Reforms In Indian Banking Sector - An Evaluative Study of the Performance of Commercial Banks

Dr. D. Suryachandra Rao[1]

Introduction

The financial development was given impetus with the adoption of social control over banks in 1967 and subsequently nationalsation of 14 major scheduled banks in July 1969. Since then the banking system has formed the core of the Indian financial system. In the three decades following the first round of nationalization (the second round consisted of 6 commercial banks in April, 1980), aggregate deposits of scheduled commercial banks have increased at a compound annual average growth rate of 17.8 per cent during this period (1969 to1999), while bank credit expanded at the rate of 16.3 per cent per annum. With branches of more than 67,000 of which 48.7 per cent being rural, touching the lives of millions of people everyday, the Indian banking sector constitutes the most significant segment of the financial system of India.

Despite this commendable progress serious problems have emerged due to the reasons beyond the control of banking sector. While nationalization achieved the widening of the banking industry in India, the task of deepening their services was still left unattended. By the beginning of 1990, the social banking goals set for the banking industry made most of the public sector banks unprofitable. The resultant 'financial repression' led to the decline in productivity and efficiency and erosion of profitability of the banking sector in general.

It is against the background of these circumstances, that the development of a sound banking system was considered essential for the future growth of the financial system. Financial sector reforms were initiated in the country in 1992 with a view to improving the efficiency in the process of financial intermediation, enhancing the effectiveness in the conduct of monetary policy and creating conducive environment for the integration of domestic financial sector with the global system.

Need for the Study

A sea change has taken place in the banking environment since the initiation of reform process in 1992-93. The period of little more than a decade witnessed remarkable changes in perceptions, policies and practices of banks. In the light of sweeping changes that have taken place in banking policies and practices during the last eleven years of reform period, it is thought appropriate to evaluate the impact of reform measures on the efficiency, profitability and overall

Associate Professor, Dept. of Management Studies, K.G.R.L College – P.G.Courses, Bhimavaram, West Godavari Dt., A.P, INDIA.[1]

performance of banks vis-à-vis bank groups in the public and private sector since 1992-93 and also to make a comparative analysis of performance of bank groups in both quantitative and qualitative aspects. Though recently a large number of studies evaluating the performance of commercial banks in the reform period have come up, yet, certain important aspects remain untouched. These studies by and large confined to economic aspects of their performance i.e., profits alone and socio-economic dimensions of their working are altogether ignored. Moreover, in most of these studies, analysis is based upon very limited number of indicators, limited number of years and for limited banks and bank groups. Therefore, against this background, it is thought desirable to take up a comprehensive study evaluating and comparing the performance of different aspects of the domestic commercial banks in India.

Objectives of the Study

The major objective of the study is to assess the impact of reform measures on the efficiency, profitability and overall performance of banks vis-à-vis bank groups in public and private sector during the period 1992-93.The specific objectives of the study are:

- To study the recommendations of Narasimham Committee-I and II and analyse their implications on banking sector.
- To evaluate the relative changes in the performance of various banks and bank groups within the public and private sector in selected aspects as a result of implementation of reform measures.
- To make a comparative analysis of the performance of public and private sector commercial banks during the course of implementation of banking sector reforms.
- To examine the customers' perception towards the services offered by banks and compare public and private sector banks' service quality.
- To suggest ways and means by which banks can improve their operational and financial performance to face the challenges of the transition and change consequent to reforms in Indian banking sector.

Period of the Study

The period of the study commences from 1992-93, the year in which reforms are initiated to 2002-03 - a little more than a decade. The period is again divided into three sub-periods to take cognizance of important landmarks like the entry of new private sector banks, the data of which is available from 1995-96 and policy changes and the reform measures suggested by the Narasimham Committee-II (1998). The sub-periods are: (a) 1992-93 to 1994-95 (b) 1996-97 to 1998-99 and (c) 2000-01 to 2002-03.

Scope of the Study

The study includes all the 27 Public sector banks operating in India. For analytical purpose, the total 27 Public Sector Banks are divided into 3 groups: (i) State Bank of India (ii) Associate banks of SBI and (iii) Nationalised banks. Out of 30 Private Sector Banks, which are operating in the year 2003, only 24 are included in the study.

The total 24 private banks are divided into two groups – (i) Old private sector banks (16) and (ii) New Private sector banks (8).Foreign banks are particularly excluded from the study, as they are not strictly comparable with their Indian counterparts. However, the Regional Rural banks (RRBs) are also excluded from the present study as their operations are confined to target groups in rural and semi-urban areas.

