PERFORMANCE DIFFERENTIALS OF FOREIGN AND DOMESTIC BANKS IN INDIA

DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF PHILOSOPHY IN APPLIED ECONOMICS OF THE JAWAHARLAL NEHRU UNIVERSITY, NEW DELHI

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I hereby affirm that the research for this dissertation titled ***"Performance Differential of Foreign and Domestic Banks in India"*** *being submitted to the Jawaharlal Nehru University for the award of the Degree of Master of Philosophy, was carried out entirely by me at the Centre for Development Studies, Trivandrum.*

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Certified that this dissertation is the bonafide work of A.Karunagaran. This has not been considered for the award of any other degree by any other University.

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CONTENTS

LIST OF TABLES

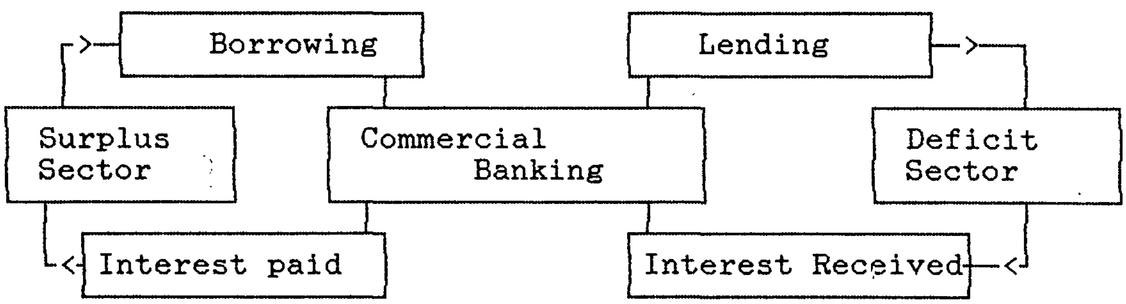
LIST OF FIGURES

CHAPTER 1

1.1 Introduction :

In a modern economy commercial banks are indispensable, for they deal with credit and capital(short term) which is the fuel for the economic machine. Commercial banks act as a conveyor between those who require access to savings and those who supply such savings[1]. As financial intermediaries the commercial banks meet the needs of both savers and borrowers by issuing secondary securities(cheque slips) to savers which are safe, convenient, liquid, and accessible. At the same time, accepting the primary securities (IOUs) of borrowers, commercial banks perform an indispensable function in a nation economy. In the process, promoting savings and making for a more optimal and efficient allocation of financial resources. It serves the simultaneous satisfaction of varied groups with varied needs and varied interests viz., business class, Governmental units and household units. The basic function of the commercial bank could be explained by means of a simple flow chart as under;

Flow Chart showing the functioning of
Commercial banks/Financial Intermediaries



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[1] Eugine S Kliss (1955)

However, modern commercial banks are highly diversified, their activities ranging from the usual acceptance of deposits, lending, to underwriting of shares and debentures, technical consultancy etc., (to the extent that one wonders if the commercial banks should carry out such functions at all).

Commercial Banks and Economic Development:

The role of commercial banks in economic development is exemplified by their principal function of creator of credit (though the effective use of credit is equally important). The credit enables a net addition to the effective purchasing power in a economy, and that is what the primary interest from the point of view of the economic development[2]. In other words, it facilitates transfer of technology, the development of overall financial and managerial skill, the creation of commercial activities, market and mobilisation of resources and thus put the overall economic activities on a higher plane and accelerates economic growth by playing the role of a catalytic agent.

In view of the above, the role of commercial banks becomes all the more important in a developing and planned economy like India. It was therefore rightly recognised at an early stage of formulation of the Five Year Economic Plan itself. For instance the First Five Year Plan document reads as "...the proper discharge of its function by the banking system will necessitate its

[2] Sayers R S (1991)

operation more and more in the light of the priorities for development indicated in the plan". Thus the banking system (which includes foreign commercial banks operating in India and the domestic banks) in general and commercial banks in particular were given to shoulder more broader and wider responsibilities in the socio-economic development of the nation. Incidentally it may be pointed out here that one of the cardinal principle of the international banking (foreign banks) is that they are expected to share the native ethos of the country in which they are operating[3]. The banking system (consisting of domestic and foreign banks) can no more get away with the traditional economic objectives alone viz., commercial profitability, growth etc., but the socio economic developmental objectives like spreading branches to remote areas, lending to hitherto neglected sectors on a priority basis etc., also gains equal consideration as they too have a strong economic justification[4].

1.2 Structure of Commercial Banks in India :

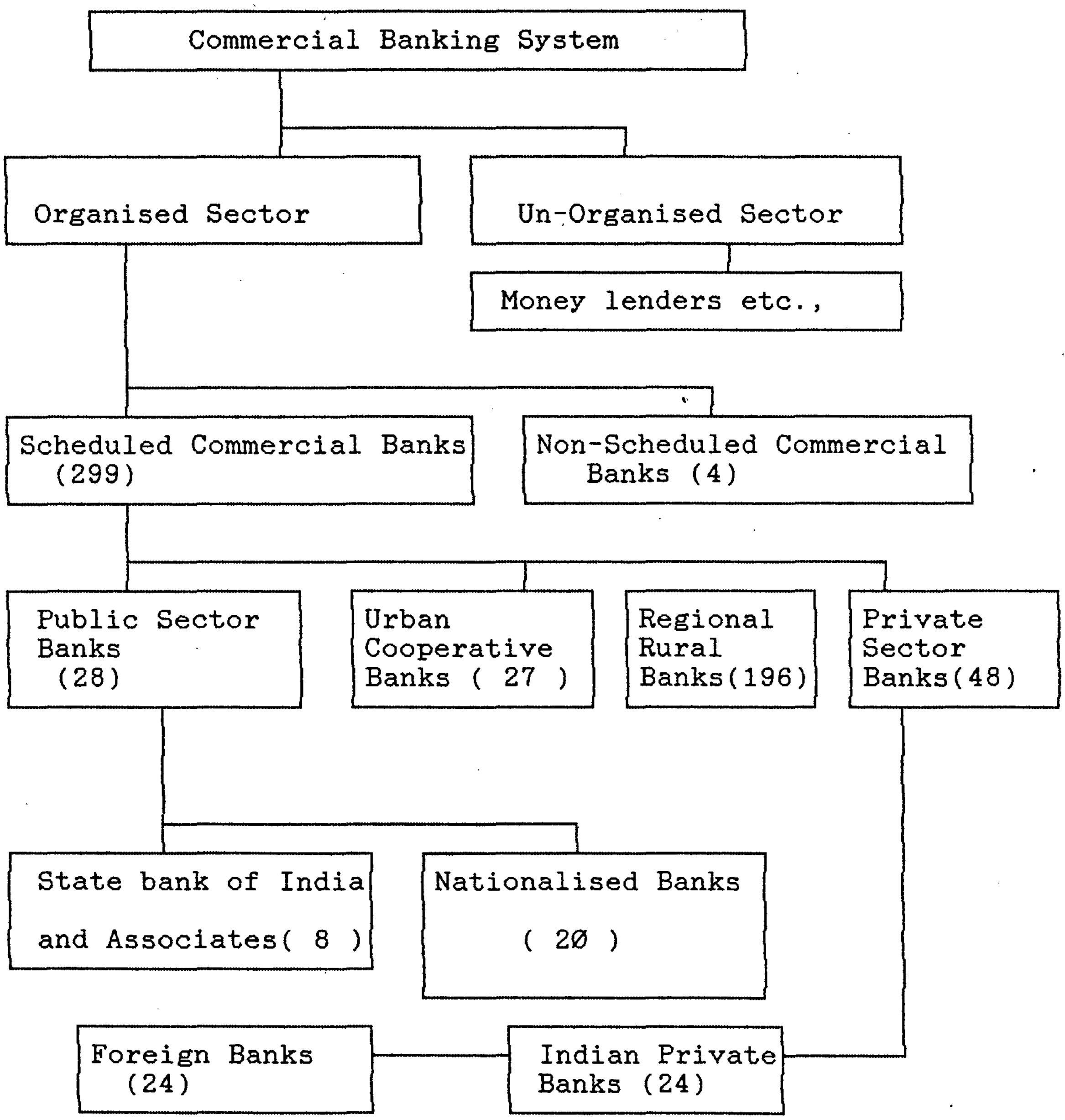
The Indian banking system broadly constitutes the organised and un-organised banking sectors. The former is well organised and regulated by Reserve Bank of India under the Banking Regulation Act, 1949, the R B I Act, 1934 and other legislations. The later comprises of the indigenous sector which do not come under the purview of regulations by the Reserve Bank of India in a strict sense. And they are of village money lenders, pawn brokers,

[3] Sambamurthy (1988)

[4] Shetty S L (1978)

sense. And they are of village money lenders, pawn brokers, merchant cum-money lenders etc.,.

Flow chart Showing the Structure of Commercial Banking in India



Note: Figures within brackets refer to the number of banks in operation as on 31 December 1991.

The organised sector as depicted in the flow chart is divided into

Scheduled and non-Scheduled banks, the Scheduled banks are those which are included in the Second Schedule of the Reserve Bank of India, Act 1934, whose paid up capital and reserves of an aggregate real or exchangeable value exceeds rupees five lakhs, which satisfies R B I that their affairs are not being conducted in a manner detrimental to the interest of depositors. The Non-scheduled banks are, as the very name implies, those not included in the second schedule of the R B I Act which are private sector banks and are very insignificant in numbers. The scheduled banks are further classified into Public Sector, Private Sector, Urban Co-operatives and the Regional rural banks. The public sector banks constitute the State bank of India and its associates, Nationalised banks. The private sector banks comprise of Indian private commercial banks and Foreign banks operating in India. Foreign banks operating in India are only the branches of those incorporated outside the Indian territory.

1.3 Place of Foreign Banks in the Indian Banking System:

Some of the foreign banks operating in India today, are more than a century old and much older than the domestic banks. These banks were originally established to carry out the exchange business and financing the foreign trade business, therefore they were called as " Exchange Banks" (more details in chapter 2). Even after independence these banks continued to play an important role in these areas. In fact one of the main purposes presumably, of allowing these banks to continue their presence in India was the expectation that they would promote foreign trade and foreign investment in India. Over the years, the foreign banks have tremendously diversified their activities through a wide range of innovations in banking business and were competing with the domestic banks even with their limited presence. Their numbers and size were reduced significantly due to many reasons such as consolidation, mergers, winding up and so on because of changes in socio, politico and economic reasons and the deliberate policy decisions to restrict their presence to a limited number. Though the magnitude of operations of foreign banks in India were very small when compared to the domestic banks, their presence were always felt on various quarters of banking. This is more so in recent years because of liberalisation and therefore there is a necessity of studying the foreign banks' operations in general. (Moreover, based on the broad indicators and the available literature on foreign banks, with their relatively very small share in the entire banking business, their proportion of profit in the banking system is on the steady increase to an abnormal proportion).

Since the nationalisation of the major commercial banks in India the entire thrust of commercial banking policy seems to be on the public sector banks. The policy documents, research work, literature etc., in fact, the whole trend of thinking consciously or unconsciously is being focused on the role and functioning of the public sector banks. Apparently the public sector banks were overburdened with the responsibility of socio-economic development of the nation than the rest of the banking sector. This tendency is likely to result in differential performance of foreign and the domestic bank groups favouring the former than the later.

1.4 A Comparative Picture of Foreign and Domestic Banks in India:

The broad comparative picture of foreign and domestic banks in India could be seen from some of the crucial indicators of business for the period since 1969.

Branches:

In terms of branches, the share of foreign banks (FBs) were at 1.45 per cent in 1969 which has come down to 0.44 per cent in 1979 and further to 0.31 per cent in 1989 though, in absolute numbers they marginally increased. As against this the share of public sector banks (PSBs) were on the increase from 81.79 per cent in 1969 to 87.01 per cent in 1979 and further to 90.29 per cent in 1989. The other Indian scheduled banks (OSBs) also, showed declining trend as the foreign banks. They had a share of 16.79 per cent in 1969 which came down to 12.55 per cent in 1979 and further to 9.4 per cent in 1989.

Deposits:

The percentage share of business in terms of deposits of the foreign banks in the banking system as a whole was 9.22 per cent in 1969 which came down to 3.56 per cent in 1979. However, their share has gone up to 5.05 per cent in 1990-91. The share of public sector banks was at 84.66 per cent in 1969 which has gone up to 91.09 per cent in 1979. However, their share has come down marginally to 90.88 per cent in 1990-91. The other Indian scheduled commercial banks showed continuous decline from 6.12 per cent in 1969 to 5.35 per cent in 1979 and further to 4.07 per cent in 1990-91 (see Table 1.1).

Credit and Investment:

The share of business in terms of credit for the FBs was around 10.21 per cent in 1969 and which declined to 3.97 per cent in 1979. However, it recovered to 5.13 per cent in 1990-91. As against this the share of the PSBs was at 83.91 per cent in 1969 It increased to 91.17 per cent in 1979 and showed a further marginal increase to 91.43 per cent in 1990-91. The OSBs had a share of 5.88 per cent in 1969 which has continuously declined to 4.87 per cent in 1979 and further to 3.44 per cent in 1990-91 (Table 1.1).

The share of the FBs in the total investments of the banking system as a whole was 8.05 in 1969 which went down substantially to 4.18 per cent in 1979 and showed a recovery in 1990-91 to 5.54 per cent. As against this the share of the PSBs was 86.27 per cent in 1969 which increased to 91.10 per cent in 1979 and declined to 90.49 per cent in 1990-91. The OISBs had a share of 5.68 per cent in 1969 which came down to 4.72 per cent in 1979 and further to 3.97 per cent to 1990-91 (see Table 1.1).

Working Fund:

The share of FBs in the working funds of the banking system, was 9.21 per cent in 1969 which came down substantially to 3.60 per cent in 1979 and but recovered to 5.72 per cent in 1990-91. As against this the PSBs had a share of 84.95 per cent in 1969 which has significantly increased to 91.50 per cent in 1979 and has declined marginally to 90.54 per cent in 1990-91. The OISBs showed a fluctuating trend, they had a share of 5.84 per cent in 1969 which decreased to 4.91 per cent in 1979 which substantially came down to 3.74 per cent in 1990-91.

Profit:

Surprisingly, despite the foreign banks lower share in all the major indicators of business, they have reported a very high share in the total profit of the banking system. It may be pointed out here that the profit is one of the crucial indicators of the performance of any firm or industry and the banks are no exception. The share of the FBs in the total profit of the banking system was at 14.5 per cent in 1969 which increased to 17.65 per cent in 1979 and a further remarkable 36.21 per cent in 1990-91. As against this the PSBs share of profit were on a continuous and substantial decline from as high as 82 per cent in 1969 to 68.19 per cent in 1979 and further down to 57.98 per cent in 1990-91. The OISBs had a share of only 3.50 per cent in 1969 which increased to a remarkable 14.17 per cent in 1979. However it has declined substantially to 5.81 per cent in 1990-91 (Table 1.1).

From the above brief review of the broad performance indicators across the banking groups, it is clear that though the foreign banks are very small in numbers and in their share of business in general, their share in the profits of the entire banking system has showed a continuous rise. The crux of the issue is how the foreign banks could make such disproportionately high profit with a smaller share in the major areas of business. This raises several questions such as where do the performance differentials lie and what factors are likely to have contributed to it. With this back drop an attempt is made to review the existing literature in the following paragraphs.

Table 1.1

(Percentage Share of Each Banking Group in the Banking System)

	1969			1979			1990-91@		
Variables	FBs	OSBs	PSBs	FBs	OSBs	PSBs	FBs	OSBs	PSBs
Deposits	9.22	6.12	84.66	3.56	5.35	91.09	5.05	4.07	90.88
Credit	10.21	5.88	83.91	3.97	4.87	91.17	5.13	3.44	91.43
Investment	8.05	5.68	86.27	4.18	4.72	91.10	5.54	3.97	90.49
Work Fund	9.21	5.84	84.95	3.60	4.91	91.50	5.72	3.74	90.54
Profit*	14.50	3.50	82.00	17.65	14.17	68.19	36.21	5.81	57.98

Note : FBs = Foreign banks
OSBs= Other Scheduled Commercial banks
PSBs= Public Sector Banks

Source : Statistical Tables Relating to Banks, RBI, Bombay.
* for 1969 and 1979 adopted from A K Nag & Shivaswamy(1990)
@ Computed from Financial Analysis of Banks in India, IBA.

1.6 Brief Review of Literature :

Although, large number of studies are available on banking in India, they are confined to banking in general or to segments like scheduled commercial banks, public sector banks, regional rural banks, co-operative banks and so on. There is hardly any comprehensive study on foreign banks operating in India either on its own or in comparison with the domestic banks. Therefore this study on foreign banks operating in India viz a viz domestic banks becomes relevant and more so in the context of Narasimham Committee's recommendations for more free and wider role to the private sector banks in general and foreign banks in particular is in the offing.

With this back drop a brief review has been undertaken here with those available few studies; **R D Sharma (1987)** in his detailed study on the "Financial Working of Multinational Banks in India" for the period from 1960 to 1980, has highlighted various aspects of the foreign banks operations viz., earnings, expenditure, investments, credit, deposits and profitability. The entire study involved the exclusive use of ratio analysis and concludes that foreign banks operating in India are performing better than Indian banks in terms of financial profitability in general. They were highly concentrated in the areas of the foreign trade, substantial proportion of profit has been repatriated to their parent office. Briefly, with a very low fund base they make huge profit. However, he suggested for their branch expansion. Further, he also carried out a similar analysis for the individual foreign banks and came out with a view that few of the banks such as Grindlays bank Ltd, Standard Chartered bank and the Mercantile Bank stand out distinctly among the rest in terms of financial performance. The shortcoming of the above study has been that, it remained more as an exposure rather than an analytical study as it lacked the plausible explanations supporting the results. Secondly there was no attempt to relate the differences in performance with any specific factors. Thirdly, periodisation could have been done through separating the phase of pre and post nationalisation of major commercial banks as this has got wider ramification on the stature and functions of the entire banking system which includes foreign banks operating in India. Finally, more relevant ratios like return on assets (ROA), productivity ratios, cost-effectiveness could have been computed to explain the performance in a better way. Similarly one more study by **V B Angadi (1990)** on the financial performance of foreign banks viz a viz State bank of India and its Associates for a short period from 1976 to 1985. This study also had used the ratios to come out with the finding that the return on asset (ROA) and the return on the operating earning (output) were higher for foreign banks. Also, higher responsiveness of operating earning to operating expenditure for the foreign banks against the State bank group. He inferred that, for the better financial performance of the foreign banks both internal factors like efficient fund and portfolio management and superior manpower etc., and external factors such as market conditions must have been the contributory factors. However, without relating or analysing any of these factors with any specific measurement. Further the author claimed that "The average yield on credit and average yield on investment in the case of both the groups were more or less the same during the period under review"[5]. This seems to be quite contrary to, what was observed as differences between the two groups. Further the author stated that the difference in the earnings between the two groups of banks are due to the difference in the non-fund based business, however

[5] Angadi V B (1990)

this statement was not supported by any concrete results. Another study by **A K Nag and K Shivaswamy (1990)** undertaken for a brief analysis of the performance of foreign banks for a short period from 1984 to 1988 arrived at a similar conclusion that, foreign banks perform better than the Indian banks in terms of financial profitability. Based on the several indicators like spread to working fund, per employee deposits and advances, size of the deposits etc.,. With a less than 5 per cent business they could share more than 35 per cent of the profit of the entire banking system. According to them such performance differentials could be due to less obligation of foreign banks in respect of priority sector lending, their benefits due to the policy induced changes in the money market rate, they were subject to relatively limited regulation unlike their Indian counterparts and they have recourse to borrowing from other financial institutions. However, other than making general statements, they did not spell out what policy aspect would affect which aspect of the business of these bank groups differently.

From the above brief review we are able to know the differences in the financial profitability performance between the foreign and Indian commercial banks in general. Though few of the above studies recognise explicitly some of the internal as well as external factors likely to affect the operations of both domestic and foreign banks differently, none of the above mentioned studies had clearly spelt out such internal and external factors. And also they did not explain by relating such factors with any specific measurement. Therefore one does not know how and what factors are being more favourable to foreign banks when compared with their domestic counterparts. Besides, there was confusion in the ratios being used for measuring the financial profitability and operational efficiency aspects, as they used some of the ratios interchangeably for measuring both the aspects. Further either directly or indirectly there were no mention on the differences in the nature, areas of operations or the sources of earnings except the one by Sharma R D (1987). Also all the above mentioned studies have examined for a shorter period except the one by Sharma R D (1987). They have not brought out which specific area and how they are efficient as compared with the Indian counterparts. Thus the above brief review leaves us with number of opportunities and areas for further probing and also for the application of different tools and techniques to study those areas already dealt with, but inadequately.

1.7 Objectives of the Study :

The broad objectives of this study is to analyse the performance differentials among the foreign and domestic banking groups. For this purpose the domestic banks are further classified in to Public Sector and Other Indian Scheduled Commercial Banks (Indian private sector banks)

The precise objectives are further crystallised as to analyse the performance in terms of :

1. Measuring the Financial Profitability among the above mentioned banking groups.

2. The difference in the profitability performance to be probed by decomposing the total operating earning and expenditure to identify the specific area and nature of business activity and their relative importance to each bank group.

3. Analysing the whole gamut of performance differences in terms of both internal and external factors which are likely to affect. Some of these factors are listed here under;

<u>External factors:</u>

a) Policy on priority lending

b) Branch expansion Policy

c) Locational advantage

d) Interest rate policy

e) Liberalised Policy to diversify business by the banks

f) Policy on recruitment and remuneration

g) Worldwide branch network

h) Market conditions under the prevailing economic environment.

i) Trade union problems

j) Policy on call money market

<u>Internal factors:</u>

a) Highly automised systems and procedures

b) Highly specialised professional manpower (Management efficiency)

d) Higher cost-effectiveness

g) Efficient investment management

h) Asset and Liability management

1.8 **Methodology:**

1.8.1 Financial Profitability :

Profitability is one of the crucial indicators of the performance of any commercial organisation, and banking being an important service oriented commercial organisation is no exception. There were a number of techniques used in estimating the profitability in banking by different studies such as ratio analysis, indexing, econometric and statistical cost accounting methods etc.,. However, the literature on banking in India shows, widely and commonly, the application of the ratio analysis to study the profitability in banking. In this study we had attempted to make use of the simple technique of Ordinary Least Square method to estimate the profitability among the different banking groups. This method had been used by Hester and Zoellner (1966), Bond (1971), Hester and Pierce (1975), Hester (1979) to study the profitability among the banks. Hester and others had used the traditional OLS models with some or the other variation based on certain assumptions such as all banks face identical interest rate on various asset and liability items so that the inter bank variations in portfolio-mix merely reflect different portfolio preferences. This model had been extended to include various other factors like market concentration, regional variation and its impact on the profitability and the impact of the general macroeconomic cycle by Kwast and Rose (1982) in their study on profitability and operational efficiency among large American banks.

Taking into account some of the institutional features specific to the Indian banking system (such as the priority sector lending, locational impact of the rural branches, market share of each banking group) and our objective of the study we have further modified the model[6] to study the profitability differentials among the foreign banks and domestic public and private sector banks.

The model assumes that all the banks are basically profit maximisers, all the banking groups face similar interest rates on both asset and liability items in the balance sheet. As the model includes other important specific aspects as mentioned above it will not only reflect merely the different portfolio preferences among different banking groups but will also reveal other important aspects such as; impact of priority sector lending, rural and non rural branches, non-fund income etc.,.

MODEL :

$$Y = \alpha 1A + \alpha 2L + \alpha 3Ps + \alpha 4(1/TA) + \alpha 5Rb + \alpha 6Sb + \alpha Mb + e$$

Where the income variable and all Balance sheet variables are deflated by the total asset.

Variables Explained :

Y = Net operating Income ie., Total income operating income minus the operating expenses.

A1 = Investments in Government securities

A2 = Investments in Other securities such as the shares, debentures

[6] The Model used by Kwast and Rose(1982)

etc.,

A3 = Total Loans /advances

A4 = Total Bills purchasing/ discounting

P1 = Priority sector lending as proportion to total credit

L1 = Total deposits minus current deposits

L2 = Total Borrowing

L3 = Other Liabilities

1/TA = Inverse of the Total Assets to capture the quantum of income flow from the items not represented in the balance sheet(off B/S items). Since it is hypothesised that the foreign banks earn substantial portion of their income through the off balance sheet items we have included this item.

RB = Rural branches as a proportion to total branches

NB = Non rural branches as a proportion to total branches. As the foreign banks are by and large located in the metropolitan cities and urban areas it is been an oft repeated complaint that their profitability is favourably affected by the locational advantage. Whereas the domestic banks particularly the public sector banks are spread out into remote corners due to the compulsion of branch expansion policy which is likely to be disadvantageous to them. Therefore we have included these variables in the model.

M1 = percentage of market share of each bank group. As it is stated that the foreign banks are operating with 'niche market' it is aimed to capture this aspect with 'Herfindel index' as the proxy.

