Role of Public Sector Banks in the Growth of Commercial Banking in India

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Abstract:

Economic reforms in India brought a drastic change in the functioning of all spheres of economy. The liberalization, privatization and globalization have given rise for private participation, free trade, etc. Privatization, which has taken its roots from the economic reforms, has spread in all most all sectors of the economy. Indian banking system too has caught into the hands of privatization, but due to the strong fundamentals and the policies of the regulatory authorities the public sector banks in India has maintained its dominance in the Indian banking system. The private sector has grown by leaps and bounds in many sectors of India, but the participation of public sector banks in a developing economy like India is crucial, as it is trusted by the public at large. The public sector banks have a key role in the wide spread of commercial banking in India, especially in the rural areas.

Introduction:

One of the major objectives of banking sector reforms has been to enhance efficiency in total earnings, interest earnings and net interest earnings. The position of public sector banks continues to play a predominant role as these banks account for nearly three-fourths of assets and income. It is important to note that public sector banks have responded positively to the new challenges and competitions that came into play due to reforms introduced in the banking sector.

The predominance of public sector banks in India's financial sector is reflected in the increase in share of these banks in the overall profit of the banking sector. From the position of net loss in the mid 1990s, in recent years the share of public sector banks in the profit of the commercial banking system has become broadly commensurate with their share of assets, indicating a broad convergence of profitability across various bank groups. Public sector banks are competing effectively with private sector and foreign banks. The market discipline imposed by the listing of most public sector banks has also probably contributed to this improved performance. Public sector banks managements are now probably more attuned to the market consequences of their activities.

Objectives of the Study:

The broad objective of the study is to examine the role of the public sector banks in the growth of the commercial banking in India. However, the following are the basic objectives of the study:

- To study the break-up of bank branches of different sectors, examine the growth of branches and their share in the total commercial banks of India.
- To analyze the share of various sources of financial savings by household sector in India.
- To examine the group-wise share of deposits of scheduled commercial banks.
- To study the bank wise share of CASA Deposits in total deposits.
- To compare the actual and statutory requirements of SLR investments of scheduled commercial banks, and
- To compare the SLR and Non-SLR investments of commercial banks.

1. Public sector banks make up the largest category of the Indian banking system. There are 27 public sector banks in India; it includes the SBI and its 6 associate banks, 19 nationalized banks and IDBI bank ltd.

Table I: Break-up of Bank Branches (as on June 30, 2009)

Type of Bank	**1969**	**2004**	**2009**	**Rural Branches As on June 30, 2009**	**Rural Branches as % of all Branches on June 30, 2009**
SBI & Associates	2462 (30.0)	13621 (20.2)	16294 (20.2)	5619 (17.65)	34.4
Nationalized Banks	4553 (55.0)	33359 (49.4)	39703 (49.3)	13425 (10.76)	33.8
Regional Rural Banks	---	14486 (21.4)	15199 (18.8)	11644 (36.58)	76.6
Total Public Sector Banks	**7015 (85.0)**	**61466 (91.0)**	**71196 (88.3)**	**30688 (96.42)**	43.1
Other Scheduled Commercial Banks	900 (10.8)	5807 (8.6)	8979 (11.1)	1126 (3.54)	12.5
Foreign Banks	130 (1.6)	218 (0.3)	295 (0.4)	4 (0.01)	1.4
Non-scheduled Commercial Banks	217 (2.6)	32 (0.1)	44 (0.2)	11 (0.03)	25.0
Total (All Commercial Banks)	**8262 (100.0)**	**67523 (100.0)**	**80514 (100.0)**	**31829 (100.0)**	**39.5**

Source: Economic Survey 2009-10, Government of India

*Figures in the brackets are percentage to totals.

From Table-I it can be seen that public sector banks have taken a lead role in branch expansion, especially in the rural areas. During 1969 public sector banks has 85 per cent of branches and the percentage has gone up to 91 per cent in the year 2004. These banks account for bulk of the branches in India with 88 per cent in 2009. The presence of public sector banks in rural areas is overwhelming in 2009, 96 per cent of the rural bank branches belongs to the public sector. SBI with its associates and national banks has one third of its branches in rural areas. Private sector banks and foreign banks have limited progress in the branch expansion and their presence in the rural areas is limited. Among all commercial bank branches around 40 per cent are in rural areas, which is a good sign for the balanced growth.

