

AN ANALYTICAL IMPACT OF PRIVATE & FOREIGN SECTOR BANKS ON PUBLIC SECTOR BANKS IN INDIA

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ABSTRACT

The Indian banking system has undergone sea changes and significant transformation following financial sector reforms. It is following international best practices with a vision to strengthen the banking sector in India. The economic reforms in India started in early nineties, but their outcome is visible now. Major changes took place in the functioning of Banks in India only after in second generation reforms. It has become very mandatory to study and to make a comparative analysis of financial services of Public and Private Sector banks. Increased competition, new information technologies, innovative products and thereby declining processing costs, the erosion of product and geographic boundaries, and less restrictive governmental regulations have all played a major role for Public Sector Banks in India to forcefully compete with Private and Foreign Banks. The present study is an attempt to capture that the public sector banks have achieved a greater penetration compared to the private sector banks. Commercial banks, especially the dominant public sector banks, have been exposed to competition from the new banks set up in the private sector with the latest technology. This has created a need for the public sector banks to improve their business efficiency and volume, which is a good sign of competitive effectiveness. Induced stiff competition in the banking sector certainly raises some issues relating to the functioning of domestic banks. The study mainly focuses on the State Bank of India (SBI), the premier bank in the Indian banking sector, as to what extent it has been affected by the entry of new private sector banks. The study applies the t-test for finding the significant difference in the performance of SBI before and after the entry of private sector banks, with the help of financial ratios selected as the parameters for ascertaining the changes in the business of SBI. The results indicate that the presence of new private sector banks does not pose any threat to SBI at the moment, however, the same cannot be said in the future. The SBI has a strong network as compared to these new banks, and its presence

has been for more than hundreds of years in the region. These facts certainly have a major impact on the results of the study.

KEYWORDS: S-Strengthen, T-Technologies, C-Commercial, P-Performance, P-Parameters.

INTRODUCTION

Share of PSBs and Foreign Banks has been contracting from 78% and 5.7% to 69% and 4%, respectively as Private Banks gain. Private sector banks are also efficient in deposit mobilization (utilization of available funds) as it stands above 85% in FY17. New/ Incremental deposit mobilization is also close to 80% for private sector banks while it stands at just 35% for the overall banking sector. A six year trend shows that growth in deposit is primarily driven by the Private Banks. These banks accounted for 23% in overall deposit in FY17 and have recorded a strong growth of 19.5%, the same year. This indicates that this group has been gaining public trust and expanding its geographical coverage of branches in remote areas. Moreover, private corporates and financial institutes are the major source of deposit for the private banks, especially for the CASA category. Similar to the private banks, we notice that the performance of Regional Rural Banks (RRBs) is also impressive. Deposit of this group (share of around 3.5%) has been expanding at 19.7%. Public sector banks and foreign banks, on the other hand, have been expanding at a slower pace. As a result, share of these groups has been contracting from 78% and 5.7% to 69% and 4%, respectively. As expected, the most prominent contributor to PSB corpus remains household savings, which accounts for around 63% (of total PSB NDTL).

Private sector banks are also efficient in deposit mobilization (utilization of available funds) as it stands above 85% in FY17. PSBs, having to deal with the SMA/ NPA situation are recording this at just 70%, at the same time. New/ Incremental deposit mobilization is also close to 80% for private sector banks while it stands at 35% for the overall banking sector. Public sector banks, as expected, on the other hand, are having weaker deposit mobility of just 12%. As this group (PSB) has a significant share in India's overall deposits (70% share) - lower deposit mobility indicates a higher cost of holding money. This means that as interest rates go up, PSB may have to provision for higher interest servicing obligation while being stuck with unproductive cash on the balance sheet. An impact on the health of the cash flows cannot be therefore ruled out.

Growth in deposits by bank groups:

YEAR	Overall	PSBs	Foreign banks	RRBs	Private Banks				
2011-12	12.78	12.67	15.34	10.91	12.93				
2012-13	15.37	15.13	3.64	13.11	19.64				
2013-14	13.45	12.8	23.1	13.59	13.96				

2014-15	12.15	10.58	14.18	14.84	17.41				
2015-16	7.59	4.28	12.82	14.05	17.68				
2016-17	11.78	9.83	0.12	19.7	19.49				

Source: CMIE, Acuité Research

Deposit mobilization by bank groups:

	All SCBs	PSBs	Foreign	RRBs	Private
2011-12	79%	79%	88%	64%	81%
2012-13	79%	78%	94%	66%	80%
2013-14	79%	78%	88%	68%	82%
2014-15	77%	76%	85%	68%	82%
2015-16	78%	76%	85%	68%	88%
2016-17	74%	70%	80%	63%	86%

Source: CMIE, Acuité Research

Incremental deposit mobilization by bank groups:

	All SCBs	PSBs	Foreign	RRBs	Private
2012-13	77%	74%	264%	82%	78%
2013-14	80%	79%	60%	82%	91%
2014-15	62%	53%	65%	65%	81%
2015-16	95%	71%	82%	68%	122%

2016-17	35%	12%	-	38%	78%
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Source: CMIE, Acuité Research

A number of questions are raised due to the increased presence of foreign banks, about their effects on the domestic banking sector. On the positive side, foreign banks entry makes domestic banks less fragile and less prone to crisis, it encourages adoption of best practices in the domestic banking system and stabilizes overall credit market in emerging economies, since domestic banks are highly sensitive to local conditions. On the negative side, foreign banks take the best credits and leave the worst for domestic banks and they tend to increase lending in good times and provide less in bad times. This study aims at empirically evaluating the effect of foreign banks presence on the operations of domestic banks in India, particularly on public sector banks. The selection of only public sector banks for the study is motivated by two reasons:

Prior to 1992, public sector banks operation were heavily regulated than the other domestic banks which resulted in low profitability and low efficiency ; the subsequent banking reforms were aimed at improving their profitability and efficiency by inducing competition and practicing deregulation policies. Allowing more foreign operations was one of them. Public sector banks were allowed to control more than 70% of the total assets, deposits and branches of the Indian Banking system. The econometric analysis is based on the bank level data for 27 public sector banks for the period 1996-2007. And investigate how foreign bank entry will influence operations of the Indian public sector banks. This paper presents a review of literature on the effects of foreign bank entry on domestic bank operations. It also explains the methodology employed and the database. Subsequently it presents the empirical results. Finally the paper gives the conclusion.

Review of Literature

In literature, several studies have examined the issue of the effects of foreign bank entry on the domestic financial institutions, markets and the economy as a whole. In the brief literature survey there is a focus on the effects of the foreign bank entry on the domestic banking industry. Several studies have mentioned the potential benefits as well as the costs associated with foreign bank entry for domestic banks. As far as the arguments on the benefits of foreign bank entry are concerned, studies by a number of researchers have highlighted the advantages of foreign bank entry. The presence of foreign banks creates a greater competition in the home country that stimulates the domestic banks to reduce their costs, improve efficiency and increase the diversity of financial services. Since domestic banks have to retain their market share in the presence of the foreign banks, they are pressurized to improve the quality of their services by putting an end to the old style of banking operations.