However, on application of the above methodology for our data we found the presence of severe multicollinearity among most of the crucial explanatory variables. Which gave opposite signs from the expected ones, we therefore opted out of the above method. Instead we opted for the ratios, proportions, and elasticity measures for the profitability analysis. Some of the crucial indicators such as Return on assets (ROA), Net return on Assets (NROA), Return on working fund (RWF), Output Input ratio, Elasticity measure, Spread ratios, Per branch profit etc.,. The details of these indicators had been explained in the concerned chapter itself.

1.9 For further insights, analysis of operating earning and operating expenditure has been carried out by the method of decomposition. This has been done by taking the proportion of each major item of operating income and expenditure to total current operating income and expenditure respectively across the bank groups.

1.10 **Source of Data ;**

One of the common problems in the area of banking is lack of availability of reliable and disaggregated data. Particularly the disaggregated data on foreign banks is something preserved as secret. The major source of data for our study was the Statistical Tables Relating to Banks in India published by the Reserve bank of India. Besides, we also resorted to Financial Analysis published by Indian Banks Association, Bombay. And various publications of RBI such as Report on Currency and Finance, Report on Trend and Progress of Banking in India and monthly Bulletins. To an extent we have also made use the un-published data obtained from Reserve

Bank of India.

1.11 Scheme of chapterisation :

Chapter 1

Introduction ;

Place of foreign banks in Indian Banking System ;

Brief review of literature ;

Objectives of the study ;

Methodology ;

Data source ;

Scheme of chapterisation ;

APPENDIX I

Chapter 2

Historical origin and development of foreign banks in India

Chapter 3

Analysis of profitability among the foreign and domestic banking groups;

Chapter 4

Decomposition Analysis of Total current operating income and Total current operating expenditure among the bank groups

chapter 5

Summing up

APPENDIX I

1 Concepts and Definitions used in this study :

1.1 Foreign Banks :

The terms "foreign bank", "foreign bank operating in India", "transnational bank" are being used interchangeably through out this study and refer to those branches of commercial banks whose head office or registered office are located out side the Indian territory. The terms "exchange banks" "multinational banks" are also used interchangeably, to mean 'foreign bank group' and not an individual bank.

1.2 Domestic Banks :

The term domestic banks refers broadly to all those scheduled commercial banks incorporated in India, both private and the public sector banks. They explicitly exclude the regional rural banks, urban co-operative banks and the non-scheduled commercial banks.

1.3 Public sector banks:

The term "public sector banks" includes only the state bank of India and its associates and the nationalised banks. Those nationalised bank includes both, those nationalised in 1969 and in 1980. It does not include regional rural banks, and it refers to 'public sector banks as a group' and not to an individual bank.

1.4 Other Indian Scheduled Commercial Banks :

The term "other Indian scheduled commercial banks" refers to all the Indian Private sector scheduled commercial banks as a group, and does not include the urban co-operative banks, regional rural banks, non-scheduled commercial banks and those mentioned in other categories above.

2 Policies governing the operations of the foreign banks in India: an overview

2.1 Capital requirement :

Under sec 11(2)a&b. BR Act 1949, all foreign banks are required to deposit a minimum capital either in cash or approved securities with RBI. At present it amounts to Rs 20 lakhs for banks located in Bombay and Calcutta and Rs 15 lakhs for the banks located in other cities.

As suggested by the Banking regulation and Supervisory Practices (Basle Committee) in 1988, the new capital adequacy requirement makes it compulsory for every foreign bank operating in India to achieve a minimum capital of 8 per cent of the risk weighted assets by 31st March 1993. While the Domestic banks have to achieve the same in two tiers. Tier I of 4 per cent of the weighted assets to achieved by 31st March 1993. And the tier II so as to reach 8 per cent by 31st March 1996.

2.2 Reserve requirement:

Like any other Indian commercial bank the foreign banks also required to create a reserve out of the net profit to the extent of 20 per cent of the net profit each year which has to be deposited with RBI. However, the Central Government has been empowered to waive this provision provided (1) RBI has recommended the case. (2) It has adequate reserve funds and capital in relation to deposits as laid down by the Indian banking companies (Amendment) Act, 1962. As on march 1991 the total amount deposited by way of this requirement was Rs 366.81 crore, which was Rs 215.83 crore in 1990 and Rs 150.81 crore in 1989.

2.3 Deployment of Owned funds:

Apart from the above the RBI made it compulsory to deploy a certain portion of their own fund against their total deposits in Indian business. All foreign banks are required to deploy foreign funds in Indian business not less than 3.5 per cent of their deposit as at the end of the previous financial year. Figures under this requirement were as on march 1991 Rs 3406 crore and in 1990 Rs 2015.15 crore against the required Rs 397.15 crore and Rs 259 crore respectively.

This is also subject to review from year to year so as to meet this requirement. If such deployment falls short of the requirement the foreign banks have to opt for any of the following methods to restore;

1. Bringing in and retaining foreign funds under a specific category of reserve in India.
2. Granting of foreign currency loan to Indian partner.
3. Keeping interest free deposit with RBI in foreign currency in

any of its account with its agents abroad with an option that if the bank which makes the deposits so requests, the RBI would be prepared to consider making an interest leasing fixed deposit with that banks office out side India on mutually agreed terms.

4. Keeping interest bearing foreign currency fixed deposit in the name of the RBI with one of the banks out side India, which is not to be treated as loan, and from the head office is concerned no entries relating there need to be passed in their books.

5. Retaining in India the remittable profits on a long term basis.

2.4 Policy Requirement under Priority Sector Lending :

For all purposes the foreign banks are treated on par with any other scheduled commercial banks in India (however, the policy relating to priority sector lending is a clear discrimination against the domestic banks). The domestic banks have to lend 40 per cent of the net credit at concessional rate of interest. The foreign banks operating in India are required to achieve a target of 10 per cent of the net credit to priority sector by March 1989, 12 per cent by 1990 and 15 per cent by March 1992[7].

2.5 Branch Licensing Policy Relating to Foreign banks :

Reserve bank was following till now, a restrictive and selective licensing policy towards the transnational banks both for entry and expansion. It broadly follows the following as the policy guidelines;

1.Reciprocity

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[7] The latest amendment in this policy requirement has been discussed in chapter 5.

2. Country wise diversification of foreign banks presence in India.
3. International standing of the banks and its global status.
4. The trade relation such as volume of trade
5. Economic and financial relation between India and the respective bank's country
6. Overall benefits accruing to the country in allowing such banks to operate in India

2.6 Policy Relating to Payment of Dividend:

Sec 15, BR Act Precludes the banks from paying dividends before providing for doubtful debts, bad debts etc., but this was not applicable to foreign banks for a long time. It seems that only in seventies this provision was made applicable to them through an RBI circular, vide dbod circular no 2051/c-452(h)-71 1971, dec 1971

2.7 Call Money Market Rate:

As a part of broad financial sector liberalisation the recent policy relating to the call money market rate has removed the existing ceiling on the call and money market rate.

2.8 Policy Relating to Recruitment and Remuneration;

Foreign banks are not governed by the RBI, Indian Banks' Association (IBA), or Govt of India guidelines in the matter of recruitment of their staff excepting certain restrictions relating to the appointment of repatriate officers. This facilitates these banks in recruiting the required talented people according to their requirement, often more experienced people from the domestic banks[8] are attracted by the handsome salaries that these banks offer.

3 Type of Foreign Banking Establishment and their Relationship in general:

There are different methods by which a commercial bank can extend the scope of its operation either directly or indirectly abroad. The various methods offer various advantages and they take various forms depending upon the laws and policies prevailing in the host countries. The following are some of the generally adopted methods of establishing foreign banks in a host country;

1. Maintaining a correspondent banking relationship.
2. Locating a representative office
3. Acquiring a non-controlling equity interest in an affiliate bank.
4. Conducting a joint-banking venture.
5. Establishing a banking subsidiary.
6. Establishing a fulfledged bank branch

The degree of penetration by a foreign bank increases as it moves from the establishment of correspondent office to a fulfledged branch office. However, this is not to suggest that the establishment of every foreign bank branch has to necessarily move in that order. But the common practice of opening a branch is preceded by the establishment of a correspondent office.

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[8] Dobby G C (1993)

3.1 Maintaining a Correspondent Office :

Generally if a foreign bank has only occasional and few transactions with the firms and individuals in a host country, it would call upon a local bank to act as the correspondent or agent for the purpose of carrying out particular transactions involved. The concerned local bank in such cases are referred to as the correspondent bank or "Banking correspondent". As the term suggests, the link between the two banks are maintained through either telegraphically, electronically or through postal correspondence. Besides such mode of communication, individuals at the senior levels of both banks do meet. The transactions involve service charges which is usually deducted from the deposits lying with the correspondent bank. It is also quite common that the foreign bank in turn acts as the correspondent bank to the local bank in the foreign country.

3.2 Representative Office :

As the very name implies, a foreign bank installs one or more individuals to represent the bank in a host country. A representative office cannot carry out the business of a normal commercial bank like accepting deposit and lending loans etc., but will seek new business for both local and the parent office. Further, it channels the vital business information to and from the host country.

The representative individuals do not always belong to the parent country but are recruited locally. One of the distinct features of these offices is having no teller counter or such facilities for handling even smaller cash transactions. However, the foreign representative office would do every effort to make its presence felt. The establishment of representative office smoothens the establishment of the branch office.

3.3 Affiliated Bank :

When a foreign bank holds an equity interest in a local bank but such interest is not large enough to permit the foreign bank to control the activities of the local bank, the latter is referred to as affiliated bank. Such banks function with the local name and local institutional set up. The equity interest may be obtained either in the existing bank or a newly set up one. While it is also possible to form an affiliated bank in another form, for instance, the US bank may acquire interest by setting up a new bank in a host country but the controlling interest may or may not be with the local hands but a third country[9]. These banks carry out the activities which are normally permitted to a foreign bank branch along with the services of the correspondent office. The basic characteristic feature of such banks are its native tint.

3.4 Joint Banking Venture :

In common parlance, the joint venture refers to an association to carry out a definite purpose or set of purposes within a stipulated period, which may be subjected to renewal. Such tasks may be either too risky or too large to be carried out by a single party. In the context of banking, Joint Banking Venture is an arrangement whereby the banks belonging to two different countries

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[9] Stuart W Robinson (1974)

ie., a foreign bank and a local bank come to an understanding to provide technical or other kind of services to each other in exploring new areas of business operations which may involve more risks. The consortium lending is one such common joint banking venture.

3.5 Banking Subsidiary :

A banking subsidiary is similar to the affiliated bank in the sense, both of them reflect local characteristics of the host country, however, a subsidiary functions with a foreign name. Generally the foreign bank exercises control directly or indirectly over the activities of a subsidiary, though not all the subsidiaries are wholly owned by the foreign bank. The de facto control however,is possible only if the foreign bank holds 50 per cent of the share holding together with one share in the subsidiary. In countries whose local law do not permit the establishment of a full fledged branch, the foreign banks prefer to hold subsidiaries which nearly offers all advantages as that of a branch.

3.6 Foreign Bank Branch :

Other than the geographical consideration the foreign branch of a bank is just another branch of a commercial bank. It is an extension rather than a separately constituted or locally chartered one. A branch is not a legal entity distinct from that of its parent bank, though it may maintain books of accounts locally. The establishment of a branch by a foreign bank makes its physical presence beyond the territory and yet could carry out its business as easily as at home without relying on any intermediaries as it was seen in other forms of establishment. Nevertheless, the branch bank has to comply with the local laws and policies of the monetary authority of the host country. Also, it might happen that the range of activities engaged in by the host country counterpart institutions form the general frame work within which the foreign branch banks has to operate.[10]

4 Type of Foreign Banking Operations Permitted in India :

4.1 Representative Office :

The present system allows any foreign bank to have a representative office in India. This does not even require any permission from the Monetary authority of India until recently. However, it has become customary to seek permission from the Reserve Bank of India before the establishment of a representative office. By definition they are not allowed to carry out any of the normal banking business. They mainly concentrate in the activities such as banking correspondence, developing export/import trade relations between India and the parent country, loan syndication, international merchant banking for Indian companies raising capital abroad. They also act as liaison centres to protect the clientele to their parent banker, and to closely watch the politico-economic developments in the country and their ramifications on the trade relations between India and their parent country. We have about 16 such representative offices in India[11].

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[10] Robinson W S (1974)

[11] V L Rao(1991)

4.2 Agency Relationship :

As a first step in overall financial liberalisation process the foreign banks were allowed to have a tie up arrangement with the Indian agents such as firms/ companies based on certain criteria notified by the Reserve Bank of India. Till 1983 there was no such arrangements in India and it was only in 1984 this scheme was introduced.

4.3 Foreign Bank branches :

The establishment of foreign bank branches in India is not a recent phenomenon but historically founded one, when the country was under the colonial rule. However, the accessibility to establish a foreign bank in India in the past and the present widely varies. To establish a foreign bank branch in India presently has to satisfy many criteria like reciprocity, trade relation with the particular country etc.,. As on 31st December 1991 we have about 140 branches of 24 Foreign commercial banks from 14 countries[12]. The ANZ Grindlays Ltd, a British based bank tops among the foreign banks in terms of number of branches in India which maintains 56 branches and the Standard chartered a British based bank stands second largest by maintaining 24 branches. An American based CITI Bank owns 6 branch outlets in India and stands third in the list.

The foreign banks are however explicitly not permitted to establish subsidiaries in India, though, they are allowed to carry out the business relating to merchant banking, consumer banking leasing etc., by the branch office itself.

[12] Country wise break-up of the number of banks are not available

CHAPTER 2

Origin and Development of Foreign Banks in India

2.1 Introduction :

Foreign banks operation in India are more than a century old. As the country was under the colonial rule, the British took the leading role in establishing foreign banks in India of the British origin. There were attempts to establish foreign banks as early as 1836 under the name of "The Bank of India" with an Anglo-Indian character to be based at London with branches spread across India. Followed by one more attempt in 1840 to set up "The bank of Asia". These were however, successfully scuttled by the agency houses and East India company, with the apprehension that it might affect their business badly. As they were the only one carrying out the banking functions particularly relating to remittance, discounting of foreign bills etc.,. Therefore, the actual beginning of the establishment of the foreign Banks (exchange banks) was only in the second quarter of the nineteenth century. The 'Oriental Banking Corporation' was the first Anglo-Indian commercial bank to be set up in 1842 at Bombay with a Royal charter. The bank has shifted its head office to London within 3 years. This was followed by the opening up of "The Chartered bank of India Australia and China" and "The Chartered bank of Asia" in 1853.[1] As the country was under the British rule, the establishment of the British based banks as the premier institutions in India seem to have been easier. Though, it was the Britishers who initiated establishing their banks, it was later followed by the banks from many

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[1] Khandelwal(1965)

other countries viz., France, Germany, Japan, Holland and of late United States. As "....the profits of banking in India have attracted the nationals of a number of countries having important trade relations with India"[2]

Most of the present day foreign banks were originally called as Exchange banks. For, the exchange transactions relating to foreign trade were the exclusive domain of these foreign banks. In western countries this term was used to refer those banks dealing with the financing of trade of India and China, as these countries did not have the gold standards and their exchange rates were subject to wide fluctuation[3]. Besides, the exchange transactions, they were also carrying out the normal transactions like financing internal trade, accepting deposits, lending to industry and so on. The reason that distinguished these banks from being called as exchange banks was their investment of considerable funds in discounting of foreign bills during the busy season[4]. However, in this study we refer them as foreign banks and not as exchange banks. It may also be mentioned that there is disagreement among authors calling these banks as 'exchange banks'[5].

2.2 Nature of Operation of Foreign Banks in India

It is known that foreign banks were normally operating both in India as well as in the country of origin and elsewhere. Some times,

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[2] S G Panandikar (1966) pp 165.

[3] Minty : pp 44,45

[4] B Ramachandra rau (1930)

[5] Ibid.,

these banks have also been categorised as Group I and Group II based on the volume of their business in India. Group I consisted of banks whose business in India was limited and formed only one tenth of their global business. Banks in Group II had their major share of business in India[6]. Their major area of business was financing the foreign trade. With the intention of maintaining close monopoly the existing banks had systematically opposed any move which would result in competition in the exchange business. They never shirked themselves from financing internal trade whenever they got an opportunity. For instance piece goods trade in Delhi and Amritsar leather trade of Cawnpore, tea plantation in Assam were extensively financed by these foreign banks. Besides, they were also carrying out the normal commercial banking such as accepting deposits, lending, purchasing/ discounting the bills of exchange etc.,. In north eastern parts of India they were competing with the Imperial banks in financing the jute industries. There are also references on financing of foreign banks to marwaries liberally on the basis of goods and bills of exchange[7]. They were also the chief importers of gold and bullion into the country.

As the financing of foreign trade and the exchange business were the principal area of business of the foreign banks (Exchange Banks) it would not be out of place to briefly mention the nature of such an operation. Financing of exports were split into two stages. First stage involved the movement of goods from the production centre to the port and the second stage involved shipment of goods and thereafter.

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[6] Ramachandra rau (1930)

[7] Ibid.,

Similar was the case with respect to import financing. In the case of exports the foreign banks were generally financing the second stage involving the shipment of goods and thereafter. The upcountry transit of goods were usually financed by the Indian joint stock banks. The financing were done on usance bills such as Documents against Payment (DP) and Document against Acceptance (DA). Usually the export bills were of DA type wherein the documents of title were delivered as soon as the importer accepted the bills. Thereafter, the normal practice was that, the bills were immediately rediscounted at London money market. This provided them with funds in terms of sterling in London which in turn helped them in getting frequent turnover. However, this practice of discounting at the London market effectively prevented the development of Indian money market[8].

In the case of imports the foreign banks were financing through either of the following methods ie., 'Documents against payments' or 'London Banks acceptance of House Paper'. The former method is same as the method of usance bills and was very common in practice. The later method though, not very common but was used only by those Indian importers who had good credit standings with the London firms. Where it involved drawing the bills on a London branch of a foreign bank operating in India instead of drawing it on the Indian branch, the same were discounted in London money market after its acceptance.

[8] Khandelwal (1965)

2.3 Status of Foreign Banks in Pre-independent India an Overview :

Prior to the country's independence, the foreign banks were prominent in the banking scene especially in financing foreign trade and foreign exchange business. This was so, because the Imperial bank of India was legally restricted almost till 1935 on participating in foreign exchange business[9] coupled with a negligible role of Indian joint stock banks in financing the foreign trade. Therefore, the foreign banks seemed to have been enjoying a near monopoly in the lucrative foreign trade finance and exchange business. "The historical role of the exchange banks (foreign banks) in the financing of India's foreign trade has been substantial and important"[10]. Although, the data on this aspect is not available to substantiate with figures especially relating to the foreign bills, there is no dearth of mention about this in the literature.

It may be mentioned here that, the data on the functioning of foreign banks are available only since 1870 onwards[11] and on only few aspects of their business. There were only 3 banks in operation in 1870 with an aggregate deposits of Rs 5.2 million constituting 4.2 per cent of the total deposit of the banking (see Table 2.1). The number of banks had increased to 4 in 1880 and the deposits to Rs 34.0 million. Though the number of banks increased very slowly the

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[9] Khandelwal(1965)

[10] Chandavakar (1984)

[11] Banking and Monetary Statistics 1954, RBI

deposits had increased rapidly. The reason for the number of banks being few and slow in their growth seems to be that, any attempt to establish new banks either of European or the Indian origin and which were likely to compete with the existing ones were frustrated by the existing few dominant banks. During the decade ending 1890 the number of banks added by one more to reach 5 and the deposits aggregated to Rs 75.5 millions.

Table 2.1

(Rs in Lakhs)

	Foreign Banks		Presidency Banks		Other Indian Banks@	
Year	Nos	Deposit	Nos	Deposit	Nos	Deposit
1870	3	52	3	1183	2	14
1875	3	107	3	1005	3	28
1880	4	340	3	1140	3	63
1885	4	476	3	1000	4	94
1890	5	754	3	1836	5	271
1895	7	1031	3	1645	8	565
1900	8	1050	3	1569	9	808
1905	10	1704	3	2538	9	1199
1910	11	2479	3	3654	16	2566
1913	12	3104	3	4236	41	2410
1915	11	3355	3	4350	45	1878
1917	9	5338	3	7543	43	3216
1920	15	7481	3	8629	58	7348
1925	18	7055	1*	8330	74	5790
1930	18	6811	1	8397	88	6765
1935	17	7618	1	7909	100	8973
1939	19	7408	1	8784	678	11544
1940	20	8533	1	9607	629	13042
1944	15	16521	1	23778	721	51217
1946	15	18128	1	27167	690	73411

@ : Includes Non-Scheduled banks of all classes
* : Converted as Imperial Bank of India
Nos: Number of Banks
Source: Banking and Monetary Statistics, RBI

Although the international trade (being one of the principal areas of their financing) has slowed down between 1870 and 1890[12] the growth of foreign banks were very rapid in terms of deposits[13] during this period. In 1900 the number of banks jumped up to 8 and the deposits multiplied to Rs 105.04 million. Though the 1910s had to face the wrath of the First World War there was no let up in the growth of deposits among these banks. A year before the First World War ie., in 1913, the deposits of 12 exchange banks had grown to 70 per cent of those of presidency banks and to nearly one third of the entire banking system. In 1917 ie., during the time of war, the number of banks were reduced to 9 due to closure of some of the banks due to hostility. However, the deposits multiplied to Rs 533.8 million (see Table 2.1). It seems the break out of war did not affect them much in so far as their capacity of deposit mobilisation was concerned. Though, war affected India's foreign trade its impact on the functioning of foreign banks seem to have been reflected only in terms of their lower turnover (compelling them to maintain very high cash balances). For instance in 1917 foreign banks were maintaining as high as 63.21 per cent of their deposits as cash balance (see Table 2.4 and Figure 2.3). The less turnover was due to less demand for credit as "...the industrial production was hampered, as the attention of both Government and the industry was focused mainly on the production of war materials"[14]. Immediately after the First World War the foreign banks have dramatically grown both in terms of numbers and deposits (see Table 2.1).

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[12] K N Chaudhuri (1984)

[13] Goldsmith R W (1983)

[14] Khandelwal(1965) pp 22

Table 2.2

Bank Group wise Percentage share in Total Deposits of Banking System (In percentage)			
Year	FBs	PBs	OIBs
1870	4.16	94.72	1.12
1875	9.39	88.16	2.46
1880	22.03	73.88	4.08
1885	30.32	63.69	5.99
1890	26.35	64.17	9.47
1895	31.81	50.76	17.43
1900	30.64	45.78	23.58
1905	31.32	46.65	22.04
1910	28.50	42.00	29.50
1913	31.84	43.45	24.72
1915	35.01	45.39	19.60
1917	33.16	46.86	19.98
1920	31.89	36.78	31.32
1925*	33.32	39.34	27.34
1930	31.00	38.22	30.79
1935	31.09	32.28	36.62
1939	26.71	31.67	41.62
1940	27.37	30.81	41.83
1944	18.05	25.98	55.97
1946	15.27	22.89	61.84

* Converted as Imperial Bank of India
Note: FBs = Foreign Banks
PBs = Presidency Banks
OIBs= Other Indian Banks
Source: Computed based on Banking and Monetary Statistics,RBI

For instance in 1920 the number of banks and the deposits increased to 15 and Rs 748 million respectively. However, towards the fag end of 1920s the world depression had an adverse repercussion over India's foreign trade, as that was the case world over. Which, noticeably had an adverse impact on the functioning of foreign banks too. Consequently, in 1930 the deposits fell to Rs 681.1 millions though the number of banks remained at 18 as in the previous year. The 1930s were prone to many economic and political problems such as recession, decline in foreign trade and the break out of Second World War towards the end of the decade. It is likely that all these precedences together brought the deposits of the foreign banks down to Rs 740.8

million in 1939 from Rs 761.8 million in 1935 though the number of banks had gone up to 19. Although nearly half the decade of the 1940s were reeling with the set back of Second World War, India's foreign trade showed good improvement[15]. However, the reliability of the data has been questioned by the author himself as the period was reeling under heavy inflation. Similarly, during this period the foreign banks performed better in terms of total deposits raising to Rs 1812.8 million in 1946, which constituted nearly one third of the total deposits of the commercial banking system, though the number of banks reduced to 15. However, the data on deposits are also likely to have been inflated due to war time inflation. Nevertheless, the foreign banks could hold up the confidence of the public during the war time uncertainties.

The distinct feature of the foreign banks operation was that, they maintained around one third of the business of the banking system, in terms of deposits, relatively consistently for a long time from 1880 till 1940. Although, there were large scale growth in the Indian joint stock banks during this period (see Table 2.2). The impact of the growth of large number of Indian joint stock banks however, seemed to have affected, by and large, only the presidency banks. This is explicit from their relative proportion of deposits in the banking system, having substantially and steadily, came down from as high as 95 per cent in 1870 to around 23 per cent in 1946 (see Figure 2.1). Therefore it is clear that the shift in the proportion of deposits were more among the domestic banks rather than between foreign and domestic banks. Also it implies that the competition

[15] K N Chaudhuri (1984)

seemed to have been among the domestic banks in place of its being between the foreign and domestic banks. This was likely because the foreign banks were located mostly in the port towns and major cities and they could establish patronage of a 'niche clientele'. While the upcoming Indian joint stock banks were mostly located in the inner parts of the country and suburban centres to seek new market altogether.

