilities are towards the ultimate savers, while their assets are form the investors or borrowers. Non-intermediary institutions do the loan business but their resources are not directly obtained from savers. All banking institutions are intermediaries. Many non-banking institutions also act as intermediaries and when they do so they are known as non-banking financial intermediaries (NBFI).

Financial markets are sometimes classified as primary (direct) and secondary (indirect) markets. The primary market deals in the new financial claims or new securities and therefore they are also known as new issue markets. On the other hand, secondary markets deal in securities already issued or existing or outstanding. Financial markets are also classified as money markets and capital markets, although there is not much wide difference between the two as both perform the same function of transferring resources to the producers. The distinction is based on the differences in the period of maturity of financial assets issued in these markets. The money markets deal in the short term claims (with a period of maturity of one year or less), capital markets do so in the long term (maturity period above one year) claims.

Financial system deals in financial services and claims or financial assets or securities or financial instruments. These services and claims are many and in varied character. This is so because of the diversity of motives behind borrowing and lending. The stage of development of the financial system can be judged from the diversity of financial instruments. The structure of financial system can be diagrammatically presented as under:

Globalisation of the economy, deregulation and dis-intermediation have at in new markets, new competitors, improved technologies, and new products. The barriers of place and time are being removed on the one hand and strict prudential norms are being introduced on the other. As a result, reforms in the financial sector have brought about a number of far reaching changes in the operational area of banking in respect of both approach and procedure that has reached satisfactory dimensions vis-a-vis global standards. And yet this segment is expected to face the world with its hands tied back. However, reform measures undertaken on the basis of the recommendation of the committee on the financial system (1991) as well as Narasimham Committee (1998) placed the Indian banking sector on a new platform. These were essential for arresting qualitative deterioration in the functioning of the banking system and making them economically viable and attaining competitive edge.

In the financial system, banking sector occupies a unique position. It has played a vital role as growth facilitators and achieved commendable heights in the national economy.
The banking sector has shown remarkable responsiveness to the needs of a planned economy. It has brought about a considerable progress in its efforts at deposit mobilisation and has taken a number of measures in the recent past for accelerating the growth rate of deposit. A recourse to this, the commercial banks have opened a number of branches in urban, semi-urban and rural areas and have introduced a number of attractive schemes and free services to the customer to attract more deposits.

It accounts about two-third of assets of formal financial sector. Of late, by 1991, this sector has been characterised as inefficient sector with low profitability, extra-ordinary low average return on assets compared to international standard, low capitalisation, low ratio of capital and reserve to total assets, poor quality of services, gradual decline in the ratio of spread to total assets, inadequate capital base to cover credit risk, unhealthy bottom lines, lack of transparency in balance sheet/profit and loss statements and so on.

The actual picture of financial health was even worse as the indicators are based on accounting concept of profit constructed by an alternative set of accounting rule, GAAP and Accounting Standards not based on “income recognition and provisioning criteria”. Therefore, this sector needs to be strengthened and consequently financial sector reform in India has emphasised much on reforms of the banking sector. The RBIs decentralisation and autonomy package will require the banks to redress their role under the market driven economy. Deepening and widening of the financial markets, growing disintermediation process, adoption of modern technology, rising customer expectation, innovative financial services and scheme supplement with suitable credit delivery mechanism and challenges for which banks would be required to reorient their organisational structure and modify their strategies. The guidelines in respect of changing and transparency of the balance sheet, capital adequacy, provisioning norms and so on have been put in place vis-a-vis global standards. While private and foreign banks have taken the lead in the process in a flux with mergers, acquisition and consolidation. The onus, therefore, lies with the public sector banks (PSBs)

2. Review of Literature

There exist a wide body of literature dealing with different aspects of working of public sector commercial banks and banking sector reforms. A brief review of these literatures
and committee’s recommendations on banking sector is highlighted from the viewpoint of both bankers and borrowers in the following paragraphs.

Rosen (1962) studied paucity of investment funds for industrial sector and concluded banks and financial institutions should be evolved to meet the financial requirements of the industry. Joshi (1965) examined involvement of financial intermediaries in providing finance to large scale industries in the private sectors. He found that these intermediaries have participated with 17 per cent of investment in various industries. While there share in the public limited companies amounts to about 39 pc. Jain (1971) observed that financial agencies have developed a preference of investing funds in the medium and large scale industrial units.

Varde and Singh (1981) and Godse and Padwal (1987) studied the issues of bank profitability and developed a simple framework to analyse the factors influencing the profitability of commercial banks. They viewed that any emphasis on the increase of the volume of business and proper management of burden would definitely result in enhancing the profitability of banks. They concluded that the key factors to the profitability of commercial banks in India are high volume of business and not the control of expenses, which were popularly practised.

Sarkar (1978) in his paper analysed the profits of public sector banks over a time frame and concluded that banks require greater maneuverability and in their operations so as to achieve the dual objective of profit with growth.

Shah (1979) examined the weaknesses of banks and suggested the remedial measures for enhancing the profitability of banks should be addressed: (i) to locate profit centers and cost centers in the bank (ii) to identify the elements that control or determine the profitability of banks.

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income and cost structure, at each such center and bank as a whole (iii) to evolve measures that could widen the spread between the cost of funds; services and administration, and return on them. (iv) to develop supplementary sources of income on profit.

Angadi (1983)\textsuperscript{11} measured the efficiency in terms of responsiveness of operating cost. Using important yardsticks like operating cost responsiveness administered prices/interest rates to output of operational efficiency of banks.

Joshi (1986)\textsuperscript{12} in his study identified weak fund management capacity of the bank due to SLR, CRR and priority sector lending. He found that the low yield rate and rising cost contributed a lot to the declining trend in profitability of banks.

Singh (1987)\textsuperscript{13} identified many exogenous and endogenous factors for the strains and stresses of banking system. The major of them being continuous increase in the SLR, CRR, persistent emphasis on social goals, growing incidence of industrial sickness, rapid branch expansion in the under banked areas, unfavourable change of deposit mix and growing incidence of financial disintermediation.