Foreign bank entry may lead to spill-over effects. To begin with, foreign banks come with new financial services and modern technology, because of their expertise in those areas, and which are new to the domestic banks. The introduction of these services and technologies may stimulate the domestic banks to also come up with such new services for improving the efficiency of financial intermediation. Foreign banks may also help to improve the management of domestic banks by participating in the stream of takeover or joint venture practices. This may directly or indirectly contribute to help managerial efficiency. Foreign bank entry may also lead to the development of the domestic banks' supervisory and legal framework, as these banks may demand improved system of regulation and supervision from the regulatory authorities. Foreign banks presence may also reduce political influence on the domestic banks since the latter may demand operational freedom to be able to compete with the former. The presence of foreign banks may also increase the quality of human capital in the domestic banking system either by importing high skilled labor or by training the local employees. More clearly, to start a business either by setting up a new branch or by acquiring an existing domestic bank, a foreign bank requires quality personnel in the domestic country. To meet their needs they may either go for importing highly skilled managers or they may go for training local people. Therefore, this increase in quality of available human capital for the domestic banks will improve the efficiency of the domestic banks as well.

All these effects may lead to more efficient domestic banking practices, which may in turn lead to reduced costs. There have been a number of arguments on the costs associated with the entry of foreign banks. These have been sided by a number of researchers like Stiglitz (1993), Peek and Rosengren (2000), etc. These studies point towards the following points:

Cost reductions may occur only in the long run, since banks need to invest first in introducing new services, improving the quality of existing services, adopting new management techniques and upgrading their staff. The presence of foreign banks will weaken the domestic banks due to increased competition, the domestic banks will have to compete with large international banks. The presence of foreign banks will diminish the ability of the domestic regulatory authorities to influence the banking sector as well as the economy, since foreign banks are less sensitive to their desires

The presence of foreign banks may also make domestic banks more vulnerable to adverse foreign shocks. The presence of foreign banks may also lead to neglect of the financial needs of the local entrepreneurs, since foreign banks usually concentrate on the multinational firms. As far as the empirical evidence with respect to the effects of foreign bank entry on domestic bank operations is concerned, it is quite limited and rather mixed. A study using a large sample of 80 countries was conducted. The study showed that the increased presence of foreign banks is associated with reduction in profitability, non-interest income and overall expenses of domestic banks, besides revealing the positive efficiency effects on domestic words. A study by Denizer (2000) where he examined the effect of foreign bank entry on Turkey's domestic banks, showed that net interest margins, return on assets and overhead expenses of domestic banks decreased after foreign bank entry. The study concluded that even though the foreign banks had a market share in the range of 3.5-5%, they put much pressure on the domestic banks. A study on the Columbian banking system found that foreign bank entry increases competition, deteriorates loan quality and increases intermediation spreads of domestic banks. A study involving 14 developed countries, 8 of which allow foreign bank entry, found that foreign bank entry is associated with lower interest margins, lower pre-tax profits and lower operating costs. Another study examining the impact of foreign banks in Hungary found no evidence to support that foreign bank entry improves performance of domestic banks. A study of the impact of foreign bank entry on the Polish banking sector found that foreign bank entry brought greater competition that led to the Polish banks lowering the total credit supply to the economy, thereby affecting the business environment of the country. A study reviewing the banking systems of East Asian countries with respect to the effects of foreign bank entry, found that, in Korea, foreign banks compete with the domestic banks and they are not interested in sharing their risk management techniques with the Koreans. The study found that profitability of foreign banks is much higher than domestic banks, and the improved competition with greater foreign bank entry provided advantages to domestic banks in technological and managerial adjustments. Using a sample of 48 countries, a study found that the effect of the foreign bank entry depends on the economic development in the host country. At the lower level of economic development, the study found that foreign bank entry is generally associated with higher costs and higher net interest margins, while at higher level of economic development foreign bank entry is negatively associated with costs, profits and net interest margins of domestic banks.

The above literature review reveals the following research gaps:

The empirical findings of these studies disclose rather inconclusive or mixed findings as some of the studies reveal the positive effects and some find negative or indifferent effects of foreign bank entry on domestic activities. The majority of the studies concentrate on banking systems of the developed countries such as the US and Europe, where the effect may differ. Such studies in emerging countries like India are rare; infact not even a single study exists with respect to the Indian banking system. Therefore, the present paper attempts to deal with this issue in depth. The findings may have policy implications for regulatory authorities on allowing more foreign bank operations in India.

Methodology and Data

The empirical analysis aims at examining the effects of foreign bank entry on the operations of the public sector banks. To examine this issue, we first need variables that account for the presence of foreign banks in the country. The measure FB_SHARE, that is, the ratio of the number of foreign banks to the total number of banks in the country, reflects the intensity of the foreign banks' presence. Next, we need variables that reflect operations of public sector banks. The following variables are used to measure the income, profitability and costs of the public sector banks:

Net interest margin to total assets (NIM)

Non-interest income to total assets (NINTINC)

Profits before tax to total assets (PROF)

Overhead expenses to total assets (OVERHEAD)

Non-performing loans to total loans (NPL)

The first two ratios show the accounting value of the bank's income. In order to reflect the profitability of the bank, PROF is considered. The last two ratios show the costs of banks in the form of entire overhead and bad loans. Changes in these variables may be associated with changes in the presence of foreign banks through competition and/or efficiency.

The model is defined as :

$$\Delta\pi_{it} = \alpha_0 + \beta\Delta FB_SHARE_{it} + \gamma\Delta BS_{it} + \delta\Delta ME_{it} + \varepsilon_{it}$$

where

π_{it} is the dependent variable (e.g. NIM or PROF) of interest for bank i at time t ;

FB_SHARE $_{it}$ is the share of the foreign banks at time t ;

BS $_{it}$ is a set of bank-specific control variables for public sector bank I at time t ;

ME $_{it}$ is a set of macroeconomic control variable at time t .

α, β, γ and δ are coefficients to be estimated

The above model is estimated by Ordinary Least Squares (OLS) method.

In order to capture the structural characteristics of the bank, we include the following bank-specific variables as control variables:

Capital: The ratio of book value of equity capital to total assets, which captures the strength of capital in the bank. It is expected that the higher the ratio, the lower the need for external funding and therefore higher the profitability. On the other hand, holding large equity ratios either on a voluntary basis or as a result of regulation can be costly for banks. Therefore, the expected relationship between capital and dependent variables is unpredictable.

Deposits: The ratio of total deposits to total assets. Deposits are the main source of funds for banks. Higher the deposit ratio, higher is the availability of funds for the bank. If a bank is able to turn those deposits into earning assets, then the bank income will increase. On the other hand, holding large deposit ratios either on a voluntary basis or as a regulatory requirement (eg. Cash reserve ratio) can be costly for banks. Moreover, pressure of large deposit ratios may lead to indiscriminate bank lending which may result in high non-

performing loans. Therefore, again, the expected relationship between deposits and our choice of dependent variables is unpredictable.