Growth in Deposits:

The growth rates of deposits were relatively consistent in respect of the foreign banks when compared with the domestic banks. It varied between as low as -1.17 per cent in 1925 and as high as 26.14 per cent in 1917. Also, major part of the period they experienced positive growth rates (see Table 2.3 and Figure 2.2). Surprisingly, the highest growth rates were achieved both during the First and Second World Wars and same was the case among the presidency banks. However, one can not rule out the possibility of figures being inflated due to war time inflation. Noticeably the Indian joint stock banks which also showed significant growth rate in their aggregate deposits despite there being large scale bank failures as well as flotations.

Table 2.3

Growth Rates@ of Deposits			
Year	PBs	OIBs	FBs
1870			
1875	-3.21	14.87	15.53
1880	2.55	17.61	26.01
1885	-2.59	8.33	6.96
1890	12.92	23.59	9.64
1895	-2.17	15.83	6.46
1900	-0.94	7.42	0.37
1905	10.10	8.21	10.17
1910	7.56	16.44	7.79
1913	5.05	-2.07	7.78
1915	1.34	-11.72	3.96
1917	31.68	30.86	26.14
1920	4.59	31.71	11.91
1925*	-0.70	-4.65	-1.17
1930	0.16	3.16	-0.70
1935	-1.19	5.81	2.26
1939	2.66	6.50	-0.70
1940	9.37	12.98	15.19
1944	25.43	40.77	17.96
1946	6.89	19.72	4.75

@ Compound growth rate
* Converted as Imperial Bank
Note: FBs = Foreign Banks
PBs = Presidency Banks
OIBs = Other Indian Banks
Source: Computed based on Banking and Monetary Statistics, RBI

Cash Balances:

It is interesting to note that the foreign banks were always maintaining relatively lesser proportion of their deposits as cash balance than Presidency banks. Although the fact remains that Presidency banks were also equally well established. During the war time however, both foreign banks and presidency bank were maintaining a very high proportion of their deposits as cash balances (see Figure 2.3). For instance for the foreign banks the cash balance stood at as high as 63.21 per cent during the First World War (see Table 2.4). One of the pathetic features of the Indian joint stock banks was that, they always maintained a paltry cash balances of their deposits.

Perhaps this could be one of the strong reasons for the frequent bank failures among them. This is clear from the observations of J M Keynes on Indian banking; "In the case of smaller banks...the cash balances seem.... to be hopelessly inadequate and it is hard to doubt that in the next bad time they go down like nine pins"[16]

Table 2.4

Cash balance@			
Year	FBs	PBs	OIBs
1870	117.31	84.28	35.71
1875	53.27	69.15	25.00
1880	52.94	65.00	26.98
1885	27.52	59.70	22.34
1890	46.42	70.64	20.66
1895	26.77	46.81	16.99
1900	22.86	32.12	14.73
1905	22.18	32.43	14.51
1910	17.71	31.06	10.91
1913	18.94	36.31	16.60
1915	22.26	33.68	22.31
1917	63.21	44.77	51.93
1920	33.66	30.17	22.77
1925*	13.35	21.04	18.62
1930	11.32	15.70	12.12
1935	16.47	24.77	22.22
1939	09.98	12.63	14.47
1940	20.15	25.85	22.60
1944	15.02	11.91	20.73
1946	17.66	15.63	20.32

@ Proportion to their respective total deposits
* Converted as Imperial Bank
Note : FBs = Foreign Banks
PBs = Presidency Banks
OIBs = Other Indian Banks
Source: Banking and Monetary Statistics, RBI

Credit:

The foreign banks were holding a proportion of 28.4 per cent of

[16] J M Keynes: Indian Currency and Finance

the total credit of the banking in 1935[17] (total credit included both bills discounting/ purchasing and loans/ advances). Their percentage share has steadily come down to 12.35 per cent in 1946, though the amount in absolute terms had gone up to Rs 675.9 million. The growth rates increased from a negative of -3.9 per cent in 1940 to 12.06 per cent in 1945 reflecting the immediate post war recovery. However it declined again, in 1946 to 8.86 per cent (see Table 2.5).

As against this the imperial banks were having a proportion of 20.75 per cent of the total credit in 1935, which came down to 17.03 per cent in 1946. It is clear from the Table 2.5 that, the other Indian joint stock banks were increasingly taking the major share of business in terms of credit both from foreign banks and the imperial bank of India. Their proportion has increased nearly steadily from a 50.9 per cent in 1935 to as high as 71.87 per cent in 1945 though it declined marginally to 70.62 per cent in 1946. The disheartening part however was that, despite the growth of other Indian joint stock banks in terms of numbers as well as aggregate credit, their role in foreign exchange business and rural credit seem to be marginal. They were mostly specialised in short term credit to trade and industry just as any other European modelled commercial bank.

The trend emerging out of the preceding analysis is that, though foreign banks showed good growth performance in terms of credit and deposits, their relative proportion in the aggregate deposit and credit of the banking system was getting reduced and were overwhelmingly taken over by the domestic banks well before the

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[17] Data is available only since that period on the lending operation of the foreign banks

country's independence.

Inspite of the foreign banks' active role in the foreign trade finance and exchange business coupled with the usual commercial banking during the major part of the century, they had always been complained that, their monopolistic position in foreign trade financing were used more to the detriment of the Indian business men. The Indian traders unlike the European business men were required to deposit 10 to 15 per cent of the value of the merchandise with the foreign banks to open a confirmed letter of credit. They always alleged to have discriminated against Indian steamship and insurance companies. The import bills were always been drawn in sterling with high rates of interest. They were not subject to any legal restrictions in India and were exempted even from the minimum statutory obligation imposed on the Indian joint stock banks[18].

Table 2.5

(Rs in Lakhs)

	Imperial Banks		Other Indian Banks		Foreign Banks	
Year	Credit*	Prpn	Credit*	Prpn	Credit*	Prpn
1935	2233	20.75	5477	50.89	3053	28.37
1940	3030 (6.29)	23.48	7372 (6.12)	57.13	2502 (-3.90)	19.39
1945	6288 (15.72)	16.52	27361 (29.99)	71.87	4422 (12.06)	11.62
1946	9325 (8.20)	17.03	38664 (7.16)	70.62	6759 (8.86)	12.35

* Includes advances, inland bills disc/purchased

Note: 1 Data based on the Returns filed under sec 42(2) RBI Act 1934 Which may not tally with the figures based on the Balance Sheet

2 Figures in brackets are growth rate(compounded)

Source: Banking and Monetary Statistics, RBI

[18] Rau (1930), Khandelwal (1965) and Chandavakar (1984)

2.4 Status of Foreign Banks in Post Independent India Until Nationalisation of Major Commercial Banks :

The banking system left behind by the Britishers changed tremendously in size, stature, scope, and nature of operations in general during the post independent era. The post independent India has seen many important events in the financial system in general and commercial banking in particular. Which directly or indirectly affected the functioning of foreign banks in India. Among several policy changes and legislative measures such as the nationalisation of Reserve Bank of India, passing of the Banking companies Act, introduction of Five Year Economic plans, conversion of Imperial bank of India, take over of the princely state owned banks, introduction of deposit insurance scheme etc., the passing of Banking companies Act, 1949 (Now Banking Regulating Act) was considered to be a land mark. It was this Act which brought both foreign and domestic banks on an equal footing. Until then it was always alleged that the foreign banks were treated with privilege, as there were no standard legislations to control and regulate their functioning in certain areas of business. The Act prescribed the minimum capital to all the banks functioning in India. For the banks incorporated elsewhere than in India the aggregate value of paid up capital and reserve shall be Rs 15 lakhs and Rs 20 lakhs if the banks are located in Bombay and Calcutta. Such amount being deposited with the Reserve Bank of India either in terms of cash or in approved securities. The Act empowers the Reserve Bank to change or mould their lending policies or even stop any particular type of business which they are carrying out in India. Further, the Act contains several vital provisions relating to issue, cancellation and forfeit of licence, closure of existing banks, calling for returns, reports, compelling the foreign banks to maintain a certain portion of assets and liabilities in India etc.,. All these were likely to have some impact on the functioning and their relative status in the banking system.

A brief review of the operational aspects of the foreign banks in the post independent India till the nationalisation of major commercial banks has been undertaken here. The declining trend that was witnessed in their proportion in the aggregate deposits and credits of the banking system, during the later part of the pre-independent period continued even after independence. At the time of India's independence ie., in 1947 the number of foreign banks were at 15 and were having a business share of 14 per cent and 17.4 per cent in terms of deposit and credit respectively (see Table 2.6) and were owning 12.45 per cent of the total assets of the banking sector (see Table 2.10). The number of foreign banks came down to 13 in 1968. Except in 1950, their share of deposits in the banking system has progressively declined to 9.3 per cent in 1968 ie., a year before nationalisation of major commercial banks (see Figure 2.4). Nevertheless, the deposits were growing appreciably and steadily at an average rate of 1.7 per cent between 1947 and 1950 and at an average rate of 8.7 per cent between 1965 and 1968 (see Table 2.9). This contradictory phenomenon of steady growth rate on the one hand and declining trend in their proportion in the aggregate deposit and credit of the banking system on the other, is mainly due to the accelerated growth rate in the deposits and credit among the rest of the banking system.

Table No 2.6

Foreign Banks

(Percentage Share in the Banking System)

Year	No	Deposit	CashBal*	Bill/dis	Advance	Total Credit
1947	15	14.19	16.61	32.38	18.93	17.27
1950	14	17.22	10.90	27.04	34.20	23.04
1955	17	16.95	10.45	28.09	23.91	23.86
1960	16	12.00	9.05	27.60	19.18	16.57
1965	15	10.67	6.32	22.40	12.04	12.47
1968	13	9.28	5.83	22.02	12.97	11.51

* Cash balance as proportion to deposits
Note : Total credit includes bill discounted/ purchased and advances
Source: Statistical Tables Relating to Banks in India, RBI, Bombay

The Imperial bank (State Bank of India since 1955) were maintaining a percentage share of 24.85 per cent of the aggregate deposits of the banking in 1947, which had increased to 28 per cent in 1968 (see Table 2.7). The growth rates were wildly fluctuating between the period 1947 and 1968. For instance it was as low as -6.89 per cent between 1947 and 1950, and as high as 24.71 per cent between 1955 and 1960 (see Table 2.9). It is worth noting that the growth rate in deposits turned positive after the nationalisation of Imperial bank. The highest growth in deposits are likely not only due to the inclusion of the associate banks with the State bank. But also due to their active involvement in the deposit mobilisation combined with large scale spread of the branches during fifties and sixties as per the plan requirement.

Table No 2.7

Imperial Bank

(Percentage Share in the Banking System)

Year	No	Deposit	$ CashBal	Bill/dis	Advance	Total Credit
1947	1	24.85	14.97	29.17	23.06	16.33
1950	1	23.15	12.18	30.21	11.26	19.46
1955*	1	19.50	13.00	34.93	12.60	15.61
1960#	9	33.72	11.58	35.19	13.53	25.05
1965	8	28.68	10.94	38.80	10.66	29.54
1968	8	28.01	9.35	35.33	25.49	30.04

* Converted in to State bank of India
\# Includes Associate Banks
$ Cash balance as percentage to deposits
Note : Total credit includes bill discounting/ purchasing and advances
Source: Statistical Tables Relating to Banks in India,various Reserve Bank of India

The other Indian joint stock banks in terms of numbers were as high as 624 in 1947 constituting more than 97 per cent. They were holding a proportion of 60.9 per cent of the total deposits in 1947 and that has been hovering around 60 per cent till 1968 (see Table 2.8). However, their numbers drastically came down to a mere 53 in 1968 due to large scale mergers and liquidation among the smaller banks, more particularly the non-scheduled banks during the late fifties and sixties. It seems 'The Bank Award of 1950' increased considerably the operational cost of banks, and consequently several uneconomic banks were forced to close down. The process of weeding out substandard and non-viable banks was however,, started with the recommendation of Travancore-Cochin Banking Inquiry Commission. This has taken the momentum especially after the enforcement of the Banking companies (Amendment) Act, 1960. Thus the outstanding feature of Indian banking development during the fifties and sixties has been the progressive expansion of the bigger banks simultaneously with the progressive amalgamation or liquidation of the smaller banks.

Table No 2.8

Other Indian Banks

(Percentage Share in the Banking System)

Year	No*	Deposit	Cash Bal$	Bill/di	Advance	Total
1947	624	60.96	19.73	38.46	58.01	66.40
1950	583	59.64	17.23	42.74	54.54	57.49
1955	437	63.55	13.76	36.98	63.50	60.54
1960	314	54.28	12.20	37.21	67.29	58.38
1965	85	60.64	10.94	38.80	77.30	57.99
1968	53	62.71	11.28	42.65	61.54	58.46

* : Includes Non-Scheduled Commercial Banks
$: Cash balance as percentage to Deposit
Note : Total credit includes bills discounting/ purchasing and advances
Source: Statistical Tables Relating to Banks in India, various volumes, Reserve Bank of India

The noticeable feature of the foreign banks operations were that, they maintained relatively lower percentage of their deposits as cash balance compared with their Indian counterparts through out (See Table 2.6). This shows their capacity to maintain the confidence among the public even at lower liquidity. Further such proportion were also progressively coming down from 16.61 per cent in 1947 to 5.83 per cent in 1968. The mutual help and understanding among the foreign banks helped them to over come if any liquidity crisis arising out of low cash balances. The decline of course was observed even among other banking groups too (see Figure 2.5).

Foreign banks were having a business share of more than 17.27 per cent of the aggregate credit of the banking sector in 1947. Which was even slightly more than the Imperial banks. Similar to what was observed in case of deposits their proportion in terms of credit also progressively declined to 11.51 per cent in 1968 (see Table 2.6). This is mainly due to the increased and active participation of the banks in lending operation on wider areas in the economy. Though a major portion of credit by the foreign banks were of loans and advances, it included bills discounting and purchasing, however,, they were of inland bills. In the absence of separate data on the foreign bills business, we are unable to know if, the foreign banks dominance in this area has been reduced with the incoming of various legislative measures during this period. Despite the fact that their proportion in the total credit of the banking system was on the decline, the foreign banks showed steady growth rates in terms of credit since 1955 though, it was lowest between 1950 and 1955 (see Table 2.9).

With the nationalisation of the Imperial banks their share of business in terms of total credit of the banking system were steadily on increase. They had a proportion of 16.33 per cent of the total credit in 1947 which has increased to 30.04 per cent in 1968 (see Table 2.7). The growth rates in terms of credit also showed increase, reflecting their larger participation in lending according to plan priorities unlike in the past (see Table 2.9).

The other Indian joint stock banks were having a proportion of 66.4 per cent in 1947 in the total credit of the banking sector. Which progressively declined to 58.46 per cent in 1968 due to closure of quite a number of non-scheduled smaller and non-viable banks (see Table 2.8). Nevertheless, the growth rate in respect of credit showed a steady increase from a negative growth rate of -2.83 per cent between 1947 and 1950 to as high as 13.03 per cent between 1965 to 1968 (see Table 2.9). The notable feature was their active participation in the bills discounting and purchasing during the post independent era, which they had seldom involved earlier.

The proportion of asset holdings by the foreign banks has increased from 12.45 per cent in 1947 to 21.04 per cent in 1955. However, thereafter it has ultimately come down to 10.69 per cent in 1968 (see Table 2.10). This was mainly due to larger growth among the assets of domestic banks during sixties.

Its a proven fact that, in the post independent India, banks had played a pivotal role in the planning process by mobilising deposits and directing the flow of these deposits into productive investment channels[19]. Foreign banks being part of the Indian banking system also had likely taken an active participation in the overall development of the economy during this period. This is reflected from their high credit deposit ratios. It ranged between 55.8 per cent in 1947 to as high as 87.06 per cent in 1960. While the domestic banks hardly crossed 70 per cent including the Presidency bank of India (see Table 2.11). However, given their restricted and concentrated location in a few places like major towns and metropolitan cities they could not have involved in lending to all the plan priorities except lending to selected industries.

The large scale progress attained among the domestic banks during the post independent period up to the first nationalisation as we have seen, were likely due to deliberate policies encouraging the domestic banks on the one hand, and simultaneously discouraging the

[19] M C Vaish (1969) The Author covers the plan periods involving only up to 1966.

proliferation of the foreign banks on the other. Although, the declining phase of foreign banks had started well before independence, i e., during the late forties, the conspicuous change in the face of the foreign banks and their relative status in the Indian banking system has changed considerably during the post independent period. One could safely assume that the post independent policy measures did likely accelerated this phase of change during fifties and sixties. The distinct feature of the foreign banks operations however was that, despite the tremendous progress among the domestic banks the foreign banks were able to establish a 'niche clientele' around them on a more stronger basis. This brief analysis makes one more curious to probe into their relative position viz., domestic banks in detail, particularly during the post nationalisation of major commercial banks. An attempt on this direction has been made in the subsequent chapters.

Table 2.9

Growth Rates@
(Deposit and Credit)

Year	Foreign Banks		Other Indian Banks		Imperial Banks	
	Deposit	Credi	Deposit	Credit	Deposit	Credit
1947	-	-	-	-	-	-
1950	1.68	13.77	-5.36	-2.83	-6.89	4.57
1955*	2.69	4.52	4.33	6.39	-0.47	0.75
1960#	4.30	4.68	8.30	11.58	24.71	22.44
1965	7.74	5.29	12.76	12.41	6.78	15.31
1968	8.67	12.03	15.12	13.03	12.95	17.20

@ : Compound growth rates
* : Converted as State bank of India
\# : Includes Associate banks
Note : IB = Imperial bank of India
OIBs = Other Indian Banks
FBs = Foreign Banks
Source: Table Nos 2.7, 2.8 & 2.9

Table 2.10

Bank group wise Assets and Liabilities

	Foreign Banks		Imperial Bank		Other Indian Banks	
Year	Asset/Li	GR	Asst/Lib	GR	Asst/Liab	GR
1947	16367 (12.45)		29940 (22.78)		85114 (64.48)	
1950	23460 (18.89)	12.75	26864 (21.63)	-3.55	73882 (59.48)	-4.61
1955*	33192 (21.04)	7.19	25761 (16.33)	-0.84	98814 (62.63)	5.99
1960#	37522 (14.34)	2.56	75660 (28.92)	24.05	148426 (56.74)	8.48
1965	49181 (11.79)	5.56	113042 (27.10)	8.36	254917 (61.11)	11.42
1968	64844 (10.69)	9.65	164143 (27.07)	13.24	377489 (62.24)	13.98

* : Converted as State bank of India
\# : Includes Associate banks
Note: 1 Does Not Include Non-Scheduled bank
2 Figures within bracket refers to percentage share in the total of the banking system
G R = Growth rate compounded

Source: Statistical Tables Relating Banks in India, RBI, Bombay Various volumes

Table 2.11

Credit Deposit Ratio

	Foreign Banks	Other Indi Banks	Imperial Banks
Year	Cred/Dep Ratio	Cred/Dep Ratio	Cred/Dep Ratio
1947	55.86	48.89	31.11
1950	78.25	52.91	44.06
1955*	85.49	58.36	46.82
1960#	87.06	67.75	42.70
1965	77.58	66.69	62.72
1968	84.98	63.12	70.08

* Converted in to State Bank of India
\# Included Associate banks with SBI
Source : Statistical Tables Relating to Banks in India, Various Volumes RBI, Bombay