2. Financial savings of the household sector forms a major source of finance in the developing countries like India, because the participation of institutional investors in the financial markets is very low in developing economies, when compared to the developed economies.

Table II: Financial Savings of the Household Sector (Gross)

Source of Savings	Percent to Total Financial Savings of Household Sector		
	2006-07	2007-08	2008-09
1. Currency	10.2	11.4	12.5
2. Deposits	49.1	52.2	58.5
a. With Banks	47.8	50.4	54.9
b. Non-banking Cos	0.2	0.5	1.8
c. Co-operative banks/societies	0.0	0.0	0.0
3. Shares & Debentures	9.0	12.4	2.6
4. Claims on Government	3.0	-4.0	-3.1
5. Insurance Funds	17.7	18.0	20.1
6. Provident & Pension Funds	11.1	9.9	9.5
Financial Savings	**100**	**100**	**100**

Source: RBI Annual Report, 2008-09

Table-II presents the different sources of financial savings of household sector during 2006-07 to 2008-09. Among different sources of savings the households preferred the deposits, as its share in the total savings is almost 50 per cent during the period 2006-09. Banks has a major role in attracting the deposits from the household sector, it accounts for 55 per cent in the total financial savings of household sector in 2008-09. The share of the shares and debentures in the total financial savings of household sector has shown an increasing trend from 2006-07 to 2007-08, but in the year 2008-09 there is a drastic decrease in the share, this is the result of the global financial crisis, which made the household to shift their savings from the shares and debentures to other sources of savings. It is also evident from the table that the insurance sector is able to attract the households due to which the share in the insurance funds has increased year after year.

3. One of the most important functions of any commercial bank is to accept deposits from the public, basically for the purpose of lending. Deposits from the public are the principal source of funds for banks.

Table III: Share of Deposits of Scheduled Commercial Banks – Group-wise

Bank Group	At the End of March (in per cent)	
	2003	2009
Public Sector Banks	79.6	76.7
a. Nationalised Banks	50.8	49.1
b. State Bank Group	28.8	24.8
c. Other Public Sector Banks	--	2.8
Private Sector Banks	15.3	18.1
a. Old Private Sector Banks	6.7	4.9
b. New Private Sector Banks	8.5	13.2
Foreign Banks	5.1	5.2
Total Scheduled Commercial Banks	**100.0**	**100.0**

Source: Report on Trend and Progress of Banking in India 2003-04 &2008-09, RBI

Table-III provides the share of deposits of different classes of scheduled commercial banks. It can be seen that the public sector banks continue to dominate in the total share of deposits with 79.6 per cent in 2003 and 76.7 per cent in 2009. Among the public sector banks the nationalized banks have a major share in the total deposits when compared to SBI group. Private sector banks has 15.3 per cent share of deposits in 2003, out of which the new private sector banks have more share than the old private sector banks. The share of private sector banks in the deposits have increase in the year 2009 as the share of the new private sector banks has been rising at the expense of the public sector banks. Foreign banks have a five per cent share in the deposits in both 2003 and 2009.

4. Current Account and Savings Account deposits are low cost deposits as compared to other types of deposits from a banker's viewpoint, because the current account is non-interest bearing, while interest payable on savings account is very low. In order to control the cost of raising deposits and lend at more competitive rates it is important for banks to garner as much low-cost deposits as possible. Banks uses different methods to mobilize CASA deposits such as offering salary accounts to companies, encourage merchants to open current accounts and use their cash management facilities, etc.