Rangarajan (1991)\textsuperscript{14} pointed out that improving the quality of loan assets is the true test of improved efficiency of banking system.

Malhotra (1991)\textsuperscript{15} examined the nature and efficacy of banking instruments and suggested that with the emergence of various savings media, banks should diversify their product and develop instruments for meeting the requirements of borrowers, investors and savers.

Goiporia (1992)\textsuperscript{16} made a general review of the profitability of banks and maintained that for adequate profit flow, the following priorities will have to be observed by the banks (a) lending operation have to be directed to areas which would maximize profitability and growth (b) non-fund based operation should be promoted and (c) charging fees for banks services should be determined after taking into consideration the

\textsuperscript{12}Joshi P.N. 1986 Profitability and Profit Planning in Banks. The journal of Indian Institute of Bankers (April-June) 57 (2).
\textsuperscript{13}Singh, S. 1987 Profitability of Commercial Banks in India. Punjab National Bank Monthly Review. (October) II (II).
\textsuperscript{14}Rangarajan, C.1991. Banking Development Since 1947;Achievement and Challenges. Financial System In India. Vol. II.
cost and benefit of services offered etc.

Ramala and Nagi (1994)\textsuperscript{17} suggested proper end-use of loans to the entrepreneurs, that could only ensure economic development of the area and the country as a whole.

Hartough (1994)\textsuperscript{18} studied the implication of bankers action plan for profitable small business portfolio. He suggested that considering customer’s payment history and market condition etc, bank should make advance to most attractive and growth potential units.

Sengupta (1995)\textsuperscript{19} in his paper examined the impact of financial sector and economic reforms in India in the context of financial market imperfection. The study pointed out that the banks will have to move step by step decision to reach the goal through trial and error in the practical world.

Goldstein (1996)\textsuperscript{20} in his study on capital norms of banking sector argued that developing countries, with few exceptions, have not set national capital standard much above the Basle minimum norms and their banks have not held actual capital much above that for banks in countries with significantly more stable operating environments.

Kohli (1997)\textsuperscript{21} examined the priority sector lending. He observed the existence of significant linkages between bank credit and investment in both agriculture and industries in India. He suggested that although directed credit programme for priority sector lending is effective in India, however, affirmative support to small-scale units is required.

Ajit (1997)\textsuperscript{22} examined the issue of para banking activities and suggested that bank should be allowed to undertake these activities, particularly use of capital as risk, from the experience of other countries like USA

Kaladhar (1997)\textsuperscript{23} in his paper examined the micro finance and its governance and suggested separate institutions like NABARD to govern micro finance.


Satish and Gopalakrishna (1997)\textsuperscript{24} suggested that systematic manner of bank operation will ensure the viability of rural banking.

Khanna (1999)\textsuperscript{25} in his paper examined the impact of the financial reforms in the industrial sector in India and found that financial sector reform have achieved a little in its their goal of making the industrial sector more efficient and globally competitive.

Patibandla and Prusty (1998)\textsuperscript{26} analysed the financial system in the context of East Asian Crisis and suggested, need of the right and effective financial institutions.

EPW Research Foundation Group examined the dynamic credit policy (1999)\textsuperscript{27} and suggested that against the prevailing backdrop of output, price and monetary trends, the credit policy has to be decisively expansionary.

Criticizing the banking sector reform Joshi (1999)\textsuperscript{28} in his paper viewed that banking sector reforms has been over emphasised on profits neglecting distributive role of banks. Strong and high net worth companies within the organised sector are capable of raising funds at a considerable rate of interest while credit disbursal to small borrowers has sharply been declined.

Hugar (1998)\textsuperscript{29} analysing first phase of reforms found that with the introduction of reform packages, banks have improved their profitability, started cleaning their balance sheet, improved the NPA position, but they are yet to give more focus on rationalising cost structure.

Verma (1998)\textsuperscript{30} viewed at in the context of ongoing globalization process Indian commercial bank is shaping well and becoming technologically better equipped and stronger in the capital base.


\textsuperscript{27}EPW Research Foundation,; 1999. High Cost of Funds Forces Industrial Slowdown. Economic & Political Weekly, (August 10).

\textsuperscript{28}Joshi, P.N. 1999. Banking Sector Reforms; The Other Side of Coin. Economic and Political Weekly, (April 3): XXXIV (14); 797-798.


To ensure the code of best practices Gadkari (2000) proposed the corporate governance in public sector banks to achieve high standard of corporate behaviour. He also suggested that the board of directors, external auditors and supervisors of PSBs strive to achieve greater degree of openness, transparency, integrity and accountability in the working of the banks.

The non-official advisory group on corporate governance (2001) of RBI highlighted the importance of corporate governance for building investors confidence. In this respect, Upadhyaya (2001) suggested to implement the recommendations of this group on corporate governance keeping all stakeholders interest as the center piece of reform.

Roy (2001) articulated that customer loyalty management programme should be an important part of the relationship marketing exercise undertaken at the bank branches.

Rao (2002) observed that customer service is a dynamic, creative and interactive process where the banker and customer are actively involved in improving the process continuously. Finally opined that the bankers should aware by keeping themselves at least one step ahead of the customers.

Srivastava (2000) stressed on speed up on the process of computerisation of bank branches to enhance the profitability, operating efficiency, service quality, and to diversify the earning base.

Taori (2000) dealt with the NPA management of PSBs and stated that surest way of containing NPAs is to prevent their occurrences. He suggested proper risk management, strong and effective credit monitoring, co-operative working relationship between banks and borrowers etc should be tenets of NPA management policy. The similar opinion has been echoed in more recent work by Battacharya (2002).