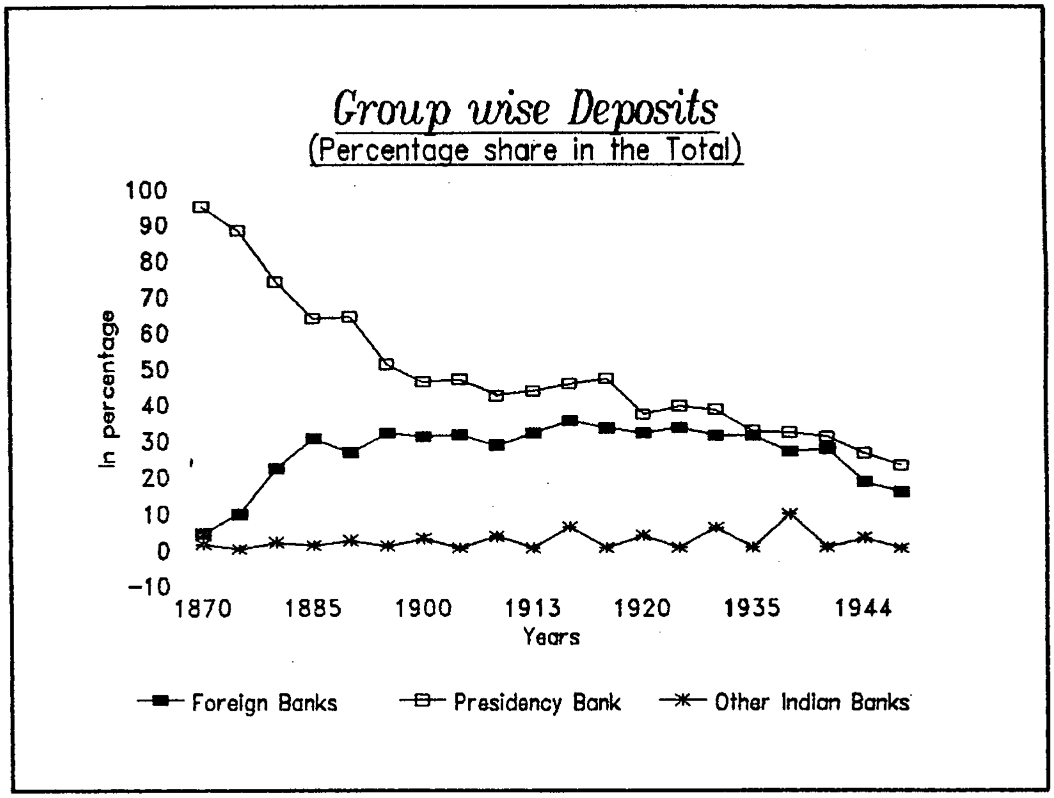


Figure 2.1

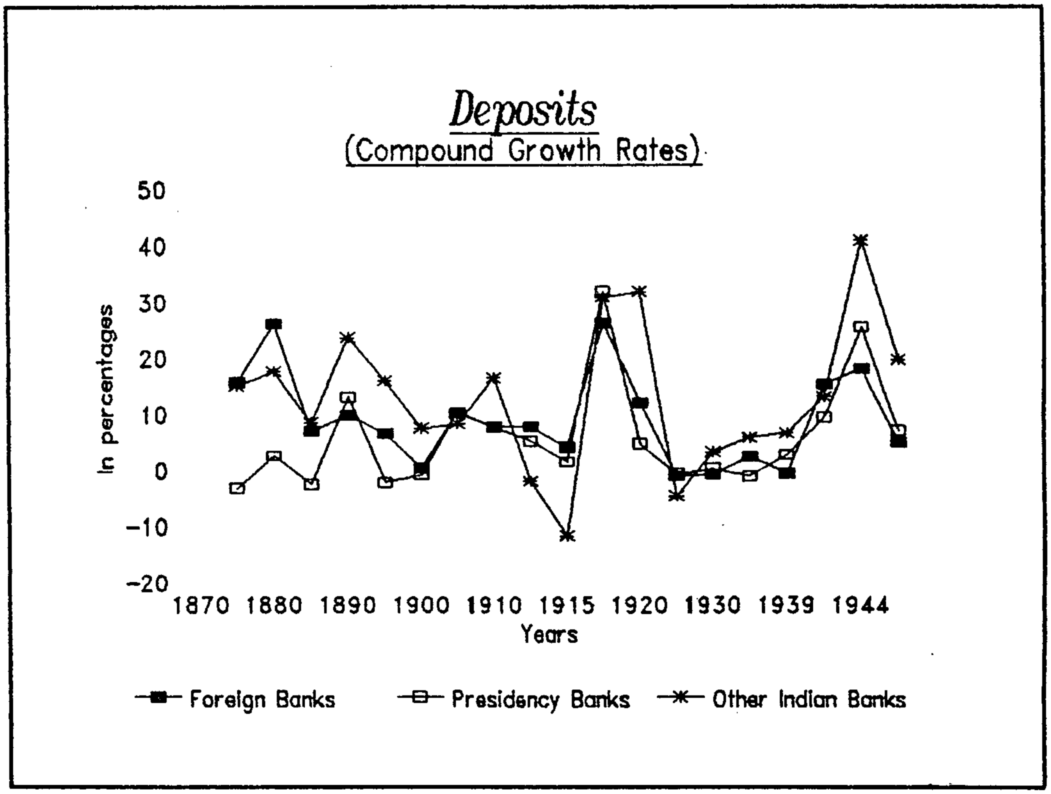


Figure 2.2

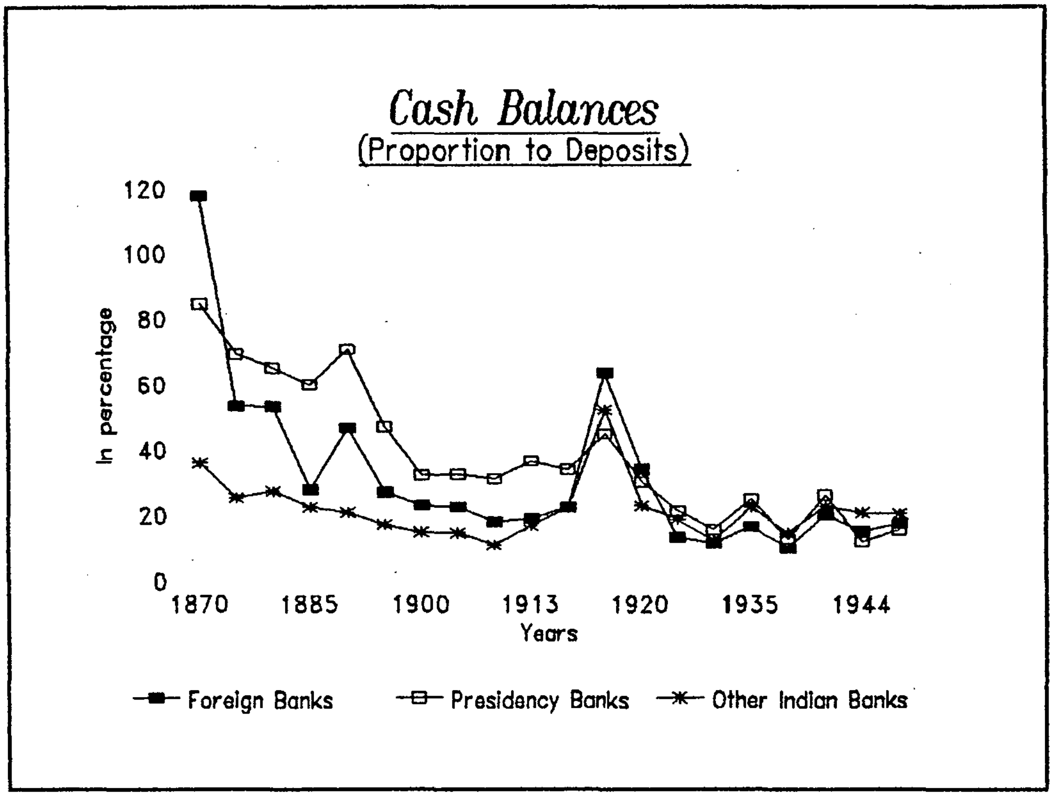


Figure 2.3

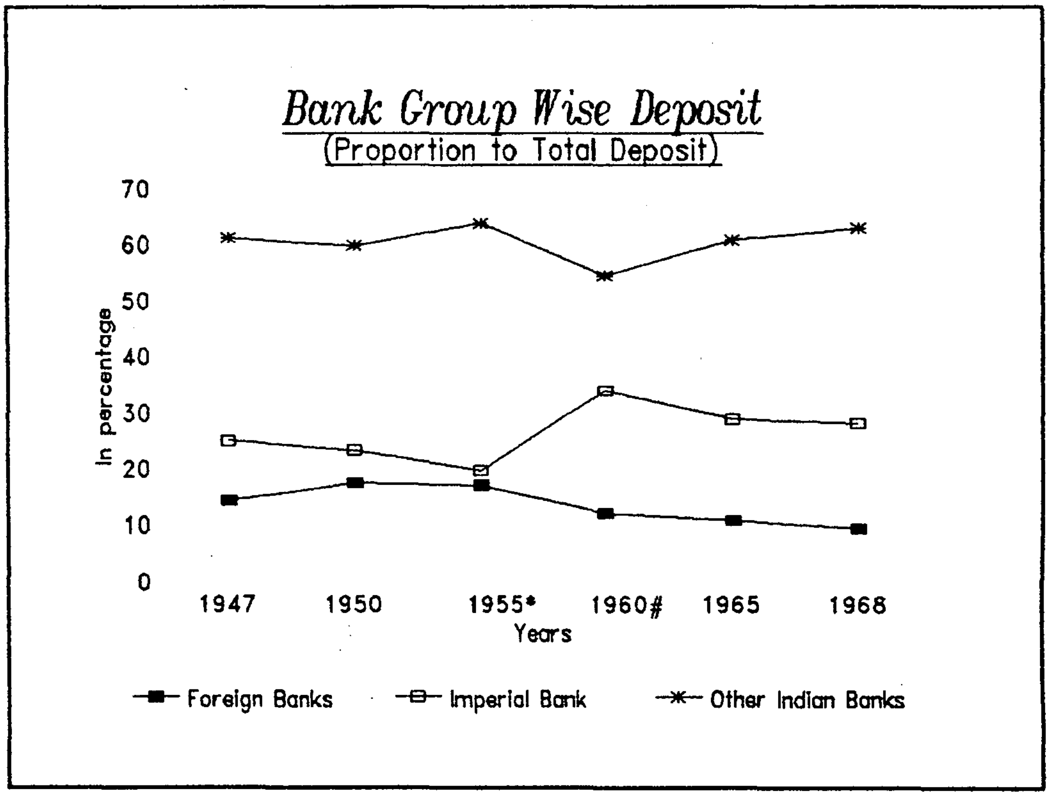
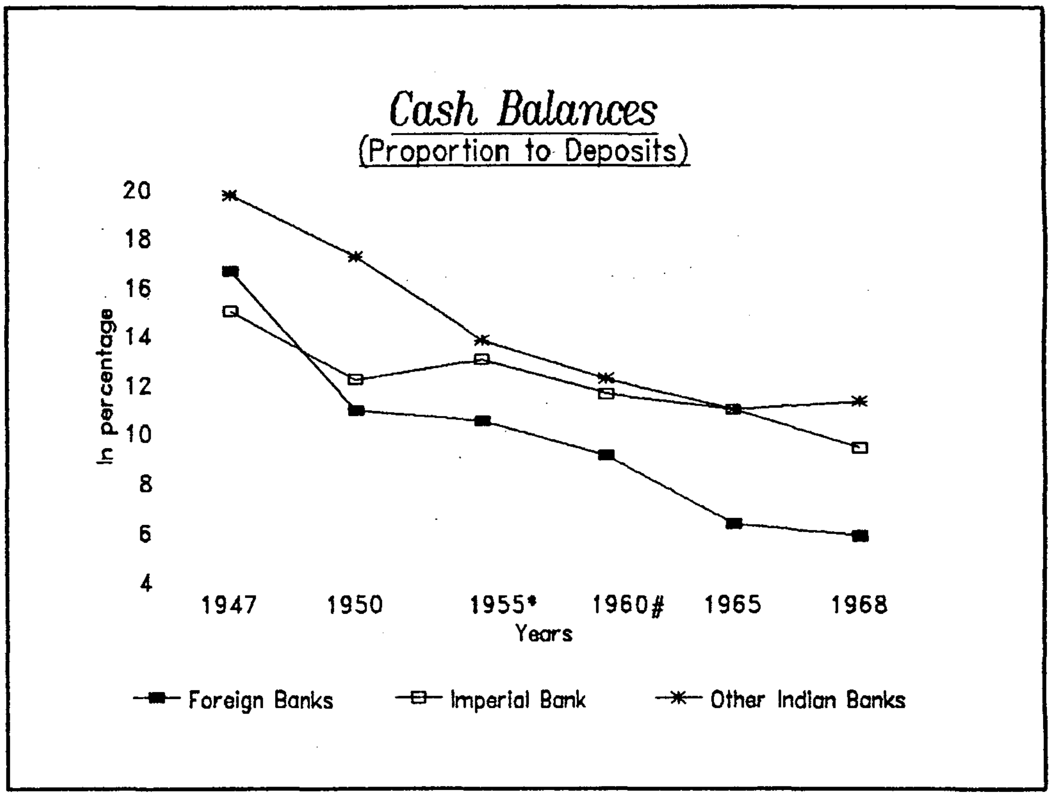


Figure 2.4



Cash Balances
(Proportion to Deposits)
20
18
16
14
12
10
8
6
4
In percentage
1947
1950
1955*
1960#
1965
1968
Years
Foreign Banks
Imperial Bank
Other Indian Banks

Figure 2.5

CHAPTER 3

Profitability Analysis of Foreign and Domestic Banks

3.1 Introduction:

Profitability is one of the crucial indicators of performance of business firms irrespective of the nature of their activity (product or service-oriented). Banking is an important service-oriented commercial activity. Therefore profitability can be considered as a good, though not a sole, indicator of performance of banks. This is also valid when it comes to the question of public sector banks, though they also undertake socio-economic obligations, which are beyond the pure commercial banking function. For, the banker being the custodian of savings of the public, his concern for not only the safety of such funds but also the best profitable way of investment of such funds, is inevitable. Further, profitability is something more than a mere test of efficiency, without which, irrespective of whether it's public or the private sector, the very survival of the firms would be at stake. Therefore "....from a long term point of view of sustained and healthy existence of banking industry.... consideration of profitability cannot be lost sight of"[1], and in recent years, there is great concern among the authorities about the gradual declining trend in the profitability among the Indian banks. The time has come to examine the various aspects of profitability among banks in general and among foreign and domestic banking groups in particular. This is more so in the context of opening up the gate for private sector banks in general and foreign banks in particular to

[1] James S Raj (1978)

play more free and wider role[2] in the changing atmosphere.

In this chapter, an attempt is made to measure and compare the performance in terms of financial profitability among the foreign and domestic banking groups. As stated elsewhere, the domestic banks are classified into public sector and private sector banks (to see if ownership matters). One of the common problems of research in this area, however, is the non-availability of reliable and disaggregated data. It is well known that the data contained in the published annual reports of the banks are not always and in all cases strictly comparable and correct. It is quite often said that "the fully correct figures are secret and are not openly available for analysis even inside the banks"[3]. While we are fully aware of this handicap, we are compelled to depend on the published source for the reason that there is no better alternative source. This problem exists with the data pertaining to all the groups of banks and are not specific to any particular bank or banking group, the interpretation would not be biased to any particular banking group, so long as its a comparative analysis.

Initially we have attempted to analyse the profitability among the said banking groups with the modified model of the one used by Kwast and Rose (1982) based on regression model with a particular specification (outlined in Chapter.1). As the assets and liability items of portfolios are the basic source of earnings and expenditures and therefore their contributions to net operating income (operational profits), we attempted to test as to how each of the important

[2] M Narasimham (1991)

[3] Ganti Subramaniam and Sooraj B Swami (1992)

portfolio items in the balance sheet, both assets and liabilities contributes to the net operating income of different banking groups. However, the data suffered with severe multicollinearity among the important independent variables. The results therefore were quite disastrous with opposite signs to the a priori ones, among the coefficients. We were unable to overcome the problem of multicollinearity though, several possible ways were tried out. It was feared, with the presence of such a strong multicollinearity among the explanatory variables the right interpretation of the results would be difficult and even misleading. Therefore we opted out of this method and chose to analyse with ratios, proportions, elasticity measures and growth rates for various important variables for the entire period of analysis.

We have chosen some of the crucial and most commonly used indicators based on the suitability of the available data. The ratios are:

1. Return on Assets (ROA)
2. Net Return on Assets (NROA)
3. Return on Working funds (RWF)
4. Return on Operating Earnings
5. Profit per branch
6. Output Input Ratio
7. Elasticity of Output to Input
8. Spread ratio
9. Earnings/ Expenditure to Assets

to measure and analyse the profitability difference between foreign and domestic banking groups and also to see the trend across them. We also attempted to compute growth rates of some ratios and to see whether they are accelerating or decelerating for the period under study. While attempting in this direction we had taken into consideration the external and internal factors (sketched out in Chapter 1) to the extent possible. Though the return on capital employed is also an important measure, here we are unable to use this ratio as the foreign banks operating in India are only the branches and their capital is not fully represented in India, we have therefore taken the working fund.

The ROA explains as to how best the total assets of the different banking groups are made use of, to maximise their profits or to put it simply what is the return (operating profit) that, every hundred rupees of total asset brings back to the banks. Higher the ratio, higher is the profitability of that particular banking group.

Net operating income (NOI) or operating profit is the difference between total operating income and total operating expenses. We have taken NOI as profit instead of net profit after tax for computing ROA for one reason that the net operating income is fairly stable. And it is not affected by the different methods of computing depreciation and secondly it represents profits from purely operational aspects as it excludes income from non-regular and non-banking business. However, the extent of influence of those aspects such as the methods of depreciation, income from non-banking business and adjusting profits through window dressing are examined by taking the net profit before tax transferred to the balance sheet as percentage to total assets as a separate ratio called as NROA.

The balance sheet total has been taken as total assets. Further, the time series data is available only on total liabilities in the published source (Statistical Tables Relating to Banks in India). As the total liability is equivalent to total assets, we have taken total liability to represent total assets in the entire analysis.

3.2 Return on Assets :

$$ROA = \frac{\text{Net operating Income}}{\text{Total assets}} * 100 \quad \text{or} \quad \frac{\text{Operating profit}}{\text{Total assets}} * 100$$

The return on assets (ROA) for different banking groups seen from the Table 3.1 clearly reveals that, the foreign banks distinctly out perform the rest of the groups, invariably they have higher ROA which clearly marks them off from the domestic banks. Unfortunately not even the private sector Indian banks are any way near to foreign banks (to see if ownership matters). The return on asset varied between 0.97 per cent in 1969 and as high as 2.84 per cent in 1981 during the period under study though it was generally fluctuating over the years. One more noticeable feature is that the ROA was not showing a steady trend except for a short period till the mid seventies. Contrary to the popular belief, the trend was not a steady increase from the mid seventies and entire eighties, more particularly between 1981 and 1985 and even thereafter the fluctuations could be observed. (see Table 3.1). As against this the domestic banks showed distinctly low performance with a very low rate of return on assets. It however did not show any wild fluctuations, as much as the foreign banks, in the movement (see Figure 3.1).

Table 3.1

Return on Assets (In percentages)			
Year	FBs	PSBs	OSBs
1969	0.97	0.64	0.37
1970	1.08	0.88	0.46
1971	1.33	0.71	0.49
1972	1.53	0.57	0.35
1973	1.25	0.47	0.25
1974	1.92	0.64	0.73
1975	1.93	0.69	0.43
1976	2.41	0.83	0.37
1977	2.10	0.76	0.28
1978	2.01	0.71	0.40
1979	2.30	0.59	0.45
1980	2.10	0.75	0.55
1981	2.84	1.09	0.75
1982	2.82	1.09	0.76
1983	2.66	1.07	0.65
1984	2.26	0.73	0.35
1985	1.98	0.87	0.73
1986	2.51	0.93	0.71
1987	2.24	0.94	0.86
1988	2.19	0.97	0.69

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks

Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

The ROA in respect of public sector banks (PSBs) was ranging between as low as 0.47 per cent in 1973 and 1.09 per cent in 1982, in fact it hardly crossed 1 per cent during the entire period of analysis, however, one heartening feature is that, the ROA of public sector banks were always higher, at least more than the Indian private sector banks. It is worth noting that, the public sector banks show cyclicality in the movement

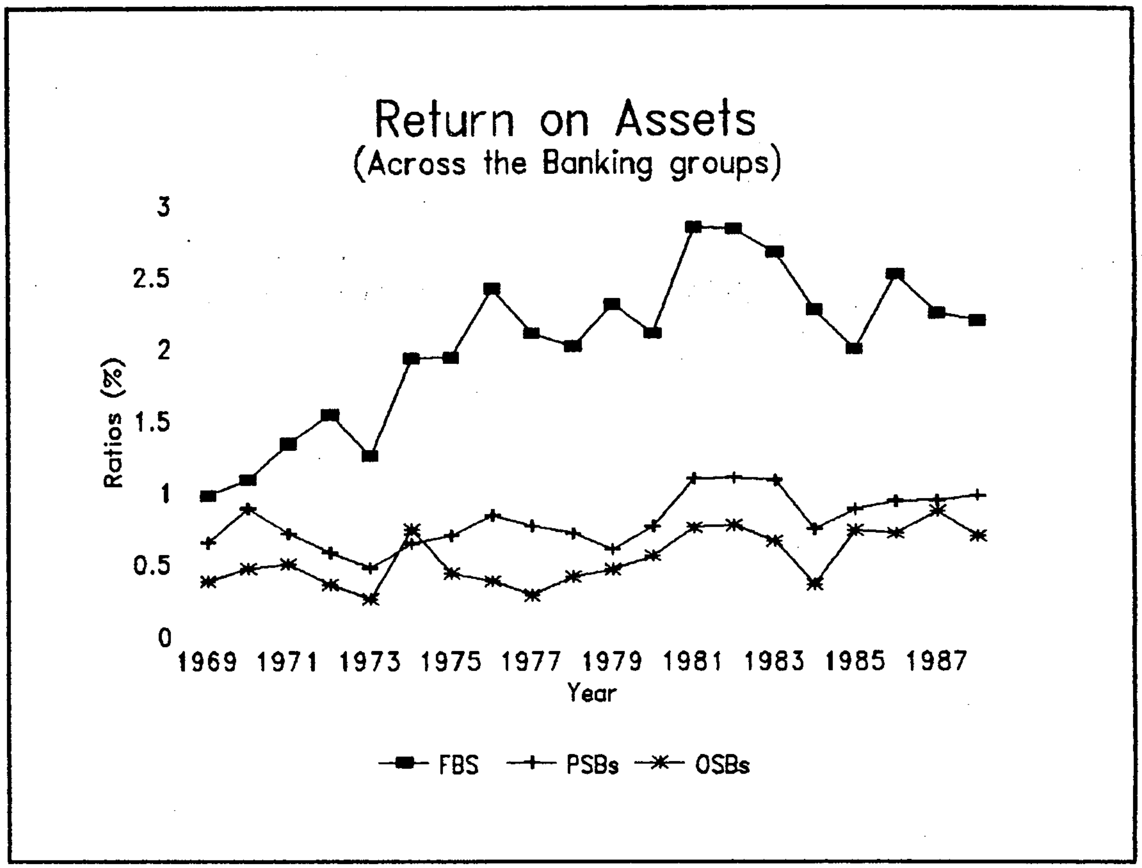


Figure 3.1

of trend, at a frequency of every fifth or sixth year, taking a deep dive in the movement (see Figure 3.2). This cyclical phenomenon with respect to the public sector banks are likely due to heavy payment of wages along with the arrears due, to employees after the wage negotiations once in every five years. However, we are unable to probe or prove this aspect with any advanced statistical tool. The ROA of the Indian private sector banks were by far the most dismal as against the rest of the banking sector with a very low return than even the public sector banks almost during the entire period of analysis. It ranged between as low as Ø.25 per cent in 1973 and Ø.86 per cent in 1987. However, both public sector and Indian private sector banks (OSBs) show a some what similar pattern and moves in a more or less similar direction.

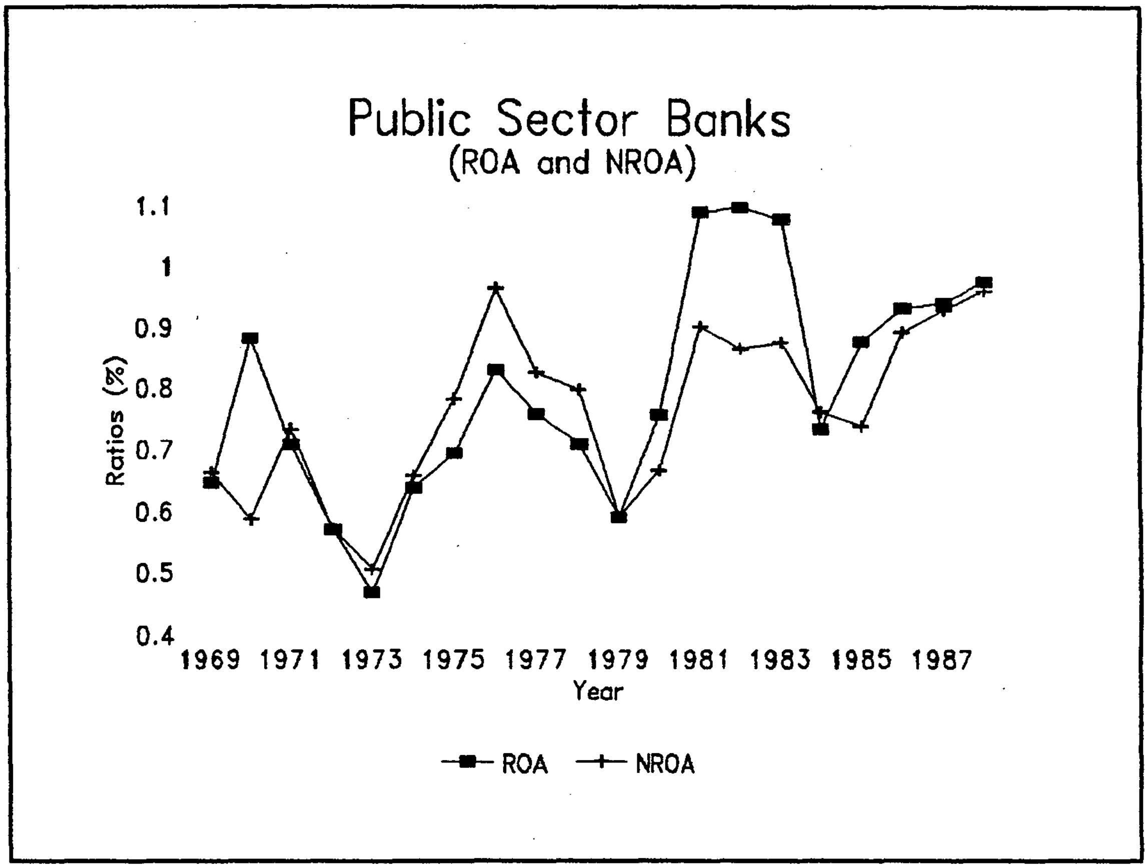


Figure 3.2

This reflects that the domestic banks irrespective of whether private or public sector are working with more or less similar strategy of asset management unlike the foreign banks. The result explains that the foreign banks are using their limited assets in a most profitable manner than the domestic banks. Further, it also reflects that not only the difference in the quality of the assets maintained by different groups of banks, but also the fact that foreign banks are maintaining relatively better quality of assets in general. Higher the quality of asset maintained, better will be the return. Though there were wild fluctuations in the trend incase of foreign banks, the gap between the foreign and domestic banks in their ROA do not seem to be widening over the years as it was widely perceived. It may be worth mentioning here that many studies had pointed out time and again that, the recovery rate among the domestic banks in general and public sector banks in particular, (especially in respect to DRI and priority sector lendings) were very low due to high rate of default in repayment. Thus leading to non-performing assets on a large scale, this could be one of the reasons for the low rate of return among the domestic banks. For instance, it was pointed out that more than one half of the loan (DRI) outstanding were overdue from 94 per cent of the outstanding borrowal accounts during 1972 to 1981[4] (impact of priority sector lending policy). Such a phenomenon would not go without its adverse effect on their profitability. However, there are general improvements during the later half of eighties in the profitability, though there is absence of secular trend. This improvement could be explained partly, in terms of payment of high interest on cash reserve ratio (CRR) balances with Reserve bank, injection of capital into PSBs, continuous monitoring of performance of public sector banks through Action plans. However, it seems that, the liberalisation measures introduced in mid-eighties in the financial sector in general, and banking in particular, has not reflected in a big way as expected, and more so in the case of domestic banks.

3.2.1 Net Return on Assets:

In order to capture the influence of the difference in the methods of computing depreciation, influence of income from miscellaneous activities, income from other business and also expenditures relating to non regular business etc., we have computed net rate of return to assets (NROA). Here we refer net profit before tax transferred to Balance sheet as net return, taking net profit

[4] Chawla, Patil and Shete;

before tax as a proportion to total assets we arrive at NROA as given under;

$$NROA = \frac{\text{Net profit before tax}}{\text{Total assets}} * 100$$

Table 3.2 shows that, the overall pattern of the NROA of all the banking groups are nearly similar to the one we had observed with respect to ROA excepting that the year to year fluctuations were not as sharp as it was experienced with respect to ROA.

