CHAPTER 2

LITERATURE REVIEW

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An academic study on the performance of the banking sector in India is very important and relevant in the context of its structural existence. Before taking up such an exercise, an attempt is made in this section to present a review of the available studies in the relevant area of banking.

The very nature of the banking business is so sensitive because more than 85% of their liability is deposits from depositors **(Saunders, Cornett, 2005).** Banks use these deposits to generate credit for their borrowers, which in fact is a revenue generating activity for most banks. This credit creation process exposes the banks to high default risk which might led to financial distress including bankruptcy. All the same, beside other services, banks must create credit for their clients to make some money, grow and survive stiff competition at the market place.[1]

During the great depression and after the stock market crash of 1929, the U.S. Congress passed the Glass-Steagall Act 1930 (**Khambata,1996**) requiring that commercial banks only engage in banking activities (accepting deposits and making loans, as well as other fee based services), whereas investment banks were limited to capital markets activities. This separation is no longer mandatory. It raises funds by collecting deposits from businesses and consumers via checkable deposits, savings deposits, and time (or term) deposits. It **makes loans** to businesses and consumers. It also buys corporate bonds and government bonds. Its primary liabilities are deposits and primary assets are loans and bonds.

Commercial banking can also refer to a bank or a division of a bank that mostly deals with deposits and loans from corporations or large businesses, as opposed to normal individual members of the public (retail banking).[2]

1 Bank Performance And Credit Risk Management by Takang Felix Achou Ntui Claudine Tenguh

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In **BANK PERFORMANCE AND CREDIT RISK MANAGEMENT by Takang Felix Achou Ntui Claudine Tenguh** (2008) shows that there is a significant relationship between bank performances (in terms of profitability) and credit risk management (in terms of loan performance). Better credit risk management results in better bank performance. Thus, it is of crucial importance that banks practice prudent credit risk management and safeguarding the assets of the banks and protect the investors' interests.

The study summarizes that banks used different credit risk management tools, techniques and assessment models to manage their credit risk, and that they all have one main objective, i.e. to reduce the amount of loan default which is a principal cause of bank failure.

The study also reveals that banks with good or sound credit risk management policies have lower loan default ratios (bad loans) and higher interest income (profitability). The study also reveals banks with higher profit potentials can better absorb credit losses whenever they crop up and therefore record better performances.

In **PERFORMANCE EVALUATION OF INDIAN BANKS USING DEA by Sathya Swaroop Debasish** {Management & Change, Volume 9, Number 2 (2005)} has made an attempt to measure relative performance of Indian banks over the period 1997-2004 using output-oriented CRR (Charnes, Cooper and Rhodes) DEA model (Data Envelopment Analysis (DEA) is mathematical programming technique which is appropriate for analyzing comparative performance of banking units, particularly for analyzing comparative efficiency of individual banks and peer group performance. DEA is essentially a linear programming based econometric tool that encompasses various outputs and inputs and distinctly stands out among different parametric and non-parametric approaches). And he concluded that foreign banks were more efficient than others and new banks were more efficient than old ones, due to latter often burdened with old debts. In terms of size, smaller banks are globally efficient, but large banks are locally efficient.

Khoury (1980) examined the idea of risk diversification as a prime motive for internationalization of banks. Using data for 1970-77 on thirteen leading U.S banks, he finds that the domestic and foreign assets of these banks exhibit essentially similar returns and risks but are negatively correlated with one another, and also that twelve of them achieved risk diversification through international expansion.[3]

Earlier, **Rugman** (1979) in an interesting study tested the hypothesis that firms accept a lower return from overseas because foreign investment lowers their portfolio risk. His tests for the period 1962-76 for US and Canadian banks show that the standard deviation of earnings for the banks were lower than those of the other major sectors of the economy while the mean rate of return is almost the same. [4]

Cosset and Lampron (1982) use data for the top five Canadian banks in the 1971-79 period and report that their average returns on international assets is lower than the rate of return on domestic ones. In addition, they investigate the risk of operations in the domestic and foreign sectors and find that although the standard deviation of returns on international assets is higher than on domestic assets, the standard deviation of returns on total assets is lower than for the separate measures. Finally they conclude that Canadian banks have significantly reduced the total risk of their operations by going international. [5]

In "**THE ROLE OF FOREIGN BANKS IN DEVELOPING COUNTRIES: A SURVEY OF THE EVIDENCE by Joydeep Bhattacharya"** (1994) says that a survey of the evidence reveals that 'following-the-customer' and interests of risk-diversification seem to be the dominant reasons for multinationalization. Some of the stated fears of countries do not seem to be supported by the evidence; foreign banks are not seen to dominate the markets they operate in, and their local commitment is sufficiently strong. There is some evidence on cream-skimming from the Indian case but it is not possible to generalize over a wide

3 The Role Of Foreign Banks In Developing Countries: A Survey Of The Evidence By Joydeep Bhattacharya

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cross-section of country experiences. Foreign banks also do not seem to make a very strong impact on the banking industry of those countries whose domestic banks were sufficiently competitive to start with. The major benefits to countries appear to be the technology as well as work-ethic spillovers to domestic banks.