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34Roy, D. C. 2001. Customer Loyalty Management; Branch level Perspective. Vinimaya, XXI. (2); 54-57
Ramaiah and Ghosh (2002) evidenced directed credit requirements, structure of banking industry and bank attitude towards risk are the main caveats of banks spread. Banmali (2001) suggested a dispassionate and unprejudiced approach to weed out NPAs. To root out the NPA problem he also suggested a multi-frontal attack to the problem involving all the concerns staff members in the field up to the grass root level as well as in the controlling points.

Das (2002) analysed the level of risk and productivity of public sector banks and observed interrelationship of the fact that the productivity, capital base and risk taking tend to be jointly determined and reinforced.

Shenoy (2001) dealt issues relating to the Indian banking and has stressed on proper asset liability management and credit monitoring system.

The banking sector in India poised to meet the changing global environment observed by Kamesam (2001). In this context, he viewed the future of banks will largely depend on excellent customer service by keeping pace with changing technology and transparent operations.

In an increasingly integrated global economy, Singh and Das (2002) studied the reforms in the banking sector. They found fragile banking system disrupt macro economic stability and suggested human resource development, technology, industrial relations and customer services are the main pillars of attaining banks efficiency.

Ravi (2002) emphasised on branch rationalisation policy of banks for bringing down loss making branches. He also suggested for continuous stress should be given on reducing deposit costs and burden, manpower re-deployment of loss making branches.

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Bhukta (2002)\textsuperscript{46} articulated that the bank reforms is against the long run objective of reducing fiscal deficit of the Govt. and totally undesirable. In this situation he argued that the reform should not be halted rather proceeded following trial and error method.

Naidu and Nair (2002)\textsuperscript{47} attempted through an empirical estimation of the technical efficiency of scheduled commercial banks and found that the technical efficiency level among bank groups has declined in the post reform era which has indicated a severe competition among the bank groups.

However, not much work on banks’ performance in the study area has so far been undertaken. Choudhury. (1984)\textsuperscript{48} dealt with the reasons and consequences of growth of commercial banks in the undivided Cachar district in the post nationalization phase. The study sheds little light on bank’s performance. Another noteworthy study, Raul (1997)\textsuperscript{49} examined nature and problems of financing of industries and assessed the efficacy of various financing schemes adopted by the banks specially to cater the financial requirements of industries pertaining to the districts of erstwhile Cachar and Karimganj district of Barak valley. Thus, the impact of the significant changes owing to the onset of economic liberalization programme, occurred in banking practices in the country as a whole have remained un-researched in the area under study.

Committee recommendations:

The Dahejia Committee (1969)\textsuperscript{50} examined the credit needs of industry and trade and observed that there was a tendency on the part of the industry to avail itself of short term credit from banks in excess of the amount based on growth in production for inventories in value terms. It recommended that the banking system should turn to the financing of industry on the basis of a total study of the borrower’s operations than on security consideration alone. Further, cash credit account should be distinguished from ‘hard core’ and in short term component. The study group suggested that hard core part

\textsuperscript{46} Bhukta, A. 2002. \textit{Banking Sector Reform in India.} A study; Yojana, (July) PP, 5-7.
\textsuperscript{50} Dahejia Committee Report. 1969. \textit{On the Extent to Which Credit needs of Industry and trade are likely to be inflated and how such trend could be eluded}, RBI Bombay.
of the working capital in case of companies with strong financial position should be segregated and put on a formal term loan basis subject to a repayment schedule.

Despite these, the enigma of expansion in bank credit incommensurate with the level of the production and inventory continued to persist. As a result, RBI appointed a study group, widely known as Tandon Committee (1975)\textsuperscript{51} under the chairmanship of P.L. Tandon in August 1975. It framed guidelines for rational allocation, optimum use and for proper follow up of bank credit. The study group identified the drawback of easy availability of bank finance i.e., borrowers were able to borrow more than his current assets requirements. The committee suggested Maximum Permissible Bank Finance (MPBF) with reference to the working capital requirements and bank should have Quarterly Information System (QIS). The group also recommended norms for inventory and receivables which represents level for holding inventory and receivables in each industry, level of the borrower's resources to enable the banker to carry on acceptable level of current assets, and the style of bank credit.

Reserve Bank of India (1967) made a directional intervention in the sectoral credit flow advising commercial banks for channelising 80 per cent of the seasonal credit expansion to the industrial sector including manufacturing industry, mining plantation etc.

Chore Committee (1979)\textsuperscript{52} reviewed the working of the operation of cash credit system and suggested that bank should appraise and fix separate limit for "normal non-peak level" as also for the 'peak level' credit requirements indicating also the periods during which the separate limits would be utilised by the borrowers.

Reserve Bank of India in consultation with Indian Bank Association (IBA) constituted a committee on penal rates and service charges in 1979. The committee recommended that the penal rate, which is a justifiable part of the banks' interest, rate policy, should not be regarded as revenue raising measure but an instrument to enforce discipline among the borrowers. As far as service charges are concerned, the committee suggested there could be no objection to bank recovery with a legal charge.

Committee on operational efficiency and profitability known as Productivity, Efficiency

\textsuperscript{51}The Report of the Study Group to frame the guidelines for follow-up of Bank Credit. Tandon Committee Report (1975), RBI, Bombay.

\textsuperscript{52}Chore Committee Report (1979), Report of the Working Group of review the system of cash credit, RBI, Bombay.
and Profitability committee (PEP Committee, 1977)\textsuperscript{53} identified a practical and realistic criteria for the evaluation of bank’s performance. The committee proposed a system of assessment on the four broad aspects viz, (i) productivity (ii) social objectives (Spatial) (iii) social objectives (sectoral) and (iv) profitability. The indicators of efficiency and profitability suggested by PEP committee that include ratios like, business per employee, proportion of rural and semi-urban branches, deposits to total assets, ratio of agricultural advances to total advances and ratio of net income to establishment expenses.