Table 3.2

Net Return on Assets

(in percentages)

Year	FBs	PSBs	OSBs
1969	1.21	0.66	0.58
1970	1.26	0.59	0.65
1971	1.58	0.73	0.63
1972	1.93	0.57	0.48
1973	1.77	0.50	0.42
1974	2.50	0.66	0.94
1975	2.58	0.78	0.59
1976	2.80	0.96	0.58
1977	2.34	0.82	0.52
1978	2.17	0.79	0.49
1979	2.51	0.59	0.57
1980	2.37	0.66	0.59
1981	3.01	0.90	0.70
1982	2.86	0.86	0.63
1983	2.78	0.87	0.62
1984	2.38	0.76	0.38
1985	1.92	0.74	0.73
1986	2.35	0.89	0.79
1987	2.19	0.93	0.88
1988	2.48	0.96	0.85

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks
Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

The foreign banks distinctly stand out from the rest of the banking groups with a very high NROA ranging between 1.21 per cent and as high as 3.01 per cent, very similar to those observed in the case of ROA. However, there was a steady trend only for a very short period till the mid seventies and the rest of the period it was increasing with wild fluctuation (see Table 3.2). The noticeable feature is that the NROA was by and large higher than the ROA except in three years contrary to the expectation, for foreign banks. The higher difference between the ROA and the NROA explains the income from other source, the different methods of calculating the depreciation, revaluation of assets etc., are influencing the operating profits. The domestic banks experienced a very low NROA as compared to foreign banks, throughout the period. Contrary to what was noticed in the case of foreign banks the NROA was generally lower than the ROA during many years in respect of public sector banks ranging between 0.50 per cent and 0.96 per cent. For the Indian private sector banks it ranged between 0.38 per cent and 0.94 per cent. There was no trend of positive or negative direction, in a proper sense, in respect of domestic banks just as the one observed in the case of ROA. One conspicuous feature is that, between Indian private sector and the public sector banks the gap was wide in the case of ROA and that has been narrowed down in respect of net return on assets (NROA). It is worth noticing that, similar to the one observed in respect of foreign banks the Indian private sector banks also exhibited NROA being higher than their ROA, although the difference was not as much as the one witnessed for the foreign banks. This however, hints that both Indian private sector banks and foreign banks involve in camouflaging of their balance sheet and profit and loss account by using depreciation, revaluating their investments etc., to show higher net profit depending upon their convenience. For, this will boost up their credibility in the eyes of public. And such camouflaging seemed to be relatively less in the case of public sector banks as the difference between ROA and NROA is too little if at all it exists. For instance, the difference between ROA and NROA was as high as 0.65 per cent in 1975 for foreign banks this was more likely due to the income from revaluation of assets, as such income was abnormally high in that particular year. However, one should also be more cautious in interpreting this, as the difference may not be solely because of the above stated reason, it is also possible because of considerable income from non-regular business.

3.3 Return on Working fund (RWF):

$$RWF = \frac{\text{Net Operating Income}}{\text{Working Fund}} * 100$$

We also attempted to compute the return on working fund as a measure of profitability as we could not compute the return on capital employed. The working fund is being defined here as the total liabilities minus the contra items. The return on working fund (RWF) is an important measure of profitability, particularly for the study of banks, which shows how best the resources were employed to earn a better return. Higher the ratio better, is the return on the resources employed or more efficient the fund employed to earn better profit. Some authors have interpreted this ratio as ROI[5] (return on investment) and return on working capital etc.,. However, equating RWF with ROI seems to be a very narrow way of interpreting the return on working fund, as the funds employed in investment by a bank amounts to relatively a small portion of the total working fund. The

[5] Kiran (1985)

empirical result showed mild fluctuations in the trend with respect to RWF for quite a long period from 1969 till almost 1981 for foreign banks. However, except the initial three years (which showed an abnormal increase) in eighties, it showed an increase with more fluctuation. As we have seen with the other parameters, here too the foreign banks show a clear mark off from the domestic banking sector with the RWF ranging between 1.11 per cent in 1969 and as high as 4.22 per cent in 1981. The domestic banks showed more or less similar pattern with respect to both public and private sector banks. Though not much fluctuation in the movement, it showed almost no trend in a proper sense, in the movement of RWF (see Table.3.3).

Table 3.3

Return on Working Fund

(In percentages)

Year	FBs	PSBs	OSBs
1969	1.11	0.68	0.42
1970	1.23	0.98	0.52
1971	1.55	0.78	0.55
1972	1.74	0.63	0.39
1973	1.41	0.52	0.28
1974	2.39	0.71	0.84
1975	2.32	0.78	0.49
1976	2.92	0.95	0.42
1977	2.76	0.87	0.32
1978	2.68	0.82	0.47
1979	3.12	0.68	0.52
1980	2.99	0.88	0.63
1981	4.22	1.27	0.85
1982	4.19	1.28	0.87
1983	3.69	1.22	0.73
1984	3.27	0.83	0.39
1985	2.85	0.98	0.81
1986	3.69	1.05	0.79
1987	3.23	1.04	0.95
1988	2.89	1.07	0.78

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks

Source: Computed based on the Statistical Tables Relating to Banks in India

Further, except in 1974, the return on working fund with respect to public sector banks were always slightly higher than the Indian private sector banks, ranging between as low as 0.52 per cent in 1973 and 1.28 per cent in 1982. Thus contrary to the popular notion, the public sector banks do attempt to employ their resources in a profitable manner, compared with at least Indian private sector banks if not with that of foreign banks - a healthy and appreciable trend. The disturbing sign however, was that though there was increase in the ratio for all the banking groups through the eighties the trend was not secular (see Table 3.3). Although the fact remains that, it was in late eighties that a number of liberalisation measures were introduced in the financial sector in general, and banking in particular, with a number of innovations and diversification.

3.4 Operating profit to Total Operating Income:

It is worth examining as to what proportion of every 100 rupees earned as total current operating income, does come by way of return to different bank groups. We had therefore computed the return to total operating earnings[6] with the following formula. Considering the total operating income as proxy for output we could possibly examine the return to output.

$$\text{Return on Total Operating Income (Output)} = \frac{\text{Net Operating Income or Operating Profit}}{\text{Total Operating Earnings or Output}} * 100$$

[6] The total operating income or the total current operating earnings are one and the same. It includes incomes from only banking business and does not include those non-regular and non-banking income such as income from other business, sale/ purchase of assets, revaluation of assets etc.,

The foreign banks earn a comfortable net operating income or operating profit, ranging between Rs 15.35 to as high as Rs 33.07 for every hundred rupees of their total operating earnings (also as output) during the period under analysis. With mild fluctuations there were upward trend till the beginning of the eighties (see Table 3.4). There after the increase was not one of a steady nature but similar to the one we had observed in the case of other above mentioned indicators. It shows their profit consciousness in their day-to-day business. As against this the domestic banks show a very low profitability ranging from a mere Rs 7.03 to hardly around Rs 14.43 occasionally, in the case of public sector banks. And a paltry Rs 3.59 to as low as Rs 9.47 per Rs 100 of total operating earnings incase of Indian private sector banks (other scheduled commercial banks) thus showed a disappointing performance in this regard. In other words the net operating income had never touched even 10 per cent of their total current operating earnings in any of the year during the entire period of analysis. Thus it is clear that unlike domestic banks the foreign banks were having relatively a very high profit margin on their total operating earnings. Almost similar is the pattern taking into consideration the net operating income as a percentage to total operating expenditure[7]. However, obviously they were always lower than the net operating income as a proportion to total operating income more particulary for the foreign banks.

7 Total operating expenditure or current operating expenditure refers to the same and includes only the regular and banking operational expenditure. It does not include the expenditures such as depreciation provisions for tax etc.,.

Table 3.4

Return on Total Operating Income
(In percentages)

Year	FBs	PSBs	OSBs
1969	15.34	10.58	5.98
1970	17.03	14.43	7.27
1971	19.26	10.44	7.65
1972	22.50	8.49	5.51
1973	18.50	7.03	3.84
1974	23.33	8.07	9.47
1975	20.52	8.17	5.12
1976	25.36	9.95	4.94
1977	24.75	9.19	3.59
1978	26.82	9.61	5.84
1979	28.98	8.55	6.20
1980	26.24	9.37	7.13
1981	32.07	12.42	8.93
1982	33.07	12.56	8.99
1983	30.30	12.49	7.72
1984	27.05	8.53	4.27
1985	22.40	10.22	8.29
1986	27.44	10.77	8.21
1987	22.88	10.82	9.44
1988	19.90	9.74	5.91

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks
Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

From the above analysis it is clear that the foreign banks profitability measured in terms of ROA, NROA, RWF and return on total operating income were distinctly high as compared with the domestic banks in general. What is to be noted in the preceding analysis was that, though the mid eighties saw major changes in financial sector in general and banking sector in particular with the introduction of many innovative instruments and institutions as a measure of liberalisation, our result does not reflect these in a major way. It only implies that neither the foreign banks nor the domestic banks could really capitalise these aspects in a big way, as much as, it was expected. However, we could not rule out its positive impact on the overall profitability of both domestic and foreign banks.

Further to the above analysis, it is worth examining how some of the crucial internal and external factors are affecting differently the foreign and domestic banks in their performance. Towards this direction we attempt to analyse by taking the per branch profit, output input ratios, elasticity of output to input and spread ratios. Each of these ratios are in some way or other will reflect the impact of some of the crucial policy factors in particular, on the differential performance.

3.5 Profit Per Branch :

To capture the much popularised policy of branch expansion and its impact on the profitability we attempted to compute the per branch profit among the banking groups as given under;

$$\textbf{Profit per branch} = \frac{\textbf{Net Operating Income}}{\textbf{Number of Branches}}$$

It may be recollected that the whole policy thrust was directed on the public sector banks on the one hand, a via media approach has been adopted towards the Indian private sector banks and virtually 'no expansion' policy towards foreign banks on the other hand. Obviously these differences in policy approach will have different impact on different banking groups. However, we are not hypothesising as to whether it will have good or bad impact on different groups of banking as such. Many studies had pointed out that, the compulsion of opening branches especially in rural areas had adverse effect on the profitability of the domestic banks though it served other purposes.

For instance, it was often repeated that banks felt great pressure on their profitability because of higher operating cost for rural branches[8], this is likely only in the case of domestic banks, as the foreign banks do not have such compulsion.

The net operating income or operating profit per branch for the whole period in respect of foreign banks showed almost a steady increase, ranging from as low as Rs 5.03 lakhs per branch in 1969 to as high as Rs 146.36 lakhs per branch in 1988 (see Table 3.5). Moreover a clear upward shift could be seen in the eighties.

Table 3.5

Operating Profit per Branch
(Rs in Lakh)

Year	FBs	PSBs	OSBs
1969	5.03	0.40	0.09
1970	6.41	0.67	0.13
1971	8.68	0.52	0.16
1972	10.99	0.44	0.12
1973	10.05	0.40	0.10
1974	18.11	0.59	0.32
1975	18.25	0.72	0.20
1976	24.61	1.00	0.21
1977	24.78	1.00	0.16
1978	29.27	1.10	0.29
1979	36.28	1.14	0.17
1980	35.99	1.46	0.40
1981	55.59	2.39	0.62
1982	66.86	2.73	0.72
1983	69.10	2.94	0.69
1984	74.17	2.26	0.43
1985	80.64	3.00	0.96
1986	132.29	3.68	1.07
1987	134.66	4.27	1.56
1988	146.36	4.49	1.12

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks
Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

[8] Sampat Singh (1981)

This only shows that the restrictive branch licensing policy adopted towards foreign banks had not really worked as major constraint in increasing their profitability. The foreign banks seem to have adopted the strategy of diversifying their area of business on a large scale with the existing number of branches in place of expanding business by expanding a number of branches. In fact it seems, because of the restrictive policy towards the foreign banks they had been literally exempted from the compulsion of opening branches in the less profitable centres on the one hand. And on the other, the existing branches were well established and were largely urban and metro based for historical reasons and therefore they also enjoy <u>locational advantage</u>. Thus it is likely that the policy measures itself has prevented them to be exposed to the higher risk and lesser rewarding business which the domestic banks are facing. Therefore it is obvious that foreign banks to have relatively higher per branch profit and higher profitability in general. The fluctuating trend in respect of ROA, NROA and RWF during eighties as observed earlier and a steady upward trend in the per branch profit for the same period are two different phenomenon. Which explains that, though the net return had grown over time it has not grown in commensurate with the overall business represented by the assets and the working funds as the case may be. And the increasing trend with respect to per branch profit during the entire period only explains that, the near stagnation in the branch expansion during eighties, was not a constraint for the foreign banks for the growth of their profitability. In respect of domestic banks, as expected, the per branch profit was very low as compared with the foreign banks, this has been brought out by many earlier studies also. The per branch profit for public sector banks varied between as low as Rs Ø.4 lakh and Rs 4.49 lakh. For domestic banks it was pointed out for instance, that the rural branches incur double the operating cost as that of the remaining branches[9]. As also pointed out by James Raj committee report that, the rapid expansion has increased the cost structure following raising salaries and emoluments and overall establishment costs, without adding to productivity, resulting in inefficiency, and which in turn affected the profitability of banks. Therefore the profit per branch and the profitability could be low. Further, recent studies[10] shows that the public sector banks have reached branch diseconomies, perhaps this could be a valid reason why the public sector banks show very low per branch profit. Theory puts forward that, expanding branches necessarily expands the business and thereby increases the profit and profitability. However, this is doubtful if it holds good for the domestic banks in general and public sector banks in particular, as the policy of "banking the unbanked and under banked" areas are based not on pure commercial viability. In this context it is a good sign that public sector banks showed a steady trend in the per branch profit despite its onerous responsibility of large scale branch expansion. What is required to be noted however is, that the branch expansion policy of public sector banks would have considerably reduced their profit per branch and profitability as commonly perceived, it still showed a steady trend over the years. Thus it doesn't seem to have acted as a drag on the profitability to the extent of becoming negative as it was widely believed. However, it needs to be examined whether the growth in the per branch profit is in commensurate with the growth rates in branches. More disturbing is the case of Indian private sector banks, though the pressure on them

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[9] Sampat Singh (1981) also pointed out by M Narasimham(1991)

[10] Sharad Bansal (1992)

in opening the branches in the remotest non viable centres was relatively lesser than the public sector banks. The per branch profit was relatively much lower than the rest of the banking groups ranging between as low as Rs 0.09 lakhs in 1969 and Rs 1.56 lakhs in 1987 and was also abruptly fluctuating.

3.6 <u>Output Input ratios :</u>

In any service oriented industry the measurement of the output is a difficult task and it is more so in the banking industry. In the banking literature it has been variously used, total deposits, total business, total assets, operating earnings etc., as output (both stock and flow concepts). Here we use current operating earning and current operating expenditure as output and inputs respectively (flow concepts). For, there are considerable volumes of off-balance sheet items in the form of services like guarantees, agreements etc., from which banks earn or lose their income. Therefore it was felt appropriate to use total current operating income and current operating expenses (same as total operating income and total operating expenditure respectively) as output and input respectively instead of stock concepts based on balance sheet.

$$\textbf{Output Input Ratio} = \frac{\textbf{Total operating Earning}}{\textbf{Total operating Expenditure}} \textbf{ or } \frac{\textbf{Output}}{\textbf{Input}}$$

The ratio between output and input as stated above would give us responsiveness of the output to input or the cost effectiveness ie., how every rupee of expenditure or the cost incurred brings back in the form of earnings among the different banking groups. For instance if the ratio is higher than 1 it reflects cost effectiveness, on the contrary, if the ratio is less than 1, then the firm has no cost effectiveness or the firm spends more than what it earns. Higher cost effectiveness results in higher profitability. It is worth mentioning that the cost control is one of the crucial aspects for improving the profitability in general. "The question of profitability over time, in turn hinges crucially on the cost efficiency"[11]. The output input ratios were always much higher for the foreign banks ranging between 1.18 in 1969 and 1.49 in 1982 and in fact it was on the increase with mild fluctuations, almost for the entire period of analysis. It was only during eighties that the ratios were more fluctuating, yet they were much above the domestic banks (see Table 3.6). This explains that, the foreign banks were more conscious in controlling their costs in general. Thus the effective control over cost could well be one of the strong contributory factor for their overall better profitability performance. It is quite possible that because of higher automation or mechanisation of foreign banks they could operate with minimum cost and have more number of transactions and variety of services (referring to economies of scale and economies of scope respectively). However, more fluctuating trends during the eighties also need to be noted. As against this, though the domestic banks too in general showed cost effectiveness their ratios were always lower than the foreign banks, thus there was a low cost effectiveness as compared with the foreign banks. The ratio ranged between 1.08 per cent and 1.17 per cent, occasionally, for the public sector banks. Domestic banks showed simply no trend in the ratios over the years. What is surprising was that, the Indian private sector banks were always having lower ratios than that of public sector banks, thus showing a very low cost effectiveness among the

[11] J C Glass & D G McKillop (1991)

entire banking groups. Our empirical results belies the popular perception of public sector banks having a very high cost structure than the Indian private sector banks.

Table 3.6

Output Input Ratios			
Year	FBs	PSBs	OSBs
1969	1.18	1.12	1.06
1970	1.21	1.17	1.08
1971	1.24	1.12	1.08
1972	1.29	1.09	1.06
1973	1.23	1.08	1.04
1974	1.30	1.09	1.10
1975	1.26	1.09	1.05
1976	1.34	1.11	1.05
1977	1.33	1.10	1.04
1978	1.37	1.11	1.06
1979	1.41	1.09	1.07
1980	1.36	1.10	1.08
1981	1.47	1.14	1.10
1982	1.49	1.14	1.10
1983	1.43	1.14	1.08
1984	1.37	1.09	1.04
1985	1.29	1.11	1.09
1986	1.38	1.12	1.09
1987	1.30	1.12	1.10
1988	1.25	1.11	1.06

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks
Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

However, in general it shows that, irrespective of ownership whether private or public sector banks the domestic banks were managed with less cost effectiveness when compared with foreign banks.

3.7 Elasticity of Output to Input:

Apart from the above ratios we also computed the 'elasticities of output to input' ie., the responsiveness of rate of change in output due to rate of change in input. As usual the total operating earning was taken as output and total operating expenditure was taken as input for the (reasons explained elsewhere) entire period of analysis.

$$\textbf{Elasticity of Output to Input} = \frac{\textbf{Rate of change of Output}}{\textbf{Rate of change of Input}}$$

The empirical results showed wild fluctuation among all the banking groups (see Table 3.7). The elasticities of output to input is not all that impressive for any of the banking groups, surprisingly, even to foreign banks. They do not move in any set pattern for any of the banking groups in general. For the foreign banks the trend is noticeably fluctuating wildly from as low as Ø.66 in 1973 to as high as 3.65 in 1976. The rate of change in the output due to the rate of change in the input was less than proportionate during many years for all the banking groups including the foreign banks. At times the elasticities for the foreign banks were found to be even less than the domestic banks, and at times they were also much higher than the domestic banks. This only explains that, as far as the elasticity of output to input (ie., the rate of change in the level) are concerned the overall difference is not much between the foreign and domestic banks (see Table 3.7).

Though almost all the indicators of profitability ratios show that the foreign banks are performing relatively better than the domestic banks in general, the elasticities of output to input surprisingly does not give us the conforming explanation either way. The empirical result for the elasticity of output to input only shows that, there was no consistent growth in output, in commensurate, with the rate of growth in the input for any of the bank groups.

Table 3.7

Elasticity of Output to Input

Year	FBs	PSBs	OSBs
1970	1.18	1.33	1.08
1971	1.20	0.82	1.02
1972	2.09	0.86	0.91
1973	0.66	0.92	0.93
1974	1.24	1.04	1.21
1975	0.77	1.00	0.86
1976	3.65	1.10	0.99
1977	0.82	0.95	0.94
1978	1.68	1.04	1.16
1979	1.30	0.94	1.00
1980	0.74	1.03	1.04
1981	1.61	1.16	1.09
1982	1.12	1.01	1.00
1983	0.75	0.99	0.91
1984	0.79	0.77	0.78
1985	0.79	1.13	1.53
1986	1.34	1.04	0.99
1987	0.74	1.00	1.09
1988	0.85	0.94	0.76

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks
Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

3.8 Spread Ratios :

Interest is one of the major source of income as well as expenditure for all the bank groups in general. It is very important to take into account for its net impact on the overall profitability of the banks. For this purpose we have computed the spread ratios. Spread is the difference between interest earned and interest paid. Spread ratio is; spread as a percentage to the interest earned. Higher the spread ratio, higher is the net interest income contribution towards overall profitability for banks.

$$\text{Spread Ratios} = \frac{\text{Spread}}{\text{Interest earned}} \quad \text{OR} \quad \frac{\text{Interest earned} - \text{Interest paid}}{\text{Interest earned}}$$

While we compute and interpret these ratios we should be reminded of the fact that our banking system is functioning under the administered interest rate system, both with respect to interest earned and paid, leaving little options to the commercial banks to fix or control the interest rates and thereby interest income according to their commercial expediency. So, there may be an argument that the computation of spread ratio is meaningless. However, it need not be so for the reason that, spread would differ depending upon the composition of deposits and the composition of loans and advances, precisely that is where a bank can use its leverage. For instance if the composition of deposits contains current deposits as a major proportion the interest burden would reduce for the banks. In fact the net spread ratio matters much for the bank due to its direct impact on profitability. Besides, the spread ratio explains the overall efficiency management of assets and liabilities of the bank.

More importantly, it may be pointed out here that the interest rate policy was also being designed to bail out the public sector banks by cross subsidising the low rate of return on the priority sector lending with the lending to other sectors by maintaining a high rate of margin, which is in a way made inbuilt[12]. The reason being that, the domestic banks in general and public sector banks in particular were obligated for a higher proportion of their aggregate credit to be lent to priority sector (to the extent of 40 per cent of the net credit). While the foreign banks are less obligated for

[12] M.Narasimham (1991), C Rangarajan (1993)

priority sector lending (only 10 per cent of the net credit and that too was introduced of late). In addition, it is an oft repeated complaint against these banks that, they are not complying with even this requirement. It is in this context, the allegations are made more often than not, that the interest rate policy has worked more in favour of the foreign banks than the domestic banks. In order to verify empirically if this is true, we have computed and compared the spread ratios among the different banking groups for the entire period. Going by our results (see Table 3.8) the above argument seems to be holding good by and large. The spread ratios were invariably high for the foreign bank group all through, though, the trend was fluctuating and was on the decline ranging between 0.33 and 0.52. Hence, it could not be ruled out that the policy inbuilt higher interest margin, basically aimed at cross subsidising the priority sector lending, having favoured the foreign banks more than the domestic banks. The distinctly higher spread ratio for foreign banks also reflect the efficient composition of deposits along with the composition of loans and advances. As mentioned earlier it broadly reflects the efficiency in asset and liability management. It is interesting to note that, among the domestic banks the spread ratios were higher for the public sector banks only for a short period till 1973, and thereafter it took a reverse ie., the ratios were higher for the Indian private sector banks than the public sector banks. This tendency explains that, despite the policy is aimed at the cross subsidisation, the public sector bank group were unable to gain much. This is more due to the high priority sector lending obligation, coupled with low recovery rate. What is more pertinent was there were instances of this ratio for the foreign bank group going up to more than double that of Indian public sector bank group. While in respect of Indian private sector banks it shows their attempt to marginally improve their spread.

Table 3.8

Spread Ratios (Spread to Interest earned)			
Year	FBs	PSBs	OSBs
1969	0.52	0.46	0.44
1970	0.50	0.45	0.43
1971	0.49	0.45	0.44
1972	0.51	0.44	0.42
1973	0.48	0.42	0.41
1974	0.45	0.37	0.41
1975	0.49	0.36	0.39
1976	0.46	0.28	0.35
1977	0.44	0.27	0.34
1978	0.38	0.27	0.34
1979	0.45	0.27	0.36
1980	0.47	0.26	0.36
1981	0.50	0.25	0.36
1982	0.52	0.25	0.36
1983	0.46	0.26	0.35
1984	0.43	0.27	0.37
1985	0.41	0.27	0.34
1986	0.42	0.26	0.33
1987	0.40	0.25	0.31
1988	0.33	0.25	0.30

Note : FBs = Foreign banks
PSBs = Public sector banks
OSBs = Other Scheduled commercial banks
Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

The general decline in the trend in respect of domestic bank groups may be partly explained in terms of low recovery rate, of interest income due to the increased non-performing assets. However, one is little sceptical in attributing the same reason for the foreign banks too, as the foreign banks are extremely choosy and selective of their clientele and thus operate in a 'niche market'. Besides, the low priority sector lending. In the case of foreign banks it is likely to be for a different reason; the relative importance of interest income itself is on the decline. This is supported by the fact that their income from lending as a proportion to total operating earnings has declined drastically (explained in detail in the next chapter).

From the preceding analysis it is amply clear that there were substantial differences between domestic bank groups and the foreign bank group in their financial profitability and the factors responsible. And the differences were observed to be too high in respect of ROA, NROA, RWF, per branch profit, output input ratio and spread ratio than the other measures (see Table 3.9). Surprisingly, even the domestic private sector banks are no way near the performance of foreign banks in terms of financial profitability. In fact, from our empirical analysis it is clear that the public sector banks are performing relatively better than the domestic private sector banks.

