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   **STATEMENT OF THE PROBLEM**

   **OBJECTIVES**

   **HYPOTHESES**

   **RESEARCH METHODOLOGY**

   **RESULTS & DISCUSSION**

   **FINDINGS**

   **RECOMMENDATIONS/SUGGESTIONS**

   **CONCLUSIONS**

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# LIBERALISATION AND ITS EFFECTS ON PROFITABILITY & PRODUCTIVITY OF PRIVATE SECTOR BANKS IN INDIA

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## ABSTRACT
*The Indian banking industry has come a long way from being passive business institution to a highly proactive and dynamic entity. Before liberalization, the Indian banking structure was largely controlled and parameters like branch size and location were given much importance. Presently, the Indian banking industry is going through a period of intense change, where liberalized business environment has affected the banking business by way of increasing competition, rising customer expectations, shrinking spreads and increasing disintermediation. Although dominated by public sector banks, India already has a significant presence of private domestic banks and foreign banks. What the banking reforms have done is to create a more level playing field where banks of different ownership types compete within a new set of broad regulations. Data on the performance of the PSB,s over the past one decade offer an opportunity to assess to what extent the regulatory changes have improved the profitability & productive efficiency of private sector banks in India.*

## KEYWORDS
PSB's-Private Sector Banks, RoA-Return on Assets, NPA's-Non Performing Assets.

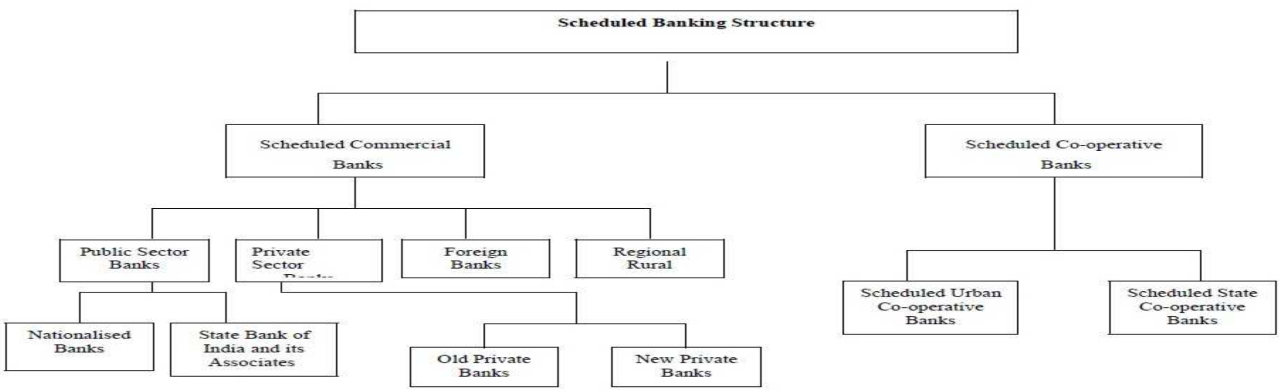
## HISTORY OF BANKING SECTOR IN INDIA
Commercial banking has been one of the oldest business in India and the earliest reference of commercial banking in India can be traced in the writings of Manu. The establishment of the General Bank of India in the year 1786 marked the development of a structured banking system in India. Later the Bank of Hindustan and Bengal Bank came into existence. The East India Company established three banks. These three banks were amalgamated in the year 1920 to form the new Imperial Bank of India. The Imperial Bank was nationalized and renamed as the State Bank of India with the passing of the Act in 1955. The Swadeshi Movement witnessed the birth of several indigenous banks, such as Punjab National Bank, Bank of Baroda and Canara Bank. In order to increase its control over the banking sector, the Government of India had nationalised 14 major private sector banks with deposits exceeding Rs.500 million in 1969. This had raised the number of scheduled bank branches under government control to 84 per cent from 31 per cent.

## LIBERALIZATION OF BANKING SECTOR
The year 1991 marked a decisive changing point in India's economic policy since Independence in 1947.Following the 1991 balance of payments crisis, structural reforms etc influnced the Government of India to frame its policies in the year 1991-92, keeping in view the benefits of liberalization.