Cornett et al (2009) exhibits that how government ownership and government participation in a country's economic system affects the performance of banking sector from 1989 through 2004. The findings of the study also show that state-owned economic and banking institutions operated less profitably when compared with privately owned state institutions. It is because that these institutions held less primary investment, and had higher credit risk than privately-owned economic institutions before 2001, and the performance variations were more significant in those nations where higher government participation and political corruption joined hands in the economical system of the respective states. In addition, from 1997 to 2000, the 4-year interval after the initiation of the economic problems of East Asian economies, the deterioration in the income profits, primary investment, and credit quality of state-owned institutions was significantly higher than that of privately-owned institutions, especially for the nations that were hardest hit by the East Asian economic and financial constraints. However, state-owned economical institutions closed the gap with privately-owned economical institutions on income profits, primary investment, and nonperforming loans in the post-crisis interval of 2001–2004.[6]

Demirguc-Kunt and Huizinga (2001) studied the performance of domestic and foreign banks in eighty countries including developing and developed countries from 1988-1995. They examined that how the net profit margin, overhead expenses, taxes paid and profitability differ between domestic and foreign banks and found that foreign banks perform better in term of profitability in developing countries, but it's totally the opposite in developed countries.[7]

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6 Domestic Vs. Foreign: A Comparison Of Financial Performance Of Domestic And Foreign Banks In Pakistan By Adeel Haneef

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Muhammet Mercan et al (2003) investigated the financial performance index of Turkish commercial banks during 1989-1999. This index allowed them to investigate the effects of scale and mode of ownership of banks with the financial performance of banks. They used the DEA model by assuming the constant return of the scales. Financial ratios were used for input and output and showing the yearly based result which determined private and foreign owned Turkish commercial banks performed better than government owned banks.[8]

Marcia Millon Cornett et al (2010) examines the effect of government ownership in the banking system during the Asian crisis. They include 16 countries from Asia to see the effect of the Asian crisis on the bank's performance during 1989 to 2004.The period from 1997 to 2000 shows the crisis effects on all the banks. They gathered the data from different sources to establish the ownership percentage of the banks. By using the capital/assets, Allowance for loan, Nonperforming loans/loans, Loans/deposits, Government securities/assets, Asset growth rate as dependent variables by using the regression, finds out that state owned banks generally operated less profitable and have lower ability to take credit risks than privately owned banks prior to 2001. The Banking sector in most of the transition countries consists of different segments with different functions and speared with an extensive branch network. Their primary function is to collect the deposit, handles the transactions including foreign currency matters. Domestic commercial banks were handled by state banks in many countries.[9]

Rizvi (2001) conducted a study during 1993-98 to measure the productivity of Pakistan banks by applying the DEA. A sample of 36 banks including domestic, foreign and public banks was used during the first financial reforms in Pakistan banking industry to see the effects of reforms. The result showed that domestic banks performed better than a foreign bank in this duration.[10]

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Qayyum et al (2006) conducted his study by taking the sample of 29 including the domestic, foreign and public banks during 1998-05. They used Stochastic Frontier Analysis by using input as labor, capital and borrowed funds while taking two outputs, loan advances and investments. The results showed that the efficiency score was highest in 2004 for all types of banks while it was lowest in 2001 for all groups. The result showed that domestic banks were less efficient than foreign banks. The scale of economies also exists in this study for all banks which shows the scale of economies was higher for small banks and lower for big banks. A domestic bank has a lower economy of scales as compare to foreign banks.[11]

Akmal et al (2008) estimated the technical efficiency of the Pakistan banking sector by taking the sample of 30 banks including 4 public, 18 private and 8 foreign banks during the period of 1996-2005. For estimation purposes they used the two stages DEA to calculate the score for technical and scale efficiency and also used the Tobin regression to find out the effect of several banks on macroeconomic factors. The results suggested that banking efficiency has increased since 2000 and foreign banks are more efficient than private and public banks in Pakistan.[12]