Table IV: Bank-wise Share of CASA Deposits in Total Deposits (in per cent)

Bank Group	March End			
	2006	2007	2008	2009
State Bank Group	43.4	42.9	42.0	38.6
Nationalised Banks	38.2	35.4	33.0	29.9
Private Banks	30.4	29.8	32.8	32.9
Foreign Banks	50.5	45.1	44.7	41.7
Total SCBs	38.6	36.6	35.7	33.2

Source**:** Report on Trend and Progress of Banking in India 2008-09, RBI

Table-IV shows the share of CASA deposits in total deposits. Banks with low CASA ratios (CASA deposits as per cent of total deposits) are more dependent on term deposits for their funding, and are exposed to interest rate shocks in the economy. From the table it is clear that the foreign banks has majority of their deposits in CASA deposits, but its share is decreasing year after year. SBI group has the next highest share of CASA deposits in its total deposits and the share of these deposits tends to decrease every year. It can also be observed that the share of CASA deposits in total deposits of the scheduled commercial banks as a whole has been declining, indicating that the cost of deposit mobilization of the commercial banks is rising, which is a challenging task for the banking sector in the coming years.

5. As per the Banking Regulation Act, 1949, the RBI prescribes the minimum SLR for the Scheduled Commercial Banks in India in specified assets as percentage of the bank's NDTL. The actual percentage i.e., the value of such assets of an SCB as a percentage of its NDTL must not be less than such stipulated percentage. The RBI may change the stipulated percentage from time to time. Over the years, the SLR ratio has changed a lot, it was 38.5 percent in 1990's and came down to 25 percent by October 1997, with the financial sector reforms giving banks a greater flexibility to determine their respective asset mix. The SLR was further reduced to 24 percent in November 2008, but has been raised back to 25 percent level since October 2009.

Table V: SLR Investments of SCBs: Actual vs. Statutory Requirement

Year (End March)	Actual SLR Investment as % of NDTL	Statutory SLR required as % of NDTL
2006	31.3	25
2007	27.9	25
2008	27.8	25
2009	28.1	24

Source: Report on Trend and Progress of Banking in India 2008-09, RBI

Table-V shows the comparison of actual SLR investments and statutory SLR requirement as percentage of NDTL. It is seen from the table that during the period of study the banks have maintained more than the required SLR investments and the percentage of SLR investments as percentage of NDTL is highest in 2006 with 31.3 per cent. This indicates that the banks have good amount of investments in the RBI approved securities and has high liquidity position and are strong enough to meet the statutory requirements.

6. The RBI has prescribed that all SCB's should maintain their SLR in the instruments which will be referred to as "Statutory Liquidity Ratio (SLR) securities", such as

➢ Dated securities as notified by RBI;

➢ Treasury Bills of the Government of India;

➢ Dated securities of the Government of India issued from time to time under the market borrowing programme and the Market Stabilisation Scheme;

➢ State Development Loans (SDLs) of the State Government issued from time to time under their market borrowing programme; and

➢ Any other instrument as may be notified by RBI.

Table VI: Investments by Commercial Banks

(Rupees in Crores)

Year (End March)	SLR Investments			Non-SLR Investments (d)	Total Investments (c+d)=e
	Government Securities (a)	Other Approved Securities (b)	Total SLR (a+b)=c		
2006	700,742 (82)	16,712 (2)	717,454 (84)	135,340 (16)	852,794 (100)
2007	776,058 (83)	15,458 (2)	791,516 (85)	140,455 (15)	931,971 (100)
2008	958,661 (84)	13,053 (1)	971,714 (85)	170,609 (15)	1,142,323 (100)
2009	1,155,786 (84)	10,624 (1)	1,166,410 (85)	207,517 (15)	1,373,927 (100)

Source**:** Handbook of Statistics on Indian Economy, RBI 2008-09.

* Figures in brackets show the investments as a percent to the total investment

The composition of investments by commercial banks is given in the Table-VI. It can be seen that with 85 per cent, the total SLR investments of commercial banks forms the major portion in the total investments during 2007-09. With almost 95 per cent in the total SLR investments, Government securities form the bulk of total SLR investments. Non-SLR investments form a relatively small part of banks' total investments. There is an increasing trend in the total investments by the commercial banks.

Conclusions:

The position of public sector banks continues to play a predominant role and these banks has responded positively to the reforms introduced in the banking sector. By expanding the branches all over the country, especially in the rural areas the public sector banks acts as a key driver in the growth of commercial banking in India and aids in balanced growth. Deposits from the major source for financial savings by the household sector in India, the public sector banks are the most preferred platform for the deposits by the public and accounts for the three-fourth share in the deposits of scheduled commercial banks.

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