In the context of global level for greater transparency of financial intermediaries, A. Ghosh Committee was set up (1982) to prescribe the bank balance sheet format. The committee had revised and enlarged for format of presentation of balance sheet and profit and loss account and suggested guidelines for compiling final accounts.

Marathe Committee (1982)\textsuperscript{54} reviewed the credit Authorisation scheme (CAS) and recommended that the banks would be allowed to deploy credit under CAS provided that-

1. Projected current ratio is not low and
2. The borrowers maintain quarterly operating statements and submit annual accounts to the banks.

Vaghul committee (1986)\textsuperscript{55} allowed to issue commercial paper to the ‘A’ rated companies having a net worth of Rs. 5 crores which has a considerable impact on banks working capital financing requirements.

Chakroborty committee (1986)\textsuperscript{56} studied the operational efficiency of commercial banks and suggested that RBI would determine spread between bank rate and bank deposit rate, Govt. borrowing rate and the prime lending rate.

Talwar Committee (1975)\textsuperscript{57} examined the nature of the customer services rendered by the banks. The committee viewed customer service as dynamic concept and recommended that the bank should assess and reassess how customer perceive bank services, appraise customer services and improve the customer services.

\textsuperscript{54}Marathe Committee Report (1983), Report of the Committee to review the working of credit authorisation scheme, RBI, Bombay.
\textsuperscript{56}Report of Committee to Review the Working of Monetary System (Chairman : Prof. Sukhmay Chakrabortty) RBI, Bombay, 1985.
\textsuperscript{57}Report of the Talwar Committee (1975)
Goiporia Committee (1991)\(^5\) recommended amicable banker-customer relationship. Tiwari Committee had recommended setting up a special tribunal for recovering outstanding credit.

Narasimham Committee (1991)\(^6\) identified the weakness of banking sector and recommended provision for capital adequacy; liberalisation of interest rate; reduction in SLR rehabilitation of PSB by the Govt.; introduction of prudential norms relating to income recognition, asset classification and provisioning; easy norms for entry of foreign bank. The committee also suggested for directed credit programme to channelise credit to priority sector.

To improve further soundness of Indian banking system Narasimham Committee (1998)\(^7\) submitted its report in April 1998 and in conformity with the committee recommendations RBI announced a package of measures in October 1998. The report has emphasised on increasing the minimum capital adequacy ratio from 8 pc to 9 pc by March 31, 2000; recognising the market risks and prescribing the risk weight for Govt./approved securities by March 31, 2000; providing 100 pc risk weight for foreign exchange and gold open limits from the year ended March 31, 1999; moving towards tighter asset classification; income recognition and provisioning norms; introduction of formal Asset - Liability Management system with effect from April, 1, 1999 and further enhancing transparency in accounting and disclosure practices.

To evolve an efficient and competitive financial system, RBI constituted a working group under the chairmanship of S. H. Khan (1997)\(^8\). The Khan working group recommended a general provision on standard assets of a minimum of 0.25 per cent from the year ending March 31, 2000, setting up a Asset Liability Management (ALM) system and set up internal ALM at the top management level to oversee its implementation.

RBI had constituted Debt Recovery Tribunals (DRT) working group (1998)\(^9\) to review

\(^8\)Report of Working Group to examine the harmonising the role and Operations of DFIs and Banks (Chairmen; S.H. Khan), RBI, April 1998.
the functioning of DRTs. The working group recommended certain legislative amendments regarding the recovery of debts due to the Banks and financial institutions and measures to improve the functioning of DRTs.

Basle Committee (1997)\(^{63}\) on banking supervision released a set of 25 principles for effective banking practices. The growing concern of international competitiveness and capital ratios led to the formation of Basle Accord (1998)\(^{64}\) which help to arrest the erosion of banks capital ratios in the changed environment. In the light of the comments from various corners, the committee proposed to revise the capital adequacy framework by March, 2000. The current Accord is based on (i) minimum capital requirement (ii) supervisory review process (iii) effective use of market discipline.

Verma Committee (1999)\(^{65}\) identified a mere three banks, viz. Indian Banks, United Commercial banks and United Bank of India, are weak on the basis of (i) accumulated losses and NPA (ii) operating profits less income from recapitalisation in negative for three consecutive years. The committee viewed that in the long run privatization is good option for restructuring weak banks. The committee also recommended the measures to clean the balance sheet with large NPA by creating Asset Reconstruction Fund (ARF), to introduce Voluntary Retirement Fund (VRF) enabling banks to reduces excess manpower and to establish Financial Restructuring Authority.

The standing committee on international financial standard and codes (1999)\(^{66}\) urges the Govt. of Indian and RBI to promote wide dissemination and debate while establishing mechanisms for continuos updating and reviewing structural aspects of financial architecture.

The committee to review the system of administered interest rates (2001)\(^{67}\) observed that most of the small savings funds are to managed with larger and diversified investment portfolios.


\(^{65}\)RBI. (1999). Report on the Working Group on Restructuring of Weak Public Sector Banks. (Chairman ; M.S. Verma) [Verma Committee].


3. Theoretical Underpinning of the Study:

3.1. Statement of the Problem:

The Indian banking has undergone momentous change and radical transformation in its structure and operation in respect of priority sector lending, advances to weaker section, implementation of various schemes through banks. Further, Banks’ initiative in reviving the sick industries through a number of rehabilitation packages, inclusion of factoring and venture capital activities in the banking network (Banking Regulation Act amendment, July 1990), providing cash clearing and settlement services to stock exchanges (Ahmedabad, Calcutta stock exchange, NSE and OTCEI) and so on became the new area of operations in the competitive environment.

The banks since nationalization, have diverted their attention from “class banking” to “mass banking” (Pandey, 1997) with little emphasis on profit element. But many problems cropped up such as inter-region inequality in bank’s operations, non-recovery of loans, willful default, political interference, deterioration of customer services, redtapism, neglect in the supervision of end use of credit, declining efficiency and profitability.