Table 3.9

Mean of Ratios at a Glance

Measures	Fbs	PSBs	OSBs
ROA	2.02	0.80	0.53
NROA	2.25	0.76	0.63
RWF	2.71	0.90	0.60
Elasticity measure	1.23	1.00	1.01
Output/ Input Ratio	1.32	1.11	1.07
Spread Ratio	0.29	0.14	0.15

Note : FBs = Foreign Banks
PSBs = Public Sector Banks
OSBs = Other Scheduled Commercial Banks

3.9 Earnings and expenditures to Assets :

It is worth examining the earning and expenditure on the total assets for their net impact on the profitability of different bank groups. This will throw light as to whether expenditure side or the earning side which contribute appreciably to the operating profit of the different bank groups. For instance higher ratio of earning to assets than the expenditure to assets means higher return on assets or higher profitability or wider the gap between these two ratios higher is the return on assets.

$$\textbf{Earnings to Assets} = \frac{\textbf{Total Operating Earning}}{\textbf{Total Assets}} * 100$$

$$\textbf{Expenditure to Assets} = \frac{\textbf{Total Operating Expenditure}}{\textbf{Total assets}} * 100$$

Our empirical results reveals that, the earnings to assets ratios show broadly a similar pattern among all the banking groups ie., both domestic and foreign banks over the period. The foreign banks however, show a slightly higher earning ratio on their assets as compared with the domestic banks almost through out the period under analysis. During the late eighties a slight shift could be observed in earning to assets ratios among all the banking groups (see Figure 3.3). It is worth noting that, the public sector banks (PSBs) despite being exposed to non-performing assets more than the other groups, always maintained higher ratios compared to the Indian private sector banks. However, the disquieting feature is that, though there was a shift towards the end of eighties the ratios literally remained constant during the major part of eighties for the PSBs. Although the fact remains that, it was in mid-eighties that a large number of diversification and innovations had taken place in banking, it is quite disappointing to note that the earning capacity of the assets particularly for the public sector banks has not improved.

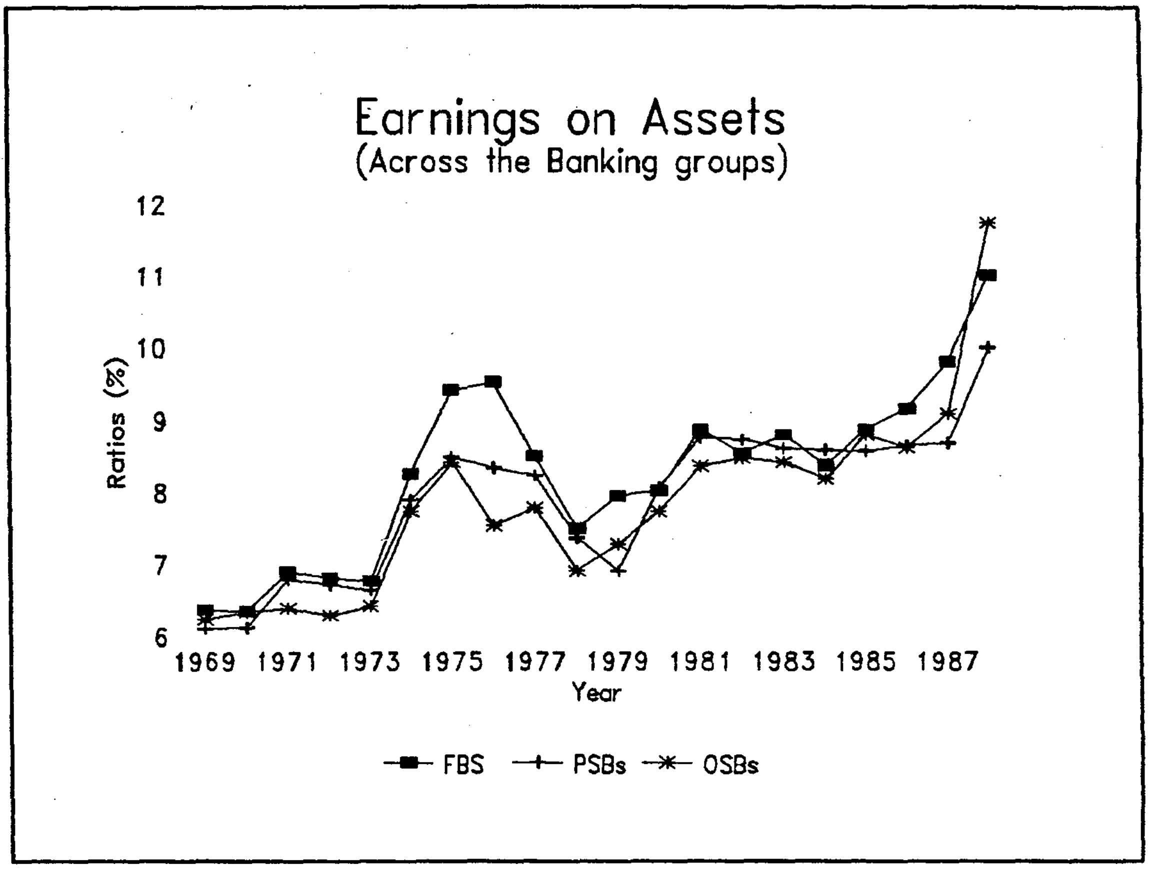

Figure 3.3

The operating expenditure as a percentage to assets among all the banking groups were also computed for the same period. It is interesting to note that, contrary to what was observed in the case of earnings ratio, the expenditure ratios were invariably lower for the foreign banks as compared with the domestic banks through out the period under study (see Figure 3.4). This makes amply clear that, it is the control on expenditure that plays a vital role in improving the net operating income or the operating profits of the foreign banks against the domestic banks. Thus the foreign banks are relatively more conscious in controlling their overall operating expenditures.

This only conforms and strengthens our earlier results of higher cost effectiveness for the foreign banks. The domestic banks both the public and the private sector showed closely similar pattern in the movement of the expenses ratios and their earning ratios (see Figures 3.3 and 3.4). They were also having equal ratios in some of the years. The higher expenditure ratios on the one hand and the relatively lower earning ratios on the other for domestic banks as compared with the foreign banks reveals that, though all the bank groups were conscious about their earning side, it is the expenditure side which play culprit in reducing the profitability among the domestic banks. This is further clear from the result that, the gap between the foreign and domestic banks in respect of expenditure ratios were significantly higher than the gap observed in the case of earning ratio (see Figure 3.3 and 3.4). Thus the lesser control over operating expenditure will definitely have an adverse effect on their profitability. The major noticeable difference was that, though the ratio of earning to assets and expenditure to assets was on the increase, during major parts of the period, in respect of all the bank groups the expenses ratio moved at a much lower phase than the earning ratios for foreign banks and in respect of domestic banks it is the other way round ie., the expenses ratio were moving at a higher phase. One could definitely find reasons in attributing broadly this tendency to be a contributory factor for the differential performance in profitability among the foreign and domestic banks.

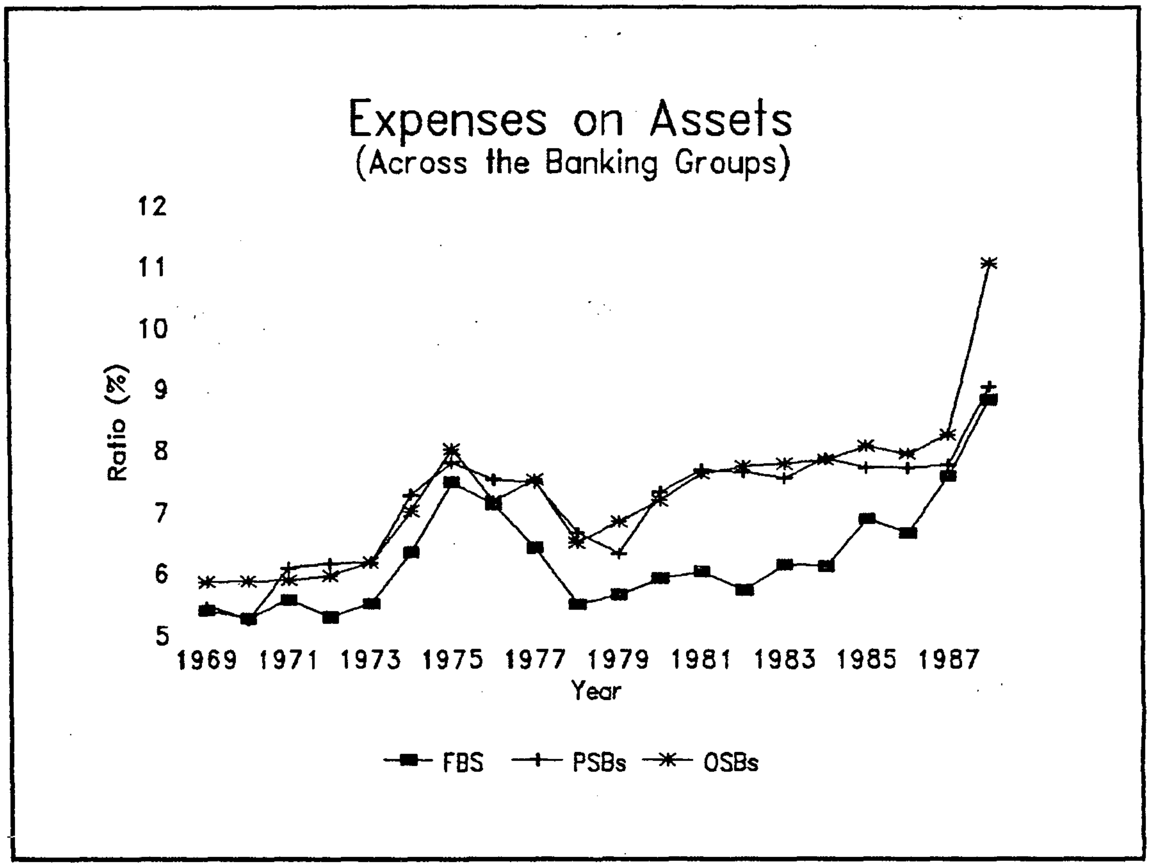

Figure 3.4

It is further confirmed by the computation of Coefficient of Variation (C V) for total operating earnings and total operating expenses for all the groups of banks. Table No 3.10 shows that the Coefficient of Variation in respect of foreign banks for total expenditures is higher. Which explains that, it is the variation in expenditure that explains the variation in the net operating income or operating profit as the case may be, more than the variation in operating income. That means the foreign banks are managing their expenditure according to the movement in their earnings more efficiently. This again confirms our earlier results that the foreign banks control their overall expenditure more efficiently. As against this the domestic banks show almost the same value of C V for both expenditures and earnings, not surprisingly similar is the case for both the public sector and private sector banks (see Table 3.10). Thus one could reasonably conclude that though the variation in both earnings and expenditures play equal role in respect of domestic banks they are not likely to have effective control over expenditures as much as the foreign banks.

Table 3.10

Co-efficient of Variation (C V)

Bank Groups	Total Operating Expenses	Total Operating Income
FBs	1.02	0.99
PSBs	0.99	0.99
OSBs	0.77	0.77

Note : FBs = Foreign Banks
PSBs = Public Sector Banks
OSBs = Other Scheduled Commercial Banks

Source: Computed based on the Statistical Tables Relating to Banks in India, RBI

Thus it is high time that the domestic banks, both private and public sector banks, give more thought to control their total operating expenditures and improve their profitability.

Growth rates and Acceleration tests :

Apart from the above analysis we had also attempted to compute the growth rates and acceleration tests for some of the crucial variables and indicators discussed above. We had fitted various functions such as linear, exponential, quadratic and log quadratic functions to capture growth rate and test if the growth rates are accelerating or decelerating. However, we found the data suffered with serial autocorelation explained by a very low D W value. In an attempt to minimise this problem we have used various techniques such as Cochrane Orcutt two stage method, CORC Iterative process, Prais Winston Iterative process, Prais Winston two stage method etc.,. Though, we could minimise the problem of autocorelation, we could not arrive at a meaningful result as the explanatory power of time (referring to growth over time) was too little with very less R^2 and the T-stats value becoming statistical insignificant. Therefore we decided not to include them as a part of this analysis.

To sum up, from the above analysis based on the crucial ratios used, it is amply clear that the foreign banks out do the domestic banks in general with respect to financial profitability. As hypothesised by us, both internal and external factors does play a crucial role for the differential performance of domestic and foreign banks. As cited elsewhere the external factors including various policy measures such as the branch expansion policy, interest rate policy, policy on priority sector lending, and even the policy on deposit mobilisation does seem to be affecting quite favourably the foreign banks as against domestic banks in general. Besides, they have locational advantage. Thus the external factors in general and the policy factors in particular had quite likely contributed handsomely to the differential performances of the foreign and domestic banks favouring the former more than the latter.

Besides the above mentioned external factors, the fast changing general economic environment (or the market condition) which is quite conducive to absorb the innovative products and services introduced by the foreign banks without much effort (otherwise the stiff competition that these banks had to face in their respective parent country or elsewhere in the developed world). In this context, it may be reminded that the foreign banks were the forerunner in introducing several of the innovations and instruments in the commercial banking[13] (which later became common products among domestic banks in varied form and varied degree) because of their long standing experience in the developed countries' markets.

The internal factors such as efficient cost control, cash management, efficient overall asset and liability management, timely diversification of the business had played a crucial role for their better performance. Besides, the high level of automation led to higher economies of scale and the likely higher economies of scope[14] due to variety of services (which we were unable to capture these aspects precisely, through any definite measure in the above analysis) we logically believe, had contributed to their better performance in profitability.

Coming to within the domestic banks ie., between the public and private sector banks the Indian private sector banks were performing badly as indicated by all the parameters in our forgoing analysis. But, it seems the domestic banks, irrespective of private or public sector banks, function with broadly similar strategies and style. The above analysis further puts us to think whether the domestic banks in general, irrespective of private or public sector, were equally exposed to the vagaries of the external factors unlike the foreign

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13 D G Gupte (1993)

14 "Economies of scope refer to cost savings from simultaneously producing several outputs in the same firm rather than producing each output separately in a specialised firm".

banks operating in the country or they are equally inefficiently managed.

We are able to make ourselves clear from the above analysis on the different profitability performance between the foreign and domestic bank groups and the likely factors, both internal and external, which were affecting for such differences. However, it is worth examining the specific area and nature of business and their relative importance to each bank group, from the point of view of their total operating earning and total operating expenditure for its net impact on their profitability performance.

CHAPTER 4

Decomposition Analysis of Current Operating Earnings and Expenditures Among Foreign and Domestic Banks

4.1 Introduction:

From the analysis carried out in the previous chapter it was amply clear that the foreign banks are performing better than the domestic banks in terms of financial profitability at the aggregate level. However, it is worth while to have further insights relating to the specific area of operations which make for the difference in performance among these banking groups. Towards this end, we have attempted in this chapter an analysis of total operating earning and the total operating expenditure by the method of decomposition. This is carried out by taking the proportion of each major item of operating earning and expenditure to their respective total operating income and expenditure. For, this will reflect directly or indirectly the nature of business each banking group is carrying out and their relative importance to them. While attempt is also made to explain them by relating with the internal and external factors likely responsible.

4.2 Analysis of Earnings;

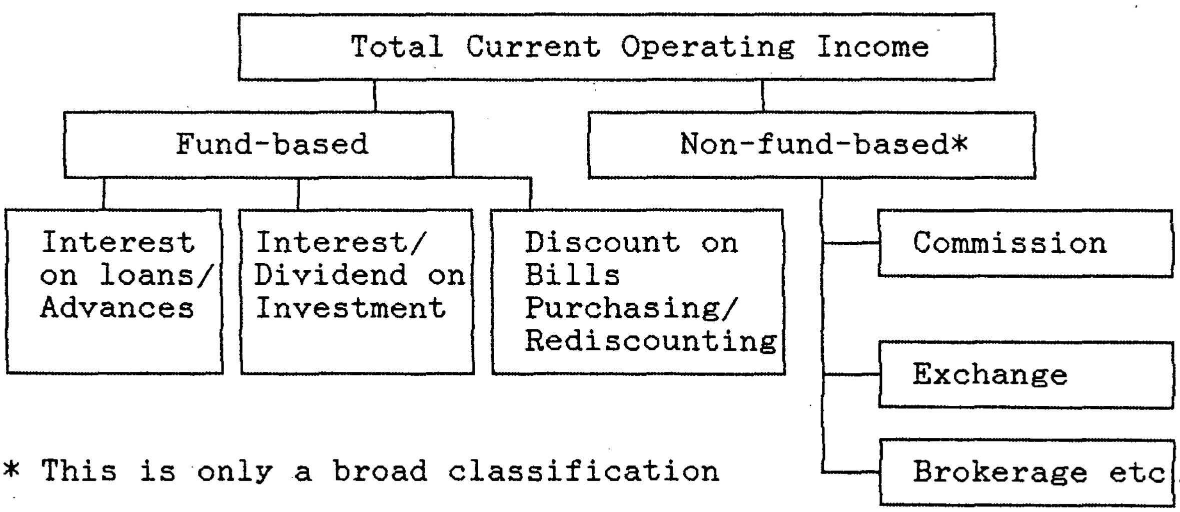
Banks earn their income through numerous services, either with or without the direct involvement of their funds. Based on this idea the total operating income has been broadly classified into fund-based[1]

[1] Fund-based income includes income from loans/ advances, investment and bills purchasing and discounting where the earnings involve the investment of funds of the banks.

and non-fund-based[2] as depicted in the flow chart.

In respect of the foreign banks a clear shift from the proportion of fund-based to non-fund-based income in the total operating income was observed towards the late seventies (see Figure 4.1). This partly indicates their dynamism in diversifying their business from the traditional banking to more, fee-based sources of income. In fact this has been the international trend too. And the compulsion of the limited availability of funds unlike the domestic banks. Further, such diversification of their activity does carry several advantages; involving lower operating cost, more importantly the least risk of assets becoming non-performing nature. Besides, the directed investment and the directed credit obligations are also reduced (this in turn relieves them investing their funds in less rewarding source). As against this, the domestic banks showed increase in the proportion of fund-based-income, reflecting their predominant reliance on the traditional banking.

Flow Chart



* This is only a broad classification

[2] Non-fund based income refers to total current operating income minus the fund-based incomes. Which includes fees, commission exchange etc.,.

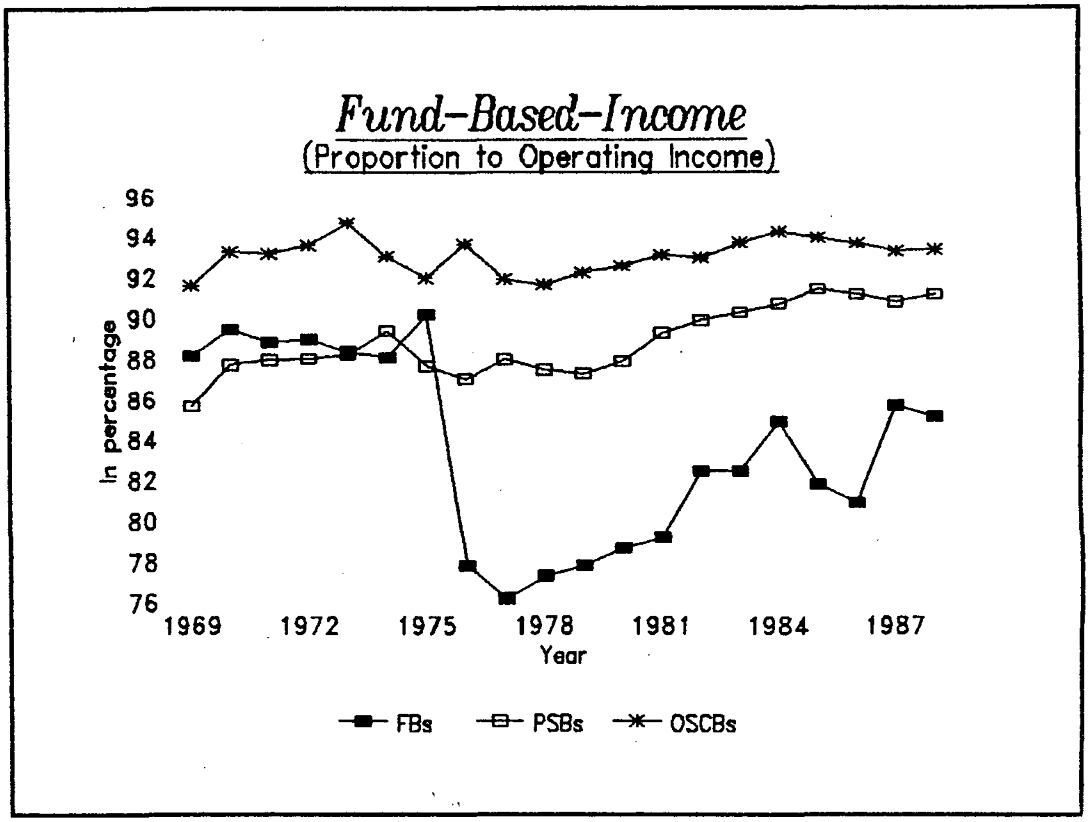


Figure 4.1

The above tendency has been further examined by taking into account each major item of operating earning.

Interest income from loans/ and advances is one of the major items of operational earning for all the banking groups in general. We have examined its contribution to total operating income. This will explain, apart from their relative importance, whether shifts or diversification had taken place from the direct lending to other sources or areas. The proportion of income from the loans/ advances to operating income with respect to foreign banks was as high as 60.9 per cent in 1969 which declined to a mere 33 per cent in 1988. The decline was more prominent during the eighties (see Figure 4.2). This would imply that the foreign banks were quick enough to diversify their source of earnings. The other compelling reason was the limited availability of funds due to their small branch network. It is evident from our results that, the domestic banks are, by and large, dependent on the traditional source of income ie., lending. In respect of the other scheduled commercial banks also, this proportion showed decline from 63 per cent in 1969 to 51.6 per cent in 1988. However, for more than fifty per cent of their operating income, they had to still depend on this source. The public sector banks showed a marginal decline in their proportion of income from loans to total operating income over the years; but it still hovering around 58 per cent. It is quite obvious for the domestic banks, in general, to have higher dependency on the primary business of lending for several reasons. Unlike the foreign banks, the domestic banks are spread far and wide across the country, and other than the big towns and the metropolitan cities, what is largely expected of from the commercial banks are the primary service of lending more than the other upcoming services and products. Besides, since the domestic banks in general, and public sector banks, in particular, were given the onerous responsibility of playing as catalytic agent in the socio-economic development. And given the low level of economic development the direct lending takes the precedence of all other activities of the commercial banks. Within the lending activity the compulsory attainment of higher credit-deposit ratio and the priority sector lending are few of factors to be worth mentioning. Though they all serve the holistic purpose of extending credit to the sectors hitherto neglected, it leaves with little leverage for these banks to deploy the funds according to their commercial expediency or diversify their activity.

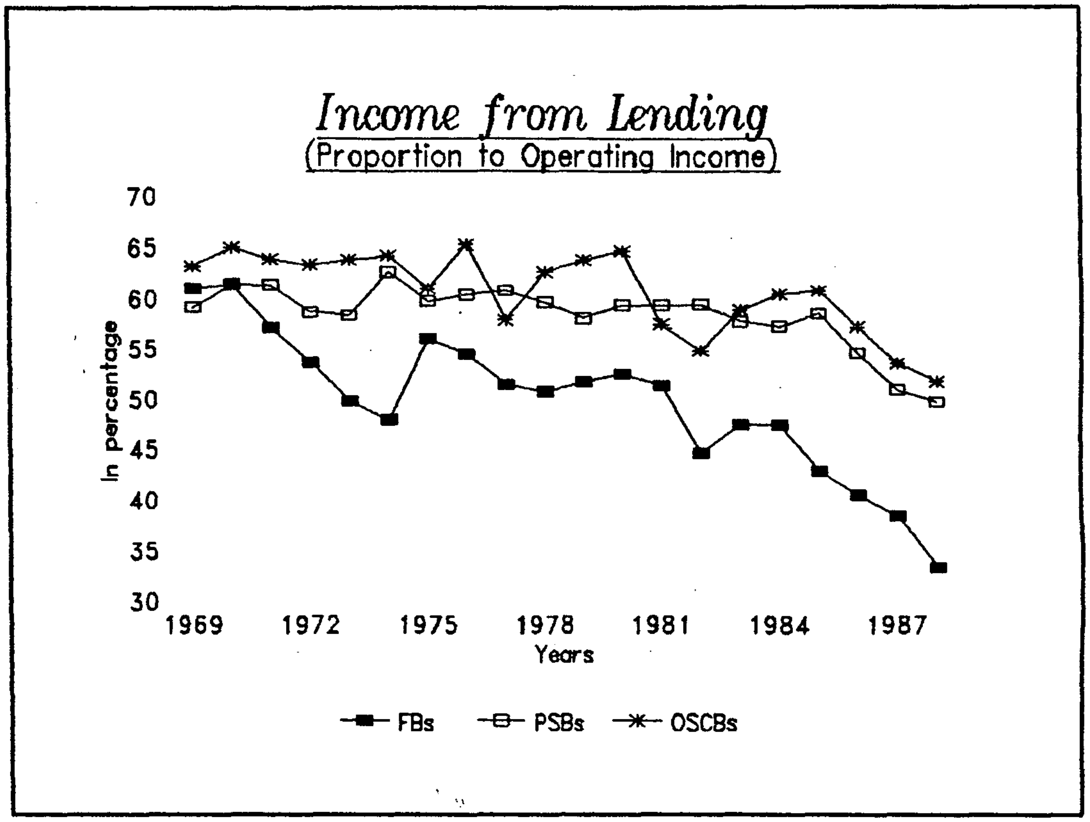


Figure 4.2

The second important item of income for all the bank groups is from investment largely because of the compulsion of directed investment. Some times out of expediency banks also does invest in securities more than the requirement of the Statutory Liquidity Ratio (SLR) and Cash Reserve Requirement (CRR) and this tendency seems to have taken some new direction in recent years. In the wake of the security scam, it would be pertinent to look into this trend, unfortunately the detailed data are not available after 1988. The empirical result shows that the proportion of income from the investment to total operating income has increased, and a clear upward shift could be observed from the eighties for all the bank groups (see Table 4.1). With respect to foreign banks the proportion of income from the total investments to their total operating earning were always less than the domestic banks. It increased from 12.57 per cent in 1969 to 20.8 per cent in 1988 with mild fluctuation in between.