Sources of Data

The study relies on the secondary data published by institutions and organizations concerned with commercial banks. The publications of the Reserve Bank of India – Report on Trend and Progress of Banking in India (Annual), Banking Statistics, Report on Currency and Finance (Annual), RBI Bulletins (Monthly) and Hand Book of Statistics on Indian Economy and Annual Reports of respective banks provided the data. Data are also drawn from Economic Survey of Government of India. Data published by the Indian Banks' Association in monthly bulletins; in special issues, annual publications on Performance Highlights of banks are the official sources of information.

Methodology

The present study follows, with certain modifications, the procedure adopted for performance evaluation by ICRA Ltd., which was commissioned for the purpose by Indian Banks' Association in 2002. The indicators used in the present study are as follows: 1) Business per branch (BPB), 2) Operating expenses per branch (OPB), 3) Profit per branch (PPB), 4) Business per employee (BPE), 5) Establishment expenses per employee (EPE), 6) Profit per employee (PPE), 7) Return on Assets (ROA), 8) Return on Equity (ROE), 9) Net-interest margin (Spread) as a percentage to working funds (NIM), 10) Non-interest income as a percentage to total income (NII) and 11) Credit-Deposit ratio (CDR). The study evaluates the performance of Public and Private sector banks separately as a first step. The performance analysis is carried out in two ways i) Time-series analysis. ii) Period-wise analysis. The performance of public sector banks is compared with that of private sector banks in each area of the eleven indicators and then their performance with regard to the adherence to prudential norms relating to the asset classification and capital adequacy during the study period is also made. Apart from the quantitative analysis, this study examines the Customers' perception towards the services offered by banks and compare Public and Private Sector banks' service quality as an ancillary to the main study. The statistical package *STATISTICA 5.5* versions is used for principal component analysis and for calculation of linear growth rates and for other computations '*Microsoft Excel'* is used.

Scheme of the Study

The study comprises of seven chapters. The first and introductory chapter describes briefly the theme of the study and need for the present study, specific objectives of this study, hypothesis, methodology and limitations. The second chapter reviews earlier research works on the topic both in India and abroad. Chapter three gives historical perspectives, progress of commercial banking in India. The fourth chapter is divided into three sections covering evolution of Public Sector Banks in the first section whereas the second section is performance analysis in terms of efficiency and profitability indices of Public Sector Banks for the entire study period and the third section deals with period wise analyses of performance of Public Sector Banks based on grouping of banks using principle component analysis. In the fifth chapter, performance evaluation of private sector banks is divided into three sections as was done in the previous chapter. Sixth chapter comprises of three sections. Section I, focuses on the relative performance of the two groups of banks in terms of selected parameters. Section-II examines how far the stipulations relating to prudential norms have been satisfied by the two groups of banks whereas section-III is devoted to examine the customer perception towards services offered by banks and give a comparative view of public and private sector banks' service quality. The last chapter provides conclusions of the study and the suggestions that emanate from the study to improve the performance of the commercial banks in India.

Major Findings

The following findings emerge from the evaluation of performance of public sector and private sector banks based on data pertaining to 11 years of the study period.

- On the analysis of the performance of the PSBs at branch level and at employee level in efficiency revealed that their performance in business, profits have increased but on expenditure side, its performance is not that good.
- Performance of PSBs on profitability front is good, especially in Return on Equity, Return on Assets and Non Interest Income. Spread has declined during the first three years due to slashing down of interest rates.
- It appears that all public sector banks have not responded to the process of reforms in the same degree and spirit. Some of them, for instance, Oriental Bank of Commerce, State Bank of Hyderabad and State Bank of Patiala etc. recorded a marked improvement, while other banks like UCO Bank, United Bank of India, Central Bank of India, Bank of India, Indian Overses Bank and Punjab & Sind Bank failed to show any significant improvement.
- On the profitability front, Private Sector Banks failed to put up consistent performance. There is a growth in Return on Assets, Return on Equity, Non-interest Income and Credit-Deposit Ratio but Net Interest Margin, on an average, declined during the study period.
- When the performance of PSBs and Private Sector Banks is analysed in three specified sub-periods, it is found that there is an increase in majority of indicators as one moves from one period to another.
- The reform measures undoubtedly improved the performance of Private Sector Banks in terms of efficiency and profitability but all

banks did not respond in similar fashion. Some of them are as for example; ICICI Bank, HDFC Bank, IndusInd Bank Ltd., UTI Bank, IDBI Bank and Bank of Punjab Ltd., showed a remarkable improvement while others like Catholic Syrian Bank Ltd., Sangli Bank Ltd., United Western Bank Ltd., Citi Union Bank Ltd. and Dhanalakshmi Bank Ltd., recorded an average improvement given the same opportunity in the changed environment.