Liquidity: The ratio of non-interest earning assets (such as cash in hand, balances with the RBI and balances with other banks) to total assets. High liquidity ratios, either self-imposed for prudential reasons or as a result of regulation (eg. Reserve or liquidity requirements), impose a cost on banks since they have to give up holding higher-yielding assets. The kind of relationship this variable will have with our dependent variables depends on what extent the banks are able to transfer this opportunity cost to borrowers. Therefore, again this relationship is uncertain.

Overhead: The ratio of overhead expenses (such as payments to and provisions for employees) to total assets. It reflects employment as well as total amount of wages and salaries and is an indicator of the management's ability to control personnel expenses. This variable is expected to have a negative impact on the bank's income and profit variables because efficient bank management is expected to operate at lower costs. In order to capture the macroeconomic environment in the country we also include the following macroeconomic variables as control variables:

GDP Growth: The annual growth rate of Gross Domestic Product (GDP). In the short run the level of economic development may play a role in determining the effects of foreign bank entry on the domestic banking system. This is because, less developed countries generally have under developed financial systems and lower levels of human capital. Therefore, there may be room for the improvement of domestic banking practices when foreign banks enter the market. This may have positive effects on the operations of domestic banks in the long run. However the short-run costs may increase and the lower the level of economic development, the greater the short run costs.

Inflation: The annual rate of inflation estimated using the GDP deflator. Inflation will raise both costs and revenues of banks. Higher inflation affects banks by making it difficult for banks to adjust their operating expenses with rising inflation. However, the effect of inflation on banks; performance depends on whether banks' expenses rise faster than the revenues, which in turn depends on to what extent an economy is matured to predict the upcoming inflation. Therefore, the relationship between inflation and the choice of the dependent variables is uncertain.

Interest: The real rate of interest is defined as annual interest rate on government securities minus annual inflation. Higher interest rates are associated with higher interest margins, especially in developing countries, where demand deposits frequently pay zero or less than market rate of interest rates. On the other hand, higher interest rates also increase the cost of borrowing in the market. Therefore, again, the expected relationship with my choice of dependent variables is uncertain.

This study consists of a panel of 27 public sector banks with a total of 324 observations for the period 1996-201014. All the statistical data was obtained from the Annual Accounts Data of Scheduled Commercial Banks, Statistical Tables relating to Banks in India, reports on Trend and Progress of Banking in India, published by RBI.

Results and Discussion

The summary statistics of the selected banks are given in Mean value of variables indicate that public sector banks, on an average, have around 3% of net interest income margin; about 2% of non interest income; about 1.77% of overhead expenses; about 2.15% of equity capital; around 84% of deposit sand about 10.73% of liquid assets to their total assets. Public sector banks on an average, get about 0.63% of returns on assets and some of the banks also experience negative returns. Public sector banks, on an average, have about 5.85% of non-performing loans in their total loans and some of the banks have very high non-performing loans. Mean value of foreign bank share indicates that the foreign banks account for more than 38% share in Indian banking system. The mean values of GDP growth, inflation and real value of interest indicate that the Indian

economy annually, on an average, evidenced about 6.45% of growth in GDP, about 5.75% of inflation and about 4.4% of real interest rates, respectively. Standard deviation of variables indicated that there is a very slight variation in the dataset and it is slightly higher in case of non-performing loans to total loans, deposits total assets and foreign bank share.

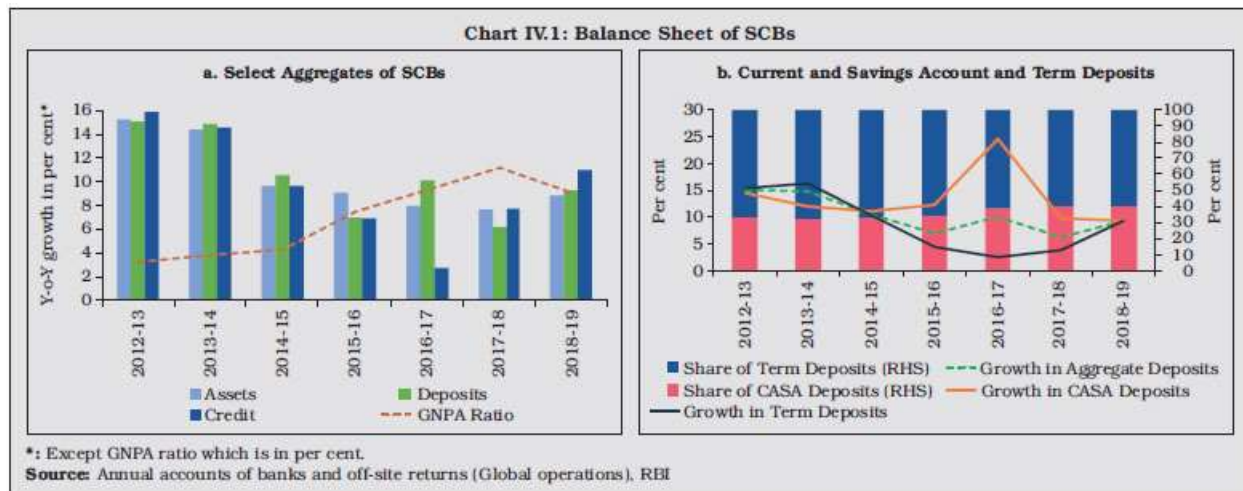
This paper investigates the effect of foreign bank entry on the operations of public sector banks in India. The empirical results reveal that foreign bank entry usually increases competition in the banking industry as is evidenced by increasing profitability of banks. The increased competition seems to be deteriorating the loan quality as evidenced by increasing default loans. Foreign bank entry also increases the overhead expenses of public sector banks. Besides foreign bank presence is negatively associated with net interest margins and non-interest income of public sector banks, even though the relationship is statistically weak. Therefore, the empirical results, in general, suggest that foreign bank entry in the Indian banking system adversely affects the operations of public sector banks.

The year 2018-19 marked a turnaround taking shape in the financial performance of India's commercial banking sector. After seven years of deterioration, the overhang of stressed assets declined, and fresh slippages were arrested. With the concomitant reduction in provisioning requirements, bottom lines improved modestly after prolonged stress and the banking sector returned to profitability after a gap of two years in the first half of 2019-20. Meanwhile, recapitalisation of public sector banks (PSBs) strengthened their capital base and the Insolvency and Bankruptcy Code (IBC) began to gain traction in enhancing resolutions.

Against this backdrop, this chapter analyses the audited balance sheets of the Indian banking sector during 2018-19 and 2019-20 so far, backed by information received through off-site supervisory returns in [Section 2](#). On this basis, an evaluation of the financial performance of 94 SCBs and their soundness is presented in [Sections 3](#) and [4](#). [Sections 5 to 11](#) address specific themes that assumed importance during the period under review such as the sectoral deployment of credit, capital market interface, ownership patterns, foreign banks in India and overseas operations of Indian banks, payment system developments, consumer protection and financial inclusion. Developments related to regional rural banks (RRBs), local area banks (LABs), small finance banks (SFBs) and payments banks (PBs) are also analysed in [Sections 12 to 15](#). [Section 16](#) concludes the chapter by bringing together the major issues that emerge from the analysis.