The enacted reforms not only affected the real sector of the economy, but the banking sector as well. It was expected that in the process of opening up its economy to the outside world, increased competition could turn the banks more efficient, bring about improvement and ultimately benefits the customers. Characteristics of banking in India before 1991 were a significant degree of state ownership and far reaching regulations concerning among others the allocation of credit and the setting of interest rates. The liberalization of the Indian banking system took its importance when the government began to implement the recommendations of the Narasimham Committee in the year 1991 and 1998 these were the blueprint for banking sector reforms. Some of the important recommendations are as follows-

1. Increase in competition via more liberal rules for the entry of new domestic and foreign banks. Foreign direct investment in private sector banks is allowed up to 74%.
2. Infusion of Government capital in PSBs followed by Injection of private equity. PSBs are allowed to increase the share of private capital upto 49% of which 20% can be foreign equity.
3. Deregulation on interest rates except for certain specific classes such as savings deposit accounts, NRI deposits, small loans up to Rs. 2 lakh, and exports credits.
4. Cuts in Statutory Liquidity Requirements (SLR) and Cash Reserve Requirements (CRR) to reduce pre-emption of bank lending and lower financial repression.
5. Reduction in credit controls to 40% from 80% of total credit.
6. Introduction of a broader definition of priority sector lending.
7. Incentives to increase consumer loans including long term home mortgages.
8. Implementation of micro-prudential measures including Basle-based capital adequacy requirements, income recognition, asset classification and provisioning norms for loans, exposure norms and accounting norms.
9. Emphasis on performance, transparency and accountability.

## SCHEDULED BANKING STRUCTURE IN INDIA




**Source:** Report on Trend and Progress of Banking India, RBI Publication, 2007-08

## INTRODUCTION TO STUDY

The Indian banking industry has come a long way from being passive business institution to a highly proactive and dynamic entity. Before liberalization, the Indian banking structure was largely controlled and parameters like branch size and location were given much importance. Presently, the Indian banking industry is going through a period of intense change, where liberalized business environment has affected the banking business by way of increasing competition, rising customer expectations, shrinking spreads and increasing disintermediation.

Although dominated by public sector banks, India already has a significant presence of private domestic banks and foreign banks. What the banking reforms have done is to create a more level playing field where banks of different ownership types compete within a new set of broad regulations. Data on the performance of the PSB,s over the past one decade offer an opportunity to assess to what extent the regulatory changes have improved the profitability & productive efficiency of private sector banks in India. Apart from analyzing the standard descriptive measures of performance, this paper uses the nonparametric approach of Data Envelopment Analysis to measure total factor productivity growth and its components to assess the impact of liberalization on PSB,s in India. To measure the impact of liberalization on the performance of, PSB,s the following objectives were framed.

## OBJECTIVES OF THE STUDY

1. To evaluate profitability and productivity of private sector banks in the post liberalization period
2. To identify the factors affecting the profitability and productivity of private sector banks in the post liberalization period
3. To examine the contribution of various factors towards profitability and productivity of private sector banks in the post liberalization period

## RESEARCH METHODOLOGY

Data collection-The study is conducted on the basis of primary as well as secondary data. But the secondary data is the major source of study. The secondary data is compiled from statistical tables relating to banks, RBI bulletins, CMIE reports, economic surveys of various years, PNB monthly review, reports on currency and finance and proceedings of state level bankers committees, and other published resources.

The information to primary resources, is collected from the proper interviews with the managers of various PSB,s. the collected data is processed, tabulated, analyzed and interpreted with the help of appropriate statistical techniques.

## LIMITATIONS OF THE STUDY

1. The study is restricted only to private sector banks
2. The study is majorly based on secondary data of various publications. These data are historical accounting concept which ignores the present conditions
3. The study is only on the quantitative accepts of profitability and productivity of private sector banks, the qualitative accepts such as motivation of employees, costumer satisfaction, image of bank are not considered
4. Due to the time constraints the data's of only 4 years has been analyzed and interpreted.