The macro economic crisis in 1991 paved the way of extensive financial sector reform (Bhagawati and Srinivasan, 1999). Despite, impressive widening of the banking system, there was a general consensus that it had not actually become sound and vibrant as it needed to be. As a result, 90’s experienced a volatile banking business (Patel, 1997). There was serious concern about the poor performance of public sector banks (PSBs), most of which became unprofitable, undercapitalized and burden with unsustainable level of non-performing assets (NPA) on their books.

In view of the extreme volatility and as a part of the financial sector reforms, Govt. of India appointed Narasimham committee to address the problems and suggest remedial measures. Following recommendations of the committee (1991) important initiatives with regard to the reforms in banking system viz, introduction of new accounting and


Bhagawati, J. N. and Srinivasan T. N. 1999. India's Economic Reforms, New Delhi


prudential norms relating to income recognition, provisioning and capital adequacy, reduction in Statutory Liquidity Ratio (SLR), a cut in Cash Reserve Ratio (CRR) and its subsequent withdrawal on the Foreign Currency Non-Resident Account (Bank) [FCNR (B)] to improve the liquidity position of financial sector, liberalization of interest rates and easy norms for entry of foreign banks have already been undertaken to face global competition in conformity with ‘Washington Consensus’. The financial sector reforms policy by Narasimham Committee aims to make Indian financial sector more efficient as well put an end to the so called “financial repression” that had held back the growth of financial savings and their efficient channelisation in the industrial activity (Khanna, 1999)\textsuperscript{72}. The financial sector reform currently underwent in India must also be seen as a component on the overall scheme of structural reforms. Apart from this, reforms are called for making the sector capable of serving the emerging needs of the growing real sector (Dhanasekaran; 2002)\textsuperscript{73}.

India’s experience with financial sector reforms perhaps far from happy. Some of the practices of banking sector were archaic. Many PSB had large NPA. During the first phase of the reforms (1991-93), the surge of the higher profits encouraged by many PSB to divert their funds to the booming stock market which further added to the losses of these banks. More over, bank loan as a proportion of total domestic financing to the commercial sector declined from 60 per cent of total finance in 1988-89 to 37 per cent in 1993-94 (IMF : 1995)\textsuperscript{74}. The rate of deposit mobilisation has reduced. The compulsory capture of bank deposit by the Govt. through CRR and SLR has been reduced. The accumulation of NPAs continues to serious strain on the profitability of banks. The Second Narasimham Committee, in view of the poor performance of financial sector (banking sector in particular) recommended a package of measures in October, 1998 such as increase of minimum capital adequacy ratio, recognition of market risks, tighter assets classification, income recognition and provisioning norms, introduction of formal Asset Liability Management system and for further enhancing


transparency in accounting and disclosure practices etc. The aggregate deposit of commercial banks increased from Rs. 884 crores in 1950-51 to Rs. 5025 crores in 1969-70 and further Rs 60,5416 crores in March 1998, then to Rs. 13, 21, 185 crores on April 2003. This accelerated rate of mobilisation of savings by banks is in keeping with the needs of economic development of the country. The deposits of scheduled commercial banks as a percentage to national income increased from 9.3 per cent in 1950-51 to 15.5 per cent in 1969 and further to 22.4 per cent in 1975 and 49.7 per cent in March 1999.

However, the operating profits of PSB declined by 3.0 per cent from Rs. 10274 crores in 1997-98 to Rs. 10578 crores in 1998-99, the net profit of commercial bank declined sharply by 28.3 per cent from Rs. 6502 crores in 1997-98 to Rs. 4660 crores in 1998-99. The ratio of net profit to total assets declined from 0.8 percent in 1997-98 to 0.4 per cent in 1998-99. The gross NPA as per cent of total advances increased from 14.4 per cent in 1997-98 to 14.6 per cent in 1998-99. The capital adequacy ratio of PSBs has declined marginally from 11.5 per cent in 1997-98 to 11.2 per cent in 1998-99. The spread (i.e., net interest income minus interest expanded) increased from 2.78 per cent in 1997-98 to 2.79 per cent in 1998-99. The quantum of net NPA as a percentage of net advances increased from 7.3 per cent in 1997-98 to 7.5 per cent in 1998-99.

As a result reform packages have resulted in increasing the cost of bank in one hand and availability of credit to private sector has curtailed on the other. Thus banking sector have therefore landed in a peculiar situation due to reform packages. Apart from these, the role of banking sector against the backdrop of East Asian currency crisis (Joshi, 1999) can not be overlooked (Patibandla and Prusty, 1998). A number of measures have already been taken following this crisis in November, 1997 and January 1998 include, CRR cuts in monetary and credit policy, deregulation of interest rate, surcharge on bank credit for imports, minimum interest rate charge, raising of bank rate, liquidity support to primary dealer (RBI Bulletin, June 1999).


It is evident, from the above discussion that banks come under severe pressure to improve their bottom line and also faced global competition with a view to attain competitiveness through judicious blending with their efficiency and profitability consideration. A study in respect of impact of financial sector reform on PSBs is, therefore likely to be extremely relevant and interesting particularly in a backward area.

Being situated in the southern part of Assam, the Barak Valley comprised of three districts (viz., Cachar, Karimganj and Hailakandi) has a population of 30.19 lakhs (Govt. of Assam 2000). The incidence of poverty and unemployment are high. The infrastructure hazards, industrial backwardness and agrarian biased population added the dimension of economic backwardness of this valley. The districts of the valley are industrially backward and have been declared by the Govt. as “A” category districts.

It is the question of above sorts that have prompted us to undertake the proposed study.