Balance Sheet Analysis

In 2018-19, the consolidated balance sheet of SCBs expanded at an accelerated pace for the first time since 2010-11, buoyed by a pick-up in deposits on the liabilities side and loans and advances on the assets side. Although private sector banks (PVBs) account for less than a third of assets of SCBs, they led the expansion in the consolidated balance sheet of SCBs, offsetting the deceleration posted by PSBs. Furthermore, despite the overall improvement in banking performance continuing during the first half of 2019-20, a slowing down of bank credit growth has emerged as an area of concern.



Consolidated Balance Sheet of Scheduled Commercial Banks

(At end-March)

(Amount in ₹ crore)

Item	Public Sector Banks		Private Sector Banks		Foreign Banks		Small Finance Banks#		All SCBs	
	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019
1. Capital	33,154	51,060	11,592	21,344	67,883	77,809	3,498	4,213	1,16,127	1,54,427
2. Reserves and Surplus	5,55,840	5,46,066	4,31,966	5,27,665	88,305	96,979	3,659	5,821	10,79,770	11,76,531
3. Deposits	82,62,322	84,86,215	30,13,688	37,70,013	4,94,901	5,81,857	23,094	49,178	1,17,94,005	1,28,87,262
3.1 Demand Deposits	5,43,630	5,52,461	4,37,408	5,17,356	1,43,538	1,71,907	966	1,955	11,25,543	12,43,679
3.2 Savings Bank Deposits	26,56,496	27,99,445	8,73,671	10,45,648	57,297	59,459	4,283	7,245	35,91,747	39,11,797
3.3 Term Deposits	50,62,196	51,34,309	17,02,609	22,07,008	2,94,066	3,50,491	17,845	39,978	70,76,715	77,31,786
4. Borrowings	8,47,034	7,61,612	6,88,188	7,75,324	1,27,690	1,51,367	19,398	21,367	16,82,309	17,09,670
5. Other Liabilities and Provisions	3,36,551	3,17,985	1,53,488	2,03,591	90,777	1,48,801	2,006	2,957	5,82,822	6,73,335
Total Liabilities/Assets	1,00,34,901	1,01,62,938	42,98,921	52,97,937	8,69,556	10,56,813	51,655	83,537	1,52,55,033	1,66,01,224
1. Cash and Balances with RBI	4,48,477	4,55,974	2,40,318	2,06,654	40,017	33,657	1,519	2,328	7,30,330	6,98,613
2. Balances with Banks and Money at Call and Short Notice	3,92,213	3,59,507	1,26,056	1,75,076	73,275	91,098	3,254	4,054	5,94,797	6,29,733
3. Investments	27,91,858	27,02,386	10,11,814	12,19,517	3,12,582	3,83,415	9,983	14,952	41,26,237	43,20,270

3.1 In Government Securities (a+b)	23,19,205	21,98,041	7,57,400	9,48,803	2,59,876	3,19,575	8,031	11,632	33,44,513	34,78,051
a) In India	22,89,822	21,67,070	7,51,458	9,30,104	2,52,063	3,05,772	8,031	11,632	33,01,375	34,14,578
b) Outside India	29,383	30,970	5,942	18,699	7,813	13,803	-	-	43,138	63,473
3.2 Other Approved Securities	244	157	-	-	-	-	-	-	244	157
3.3 Non-approved Securities	4,72,409	5,04,188	2,54,414	2,70,714	52,706	63,840	1,952	3,320	7,81,480	8,42,062
4. Loans and Advances	56,97,350	59,26,286	26,62,753	33,27,328	3,51,016	3,96,724	34,879	59,491	87,45,997	97,09,829
4.1 Bills Purchased and Discounted	2,34,188	1,66,381	95,125	1,17,234	74,201	76,557	0	4	4,03,515	3,60,177
4.2 Cash Credits, Overdrafts, etc.	24,14,793	24,89,272	7,86,825	9,45,461	1,44,602	1,66,037	4,022	5,948	33,50,242	36,06,719
4.3 Term Loans	30,48,368	32,70,633	17,80,803	22,64,633	1,32,212	1,54,129	30,856	53,538	49,92,240	57,42,934
5. Fixed Assets	1,10,041	1,07,318	26,293	36,142	4,509	4,426	1,031	1,251	1,41,874	1,49,137
6. Other Assets	5,94,962	6,11,466	2,31,688	3,33,221	88,157	1,47,493	990	1,461	9,15,797	10,93,641

Notes: 1. -: Nil/negligible.

2. IDBI Bank Limited has been categorised as a PVB for regulatory purposes by Reserve Bank with effect from January 21, 2019. As such, in this chapter, it has been classified as a PSB in 2017-18 and as a PVB in 2018-19, unless otherwise specified.

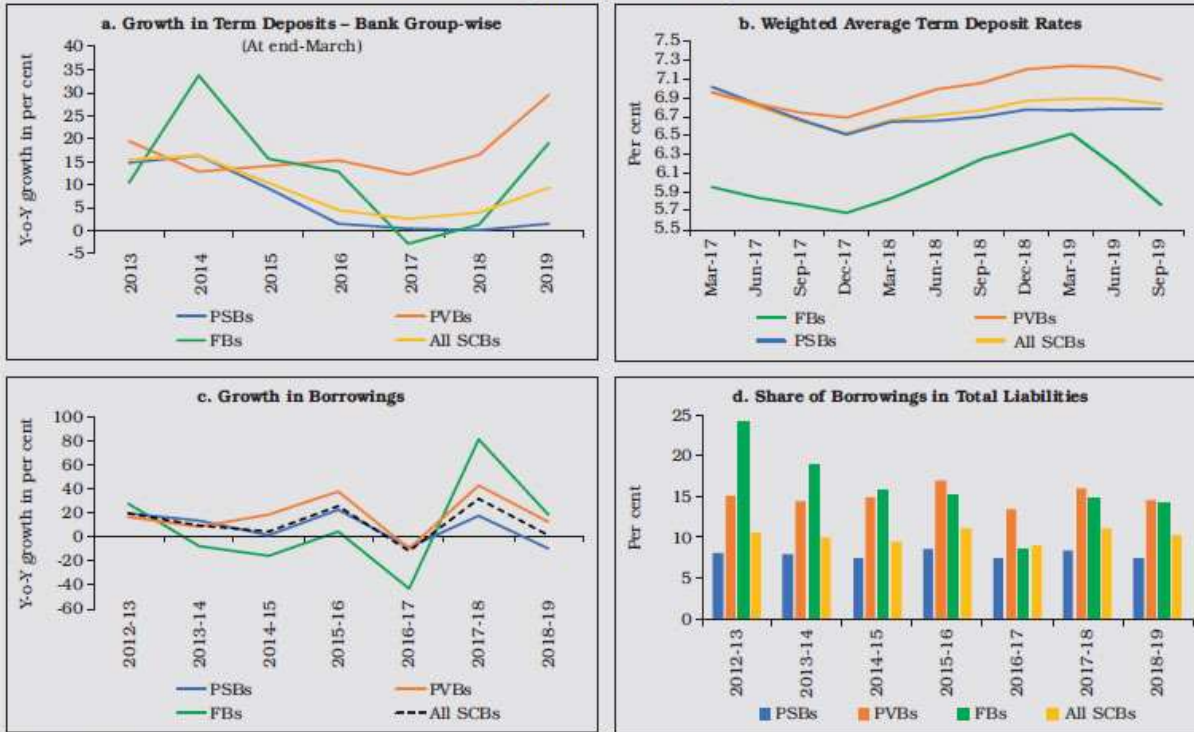
3. #: Data pertain to six scheduled SFBs at end-March 2018 and seven scheduled SFBs at end-March 2019.

