Global pressure and the public sector banks in India

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ABSTRACT:-After several false starts, global growth and trade have been gaining traction in 2017 so far, supported by accommodative monetary policy and conducive financial conditions. Despite commodity prices firming up, inflation has remained quiescent in both advanced and emerging economies. Global financial markets have been generally buoyant and the effects of geopolitical events, including announcements, have been muted or short-lived. With accommodative policies in advanced economies (AEs) supporting asset prices and spurring a search for returns, investor appetite for emerging market economies (EMEs) as an asset class has been stoked, propelling capital flows to them, albeit with some discrimination against economies with relatively weaker macro fundamentals. Nonetheless, risks to the outlook are still tilted to the downside, with political and policy uncertainties posing threats to global financial stability. In this environment, banking regulators are preparing for the full implementation of Basel III prudential regulations and the adoption of the revised global accounting standards. In parallel, developments like FinTech and the growth of crypto currencies are presenting both opportunities and challenges.

Turning to the financial sector, impairment in the asset quality of the banking sector remains unconscionably high, necessitating sizeable provisioning and deleveraging, thereby constraining banks' capacity to lend. Consequently, profitability and capital positions of banks have faced some erosion, especially in the case of public sector banks (PSBs). In the process, businesses have increasingly switched to alternate and more costeffective sources of funds to meet their financing needs, resulting in some disintermediation for banks.

Keywords:- Global financial, Emerging market economies, Mergers, Acquisitions, Indian Banking Sector, Performance

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I. Introduction-The day of traditional banking, where the deposits from the public used to be parked in Government securities and the banks used to earn profit, is over and the banking industry has undergone sea change. The coming of the private sector banks and foreign banks, have enlarged the definition of banking and the stiff competition posed by them have made this happen. Ask the aged bankers in the Public Sector Banks (PSBs) and they would say that they had never expected that something like cent percent computerization, cross selling of products, marketing, mobile banking, internet bank, selling of mutual funds and insurance products will ever happen in the banking sector at such a fast pace, especially in the public sector banks. But now, it is all there, though the PSBs were late in implementing these processes still they have fared well and have been able to hold on, though there has been a decline in its market share over the years.

With the effect of globalization, the whole world has come together and the corporate clients are making their mark world- wide, their demand for upgraded and prompt services is becoming a necessity to be met. Moreover, with the implementation of Basel II norms, the ever upgradation on the technology front, the upcoming of internet banking, mobile banking, it seems that in order to compete with the global players, the Indian Banks need to consolidate to provide banks with the required scale in terms of the size of the asset so that they can provide for the investment, search new areas offshore and capitalize on the low operating costs through merger of resources.

Narasimham Committee (1991) on the financial system had recommended a four-tier broad structure of the Indian banking system:

• 3–4 large banks (including the SBI), International Banking in character
• 8–10 banks with a pan-India presence for 'Universal' banking
• Region specific - Local banks
• Rural banks [including regional rural banks (RRBs)] – confined to financing agriculture and allied activities in rural areas.

The Committee also viewed that the system should be market driven and based on profitability considerations, the process of Mergers & Acquisitions should be brought about.

It is under these credentials of the banking sector that the present chapter is consistence with global pressure and its impact on Public Sector Banks in India. The chapter is organised into four sections. Section I is introductory. Section II briefly sets out the theoretical underpinnings of the Basel II norms. Impact of accounting measures of efficiency is discussed in section III, while section IV sums up the main points of discussion.

I.Basel II Norms-In keeping with RBI's goal to be consistent with international standards, in 2003, it was decided to adopt Basel II. The standardized approach for credit risk and the Basic Indicator Approach for operational risk were adopted. The Basle II framework details out risk-sensitive minimum capital requirements for banking organizations. It entails 3 pillars-

- Minimum Capital Requirement
- Supervisory Review
- Market Discipline

Minimum Capital Requirement-Instead of fitting all banks into a single framework, it allows banks to determine their own capital requirements (subject to other 2 pillars). For credit risks, two approaches are proposed-Risk Weighted Assets (RWA) approach done by external credit rating agency (ECRA) and the Internal Rating Based (IRB) approach. For market risk, firstly the capital charges are determined directly and then multiplied by 12.5 (reciprocal of 8%) to make them comparable to the RWA.