3.2. Background of the Study Area:

The Barak valley is the southernmost region of Assam located between latitude 24°8' and 25°8' North and longitude 92°15' and 93°15' East covers an extensive area of 6922 sq. kms comprising 2313 villages and 8 towns in 4 sub-divisions of three districts (Cachar, Karimganj and Hailakandi) of South Assam. The topography of the valley is heterogeneous composed of high hills, low lands called ‘beel’ and ‘haor,’ and level plains dotted with low ranges isolated hills called ‘tillas’. The river Barak flows through the plain portion of the valley. The climate condition of the valley is characterised by high temperature and heavy rainfall. The average maximum temperature recorded 31.6° centigrade and minimum 16.1° centigrade, rainfall varies from 19.6 mm to 561.1 mm during 1995-96. The economy of the valley had been a periphery to the economic mainstream of Bengal during the British rule. The partition of the country in the wake

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79 Villages covered revenue Villages out of which 2244 are inhabitant and 69 are uninhabitant.
80 Towns covered 3 Municipal Boards (MB) viz, Silchar Municipal Board, Karimganj Municipal Board and Hailakandi Municipal Board: 3 Town Committee, viz, Lakhipur Town Committee, Badarpur Town Committee, Lala Town Committee and 2 Census Towns viz, Badarpur Railway Town and Ramkrishna Nagar Town.
82 The River Barak originates from the Southern slopes of lofty ranges of Nagaland and forms northern boundary with Manipur. The River bifurcates near Banga Bazar of Karimganj district in the Surma flowing the north wards and Kushiara flowing west wards.
of independence and the consequent emergence of East Pakistan (now Bangladesh) not only had shattered the traditional cheapest and quickest lines of transport and communication but also had snapped the age old channels of trade, commerce and transactions. The post independence phase did not adequately compensate the valley for all the loss inflicted on it by partition.

As per the Expert Committee on population projection in 2000 the valley got altogether 30.19 lakhs persons. The valley is characterised by thickly populated area with density of 360 persons per Sq. Km and urban population comprises about 9 pc of total population. The basic statistics of NER states that the valley is more populous than at least five out of seven states of North Eastern Region viz. Mizoram, Arunachal Pradesh, Nagaland, Meghalaya and Manipur (GOI, 2000). The literacy rate in the valley is 56.6 pc which is higher than the national average of 52.2 pc. The work participation rate in the valley is 8.6 pc which is much lower than the national average 25.7 pc.

The valley is agrarian biased. In 1991, it has been observed that about 49 per cent of the geographical area are under agriculture and 36.9 pc are under forest. The irrigated area as percentage of gross cropped area was 1.69 and fertiliser consumption per hectare of gross cropped area was 11.7 kg which were much lower than the national average of 40.22 pc and 70.3 kg respectively. The average yield of rice per hectare in the valley was 1423 kg as against 1745 kg in the national average during 1997-98.

The number of existing industries (factories and small-scale industries) in the valley constituted about 8 per cent of the total number of industries state Assam during the period 1977-2000. The district industries centres (DICs) are imparting training to the rural artisans in trade, leatherwork, tailoring, bamboo work, carpentry etc. Until 1985 there was only one Industrial Training Institute (ITI) at Srikona, Cachar District catering specialised training to the entrepreneurs of the valley. However, another ITI came up in Karimganj district since 1985 to impart training to the prospective entrepreneurs.

Only 4.3 per cent of the workers are engaged in manufacturing, processing etc.

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84 Projected by the Expert Committee on Population Projection, South Assam Zone, Silchar.
86 Office of the Joint Director of Agriculture, South Assam Zone, Silchar.
87 Calculated on the basis of data obtained from Directorate Economics and Statistics & District Industries Centres of the area under study.
88 Superintendent, Industrial Training Institute, Karimganj, Assam.
as against national average of 10.2 per cent of the work force in manufacturing sector. The valley has 7.2 per cent of the road ways and 19.8 per cent of the railway network of the state Assam. The per capita consumption of electricity in the valley was 34.5 kwh in March 1997 (as against 89.3 kwh in Assam and 331.2 kwh in all India average). 55 per cent of the total villages are electrified in the valley while 65 per cent in Assam. The number of registered unemployed in the valley increased from 23161 in 1975 to 204790 in 2001.

Finance is essential for the development of industries in a particular area. The rate of growth of flow of institutional finance in the valley has not shown significant rise. The valley has 12.5 per cent of the total bank offices of state Assam. At present, 12 public sector banks, 1 regional rural bank, 1 private banks and 2 co-operative banks are operating with a net work of 145 branches. Table 1 shows the banking infrastructure in Barak valley.