Source: Annual accounts of respective banks,

Liabilities

Deposits, which constituted 77.6 per cent of the total liabilities of SCBs at end-March 2019, recovered from a secular deceleration that set in from 2009-10, barring the demonetisation-induced spike in 2016-17. This turnaround overcame unfavourable base effects and was mainly driven by a pick-up in term deposits. PVBs attracted a significant portion – 77 per cent – of this increase in term deposits¹, primarily reflecting the higher interest rates offered by them. Current and savings account (CASA) deposits kept pace with term deposits and maintained their share in total deposits at 40 per cent. The expansion in deposit mobilisation tempered banks' borrowing requirements, especially those of PSBs.

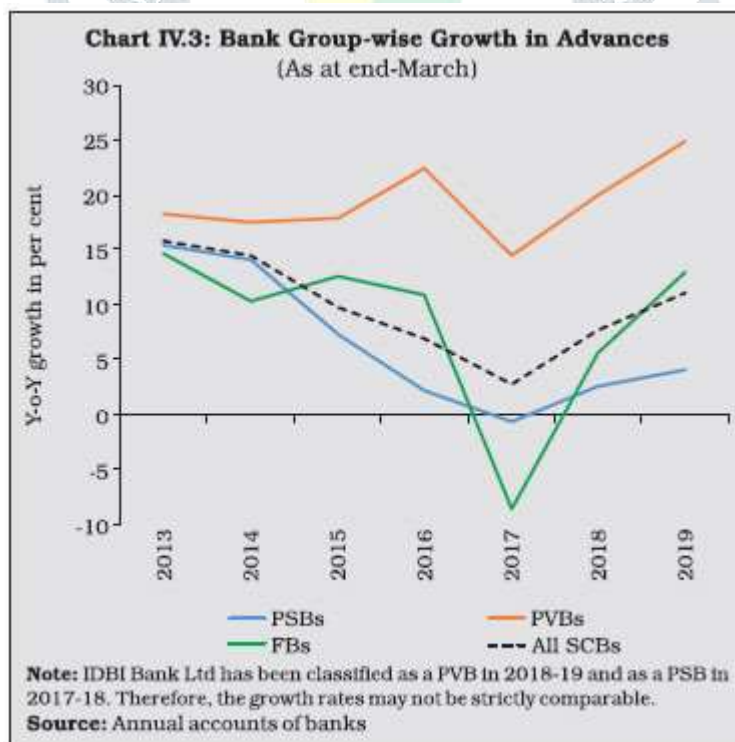
Chart IV.2: Deposits and Borrowings of SCBs



Note: IDBI Bank Ltd has been classified as a PVB in 2018-19 and as a PSB in 2017-18. Therefore, the growth rates may not be strictly comparable.
 Source: Annual accounts of banks and RBI

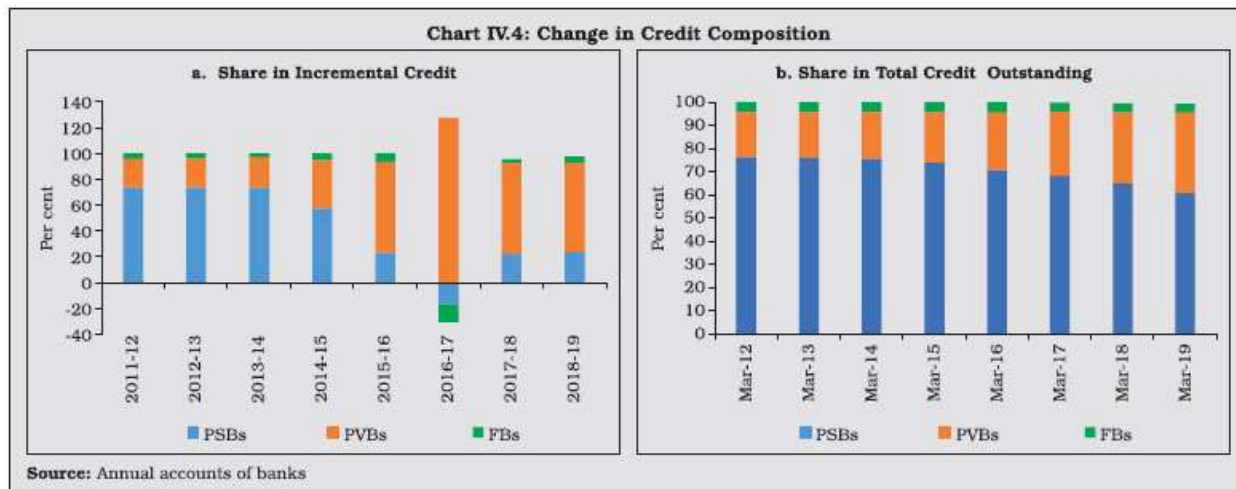
Assets

The revival in the growth of loans and advances – the most significant component in the asset side of the SCBs’ balance sheet – that began in 2017-18, maintained momentum into 2018-19 . The recognition of non-performing assets (NPAs) nearing completion, recapitalisation of PSBs, and the ongoing resolution process under the Insolvency and Bankruptcy Code (IBC) helped in improving the credit environment.



Note: IDBI Bank Ltd has been classified as a PVB in 2018-19 and as a PSB in 2017-18. Therefore, the growth rates may not be strictly comparable.
 Source: Annual accounts of banks

PVBs led the upturn in credit growth. Their share in incremental loans was 69 per cent in 2018-19 , commensurate with their share in incremental deposits². Consequently, their share in outstanding credit increased . In H1:2019-20, however, credit growth has decelerated across all bank groups.