Table 4.1

Income from Total Investments as a Proportion to Total Operating Income

(In percentages)

Year	FBs	PSBs	OSBs
1969	12.57	15.71	15.75
1970	12.73	15.54	16.07
1971	12.12	14.99	16.50
1972	13.67	16.87	17.27
1973	15.39	18.05	16.67
1974	12.46	12.98	13.27
1975	12.10	13.30	12.65
1976	12.42	14.40	13.38
1977	13.15	15.27	13.41
1978	13.20	17.51	15.72
1979	13.70	18.05	15.10
1980	13.17	16.75	14.82
1981	11.76	18.66	23.02
1982	17.22	20.41	26.17
1983	12.82	21.45	21.87
1984	12.76	21.26	19.75
1985	12.49	19.40	18.68
1986	14.29	22.42	21.56
1987	19.35	26.66	24.50
1988	20.80	27.75	26.79

Note: FBs = Foreign Banks
PSBs = Public Sector Banks
OSBs = Other Scheduled Commercial Banks

Source: Computed based on Statistical Tables Relating to Banks in India various volumes. RBI, Bombay

The domestic banks were however, having quite a high proportion of their income from the investments as compared with foreign banks. And also it showed closely similar pattern between the public and private sector banks thus implying similar investment strategy. For public sector banks it increased from 15.71 per cent in 1969 to as high as 27.75 per cent in 1988 with fluctuation. One plausible reason for the higher proportion of income from this source is their relatively higher proportion of assets in investments. In respect of Indian private sector banks the proportion of income from investment has moved up from 15.75 per cent in 1969 to 26.79 per cent in 1988. We must however, remember that the banks have little leverage in the proportion of their investment of funds in the securities and some times the choice of securities because of 'captive market' for the government securities and public sector bonds. This is more so in the context of the high percentage of CRR and SLR requirements. Further, as the proportion of income from investment is closely depended on the pattern of investment, we had attempted to look into this aspect.

4.1.2 Investment pattern :

Since the earnings from the total investments for a bank is an important item of operating earning it is worth looking into the investment pattern among the banking groups. Within the available data in this area, we have taken the proportion of earnings from Government and private trust securities to earnings from the total investments. For, this would bring an insight into different type of securities and their relative share contributed to the total earnings from investment. This would ultimately reflect how each bank group attempts to maximise their earning from the investment by a proper mix of different securities.

We observed that the proportion of earning from the Government securities were quite high for all the banking groups in general (see Figure 4.3). However, conspicuously, for the foreign banks the trend was wildly fluctuating.

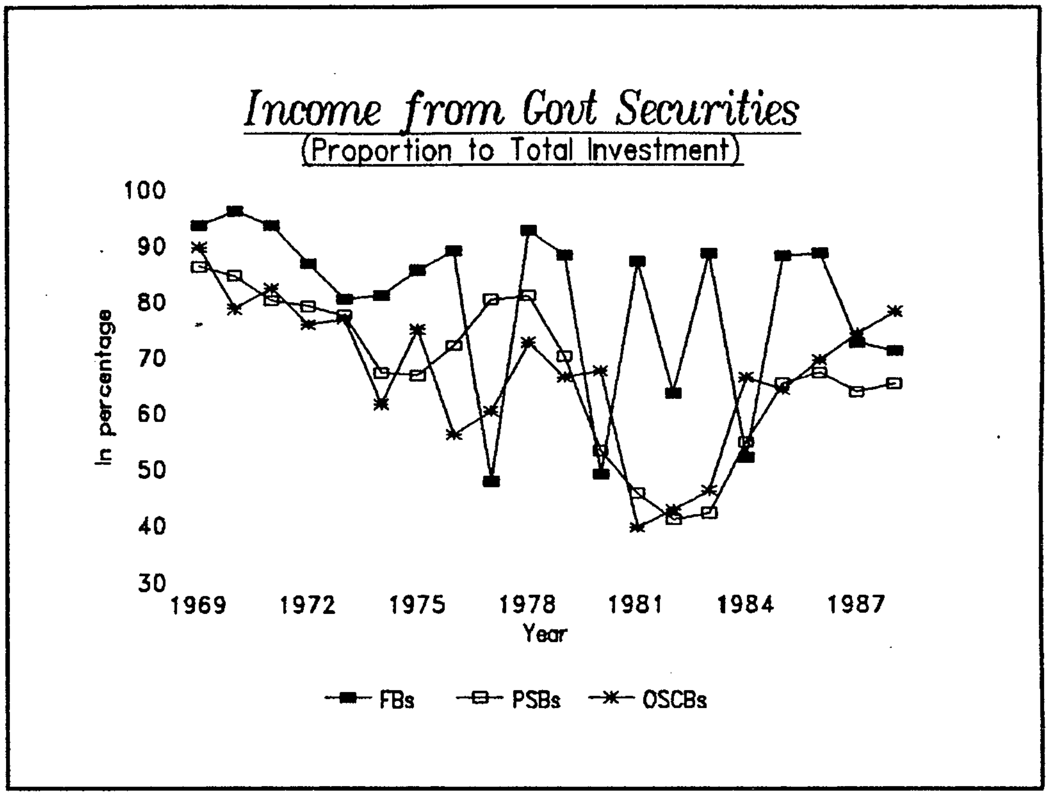


Figure 4.3

It is known that the return on investment in government securities are generally lesser than the other sources as the Government borrows at subsidised rates of interest through captive market. And which are far smaller than the income from loans and advances and even the interest rates paid on fixed deposits[3] nevertheless banks cannot escape from this obligation. Therefore, the foreign banks seem to be more efficient in managing the overall investment by efficiently substituting between the private trust and the Government securities, on the basis of commercial expediency, so as to yield higher income from this source. Not withstanding the external factor permitting banks to take active participation in the securities market also equally matters (such operations are restricted to only investment banks in many of the developed countries, including the United

[3] Birla Institute of Scientific Research (1981)

States). In respect of domestic banks the proportion of earnings from Government securities showed almost similar pattern for both public and private sector banks. Towards late eighties an upward shift was observed in respect of both of these banking groups. Which again conformed that the domestic banks in general, irrespective of public or private sector, adopt nearly similar investment strategies.

The income from bills discounting/ purchasing formed a third major item. In respect of foreign banks, the proportion of income from bills to their total operating income, as expected and as brought out by the previous studies, had been higher than the domestic banks. It increased from 12.6 per cent in 1969 to as high as 26.3 per cent at times, with a temporary decline in mid seventies (see Figure 4.4). During eighties a clear upward trend and a steady increase was observed. It may be remembered that historically foreign banks role in bill financing were too prominent and it was their monopoly especially in foreign trade bills (explained in detail in chapter 2). As the risk of funds getting locked up for a longer period is fairly low in bill financing because of its self liquidating nature, and hence quick rotation is ensured. Therefore foreign banks find this source of earning more lucrative. Moreover, as these banks are located in big commercial centres it facilitates them to concentrate on this area of business. The domestic banks on the other, both public and private, were having a very low proportion of their income from bills to their respective total operating incomes. And they were on the continuous decline since mid seventies and noticeably during the eighties, further they also showed a similar pattern.

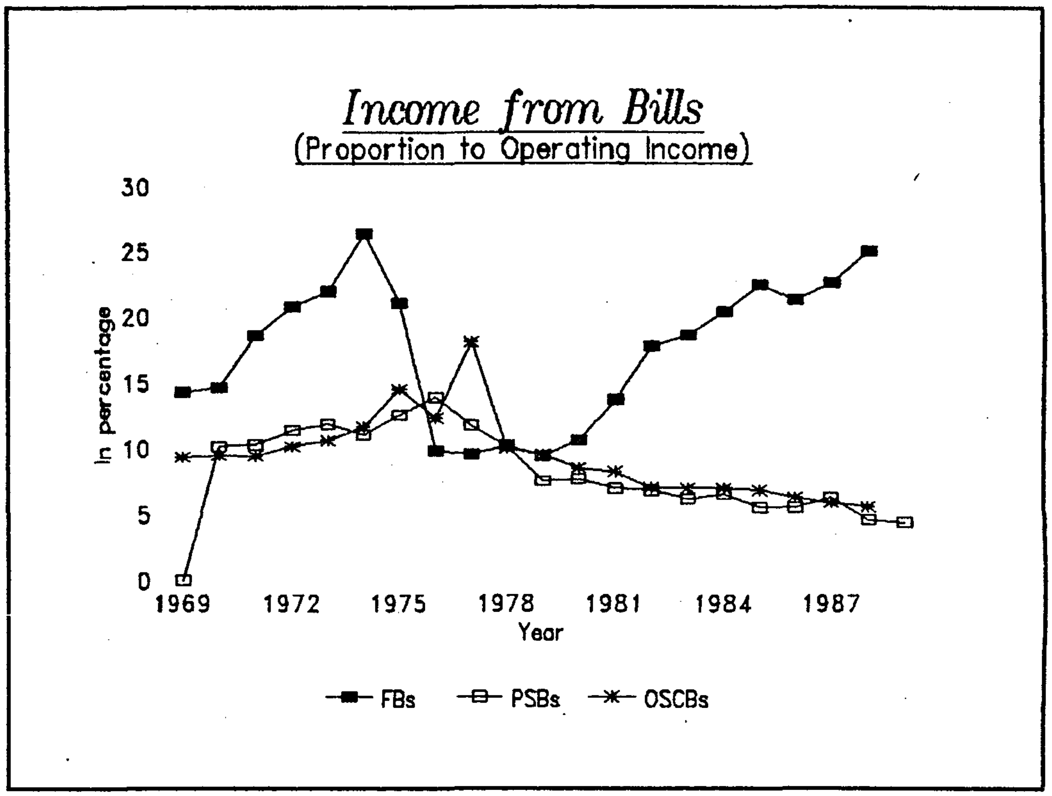


Figure 4.4

Since the foreign banks are facilitated with the <u>worldwide branch networks</u> they are expected to have higher income from the transactions relating to the foreign business[4]. Obviously, one could expect this item to contribute quite handsomely to their total operating earnings and thereby to their profitability also. Therefore we have taken this item of earnings, although in general this is not a major source, for all banking groups. The proportion of income from this source was quite high, as expected, ranging between 2.46 per cent in 1972 and 20.06 per cent in 1977 for foreign banks. However, they showed a declining trend during eighties. It may be mentioned that one of the reasons presumably, to allow the foreign banks to operate in India is that they would do well in transactions relating to foreign business

[4] Transactions relating to foreign business as defined in the Statistical Tables Relating to Banks in India, RBI and the precise components are not known.

and foreign investment through their well connected worldwide branch network. With respect to the domestic banks the proportion of income from the foreign business transactions were far lower. Though the Indian banks, particularly the public sector banks, are fairly well represented abroad with branch network it still did not seem to have contributed much to their earnings. For the public sector banks the proportion was hovering around 1 to 2 per cent. In respect of the Indian private sector banks the earnings from foreign business as a proportion of their total operating earning were higher than the public sector banks, ranging between 1.15 per cent in 1973 and 4.41 per cent in 1978.

From the above analysis it is clear that the foreign banks are diversifying their income from fund-based source to non-fund source, though the major source of income are still the fund-based business. This tendency helped them to increase the earnings with the limited funds at their disposal on the one hand and with higher cost effectiveness. On the other the domestic bank groups were by and large dependant on the fund-based income.

The proportion of income from direct lending as loans/ advances to total operating income has drastically come down over the years. But the income from bills discounting/ purchasing substantially increased, this indirectly explains foreign banks business being increasingly concentrated in financing the trade and industrial sector. While for the domestic bank group the proportion of loans/ advances and investments were high but the proportion of income from bills were meagre. The composition of investment basket is highly concentrated with the Government securities for the domestic banks as against, a random mixture of all type of securities for the foreign banks. This explains that the foreign banks manage their pattern of investment so as to maximise their overall operating earnings.

Not surprisingly the income from the transactions relating to the foreign business was also much higher for foreign banks than the domestic banks. This may be due to their well connected branch network across the world.

4.3 Expenditure Analysis:

We have also carried out a similar analysis with respect to the major items of operating expenditures, that would throw light on the precise item of expenditure that each banking group attempts to control or minimise in order to maximise their profit. For this purpose we have broadly categorised the total operating expenditure as interest expenditure[5] and non-interest expenditure[6], as the nature of these two expenditures differ widely and has different significance for the functioning of banks.

The proportion of interest expenditure to total operating expenditure has been increasing for all the bank groups. Among the bank groups the proportion was lowest for the foreign banks almost throughout the period of analysis. The principal reason is that their fund-based business, as we had seen earlier, is relatively smaller

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[5] Interest expenditure includes interests on loans/ advances, borrowing, and rediscounting,

[6] Non-interest expenditure refers to total operating expenditure minus the interest expenditure. The establishment expenditures and other working expenditure constitute the major items.

than the rest of the bank groups though, still the fund-based business are the major area of business. Among the domestic banks the proportion of interest expenditure in the total operating expenditure was lower in respect of public sector banks only for a shorter period during early seventies. Then onwards it took an upward shift and a steady increase in the trend which exceeded the proportions for the Indian private sector banks. In respect of Indian private sector banks it was increasing, but at a very slower phase (see Figure 4.5). It may be stressed that the controlling of interest expenditure has relatively limited options, as it warrants various aspects of business to be taken in to account, such as fund-based or non-fund-based business, composition of funds, composition of deposits, the overall asset and liability management of the banks and in fact the whole gamut of fund management. Though an increasing trend in interest expenditure was observed in respect of all the bank groups, the foreign banks seem to be relatively more efficient than the domestic banks in controlling their proportion of interest expenditure.

It is worth noting that the trend in the proportion of non-interest expenditure to their respective total operating expenditure for all the bank groups showed decline. However, it was relatively higher for the foreign banks.

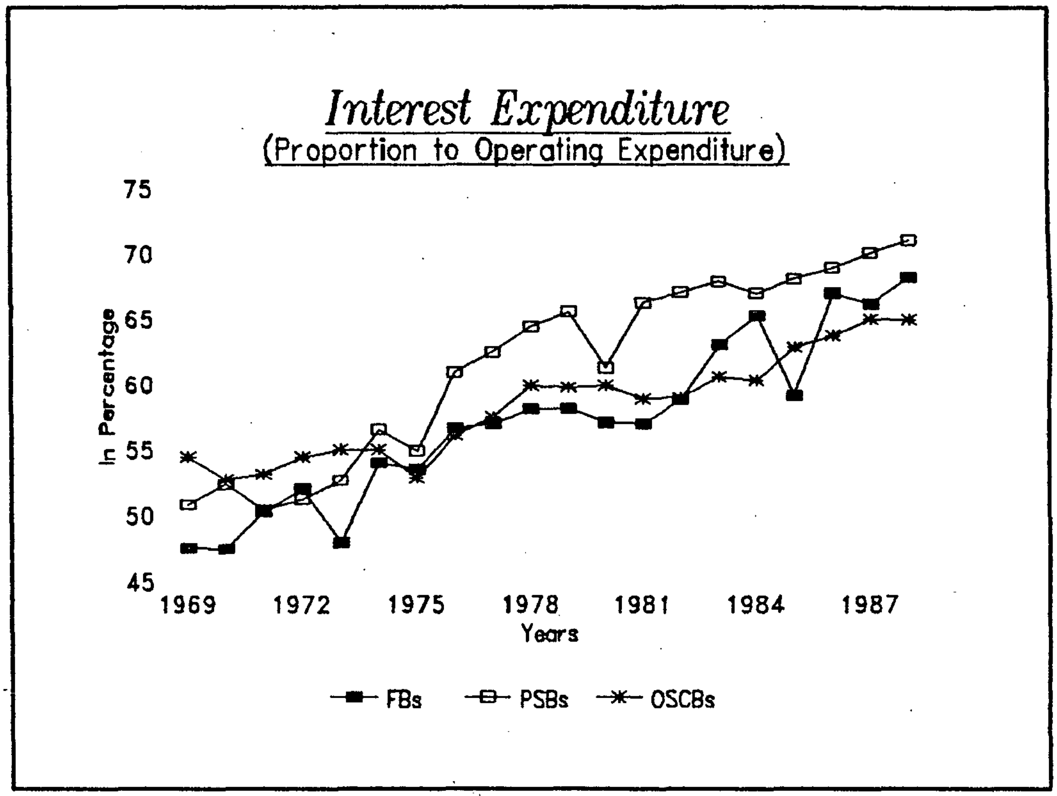

Figure 4.5

The item-wise analysis of the major operating expenditures of both interest and non-interest nature are done for further insights. The proportion of operating expenditure spent as interest paid on deposits formed the major item for all the banking groups in general but, was lowest for the foreign banks almost throughout the period. It moved within the narrow range of 40.8 per cent and 49.7 per cent (see Table 4.2). The obvious reason is their limited branch network which imposes a constraint on their capacity to mobilise deposits. Though, deposits are still a major source of funds for the foreign banks too, it is not as big a source as it is for the domestic banks. Also as highlighted by the earlier studies[7] the composition of deposits consisted of higher proportion of current deposits than the savings deposits which would in turn reduce the interest burden. The

[7] A K Nag and K Shivaswamy (1990):

lesser burden of interest payment would consequently result in increasing the operating earnings and profitability. While for the domestic banks the proportion of interest paid on deposits is very high and were on the increase. For the public sector banks it increased from 48.61 per cent in 1969 to 61.21 per cent in 1988. And for the Indian private sector banks it increased from 53.20 per cent in 1969 to 60.2 per cent in 1988 with occasional fluctuation (see Table 4.2).

Table 4.2

Interest on Deposit as a Proportion to Operating Expenditure

(In percentage)

Year	FBs	PSBs	OSBs
1969	41.55	48.61	53.20
1970	41.19	48.68	50.71
1971	40.82	47.10	51.37
1972	48.91	49.70	52.26
1973	45.54	50.50	52.32
1974	42.38	50.82	51.88
1975	44.46	50.74	50.18
1976	48.53	52.21	50.73
1977	49.31	54.89	51.74
1978	49.70	59.40	55.49
1979	49.46	59.22	56.69
1980	45.07	58.60	56.88
1981	45.36	57.61	54.20
1982	45.09	58.20	55.94
1983	47.07	59.43	57.60
1984	47.63	59.41	56.80
1985	39.23	60.56	58.43
1986	45.49	61.39	59.73
1987	43.91	61.71	60.90
1988	47.11	61.21	60.27

Note : FBs = Foreign Banks
PSBs = Public sector Banks
OSCBs = Other Scheduled Commercial Banks

Source: Computed based on Statistical Tables Relating to Banks in India, various volumes, RBI,

Among the domestic banks they showed closely similar pattern in the trend. For the public sector banks the proportion was lower than the

Indian private sector banks until the mid seventies. However, thereafter it exceeded the Indian private sector banks for almost throughout the period. It is worth mentioning here that, this was also the period were the domestic banks involved in expanding the branch network to reach out banking to all parts of country and all sections of society.

In the process the domestic banks did not seem to have given much thought to the composition of deposits, which matters for the profitability of banks[8]. Incidentally it may be pointed out here that, <u>the policy stress itself is more on inculcating the banking habits among all the sections of society rather than the type of deposits which the domestic banks should concentrate.</u> Here we underline that, it is not our intention to judge whether such a policy is right or wrong but to highlight how does it matters from the point of view of profitability of the banks. It is also worth mentioning here that, as brought out by the earlier studies[9], the composition consisted of largely savings and term deposits. Foreign banks seem to be not only particular about the type of deposits and type of clients but also the size of deposits, as all these are important from the point of view of minimising the interest cost.

The trend in the proportion of operating expenditure spent on the borrowing showed almost no definite pattern for any of the bank group in general. Interestingly for foreign banks it was observed to be higher during the major of period of analysis, and occasionally too high. It varied between 2.34 per cent in 1973 and 11.56 per cent in

[8] Hester and Zoellner (1966)

[9] A K Nag & K Shivaswamy(1990)

1974. This explains; foreign banks resorting to borrowing on a large scale due to dearth of funds available through the deposits. This is also supported by their higher proportion of funds borrowed to their total liabilities (see Table 4.3). Among the domestic banks the Indian Private sector banks showed lesser proportion of their operating expenditure being spent on the borrowing, ranging between as low as 1.14 per cent in 1969 to occasionally 5.01 per cent in 1977 (see Figure 4.6). And for the public sector banks it varied between the lowest of 1.48 per cent in 1972 and as high as 7.87 per cent in 1988 (see Figure 4.6). It only explains that, unlike the foreign banks the domestic banks in general resort to the borrowing on a lesser extent. This has also been supplemented by their lesser proportion of borrowing to their total liabilities (see Table 4.3).

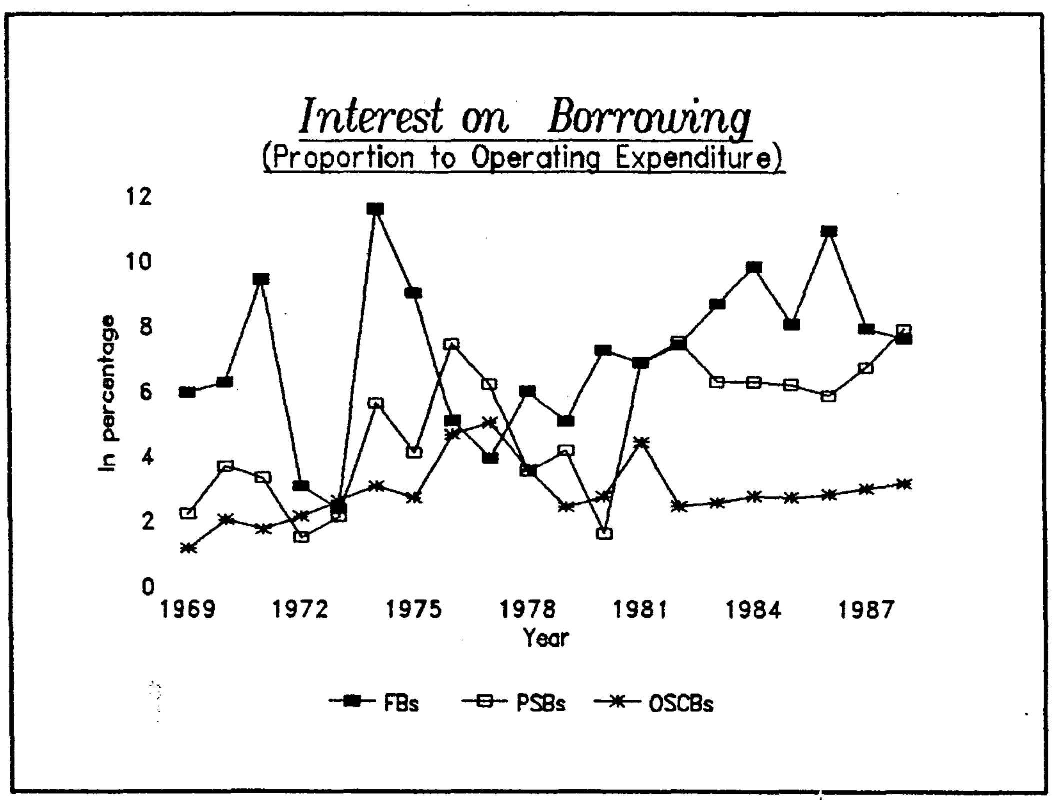

Figure 4.6

Table 4.3

Borrowing as proportion to Total Liabilities (In percentage)			
Year	FBs	PSBs	OSCBs
1969	6.14	2.64	1.61
1970	8.24	5.45	2.19
1971	4.88	3.07	2.36
1972	6.51	1.62	2.17
1973	6.58	3.71	3.60
1974	6.55	3.57	2.17
1975	5.36	5.23	2.56
1976	5.89	6.30	4.12
1977	7.35	4.95	3.44
1978	5.44	3.75	2.69
1979	7.40	4.20	2.37
1980	6.81	4.30	1.97
1981	3.58	4.65	2.32
1982	8.34	5.65	2.20
1983	9.66	5.74	2.83
1984	9.98	6.29	2.92
1985	10.69	5.77	3.32
1986	9.06	5.11	3.56
1987	9.50	6.51	3.55
1988	11.69	7.28	4.06

Note : FBs = Foreign Banks
PSBs = Public sector Banks
OSCBs = Other Scheduled Commercial Banks
Source: Computed based on Statistical Tables Relating to Banks in India, various volumes, RBI,

With the amendments to the section 17(2)(a) of the RBI Act, the provision allows for rediscounting only genuine bills with the rediscounting agents unlike in the past where a portion of cash credit could be converted as usance bills and rediscounted. The foreign banks seem to be using this bills rediscounting facilities to the maximum unlike the domestic banks. This is reflected in their steadily increasing trend in the proportion of rediscounting charges in total operating expenditure from 3.05 per cent in 1976 to 13.44 per cent in 1988 (also higher proportion of income from bills discussed elsewhere). This however involves them low cost of funds on the whole. As the foreign banks are highly selective in their dealings they were likely to be possessing more of eligible bills that facilitate rediscounting. Domestic banks however, incur low proportion of their expenditure on this item, explaining that they resort to rediscounting facilities to a lesser extent. Further, among the domestic banks the Indian private sector banks have very low proportion of their expenses on this item. It was hovering around less than 2 per cent for the public sector banks and for Indian private sector banks it varied between 0.22 per cent in 1981 and 1.63 per cent 1985. For, they involve to a lesser extent in the food procurement credit and defence packing-cum-supply credit (which involves discounting and rediscounting of bills) unlike the public sector banks.