**TABLE 1**

**BANKING INFRASTRUCTURE IN BARAK VALLEY AS ON 31 – 12 – 2000**

<table>
<thead>
<tr>
<th>Types of banks</th>
<th>No. of Branches</th>
<th>Cachar</th>
<th>Karimganj</th>
<th>Hailakandi</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public Sector Banks (PSBs)</td>
<td></td>
<td>50</td>
<td>32</td>
<td>12</td>
<td>94</td>
</tr>
<tr>
<td>(a) State Bank group (SBs)</td>
<td></td>
<td>10</td>
<td>6</td>
<td>3</td>
<td>19</td>
</tr>
<tr>
<td>State Bank of India (SBI)</td>
<td></td>
<td>40</td>
<td>26</td>
<td>9</td>
<td>75</td>
</tr>
<tr>
<td>(b) Nationalised Banks (NBs)</td>
<td></td>
<td>17</td>
<td>16</td>
<td>4</td>
<td>37</td>
</tr>
<tr>
<td>(i) United Bank of India</td>
<td></td>
<td>3</td>
<td>2</td>
<td>Nil</td>
<td>5</td>
</tr>
<tr>
<td>(ii) Allahabad Bank</td>
<td></td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>(iii) Punjab National Bank</td>
<td></td>
<td>7</td>
<td>2</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>(iv) Central Bank of India</td>
<td></td>
<td>1</td>
<td>Nil</td>
<td>Nil</td>
<td>1</td>
</tr>
<tr>
<td>(v) Indian Bank</td>
<td></td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>(vi) Union Bank of India</td>
<td></td>
<td>2</td>
<td>1</td>
<td>Nil</td>
<td>3</td>
</tr>
<tr>
<td>(vii) Punjab &amp; Sind Bank</td>
<td></td>
<td>2</td>
<td>1</td>
<td>Nil</td>
<td>3</td>
</tr>
<tr>
<td>(viii) Bank of Boroda</td>
<td></td>
<td>2</td>
<td>1</td>
<td>Nil</td>
<td>3</td>
</tr>
<tr>
<td>(ix) United Commercial Bank</td>
<td></td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>(x) Canara Bank</td>
<td></td>
<td>1</td>
<td>Nil</td>
<td>Nil</td>
<td>1</td>
</tr>
<tr>
<td>(xi) Vijaya Bank</td>
<td></td>
<td>1</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>2. Regional Rural Bank (RRBs)</td>
<td></td>
<td>19</td>
<td>17</td>
<td>8</td>
<td>44</td>
</tr>
<tr>
<td>Cachar Gramin Bank. (CGBs)</td>
<td></td>
<td>1</td>
<td>Nil</td>
<td>Nil</td>
<td>1</td>
</tr>
<tr>
<td>3. Private Sector Banks</td>
<td></td>
<td>1</td>
<td>Nil</td>
<td>Nil</td>
<td>1</td>
</tr>
<tr>
<td>Federal Bank</td>
<td></td>
<td>1</td>
<td>3</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Co-operative Banks</td>
<td></td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>71</td>
<td>52</td>
<td>22</td>
<td>145</td>
</tr>
</tbody>
</table>

*Source: Lead Bank Office, United Bank of India, Cachar, Karimganj and Hailakandi district*

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90 Percentage of Roadways are calculated on the basis of data obtained from *District Transport Office*.
91 *Area Manager, N.F. Railway, Badarpur, Karimganj, Assam*.
92 *Office of the Electrical Division, Karimganj, Assam*.
93 *Electrical Division, Silchar, Assam*.
94 *Office of the District Employment Exchanges, Cachar, Karimganj and Hailakandi District*.
95 *Lead Bank Office, United Bank of India, Silchar, Assam*. 

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The table exhibited that as on 31.12.2000 there are 94 number of branches of PSBs operating in the valley. The district Cachar is bestowed with 50 branches (10 from SBI and 40 from nationalised group) while the district Karimganj got 32 branches (6 from SBI and 26 from nationalised group) and 12 branches (3 from SBI and 9 from nationalised groups) in the district of Hailakandi are taking the care of banking activities. It is also revealed that branches of PSBs constitute 64.3 pc of total existing commercial banks in the districts under study.

The foregoing discussion revealed that the valley is economically and industrially backward. The socio-economic backwardness of the valley is discerned by the symptoms like under utilization of resources, agrarian bias of population, low level of industrialisation, fragility of prevailing infrastructure and high incident of unemployment. Thus, development of infrastructure like transport, communication, power, education and banking network etc is urgently needed in the direction of industrial and agricultural development. As sequel to this, there would be overall development of socio-economic life of the people in the district under study.

4. Objective of the Study.

The objective of the proposed study is to evaluate the performance of the public sector banks operating in Barak valley. It aims to progress in the following areas –

1. To examine the inter-bank performance in respect of growth rate of deposits, advances, loan recovery, targeted lending, Credit Deposit (C/D) ratios, profitability and productivity.

2. To study whether deregulation policies have ushered any radical change in the management of resources of banks in the area under study.

3. To examine the factors affecting the volume of NPAs and its interrelationship with branch expansions.

4. To study the nature of customer services rendered by the banks in the context of financial sector reform.

5. To assess the measures taken to avert the risk factors in the banking operations.
5. Hypotheses of the Study:
The following hypotheses have been framed to meet the objectives of the proposed study –

1. There have been no significant change in the bank operation, shift in assets and liabilities and volume of priority sector lending during the post liberalisation period from that of pre-reform regime.

2. The branch expansion of banks over the year led to insignificant increase in the volume of NPAs.

3. The earning capacity of banks has not been significantly affected by income recognition norm based on realisation instead of accrual basis.

4. For greater transparency in the accounting and disclosure practices, the banks have no alternative rather to follow tighter asset classification, income recognition and provisioning norms as well as developed Asset Liability Management System specially to aligning with international standard.

6. Methodology:

(a) Research Population:
The PSBs operating in the three districts of the Barak Valley mentioned in the earlier table have been considered as research population of the study. As on December 2000, there are 12 PSBs with 94 number of branches catering financial requirements of the three districts in the valley. For the purpose of the study of this nature we have considered all PSBs particularly for the analysis of financials of the banks as a whole. On the other hand, more than 20 pc population encompassing 10 number of urban and 10 number of rural branches have been considered for collection of first hand data to assess nature of services rendered by the banks. The details of which have been given in the appropriate chapter. It is mention-worthy in this respect that branches in town areas and branches in villages have been considered urban and rural branches respectively.

(b) Data Collection:
Both primary and secondary data have been used for the purpose of the study. The sources of secondary data are financial statements compiled by the regional offices of the banks operating in the study area, RBI bulletins, Lead Bank statements, potential
linked credit plan of NABARD, Directorate of economic and statistics, various reports, surveys, published and unpublished research papers and dissertations. However for primary data a widely used technique known as survey cum interview method has been used for assessing the nature of services rendered, work system, recovery system, processing loan applications and other impeding factors associated with the bank performance. In this respect a comprehensive questionnaire was administered among randomly selected respondents; banks as well as customers.

The multi stage purposive sampling technique has been used to select the sample units to assess the nature of services rendered by the banks. Selection of regional managers constitute the first stage, selection of bank managers in the second stage and general customers i.e., person having at least a bank account are in the last stage. Further, bank customers are classified into different groups; occupation wise, income wise, volume of transaction wise, nature of loan wise etc. Parity has been maintained in respect of number of respondents in each group. The information so collected have been supplemented by arranging interviews with the top bank officials, lead bank officials in the study area.