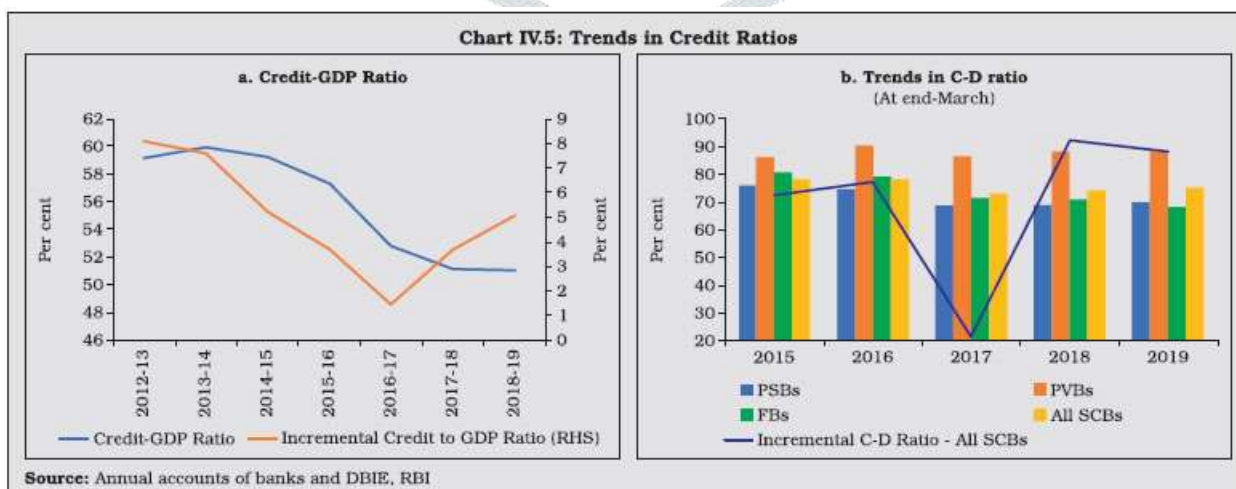


India’s credit to GDP ratio is lower than that of its emerging market peers³. The incremental credit to GDP ratio has been increasing since 2016-17, though the credit-GDP gap remains negative⁴, indicative of the potential for further financial penetration. The outstanding C-D ratio increased marginally for the second consecutive year in 2018-19. The ratio was highest for PVBs as they led the credit expansion in 2018-19.

Investments—the second largest component in the asset side of SCBs’ balance sheet—decelerated in 2018-19, as PSBs economised on their investments in government securities and other approved securities, reflecting the shedding of excess statutory liquidity ratio (SLR) investments by them to accommodate the uptick in credit growth.

Flow of Funds to the Commercial Sector

During 2018-19, credit flow from Housing Finance Companies (HFCs), Systemically Important Non-Deposit taking (NBFC-ND-SI) and Deposit taking NBFCs (NBFC-D) declined. Public issuances of debt and equity by non-financial entities and net investment in corporate debt by LIC also exhibited a similar pattern. On the contrary, a sharp rise in commercial paper issuances, higher accommodation provided by All India Financial Institutions (AIFIs) regulated by the Reserve Bank, and a pick-up in net flows from foreign sources partly compensated for the decline in non-bank flows. External commercial borrowings (ECB)/ foreign currency convertible bonds (FCCB) registered net inflows for the first time in four years, partly reflecting the new ECB framework introduced by the Reserve Bank to simplify overseas borrowing norms. Foreign direct investment (FDI) flows grew at 18.9 per cent in 2018-19.

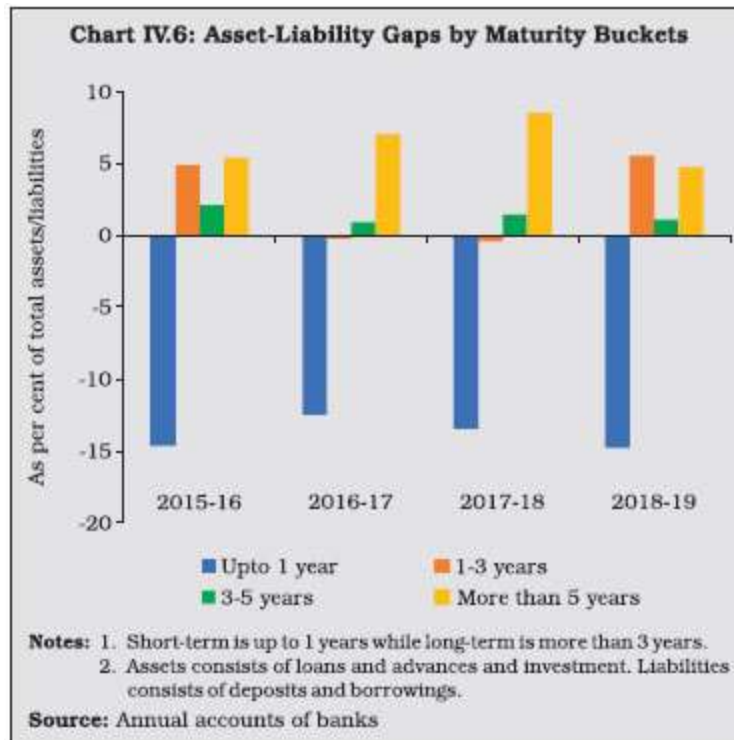


The scenario appears to have altered in the first half of 2019-20 as the total flow of resources to the commercial sector declined by 60 per cent on a year-on-year basis, largely driven by a contraction in adjusted

non-food bank credit. Flows from foreign sources, in contrast, accelerated in the first half of 2019-20 as ECB norms were eased further in July 2019 .

Maturity Profile of Assets and Liabilities

As regards the maturity profile of SCBs' balance sheet, the asset-liability gap in the 1-3 years category increased sizeably, while it declined in the more than 5 years category . Although the maturity structure of liabilities for all the buckets remained broadly similar to a year ago, the share of loans with maturity above five years declined, whereas those with maturity between 1-3 years increased sharply . This indicates that the SCBs, especially PSBs, have shifted their lending strategy.



Flow of Financial Resources to Commercial Sector								
Bank Group-wise Maturity Profile of Select Liabilities/Assets								
(As at end-March)								
(Per cent to total under each item)								
Liabilities/Assets	PSBs		PVBs		FBs		All SCBs#	
	2018	2019	2018	2019	2018	2019	2018	2019
1	2	3	4	5	6	7	8	9
I. Deposits								
a) Up to 1 year	44.8	43.6	42.4	42.9	63.0	64.2	45.0	44.4
b) Over 1 year and up to 3 years	23.2	22.4	25.3	26.8	28.9	28.6	24.0	24.0
c) Over 3 years and up to 5 years	10.0	10.7	10.7	9.5	8.0	7.2	10.0	10.2
d) Over 5 years	22.0	23.3	21.6	20.9	0.1	0.0	20.9	21.5
II. Borrowings								
a) Up to 1 year	60.2	61.6	45.7	47.9	89.1	87.5	56.3	57.4
b) Over 1 year and up to 3 years	13.4	14.1	22.2	19.8	5.8	8.1	16.8	16.5
c) Over 3 years and up to 5 years	8.4	8.3	12.9	14.0	2.2	1.8	9.8	10.3
d) Over 5 years	18.0	16.0	19.2	18.3	2.8	2.6	17.1	15.7
III. Loans and advances								
a) Up to 1 year	32.8	26.0	31.9	31.3	59.1	57.8	33.6	29.2
b) Over 1 year and up to 3 years	26.3	41.2	33.8	34.1	20.9	21.0	28.4	37.9