In **Domestic vs. Foreign: A Comparison of Financial Performance of Domestic and Foreign Banks in Pakistan by Adeel Haneef**,(2012) studied financial performance of banks in Pakistan from 2001 to 2010. This study has examined the effects of ownership structure on the performance of banks operating in Pakistan. Researcher has chosen the performance indicators that are Return on Assets (ROA), Return on Equity (ROE) and Dividend Payout which reflects the liquidity and profitability of the banks in aspects of performance. The Hausman Test analysis for domestic and foreign banks reflects that the domestic banks operating in Pakistan are performing better than foreign banks. The main reason of this would be the deposit of domestic banks. As all the domestic banks have a major proportion of deposit in Pakistan. According to the economic survey of 2012 the five major banks of Pakistan have above 50% proportion of deposits. This automatically enhances the probability of having the better ROA and ROE. The other

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factor would be having the higher total assets and equity than foreign banks. To be at the level of domestic banks it would be the long run for foreign banks operating in Pakistan. The analysis can be extended in new horizons as well. This initiates the several discussions and research dimensions.

Molyneux and Seth (1996) examine foreign bank profitability and commercial credit extension for the period 1987-1991 in the USA and they find out that the capital strength and demand on loan have positive effect on the foreign bank profitability but unfortunately unrelated to an improvement in commercial lending. Furthermore, in order to generate higher profitability, a foreign bank in USA should deal with a considerable capital, in other words with a certain higher level of capital compare to other financial institutions.[13]

Analyzing efficiency and productivity of Malaysian domestic and foreign commercial banks from 1994 till 2000, **Matthews and Ismail** (2005) figure out that efficiency is related to size instead of profitability and productivity is based on technical change. They conclude that foreign banks are in a better position than domestic banks in the case of efficiency.[14]

Flamini, McDonald and Schumacher (2009) analyze the determinants of commercial bank profitability in Sub-Saharan Africa (SSA) by testing a sample of 389 banks in 41 SSA countries. The results of this study show that private and foreign banks are doing better than public and local banks respectively in term of profitability. It is also mentioned that bank size, activity diversification and private ownership are positively related to the banking profitability in terms of return on asset. In contrast, credit risk and macroeconomic variables have a negative impact on bank profitability.[15]

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In order to examine Efficiency of Indian banks, **Varadi, V. Kumar, P. Kumar and Boppna, Nagarjuna** (2006) have used four indicators which are profitability, productivity, asset quality and financial management for public, private and foreign banks for a period of 1999-2003. The results of the study show that public banks have a high efficiency according to both above ratios, whereas private banks have a very high inefficiency, but foreign banks are in a better situation compare to private in term of efficiency.[16]

In **Financial Performance of the Malaysian Banking Industry: Domestic vs. Foreign Banks by Mamadou Lamarana Guisse (**June 2012) studied the performance of the Malaysian's local and foreign banks, and compared their profitability in the financial sector. Profitability of commercial banks can be influenced by several factors, such as liquidity, Asset Quality, capital, operating expenses, and the size of the banks. Measuring the profitability in term of Return on Asset (ROA) and Return on Equity (ROE) is done by using bank specific variables and Dummy is introduced in the regression as another factor that influence profitability especially during the period of 2008 to indicate whether the financial institutions have been affected by the crisis or not. For this analysis, a panel regression methodology has been applied to empirically investigate the performance of seven (7) local and seven (7) foreign commercial banks, covering a period between 2005 and 2011. The comparison between the two categories of ownership indicates that foreign banks are more profitable than domestic.

"Liquidity, Productivity and Profitability of Foreign Banks and Domestic Banks in India, A comparative analysis" by **D.N. Nayak** described the high rate of growth in the business of foreign banks during the last decade. The performance of those banks in terms of other indicators like productivity and profitability made that group of banks a better performer than all other Domestic Banks in India**.**[17]

The study questioned as to "Does the better performance of Foreign Banks relative to Domestic Banks indicate that foreign banks adopt better management practices, policies and procedures and possess superior organizational skills and know how or are there any special

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factors which are responsible for the relatively good performance of foreign banks ?

"Determinants of profitability of SBI group, other Nationalized Banks and Foreign Banks in India" by **Saveeta and Satish Verma**. They examined the profitability of commercial banks. They have depicted a declining trend in profitability since 1969, showing a comparatively better performance of foreign banks.

Their study was based on time series data from 1971-1996 and have analyzed the data using a number of statistical tools like ratios, averages, percentages etc. The performance of SBI group and other nationalized banks improved during 1981-1990 and it further improved after the initiation of the financial sector reforms in 1991 and the profitability of SBI group was observed to be higher as compared to that of foreign banks.[18]

Sankar and Das (1997) compared performance of public, private and foreign banks for the year 1994-95 by using measures of profitability, productivity and financial management. They find PSBs (public sector bank) comparing poorly with others.