## ANALYSIS AND INTERPRETATION

**TABLE – 1: SHOWING THE DETAILS OF RETURN ON ASSETS OF PSBs** (for year 2001-02, 2004-05, 2010-11&2011-12)

| Sl/no | Bank group year | Return on Assets in percentage | | | |
|---|---|---|---|---|---|
| | | 2001-2002 | 2004-2005 | 2010-2011 | 2011-2012 |
| 1 | **Private sector banks** | **0.8** | **0.7** | **1.43** | **1.53** |
| | 2.1 old private banks | 1.1 | 0.4 | 1.12 | 1.20 |
| | 2.2 new private banks | 0.4 | 1.0 | 1.51 | 1.63 |

**Source:** Compiled from Statistical Tables of RBIs report on trend &progress of banking in India, Various Issues.

Return on assets (RoA) reflects the efficiency with which banks deploy their assets. The financial performance of scheduled Private Sector Banks (PSBs) has improved as a result of financial liberalization in the Indian banking sector. The net profit to total assets ratio of all scheduled Private Sector Banks (PSBs) remained in the range of 0.4 per cent to 1.13 per cent during the period of study, i.e., 2001-02, 2004- 05, 2010-11 & 2011-12. From the above table it is clear that RoA of PSB's in total is in increasing manner from 0.8 percent in 2001-02 to 1.53 percent at the end of 2011-12 there is an absolute increase in the returns. By this it is clear that the performance of PSB's is significant. In the year 2004-05 there is decrease in RoA by 0.1 percent due to the economic down fall and recession.

**TABLE-2- SHOWING THE DETAILS OF BRANCHES AND ATMS OF SCHEDULED PRIVATE BANKS**(As at end of March)

| Year | Bank group | Branches | | | | | ATMs | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Rural | Semi-urban | Urban | Metro | **Total** | Onsite | Off-site | Total |
| 2002 | **Private sector banks** | 1,145 | 1,609 | 1,102 | 860 | **4,176** | NA | NA | NA |
| 2005 | | 1,102 | 1,847 | 1,739 | 1,508 | **6,196** | 2,683 | 4,170 | **6,853** |
| 2011 | | 1,269 | 2,358 | 2,040 | 1,925 | **7,592** | 8,603 | 9,844 | **18,447** |
| 2012 | | 1,581 | 4,687 | 3,569 | 3,165 | **13,452** | 13,249 | 22,830 | **36,079** |

**Source:** Compiled from Statistical Tables of RBIs report on trend &progress of banking in India, Various Issues.

The number of branches is a very important factor in providing banking products and services, especially in a country like India where a majority of a bank's customers are likely to have only limited ability to travel. An extensive bank branch network should cut the shoe-leather costs of banking and allow a bank to generate more deposits and more loans with the same level of operating expenses. From the above table we can analyze that there is a significant increase in number of branches from 4,176 in the year 2002 to 13,452 in the year 2012 and number of ATMs were 6,853 in the year 2005 to 36,079 in the year 2012. This shows that in recent years, private banks are significantly increasing their market. As a result of transition to automation and computerization of branches as well as ATMs, operating costs are likely to decline while fixed costs increase but we would still expect an overall improvement in bank efficiency and profitability. Both Old and new private banks have increased their market share in terms of number of branches and ATMs.

**TABLE-3-TRENDS IN NON-PERFORMING ASSETS OF SCHEDULED PRIVATE BANKS**(for year 2001-02, 2004-05, 2010-11&2011-12)

| Sl/no | **Net NPAs of Private sector banks at different years** | Amount in Billions (Rs) |
|---|---|---|
| 1 | Closing balance 2001-2002 | 67 |
| 2 | Closing balance 2004-2005 | 42 |
| 3 | Closing balance 2010-2011 | 44 |
| 4 | Closing balance 2011-2012 | 44 |

**Source:** Compiled from Statistical Tables of RBIs report on trend &progress of banking in India, Various Issues.

The measure of Non-Performing Assets (NPAs) explains the efficiency in allocation of resources made by the banks to productive sectors. The problem of NPAs arises either due to bad management by banks or due to change in business cycle. The sharp rise in credit growth continued to be accompanied by significant improvement in assets quality. The net NPAs as percentages of net advances have significantly reduced from 67 billions in 2001-02 to 44 billions in the year 2011-2012. The decline of NPAs, along with recovery shows the asset quality of private sector banks. The increasing industrial performance along with recovery shows a significant reduction in the level of NPAs. There has been a distinct improvement in recovery climate in recent years facilitated by strong macroeconomic performance and institutional measures adopted by the Reserve Bank of India