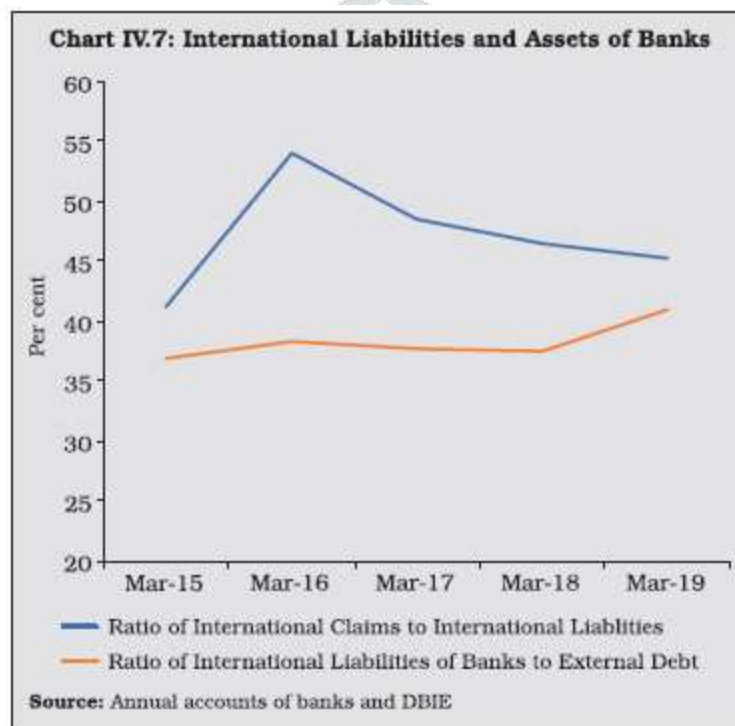
c) Over 3 years and up to 5 years	12.7	12.4	12.8	12.9	8.0	7.9	12.5	12.4
d) Over 5 years	28.2	20.3	21.4	21.7	12.0	13.4	25.5	20.4
IV. Investment								
a) Up to 1 year	17.6	17.9	50.7	49.6	81.2	82.6	30.6	32.7
b) Over 1 year and up to 3 years	13.0	13.5	16.9	16.1	12.1	10.9	13.9	14.1
c) Over 3 years and up to 5 years	13.3	13.5	8.6	8.2	2.3	2.2	11.3	11.0
d) Over 5 years	56.2	55.1	23.7	26.1	4.4	4.2	44.2	42.2

Notes: 1. The sum of components may not add up to 100 due to rounding off.

2. #: Data includes SFBs.

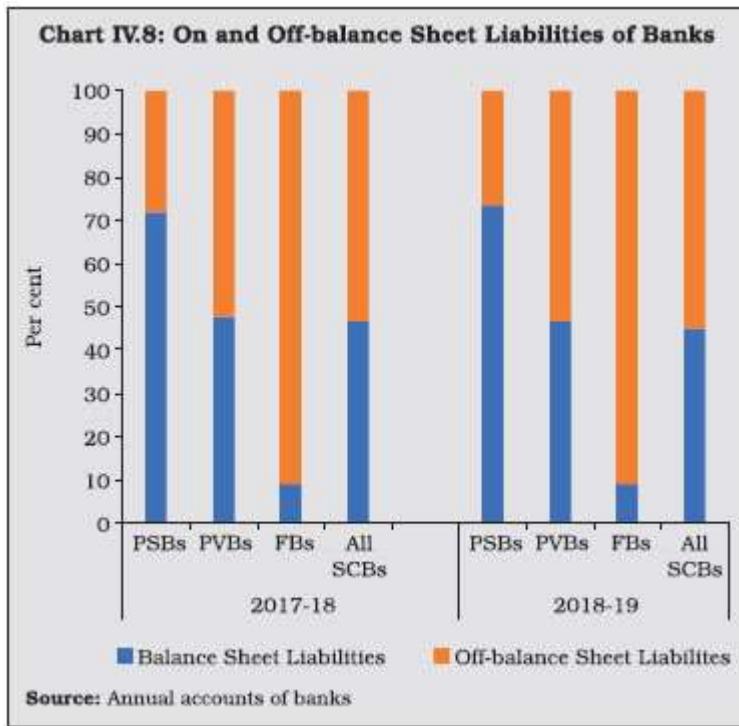
Source: Annual accounts of banks

The concentration of claims of short-term maturity in the total consolidated international claims of banks increased in 2018-19. The country-composition of international claims remained broadly stable, with the United States (US) increasing its share further.



Off-balance Sheet Operations

The size of contingent liabilities of all SCBs in India increased to 1.2 times of their on-balance sheet as at end-March 2019, driven primarily by an expansion in forward exchange contracts, including derivative products. The composition of on and off-balance sheet liabilities across bank groups has remained stable, with FBs and PVBs having significantly higher off-balance sheet exposures than PSBs.



Financial Performance

The financial performance of SCBs in the period under review was marked by PSBs reporting positive net profits after 3 years in H1:2019-20. As provisioning requirements slackened and credit growth revived modestly, interest income increased, even though interest expenses picked up on account of the increase in deposit growth. The net interest margin as well as the spread improved.

On the other hand, SCBs' income from non-interest sources declined, contributed by spreading of mark-to-market losses in government security portfolios and transfer of funds to the investment fluctuation reserve (IFR). Apart from these factors, the muted growth in off-balance sheet exposures, mainly guarantees, and a fall in income from trading and forex transactions adversely affected the PSBs. In H1:2019-20, however, the non-interest income of SCBs has revived.

Trends in Income and Expenditure of Scheduled Commercial Banks				
(Amount in ₹ crore)				
Item	2017-18		2018-19	
	Amount	Percentage Variation	Amount	Percentage Variation
1. Income	12,17,567	1.0	13,23,680	8.7
a) Interest Income	10,21,968	1.0	11,40,727	11.6
b) Other Income	1,95,598	1.2	1,82,953	-6.5
2. Expenditure	12,50,004	7.6	13,47,077	7.8
a) Interest Expended	6,53,510	-2.3	7,10,890	8.8
b) Operating Expenses	2,71,470	9.3	3,07,457	13.2
of which: Wage Bill	1,32,479	3.9	1,48,989	12.5
c) Provisions and Contingencies	3,25,024	33.3	3,28,731	1.1
3. Operating Profit	2,92,587	1.7	3,05,333	4.4
4. Net Profit	-32,438	-	-23,397	-
5. Net Interest Income (NII) (1a-2a)	3,68,458	7.5	4,29,837	16.7
6. Net Interest Margin (NII as Percentage of Average Assets)	2.5	-	2.7	-

Notes: 1. Data include SFBs.