Supervisory Review-Here, the emphasis is on how banks handle their risk management and internal capital allocation process. Supervisors expect banks to operate above the minimum capital ratios and devise strategies to prevent capital from falling below prudent levels.

Market Discipling-Banks shall be encouraged to disclose ways in which they allocate capital among their different activities. These include:

- Structure & components of bank capital
- Terms and main features of capital instruments
- Qualitative & quantitative information about its risk exposures
- Its capital ratio and other data related to capital adequacy
- A breakdown of risk exposure

The RBI undertook a few regulatory initiatives:

- Introduction of Risk Based Supervision (RBS) in 23 banks on a pilot basis.
- Encouraging banks to formalize their Capital Adequacy Assessment Program (CAAP) in alignment with business plan and performance budgeting system.

- Enhancing the area of disclosures so that there is greater transparency of the risk profile of banks.
- Improving the level of corporate governance standards. However, the challenges envisaged in the process are:
- The level of rating penetration is not very significant.
- Basle II provides scope for the supervisor to prescribe higher than the minimum capital levels for banks.
- The existence of large and complex financial conglomerates could pose a systemic risk.

Operating Costs to Total Assets:-This ratio indicates the amount of operating costs expended per unit of assets. All efforts by a bank to cut cost by rationalising its labour force and branches and bank office operations should get reflected in this ratio. *Larger the ratio, the lower is the efficiency.* This ratio is also used to represent the intermediation cost of banking system by some researchers. The logic for such usage lies in the fact that ultimately, the banks use these operating costs to generate assets (*i.e.*, loans) from their available funds (*i.e.*, deposits). A reduction in operating costs is expected to ultimately result in reduction in lending rates and also net interest margins, thereby facilitating greater credit off take, and hence, economic growth[I]. In terms of the Basel II norms, banks should have cost to asset ratio of about one per cent[II]

Assets of Scheduled Commercial Banks in India-

In the backdrop of global financial crisis and its repercussions on the Indian economy, the year 2008-09 has been a testing year for the Indian banking sector. The Indian banking sector, however, withstood this test and the resilience of this sector was more than evident. The Indian banks were largely immune from the crisis, as their exposure to toxic assets was minimal. More importantly, the Reserve Bank's initiatives regarding adoption of counter-cyclical prudential regulations framework, both during credit boom period as well as during the slowdown, proved to be successful. However, the Indian banking sector was not completely insulated from the effects of the slowdown of the Indian economy as evident from the financial performance of SCBs. The growth rates of income as well as the expenditure of SCBs decelerated, leading to deceleration in growth of net profits. This deceleration in growth of profit was due to the rising cost of deposits and borrowing but declining return on investments. The efficiency parameters like RoA, RoE and improvement in the CRAR, however, increased during the year. In a nutshell, as highlighted by the Report on Financial Sector Assessment (2009), 'The Indian economy has withstood the shocks of the global meltdown well and none of the key financial parameters point to any discernable vulnerability'. Assets of commercial banks in India are shown in table 3.2.