**TABLE-4- SHOWING THE DETAILS OF MATURITY PROFILE OF SELECTED LIABILITIES/ASSETS** (As at end -March)

| Asset/liabilities | Private sector banks in percentage | | | |
|---|---|---|---|---|
| | 2004 | 2005 | 2011 | 2012 |
| **1.deposits** | | | | |
| Up to 1 year | 50.2 | 53.8 | 46.1 | 48.7 |
| Over 1 year up to 3 years | 40 | 40 | 38.6 | 30 |
| Over 3 year up to 5 years | 4.2 | 2.85 | 6.1 | 5.7 |
| Over 5 years | 6.5 | 3.3 | 9.1 | 15.7 |
| **2.Borrowings** | | | | |
| Up to 1 year | 68.05 | 65.55 | 42.4 | 50.3 |
| Over 1 year up to 3 years | 20.85 | 16.00 | 16.2 | 11.8 |
| Over 3 year up to 5 years | 5.55 | 10.2 | 9.8 | 12.5 |
| Over 5 years | 5.55 | 8.30 | 31.6 | 25.4 |
| **3.Loans & Advances** | | | | |
| Up to 1 year | 37.95 | 41.25 | 37.6 | 35.2 |
| Over 1 year up to 3 years | 33.55 | 32.55 | 36.4 | 37.1 |
| Over 3 year up to 5 years | 11.4 | 9.25 | 11.4 | 11.3 |
| Over 5 years | 17.1 | 16.95 | 14.5 | 16.4 |
| **4.Investments** | | | | |
| Up to 1 year | 31.5 | 69.3 | 36.6 | 42.5 |
| Over 1 year up to 3 years | 18.75 | 19.2 | 22.7 | 17.3 |
| Over 3 year up to 5 years | 8.5 | 9.7 | 10.0 | 9.2 |
| Over 5 years | 41.25 | 36.50 | 30.7 | 31.0 |

**Source:** Compiled from Statistical Tables of RBIs report on trend &progress of banking in India, Various Issues.

Deposits, borrowings, loans and advances & investments are the key elements in analyzing the productivity and profitability of any banks. In the above table the data's relating to Deposits, borrowings, loans and advances & investments of PSB's are collected for the years 2004, 2005, 2011 & 2012. In the year 2004 the deposits upto one and 3 to 5 years were more compared to 2011-12 and there is an overall decrease of some 5 percent, but there is a significant increase when it comes to the deposits over 5 years which has been increased from 6.5 percent in 2004-05 to 15.7 in 2011-12 an increase of 10 percent which is a positive trend towards the productivity of PSB's. When it comes to the investments including the investments over 5 years is diminishing and the investments were at the peak between the periods of 2004-2008 because most of the banks under PSB's found this period as the prime to extended their wings of operations, the investments by PSB's started declining after 2010 as they reached the peak .But still today the investment percentage is not less than 20 percent as average of all the kinds of investments which projects the greater productivity of PSB's in future. The borrowings is influenced by the investments, the percentage of borrowings was more in the period of 2004-08 as the investments were also more and later it diminished as the investments diminished.

The banks productivity & profitability always depends upon the deposits, loans & advances. in the beginning of this analysis we have come to know that the PSB's have an more than 30 percent of shares in deposits consistently for past 10 years by facing a tough competition from Public Sector Banks, Co-operative Banks & foreign banks. In the similar way the share of PSB's in loans and advances is also good it has never reached below 35 percent when it comes to the loans up to one year, not less than 30 percent for the loans between 1-3years.and the percentage of loans above 3 years is consistently low because of the high interest rates and internal policies of Private Sector Banks.

## CONCLUSION

It has been observed that the banking sector in India has provided a mixed response to the reforms initialed by RBI and the Govt of India since 1991. The Private Sector Banks in Indian is growing in a significant manner. The sector has responded positively in the field of profitability, productivity, assets quality (reduction of NPAs), enhancing the role by increasing market share by increasing the number of branches & ATMs, income recognition, and the up gradation of technology. The financial sector reforms have brought the Indian Private Sector Banks closer to the global standards. Though the productivity & profitability of the Indian Private Sector Banks has been significantly increased from the day of liberalization to till date, still a long way to go to catch up with their counterparts

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