2. Percentage variations could be slightly different as absolute numbers have been rounded off to ₹ crore.

Source: Annual accounts of respective banks

While the quantum of provisions declined for PSBs, it increased for PVBs in 2018-19, due to a rise in the latter's NPAs. Similar movements were discernible in H1:2019-20. The provision coverage ratio (PCR) of all SCBs improved to 61 per cent by end-September 2019, as PSBs' gross NPAs declined faster than the decline in their provisions and PVBs' provisioning went up markedly. In the case of profitability ratios as well, differentials in performance of PSBs vis-a-vis PVBs were evident. For PVBs, both Return on Assets (RoA) and Return on Equity (RoE) worsened in 2018-19 from the previous year, although they were considerably better than those of PSBs. In contrast, the latter were more successful in reducing their losses, building on the improvement in their asset quality. There was an overall increase in profitability in H1:2019-20 as interest income accelerated and non-interest income revived. Supervisory data suggest that RoA of SCBs improved to 0.35 per cent at end-September 2019.

Cost of Funds and Return on Funds - Bank Group-wise								
(Per cent)								
Bank Group / Year		Cost of Deposits	Cost of Borrowings	Cost of Funds	Return on Advances	Return on Investments	Return on Funds	Spread
1	2	3	4	5	6	7	8	9 = 8-5
PSBs	2017-18	5.1	4.7	5.1	7.8	7.1	7.5	2.5
	2018-19	5.0	4.8	5.0	8.1	7.2	7.8	2.8
PVBs	2017-18	4.9	6.2	5.2	9.5	6.9	8.8	3.6
	2018-19	5.1	6.6	5.4	9.8	7.0	9.0	3.6
FBs	2017-18	3.9	3.0	3.7	8.1	6.6	7.4	3.7
	2018-19	3.8	2.9	3.6	8.2	6.2	7.2	3.6
All SCBs	2017-18	5.0	5.3	5.1	8.3	7.0	7.9	2.8
	2018-19	5.0	5.5	5.1	8.7	7.1	8.2	3.1

Notes: 1. Cost of deposits = Interest paid on deposits / Average of current and previous year's deposits.

2. Cost of borrowings = (Interest expended - Interest on deposits) / Average of current and previous year's borrowings.

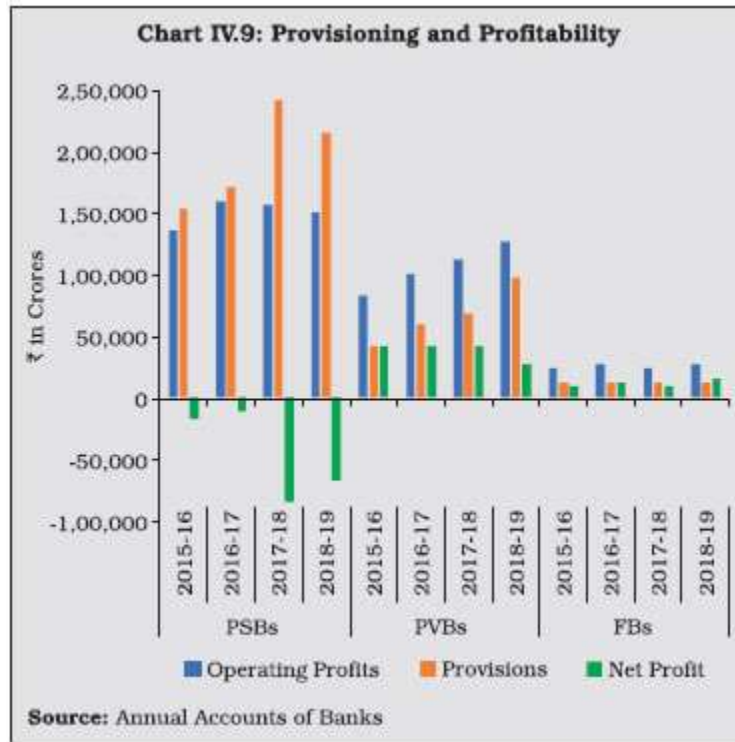
3. Cost of funds = Interest expended / (Average of current and previous year's deposits plus borrowings)

4. Return on advances = Interest earned on advances / Average of current and previous year's advances.

5. Return on investments = Interest earned on investments / Average of current and previous year's investments.

6. Return on funds = (Interest earned on advances + Interest earned on investments) / (Average of current and previous year's advances plus investments).

7. Data include SFBs. For PSBs and PVBs, data adjusted for reclassification of IDBI Bank Ltd.
Source: Calculated from balance sheets of respective banks



Return on Assets and Return on Equity of SCBs – Bank Group-wise

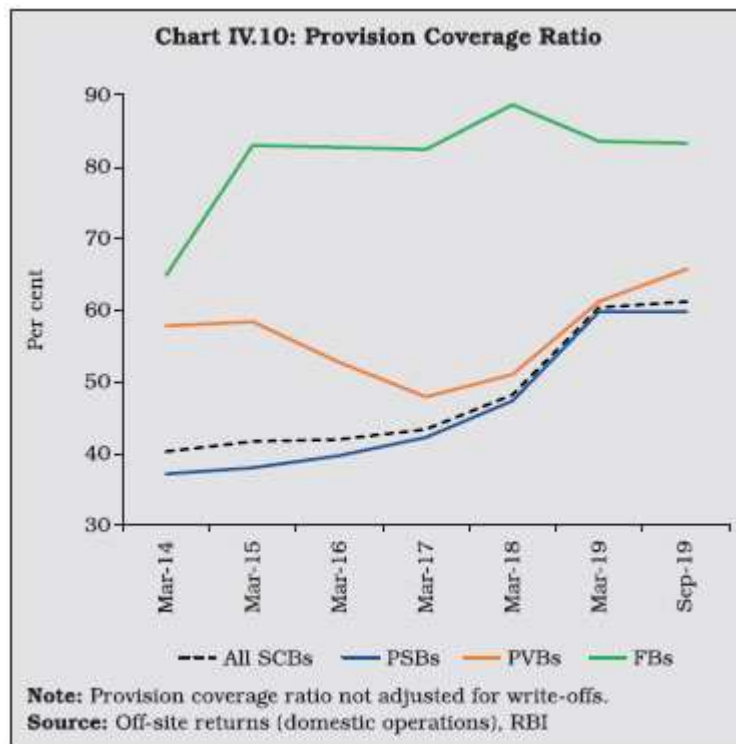
(At end-March)

(Per cent)

Bank Group	Public Sector Banks		Private Sector Banks		Foreign Banks		All Scheduled Commercial Banks	
	2017-18	2018-19	2017-18	2018-19	2017-18	2018-19	2017-18	2018-19
RoA	-0.84	-0.65	1.14	0.63	1.34	1.56	-0.15	-0.09
RoE	-14.62	-11.44	10.12	5.45	7.16	8.77	-2.81	-1.85

Note: For PSBs and PVBs, data adjusted for reclassification of IDBI Bank Ltd.

Source: Annual Accounts of Banks.



Soundness Indicators

Soundness indicators are matrices that enable a comparison of financial health across banks and time. During 2018-19 and 2019-20 so far, there has been a gradual improvement in capital adequacy, liquidity and asset quality.

Capital Adequacy

The capital to risk-weighted assets ratio (CRAR) of SCBs has been improving from the low of 13 per cent reached in 2014-15. Evidence suggests that strengthening the capital base of banks facilitates credit expansion in a non-linear fashion. .

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