Bhattacharya (1997) studied the impact of the limited liberalization initiated before the deregulation of the nineties on the performance of the different categories of banks, using Data Envelopment Analysis. They covered 70 Banks in the period 1986-91.

Ram Mohan (2000) studied the performance of public sector banks with private & foreign banks for the period of 1994-95 to 99-2000 regarding profitability and credit efficiency.[19]

The optimism that the process of liberalization, privatization and globalization would transform the otherwise ancient and miserable banking organizations into a multi-modal, technology-savvy, customer-centric, growth and profit-oriented modern financial intermediaries, has also been blemished with the fear that the conventional public sector

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banks would not be able to face the onslaught of competition from the Indian and foreign private sector banks and would be pushed to the edges of bankruptcy. These fears were found to be true by studies on performance and profitability of public sector banks but the research evidences in this regard have been only irregular and often contradictory. It has been reported that in the post-reform period the public sector banks were looser in terms of their market share in deposit mobilization and credit deployment and were saddled with relatively higher share in the non-performing assets **[Chansarkar, 1999, Shirai, 2002]**. Share of public sector banks in deposit base which as high as 91 percent in 1991, has already shrunk to 82 percent in 2001 and most of these losses have been in favour of the private sector banks whose deposit base has skyrocketed from a mere 4 percent in 1991 to 12 percent in2001. Interestingly, however, the share of foreign banks in the deposit base during the corresponding period has increased only marginally, from 5 percent to 6 percent **[Shirai, 2002]**. Employee morale and motivation in the public sector banks have also been reported to be low resulting into lower business and profitability per employee in such banks **[Charansarkar, 1999].** In contrast, studies have also shown that the public sector banks have continued to enjoy the confidence, faith and trust of common public and are still considered to be their favoured banking destination **(Qamar, 2003).** There have been strong perceptions that the public sector and old private sector banks have an edge over the new private sector and foreign banks **[Ramamoorthy, 1998]** and those they have the potential to compete successfully, particularly if they could leverage technology. There are also views that the public sector banks have been doing quite well except for the political intervention **[Saikia]**.[20]

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In **A THESIS ON THE STUDY OF FINANCIAL PERFORMANCE OF BANKING SECTOR OF INDIA by NIRMAL NATHWANI** (April 2004), the whole banking sector is not covered in some studies or if it is covered, the period of study has been of a particular year or till the year 2000. But, the five years study from the year 1997-1998 to 2001-2002 for the whole banking sector divided into five groups has not been found so far. So, the need felt by the researcher to focus on the latest development and performance till the year 2002.

Banking group	**No. of banks**
SBI group	08
Other nationalized banks	19
Old private sector banks	23
New private sector banks	08
Foreign banks	42
Total	**100**

In this research the researcher has said that, the quality of products, services and process will be highly critical for the success of any business enterprise in the new era. Only the business that offers top quality products and services will succeed in the days to come. The road ahead has immense potential and opportunities but with challenges at every turn. It is only those banks which adapt themselves to the changes, innovate and introduce new technologies to meet the needs of the customer will succeed. Banks which have new and innovative business models in place will be geared to meet the challenges and compete effectively in the market. It is these banks which would attain higher reaches of success in the days to come. [21]

A clear split can be seen between banks with a big emerging markets presence and focus, and those rooted in the developed Western economies. The banks' UK operations produced some slow growth, but the situation in the Eurozone proved more challenging, with Lloyds suffering impairment losses in Ireland, and Barclays hit by impairment in Spain. The increasing economies of Asia by contrast, offer stronger growth opportunities.

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As a result, HSBC and Standard Chartered, which are heavily focused on Asia in particular, sound a more upbeat note about future prospects. Lloyds and RBS, and to a lesser extent Barclays, have a more cautious outlook that highlights potential challenges ahead, not least the impact of public sector austerity measures and the risk of a double dip recession in the West.[22]

Underlying the rebounds in profitability a number of key trends are emerging:

- Significant reductions in impairment charges from the record highs of 2009 have been the main driver of increased profitability across the banks, with underlying income levels remaining relatively flat.

- Those banks with large investment banking businesses are continuing to benefit from healthy trading profits, although not quite repeating the exceptional levels experienced in the first half of 2009.

- There is a clear distinction between those banks that are running down legacy non-core business (i.e. Lloyds and RBS), and those which are targeting growth (i.e. HSBC, Barclays and Standard Chartered).