Table - 2 Assets of Commercial Banks in Indian (Rupees Crores)

Year	Cash and balances with RBI	Money at call and short notice	Investment	Advances	Fixed assets	Other assets	Total assets
	Cash						
1	2	3	4	5	6	7	8
1991-92	35474 (10.39)	13674 (4.01)	98736 (28.91)	159808 (46.79)	1991 (0.58)	31841 (9.32)	341524
1992-93	39464 (10.23)	14502 (3.76)	117504 (30.46)	173524 (44.98)	3587 (0.93)	37197 (9.64)	385778
1993-94	51561 (11.85)	12773 (2.94)	154083 (35.43)	168338 (38.70)	5042 (1.16)	43150 (9.92)	434947
1994-95	63050 (12.24)	17442 (3.39)	172849 (33.43)	208819 (40.55)	7062 (1.37)	45768 (8.89)	514990
1995-96	70194 (11.72)	30361 (5.07)	185612 (30.98)	252438 (42.13)	9537 (1.59)	51025 (8.52)	599167
1996-97	60930 (9.06)	47005 (6.98)	223880 (33.28)	275635 (40.97)	10855 (1.61)	54432 (8.09)	672737
1997-98	71590 (8.99)	60195 (7.57)	272074 (34.20)	324586 (40.80)	12608 (1.58)	54453 (6.85)	795506
1998-99	81342 (8.56)	88858 (9.35)	339496 (35.71)	369570 (38.88)	14500 (1.52)	56781 (5.97)	950547
1999-00	85371 (7.69)	81020 (7.29)	413871 (37.27)	443469 (39.94)	15480 (1.39)	71158 (6.41)	1110369
2000-01	84504 (6.53)	105900 (8.18)	491908 (37.98)	525683 (40.59)	16209 (1.25)	70771 (5.47)	1294975
2001-02	86760 (5.65)	117518 (7.65)	588058 (38.29)	645743 (42.05)	20083 (1.31)	77350 (5.03)	1535512
2002-03	86064 (5.07)	74531 (4.39)	693085 (40.85)	739233 (43.57)	20198 (1.19)	83635 (4.93)	1696746
2003-04	113246 (5.73)	81962 (4.15)	802755 (40.65)	863632 (43.73)	21403 (1.08)	92023 (4.66)	1975021
2004-05	118075 (5.01)	95357 (4.05)	869737 (36.92)	1150836 (48.85)	23051 (0.97)	98453 (4.18)	2355509
2005-06	144474 (5.18)	116440 (4.18)	866505 (31.10)	1516810 (54.45)	25080 (0.90)	116540 (4.18)	2785849
2006-07	195264 (5.64)	158298 (4.58)	950977 (27.48)	1981235 (57.26)	31363 (0.91)	142809 (4.13)	3459946
2007-08	322971 (7.46)	109109 (2.52)	1177329 (27.21)	2476936 (57.25)	42394 (0.98)	197425 (4.56)	4326164
2008-09	297263 (5.67)	198581 (3.79)	1449474 (27.68)	3000906 (57.25)	48361 (0.92)	246743 (4.71)	5241328
Average	111533.2	79084.78	548218.5	848733.4	18266.89	87308.56	1693148
CV (%)	71.27	63.82	70.96	97.86	67.24	63.85	82.34
CAGR (%)	13.32	17.05	17.12	18.83	20.64	12.80	17.43

Source: Report on trend and progress of banking in India

Figure 1: Assets of Commercial Banks in India (%)

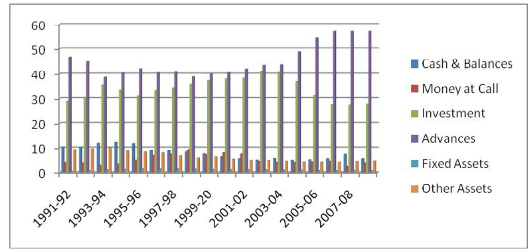
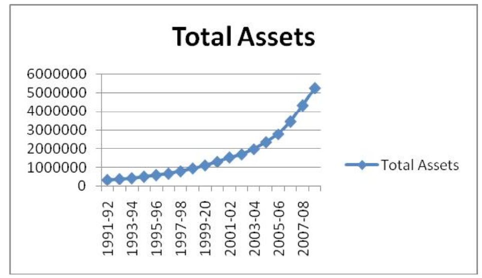


Figure 2: Total assets of SCBs (Rs. Crores)