- A Comparison of the relative performance of public and private sector banks reveals that on an average, Private Sector Banks are much a head of Public Sector Banks in efficiency.

- When the performance different bank groups is considered, New Private Sector Banks is better than that of Old Private Sector Banks and even various groups of Public Sector Banks as well. Because of its inherent strength and image, SBI is much stronger in efficiency than other groups of Public Sector Banks.

- When the profitability of both the groups and sub-groups is analysed, Private Sector Banks, on an average, appeared to be better than Public Sector Banks in all the profitability indices except Net Interest Margin. New Private Sector Banks and State Bank of India continued to show better results in most of the profitability indices.

- An interesting feature is that the New Private Sector Banks which have from their very start rendered various types of fee based services have been able to earn a higher percentage of Non Interest Income compared not only their counterparts but also to different groups of Public Sector Banks.

- Consequent upon the introduction of prudential norms relating to asset classification, income recognition and provisioning the most visible structural change in the banking sector was improvement in asset quality.

- With the introduction of Capital to Risk Weighted Asset Ratio norms in 1992, significant improvements were noticed in the capital position of banks.

- When the service quality and customer satisfaction of selected public ad private sector banks were examined by undertaking a survey, it is found that private sector banks operating in Hyderabad and Secunderabad provide better service quality to its customers as compared to public sector banks.

Concluding Observations

Based on analysis and major findings, here is a list of concluding observations.

- The response of the banks to the reforms has been impressive. The banks have been adjusting very well to the new environment, though gradually.

- The reforms have not only enhanced the opportunities for banks but at the same time through challenges as well.

- As a result of entry of new generation private sector banks, the competitive pressures are constantly on the increase.

- The profit performance has been varied among different bank groups with respect of individual banks as well. New private sector banks have fared better than public sector banks and old private sector banks.
- There is shift of focus from process-based management to risk based management.
- The Interest rate spread has exhibited a decline over the years in the case of different groups of public sector banks and Indian private sector banks.
- The level of Non-Performing Assets of public sector banks remained high; a noteworthy development has been their significant reduction in relation to net advances in recent years.
- The expectations of consumer have been growing. Broadly, these expectations are swift service with minimal response time, efficient service delivery, tailor-made and value-added products to suit specific needs, hassle-free procedures and minimum transaction costs, and pleasant and personalized service.
- The Non-interest income of both public and private sector banks exhibited an increase during the period under study.
- The financial health of banks improved due to prescribed prudential norms. Almost all banks improved their Capital adequacy and Asset quality during the period of the study.

Suggestions

Indian banking needs to focus on the following aspects and build required capabilities to cope up with the challenges of the dynamic banking environment.

- Without adversely affecting the quality of services, the banks should device the strategies to cut down and control the costs.
- The future strategies of banks should be to earn more of 'other income 'and reduce dependence of interest income.
- To fulfill the expectations of customers, to improve the profitability and efficiency, banks should adopt latest and cost-effective technology, because technology has emerged as a strategic tool in the operations of banks.
- In the coming years, the key word is marketing would be innovation. It would become impossible to survive and prosper unless organizational skills are effectively channalised towards innovating new ideas, new products, and new strategies for winning over and retaining the customer.
- Since the service sector in India started contributing around 50 per cent to the Gross Domestic Product, banks should explore the possibilities to tap this sector.
- Another area, which requires urgent attention, is improving staff productivity particularly in public sector banks. There is need to downsize staff to cut high cost of staff expenses. It is also necessary to redistribute staff to strengthen the neglected areas of marketing.
- Since customers' perception of banks' products are influenced more by the quality

of services associated with it than by the physical product itself, banks have to undertake a continuous process of monitoring customers' perceptions of service quality, identifying the causes for service quality shortfalls and taking appropriate remedial action to improve quality.

- There may be several reasons for the indifferent behaviour of the staff towards the customers like less number of staff, too much of work, lack of training and orientation etc. Whatever may be the reason, it is certain that behaviour of the staff with the customer needs improvement.

- Majority of the customers especially from public sectors banks strongly felt that the system followed in the banks need a review in term of simplifying various forms used and procedures followed for sanctioning loan.

- Total elimination of Non Performing Assets is not possible in banking business owing to externalities but their incidence can be minimized. Sound credit appraisal, credit risk evaluation and credit monitoring through periodic interaction with borrower to find out the end use of credit are some of the measures to prevent the growth of Non Performing Assets.