(c) Variable selected:
To assess the impact of new disclosure norms, we have taken the variables like deposits, advances, volume of business (deposit + advance), provisions and contingencies, net profit, interest accrued, paid up capital plus retained earnings, advances outstanding, loans recovered, total expenditure. Further, to examine how far banks have adhered to the standard norms of disclosure, a ranking of banks operations is made with the help of analysis of CRAMEL (CRAMEL stands for Capital Adequacy, Resource Deployed, Asset Quality, Management, Earnings Quality and Liquidity). In this respect we have considered variables like the deployment of capital, liquid assets, investments, advances fixed assets, other assets, net non performing assets, contingent liabilities, net profit, number of employee, profit after tax (PAT), earning per share (EPS) etc To assess the nature of unbridled virus of NPAs in banks during the reform regime the variables are net and gross NPA, total standard, doubtful and loss assets, total write off amount during the year, total unrealised interest and amount recovered from bad loans. Further,
25 variables (discussed in appropriate chapter) were considered to measure customers' satisfaction level regarding services rendered by the banks.

(d) Research tools and techniques:

With a view to test the hypotheses, a wide range of statistical and financial techniques have been applied. Moreover, to assess the interrelationship between the variables and their interdependency, we have used Pearson's correlation coefficient and regression analysis. Besides, measures of central tendency, dispersion have been used in appropriate cases. The parametric tests like 't' test, 'z' test and 'F' test have been conducted in appropriate cases. We have also used non-parametric test to know the efficacy of schemes, procedures adopted by the bank to maintain an amicable relationship with the customer. In this respect we have used 'Median' test, Factor analysis, Inter-Quartile Range (IQR), Skewness.

A wide range of ratios are used as performance indicators which include: return on average assets, return on equity, expenses to income, employees efficiency (net profit per employee), capital adequacy ratio, debt-equity ratio, liquid asset ratio, investment, fixed assets, advances to total assets deployed, interest income, non-interest income, operating profit as a percentage of working funds, non-interest income to gross income, net profit to deposit, net profit to spread, staff expenses to operating expenses, spread to total assets, business (deposits and advances) per employee, gross NPA ratio, gross NPA to total assets, total standard assets to total outside liabilities, depositors safety ratio, net NPA to total capital and reserve, slippage ratio (fresh NPA added during the year to standard loan assets at the beginning of the year), de-recognised interest ratio (total de-recognised interest to gross NPA), NPA accretion ratio (total NPA added during the year to total NPA reduce during the year), negotiability ratio (total compromise settlement amount to total NPA compromised) and so on.

(e) Periodicity of the study:

The period coverage for the proposed study was 20 years commencing from 1981-82. It has further been classified into two distinct groups comprising 10 years each relating to pre-reform regime (1981-82 to 1990-91) and post reform years (1991-92 to 2000-01). The growth of different variables as well as the impact of reform measures on overall workings of the banks have been compared with during the aforesaid time periods.
7. Layout of the Study:

The study has covered important aspects of the working of public sector banks in the context of financial sector reforms and coached in the ten chapters. After having analyses the need of financial sector reform in Indian context the chapter one **introductory**, sets forth the parameters of the study in both theoretical and problematic framework. It also highlights on the objectives and hypotheses framed, methodology adopted for collection of data and techniques used for analysis. Conceived with the frame work of the study, the second chapter, **Financial Sector Reform : Need and Implications**, is devoted to examine the details of different facets of financial sector reform with a special emphasis on banking sector reform. It covers the committee recommendations and their subsequent implementation. Taking the queue from the earlier chapters the third chapter, **Growth and Development of Public Sector Banks : An Assessment**, analyses the growth and development of PSBs in the national level under the broad heads : (i) Banking scenario during post nationalisation era, (ii) performance of banks in the changing economic scenario, (iii) Comparative performances appraisal of different banks at the national level. Chapter four, **Evaluation of Performance of Public Sector Banks : Deposits, Advances and C.D Ratios**, presents an analysis of the growth and development of public sector banks in the area under study on the basis of the selected parameters viz. deposits, advances and C/D ratio. Further a comparison of growth rate has been made in two periods – pre and post reform regime. The fifth chapter, **Profitability in Public Sector Banks : An Appraisal**, deals with the nature and trend of profitability of PSBs operating in the study area in the context of their performance at national level on the basis of analysis of some standard ratios. The chapter six, **Productivity in Public Sector Banks – An Analysis**, has incorporated the productivity and efficiency analysis of Public Sector Banks with the widely used indicators like labour productivity, branch productivity, cost responsiveness and return on working fund. The causes of low productivity also have been compared in two different time period as well as at national and districts level. **Non-Performing Assets : Nature and Trend – A Critical Assessment**, the contents of the of chapter seven attempts to assess position of the bad loans of banks and measures adopted to contain them at the national level vis-à-vis districts level. The eighth chapter,
Asset Liability Management of Public Sector Banks: An Overview, covers the issues relating to the asset liability management of banks with the special reference to public sector banks only in the national level. Due to paucity of relevant information the empirical analysis has not been attempted. The chapter nine, Customer Services of Public Sector Banks: An Empirical Investigation, presents an empirical study on the basis of responses in respect of suitability of bank services rendered. It has covered the analysis of the determinants as well as the level of customer’s satisfaction on the basis of structured variables. It also highlighted the marketing strategies for increasing the level of customer's satisfaction. The concluding Chapter ten, Epilogue, gives a brief summary of main findings and some workable suggestions for further improvement of working of the Public Sector Banks operating in the districts of Barak valley.

The entire subject of impact of banking sector reform on the performance of PSBs remained largely un-researched so far in this part of the country. It is expected therefore that this study will provide intellectual stimulus for many more studies on various aspects of banking sector reform and also serve as basis for bank executives to frame guidelines for better performance of the banks in other areas similar to this.

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