Thus, the lower proportion of interest expenditure in total operating expenditure for the foreign banks are purely on account of lower proportion of expenditure being spent on the deposits unlike the domestic banks. This only supplements our claim that the foreign banks' dependency on deposit as source of fund is low. However, they also manage the funds relatively more efficiently to minimise their overall interest expenditure.

Among the non-interest expenditure the establishment expenditure constituted the major and important item of operating expenditure for all the bank groups. The establishment expenditure includes salaries and wages to employees as major component. In respect of foreign banks, the proportion of establishment expenditure to their total operating expenditure besides being lower than the domestic banks, were on steady decline (see Figure 4.7). As a substantial portion of this expenditure includes wages and salaries paid to the employees, it is likely that the proportion of expenditure on wages and salaries is also on the decline. This is possible for the foreign banks because, their recruitment pattern consists of higher officer employee ratio. And they also recruit more of specialists but less of total number of employees to extract higher labour productivity. Besides, of course higher technological adoption and application in their operation, both are expressed in terms of higher economies of scale[10]. Their conscious control over the establishment expenditure goes in line with our earlier finding of their higher cost effectiveness. It may be stressed that control on the establishment expenditure is a necessity to increase the net return.

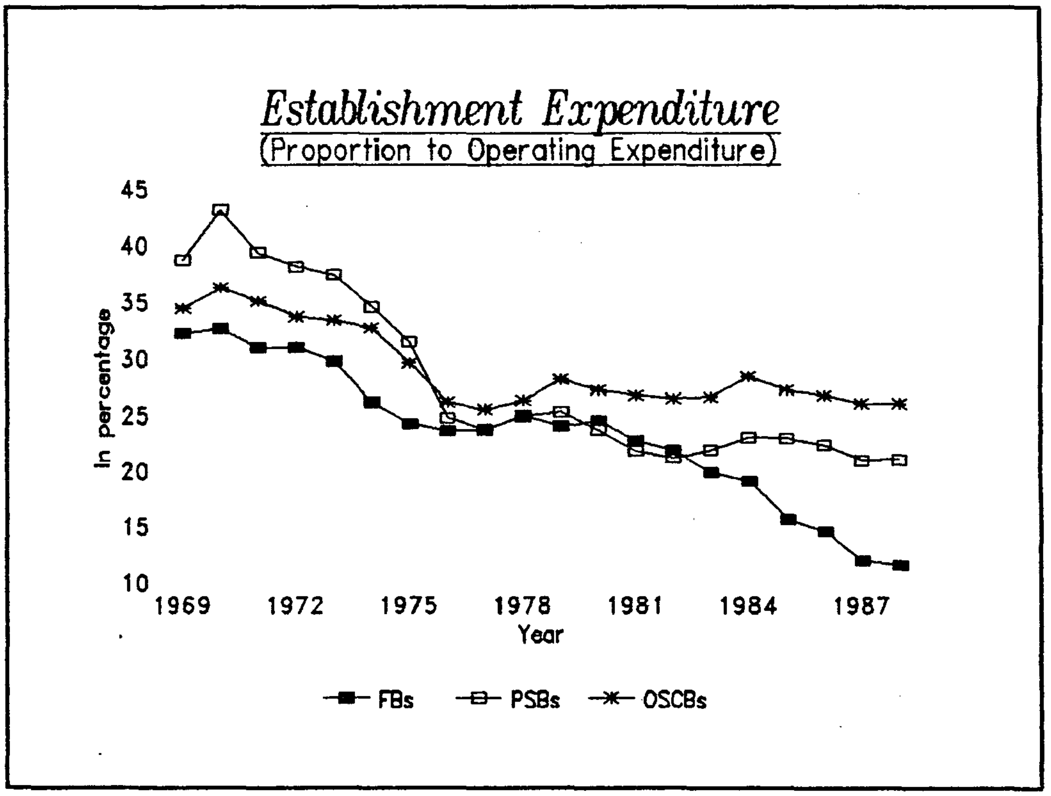

Figure 4.7

With respect to domestic banks, their proportion of establishment

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[10] Angadi V B (1990), Dobby (1993)

expenditure were higher than the foreign banks in general. Quite surprisingly, for public sector banks though their proportion were higher (as they are extremely larger in size with a very large labour force) than the foreign banks they showed a continuous decline through out the period of analysis, specifically during the eighties(see Figure 4.7). Further it is worth noting that, they were lower than the private sector banks. This tendency in the proportion of establishment expenditure to their total operating expenditure questions the widely prevailing perception among the scholars and the practical bankers, that the low profitability among the public sector banks are mainly due to their highly increasing proportion of establishment expenditures to their total expenditure or earnings. While the other scheduled commercial banks or the Indian private sector banks showed a very high proportion of establishment expenditure, particularly during the eighties, which looks quite disturbing. It only strengthens our earlier finding that the Indian private sector banks has lesser control over the expenditure in general despite having less constraints unlike the public sector banks. And now that, it is explicit, the higher proportion of the establishment expenditure in total operating expenditure could be a strong reason for their low profitability.

It is also worth mentioning here that, because of higher officer employee ratio, the foreign banks generally have lesser trade union problems. This obviously matters for the smooth functioning of these banks, which in turn improves their overall efficiency and therefore profitability. However, we are unable to explain the extent of impact of this factor on the profitability performance of the foreign and domestic banks. Further, it is known that foreign banks are highly diversified from the traditional banking to new areas than the domestic banks in general. This has been facilitated by giving foreign banks, the freedom to design their recruitment pattern to include specialised personnel (such as merchant bankers, management experts, chartered accountants etc.,.) unlike the domestic banks where the recruitment is centralised and the policy is more tilted towards the general labour.

Similarly the foreign banks also have very high proportion of their total operating expenditure in the nature of other working expenditure. It ranged between 11.55 per cent in 1984 and as high as 20.30 per cent in 1987. Though the composition of this expenditure is not known, it could fairly be presumed that they are more incidental to the business operation. If it is so it only reflects the extent that foreign banks giving importance to the promotional aspects of their business or it might be directly related to those transactions involving non-fund-base business. It may be recollected here, that the higher proportion of non-interest expenditure, as observed earlier in respect of foreign banks, is mainly due to the higher proportion of other working expenditure. In respect of domestic banks this item of expenditure constituted relatively lesser proportion in general. It was hovering around 7 and 11 per cent respectively for the domestic public and private sector banks.

In sum there are certain subtle differences in the areas and types of operations between the foreign and domestic banks. It is also made clear on the relative importance of each major source of earning and expenditure among the bank groups. This is reflected in the differential composition of earnings and expenditures across the bank groups. Which in-turn affects the profitability performance of the groups differently. On the earning side the domestic banks were steadily concentrating on the fund-based business and foreign banks are relatively giving more importance to non-fund-based income. For such differences in the sources of earning and expenditure and their relative importance for different banking groups, both internal and external factors as discussed play vital role.

Within the fund-based source the income from direct lending operation is on the decline in respect of the foreign banks and they are moving towards the investments and bills discounting activities on a larger scale. Their investment pattern revealed their higher efficiency in investment management. This indirectly explains that they are concentrated in trade and industry sector which are their traditional area of operation. It was also observed that the proportion of income from the transactions relating to foreign business were higher for the foreign banks than the domestic banks. This is obviously due to their worldwide branch network. While the domestic banks, both public and private sector are very similar in their operations it is the public sector bank group which is highly concentrated with the direct lending operations. Their investment operations were considerably in the nature of Government securities. Their business in terms of bills is also low.

On the expenditure side, interest expenditure were on the increase for all the bank groups. Unlike the domestic banks, in the case of foreign banks the higher interest burden were on borrowing and rediscounting rather than on the deposits. This seems to be favourable for the foreign banks in increasing their profitability.

Among the non-interest expenditures the proportion of establishment expenditure to operating expenditure were observed to be very high among all the bank groups. However, they showed declining trend in respect of all the bank groups including the domestic ones. Further, for foreign banks it was relatively lower reflecting lower cost of operation. This is one of the vital areas of controlling the overall cost for the banks in general. This goes in line with what was observed as higher cost-effectiveness in respect of the foreign banks in the previous chapter. In respect of domestic banks in general, it was always higher than the foreign banks and was very high for the Indian private sector banks. This could be a strong reason for their low cost-effectiveness leading to low profitability. The proportion of other working expenditure in the total operating expenditure were higher for the foreign banks when compared with the rest. This is more due to their operations in the non-fund-based business.

CHAPTER 5

Summing up

This chapter attempts to summarise the analysis carried out in the preceding chapters. The study is itself concerned with the issue of measuring and analysing the performance differential between the foreign and domestic banks (domestic banks are categorised as public sector banks and Indian private sector banks) for the period 1969-1988. The performance was examined in terms of 'Financial profitability'. Besides, the study also dealt with the historical origin and development of foreign banks, within the limitation of data availability, with a view to know their relative status and the nature of activities they carried out in the past.

The performance differentials, were analysed by taking into cognizance the possible external and internal factors likely affecting them. The external factors in general and policy measures in particular were postulated to have created the playing field more favorable to foreign banks than the domestic banks. It may also be reminded that, in many an occasion the strict distinction between the internal and external factors was not possible, as the internal factor may be a result of the external one.

The profitability performance was measured in terms of some of the crucial indicators such as; Return on Assets (ROA), Net Return on Assets (NROA), Return on Working fund (RWF), return on total operating earning, profit per branch, spread ratios, operating earning/ expenditure to total assets, output input ratio and elasticity of output to input.

In order to have further insights, we analysed the total operating income and expenditure by the method of decomposition. This was carried out by taking each major item of earning and expenditure as a proportion to total operating earning and total operating expenditure respectively. For, this will bring out the differences in the sources of earning and expenditure among the banking groups. Besides, the relative importance of each source of earning and expenditure (reflected by the difference in the quantum of each source of earning and expenditure that contributes to various bank groups). Thus it will explain directly or indirectly the type or nature of business activity carried out by each bank group.

Findings:

From the time foreign banks (Exchange banks) were established in India they occupied a predominant position in the modern commercial banking scene of India. Although they were located in selected port towns and major cities they had a major share in the business. Besides, the financing of the trade in general, and the external trade in particular, were the exclusive preserve of these banks. The distinct feature of these banks were that they carried out the business with relatively smaller proportion of deposits as cash balance, when compared with the presidency banks.

These banks maintained their share of business in tact for a longer period, from late nineteenth century till the beginning of the present century. However, with the emergence of Indian joint stock banks on large scale, the foreign banks' share in the total business of the banking system had started declining fast ie., well before the country's independence. With the country's independence, and more particularly with the passage of several legislative measures specific to the banking, their position both in terms of number and share of business had considerably reduced.

Based on the preceding analysis for the period from 1969 to 1988, it is evident that foreign bank group has been performing better than the domestic bank groups, in terms of financial profitability. And among the domestic banks, the Indian public sector bank group is performing better than the Indian private sector bank group. This was clear from almost all the measures that we used. The financial profitability performance measured in terms of certain indicators such as; return on assets (ROA), net return on assets (NROA), return on working funds (RWF), per branch profit, output input ratio and spread ratio exhibited higher difference between the foreign and domestic bank groups. It was also brought out that foreign banks are having relatively a higher margin on their operating earnings. However, elasticity measure of output to input did not show high difference as much as it was observed in other cases.

Besides, the decomposition analysis brought out the subtle differences in the sources of earning and expenditure and their relative importance for foreign and domestic bank groups. Between the domestic public and private sector banks the differences in the the sources of earning and expenditure were not very conspicuous. This explains their similar strategies, styles, areas and even the nature of business operations among the domestic banks in general.

For instance, the domestic banks being more traditional with less diversification in their business has been partly reflected in their larger dependency on the fund-based-source of income than the foreign banks. While in the case of foreign banks the non-fund-based-source of income appeared to be relatively more prominent, although the fund-based activities still remain the major source of income. Further, the direct lending as a source of income has drastically come down in respect of foreign banks. For the domestic banks the direct lending is 'the major' source of earning due to both, external factors such as higher credit deposit ratio, compulsion of priority sector lending, branch expansion into rural areas etc., and the internal factors like inefficient asset and liability management, less diversification into new products and services etc.,.

Investment is quite an important source of income for all the banking groups. This is largely due to the compulsion of directed investment policy. However, interestingly, for foreign banks the income from this source was relatively lower than the domestic banks. It belies the commonly perceived notion among the practical bankers and others, that the foreign banks' main source of earnings are investment and treasury operations[1]. Such an understanding 'may be' true for the early nineties as instances of such references are found in the Janakiraman committee report. However, we were unable to look into the details during this period for non availability of disaggregated data. In respect of domestic banks income from investment constituted as a second major source and their proportion was higher than the foreign banks. The investment pattern revealed

1 Charvaka (1993)

foreign banks were more dynamic than the domestic banks. And of course the policy permitting banks to take active participation in investment of all types of securities provided them with better choice and higher earning.

Foreign banks earn relatively higher proportion of their total operating income from the bills than the domestic banks. For, bills have a self liquidating nature which provides them quick rotation of funds. Moreover, since the foreign banks are largely located in big trade and commercial centers it facilitates them for this segment of business.

And, as expected, the foreign banks earn relatively considerable proportion of operating earning from the transactions relating to foreign business. These banks are blessed with a worldwide branch network and therefore their dealings with the multinational corporations and foreign based companies, favour them for the higher earnings in these transactions. It emerges that they are operating by and large in a 'niche market' involving business with trade and industry (loans, investment and bills) than the other sectors.

Similar analysis of the operating expenditure also highlighted the subtle differences between the two banking groups. For instance, the proportion of overall interest expenditure were relatively lower for the foreign banks when compared with the domestic banks. This reflects their efficiency in asset and liability management in general and interest cost minimisation in particular.

Deposit as a source of fund was relatively very low for the foreign banks than the domestic banks. While this phenomenon is partly due to the branch restriction policy towards the foreign banks, it also reflects their efficient mix up of deposits and relatively larger size of deposits with less number of accounts (as pointed out by the earlier studies). And also ".....their international networks which gave access to the affluent Non-resident Indians, enabled the foreign banks to build up financial resources at effective cost far lower than the domestic banks"[2]. While their dependency on the borrowing and rediscounting are relatively higher for the foreign banks than the domestic banks. Though the limited availability of funds through the deposits compels them to resort to these sources, they also manage their total funds so as to work out relatively less expensive on the whole.

The establishment expenditure as a proportion to their respective total operating expenditure were generally on the decline over the period. However, among the banking groups it constituted lowest for the foreign banks and this was a strong factor for their better performance against the domestic banks. As the number of branches are few and located in towns and cities the establishment cost are less for the foreign banks.

In sum, as hypothesised by us, it is fairly clear from the preceding analysis that among the external factors, various policy measures such as differences in priority sector lending, branch expansion policy, interest rate policy, policy compulsion on credit-deposit ratio, policy relating to recruitment and remuneration, policy permitting the banks to take active participation in the securities

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[2] Dobby(1993)

investment, difference in the reserve requirement (of course this distinction has been removed of late), are distinctly more favorable to foreign banks than the domestic banks. Differences in some of these policy measures had resulted, either consciously or unconsciously, in creating the environment more favorable to the foreign banks. In addition, some of the other external factors like locational advantage, worldwide branch network, domestic market conditions were also crucial for the foreign banks to perform better. To put it shortly, all these differences had led to an increase in their operating earnings and minimise their operating expenditures which in turn helped them for better profitability performance.

Besides the external factors, the results brought out some crucial internal factors such as efficient cost management (reflected in higher cost-effectiveness), efficient asset and liability management (reflected in effective deposits composition and the composition of loans and advances), efficient investment management reflected in their investment pattern. Along with efficient cash management which are responsible for relatively higher performance among the foreign bank group. It may be apt to say that, the bank groups which showed higher level of profitability have made best use of the resources available, by both securing good margin on their funded business and good return on their non-funded business[3].

Further, the quick and large scale adoption of automation and latest technology and timely introduction of the innovative products and services (many of the products and services were introduced by the foreign banks for the first time in India) required by the market were

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[3] Gomathi nayagam (1991)

some of the important factors for their better performance.

In respect of domestic banks besides many of the external factors being not favorable to them, their internal performance were also not satisfactory. For instance the cost control was not as effective as it was observed for the foreign banks, especially the interest expenditures were very high for them. Similarly the assets and liability management were also observed to be less efficient. The investment pattern consisted of low return government securities in higher proportion. Which explains their less dynamism in securing optimal combination of different types of securities. Relatively less diversification in terms of products and services coupled with the lesser adoption of automation and advanced technology among the domestic banks in general, are some important reasons for their low profitability performance.

Likewise, we believe some of the factors such as less labour union problems, efficient customer services, higher economies of scale and economies of scope too have played for the better performance of foreign banks. However, it was not possible to capture all of them in our preceding analysis either for one or the other reason.

Within the domestic bank group the public sector banks were observed to be performing better than the Indian private sector banks indicated by all the measures that we used. However, as far as their style, strategies and areas of operations, relating to the operating earnings were concerned, there was not much difference. Nevertheless, the control on the operational expenditure in general, and the establishment expenditure in particular, the Indian private sector banks are lagging behind. Which ultimately has an adverse effect on their profitability performance.

It therefore arises from our analysis that among the domestic banks the ownership, as to either public or the private sector, is not really an important issue as much as it has been talked of. Hence, the privatisation of the public sector banks to improve the overall profitability or the efficiency of the domestic banks are not the panacea. As it was already suggested by the Narasimham committee it is not the ownership but the internal autonomy that is needed for the Indian public sector banks.

Implications of the Study :

The banking system as a whole has been given due recognition and the onerous responsibility to play an active role in the socio economic development of the nation. In which the foreign banks constitute a part and work in the business environment provided by the country. However, from our analysis it is clear that these banks have been working in a 'niche created around them' devoid of many of the obligations that the domestic banks had to undertake. For such a phenomenon, as we had discussed, differences in many of the policy measures themselves are responsible, which in turn had helped them to perform better in terms of profitability than the domestic banks. It is therefore necessary to share the responsibility of the socio economic development of the country by all the banks alike.

In this context it is desirable to give thought to certain aspects of the external factors especially policy aspects. Any policy measure framed, need to take into account its implication on both domestic and the foreign banks operating in India. And for the mere reason that foreign banks are in smaller number should not be ignored or taken lightly.

The priority sector lending obligation is one of the clear discriminations against the domestic banks for its adverse impact on their profitability as against the foreign banks. Therefore there is an urgent need to bring both these bank groups on par with each other. In this connection the recent policy measure dictated by the RBI for the foreign banks to raise the priority sector lending from the existing 15 per cent of net credit to 32 per cent by the end of March 1994 is worth welcoming. Since they do not have the rural branches the composition of priority sector lending includes the export credit and lending to small scale industries (SSI) to the extent of 10 per cent of the net credit to each. And any short fall in the stated requirement will have to be made good by depositing that amount with the Small Industries Development Bank of India (SIDBI) at the interest rate of 10 per cent per annum. This is a step in the right direction to reduce the disparities between the foreign and domestic banks on the whole. However, the inclusion of export credit in the priority sector would pave the way for the foreign banks to rely more on this sub-sector, by neglecting the other essential segments, to meet the overall requirement. Depositing the short fall with the SIDBI would be an easy way of earning without any risk.

The foreign banks, be made to extend their credit even to agriculture and other allied activities of rural development. This could be done by lending through other agencies such as; National Bank for Agriculture and Rural Development (NABARD) or the regional rural banks (RRBs). For, they are already complaining of their inability to comply with even the present requirements, on the ground of their absence in the rural areas. However, since lending to the priority sector involves high incidence of default and risk of loss, an arrangement should be worked out for <u>sharing certain amount of risk of loss</u> by all banks. Further, it is not beyond the possibility of foreign banks to lend other essential segments such as small transport operators, retailers etc., even if these banks are metro based. Moreover, what is required is the strict supervision by the Authority on the compliance coupled with the willingness on the part of foreign banks.

As regard the interest rate policy, it is necessary to take into account its different implication on foreign and domestic banks, due to the existing differences in the priority sector lending obligation among these groups.

The recruitment pattern for the domestic banks, particularly in the case of public sector banks, should be need based and be given the freedom for each individual bank's specific requirement. Especially recruitment relating to the specialised skilled labour against the present mass recruitment. In this context it is worth mentioning the recommendations of the <u>Narasimham Committee</u>.

The branch expansion policy needs to be more rational both for foreign banks as well as domestic banks. In place of the complete restriction on expansion of foreign banks, they should be allowed to expand on a limited and selective basis. The banks having branches already in the major towns and metropolitan cities should be restricted to expand with branches again, in and around the big cities and metropolitan centers. Such banks should be made to move into smaller towns which will facilitate financing all segments of priority sectors by these banks, which otherwise they complain of for not complying with the requirement. However, the unrestricted entry in general and location of the new foreign banks and new branches of the existing foreign banks in particular again in and around the metropolitan and major cities would obviously result in the concentration of these banks in the more profitable areas of business. And the domestic banks would increasingly be pushed into the traditional banking and less profitable areas. On the other hand domestic banks expansion should be strictly based on their commercial viability. The banking extension into remote rural areas should be made in terms of regional rural banks in place of full scale commercial banks as they are more suited to the rural business. This also goes along with the recommendations of the Narasimham committee report.

The improvement of internal efficiency in general, and the cost consciousness in particular, among all the domestic bank groups calls for an immediate attention. More so in the case of the domestic private sector banks.

The domestic banks in general need to improve their business in non-funded areas as that would reduce their overall cost of operations and in turn increase their earnings. The domestic banks need to be more diversified into new and upcoming areas of business in line with the foreign banks, again this need not be at a blanket style (spread across the entire banking system) but of need based. It is worth mentioning that the future is going to be a more competitive and hi-tech environment, especially when the corporate clients would be in demand of a wide range of products and services. To mention a few; expert portfolio management services, electronic fund transfers, factoring, syndication of loans to raise funds from the international capital market, participation certificates, bridge loans, swap transactions, issue management and other merchant banking related activities. In many of the above mentioned areas the foreign banks are already well placed against the domestic banks. However, it is possible for the domestic banks to move in line with the foreign banks, need to equip themselves to face up to the challenges from the foreign banks. It would be more advisable to open branches at selected centers with specialised services coupled with automation and latest technology in line with those of the foreign banks especially in urban and metropolitan centers.

The preceding analysis concludes that the domestic banks in general need to minimise the interest expenditure through improving the overall fund management.

The domestic banks need to concentrate more on the bills business as this would help in quick rotation of funds and also minimise the risk of non-performing assets. Further, the investment pattern to reflect the optimal combination of different types of securities so as to improve their investment management.

Scope for the future studies in foreign banks:

Since these banks are highly automised on the one hand and employ highly specialised labour on the other as compared with the domestic banks, it is most likely that these banks reap higher economies of scale. Therefore the study of 'economies of scale' will be an interesting area for future researchers. Further, the study of 'economies of scope' for the jointness in the services in banking in general will be worthwhile. And more so for the foreign banks as they are widely diversified in their operations.

Another area worth looking into is a cross sectional analysis of selected individual foreign banks operating in India, though the availability of detailed data, other than the published balance sheets, is difficult.

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