The above table & figure shows that the main contribution of assets comes from advances, the average contribution in total assets for eighteen years ranging from 1991-92 to 2008-09 is 45.46%. However, this achievement is with highest degree of fluctuation among the various components of assets during the period of study (C.V.=97.86) to be followed by investments by banks (C.V.=70.96). The calculations for CAGR shows that fixed assets registered a maximum growth rate (20.64%) in the period under study followed by advance (18.33%). The growth rate of cash and balances with RBI was lowest at 13.32%. The compound annual growth rate of overall assets registered 17.43% increase since 1991, which is a sufficiently high value. The steep increase in asset value of SCBs could easily be seen in figure-2.

Table-3: Total Assets in Rs. Billions at 1993-94 prices

Year	PSBs	private Banks	Foreign Banks	RRBs	All Banks
1991-92	3633.15	146.69	254.59	92.25	4126.68
1992-93	3372.84	159.24	281.69	96.51	3910.28
1993-94	3434.64	181.96	323.54	100.7	4040.83
1994-95	3526.59	212.06	311.16	111.66	4161.46

1995-96	3744.54	326.75	322.83	127.02	4521.13
1996-97	4010.82	361.92	378.03	150.4	4901.18
1997-98	4153.99	452.27	417.53	182.03	5205.83
1998-99	4478.07	558.96	450.35	203.27	5690.66
1999-00	5100.79	686.03	507.37	237.19	6531.37
2000-01	5638.22	864.24	524.3	267.28	7294.04
2001-02	6329.25	1004.18	625.84	304.83	8264.11
2002-03	6850.84	1586.72	664.47	336.7	9438.74
2003-04	7345.46	1686.73	665.16	357.2	10054.56
2004-05	8089.21	2019.11	749.4	385.9	11243.62
2005-06	9452.16	2279.9	818.61	414.91	12965.58
2006-07	10361.91	2939.73	1025.24	461.08	14787.97
2007-08	12206	3728.88	1390.77	529.1	17854.76
Average	5984.03	1129.14	571.23	256.35	7940.75
C.V. (%)	45.26	95.52	52.66	54.44	53.08

The above table and corresponding figure shows the asset position of SCBs group wise over a period of time. The data reflects that the growth in PSBs has been most significant over the periods under consideration with least degree of variability. The total assets increased by almost 3.35 times in 2007-08 as compared to 1991-92. The most spectacular growth has been seen by private sector banks whose assets increased by more than 25 times during the said period. Foreign banks have also seen a growth of more than five times.

In a nutshell, it can be said that the Indian banking sector has been dominated by the public sector banks in terms of number and asset share. The banking sector comprises of 28 public sector banks with majority government ownership (Table3.4), 23 private banks and 27 foreign banks. It can be seen that the number of public sector commercial banks has almost remained the same over last three decades. And in terms of asset share, the public sector banks constitute about 78 percent (average for the period 1991-2007-08) of the total banking asset. But the point to be noted, the asset share of the public sector banks has gone down from about 88 percent in 1991-92 to about 68 percent in 2006-07. Even though the number of domestic private banks has declined since 1980s, the asset share of these banks has gone up to about 20 percent in 2007. On the other hand, even though the number of foreign

banks has gone up significantly, their asset share has not increased in that way. The total banking sector asset constitutes more than 91.8 per cent of the GDP at the end of March 2008 and the commercial banking asset constitutes more than 95 percent of the total banking asset.

Table - 4 : Private shareholding in PSBs:

Shareholding (%)	Number of Banks
Up to 10	3
More than 10 & up to 20	1
More than 20 & up to 30	3
More than 30 & up to 40	3
More than 40 & up to 49	11

Source: RBI

Further, the following table and corresponding graph clearly reflects that the share of total assets of Public Sector Banks has has shown a declining trend in the post liberalization era. *This confirms our first hypothesis that the share of assets of public sector banks has gone down in the post liberalization period.*

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