- HSBC and Standard Chartered are continuing to focus on Asia and have generally fared better in recent years and now report the profits from their Asian businesses as representing 56 percent and 86 percent of their total profits respectively.

- Revaluation of own debt and/or one off gains and losses on restructuring funding arrangements at Barclays, RBS, Lloyds and HSBC benefited the results of the banks' underlying core businesses.[23]

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HSBC and Standard Chartered stand out from the other banks as having showed strong performance through the financial crisis due to their geographical diversification. They are both significantly less dependent upon the European and North American markets, instead focusing on the less troubled Asian regions. HSBC reported that only 15.9 percent of its net operating income was generated from North America, whilst Asia saw the most growth. Standard Chartered generated only 9.7 percent of its operating income from the Americas, UK and Europe, down from 12.9 percent in the equivalent period of 2009.

As the banks have looked to strengthen funding and capital bases, and take advantage of relatively low values on own debt, a number of restructuring transactions have taken place. Repurchases, extinguishment and exchange of debt for equity has generated gains for RBS and Lloyds in the period of £0.6 billion and £0.4 billion respectively. Alongside this, Barclays, RBS and HSBC have benefited from significant gains on the revaluation of their own issued debt as credit spreads push down valuations in the second quarter following concerns over sovereign debt in certain Eurozone countries.

Without question the future regulatory environment in markets around the world will look different. The problem is that its exact shape and the consistency of its application across jurisdictions remains clouded in uncertainty.

High level of volatility during 2009 and favorable market conditions in the first quarter of 2010 generated large revenues for the banks from their flow businesses. However, activity tailed off in the second quarter of 2010 and if market activity remains subdued through the rest of the year banks' revenues will continue to suffer. [24]

HSBC continues to focus on leveraging its strength across Asia, the Middle East and Latin America. As a result, it increased the revenue contribution made by emerging markets from 35 percent to 37 percent period-on-period. In its results, the bank also emphasized efforts to build out its equities platform across advisory, equity capital markets, research and distribution, producing expansion in Hong Kong, mainland China, India, the Middle East, Brazil and Mexico, as well as the UK, France and Germany.

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Likewise, Standard Chartered's strategy continues to focus on Asia, Africa and the Middle East. In its Corporate Finance division, the bank has combined investment in its organic business with some acquisitions, producing an increase in first half income of 52 percent on the same period of last year.

Barclays Capital continues to expand too following on from its 2008 acquisition of Lehman Brothers' North American operations. [25]

The ECB (European Central Bank) financial stability review released in June 2010 indicated that loan losses in the European banks may continue until 2011. This, again, raised concerns in respect of the banks' Eurozone related exposures, in particular exposures to Greece, Ireland, Italy, Portugal and Spain which have relatively low credit ratings.

Following the publication of the stress test outcomes on 91 European banks by the CEBS (Committee of European Banking Supervisors) recently, Barclays, RBS, Lloyds and HSBC disclosed their sovereign exposures across the 30 CEBS-defined European Economic Area (EEA) markets as at 31 March 2010 through the FSA (Financial Services Authority). Their gross exposure (net of impairment) to the central and local governments of the above mentioned Eurozone markets as at 31 March 2010 are as follows:

- Barclays -£6.7 billion
- HSBC -$9.8 billion (equivalent to £6.5 billion)
- Lloyds -£0.2 billion
- RBS -£11.7 billion

Standard Chartered was not subject to the CEBS stress test and comparable information on its sovereign exposures was not available.

As the International Monetary Fund (IMF) noted in its July Global Financial Stability Report Market Update: "Spillovers between sovereigns and the banking system increased market and liquidity risks. Banks again have become less willing to lend to one another, except at

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the shortest maturities, especially to banks in euro area countries perceived to be facing greater policy challenges. Moreover, financial asset price volatility increased and investor risk appetite declined. Such financial risks have raised the chances of re-establishing an adverse feedback loop to the economy, though to date there is little evidence of this.” [26]

According to the IMF’s July Market Update, uncertainty about the banks’ exposures was producing “significant interbank funding strains” with longer-term LIBOR (London Interbank Offered Rate) - overnight index swap (OIS) spreads widening again. Bank funding pressures, it went on to say, “May accelerate the ongoing deleveraging process.”

Meanwhile, along with deteriorating bank lending conditions, the IMF reported a marked reduction in nonfinancial corporate bond issuance, especially from European firms. Any tightening in credit availability for corporates risks provoking a rise in insolvencies, and further depressing economic growth. [27]

Geographic focus has been, and will continue to be, an important factor in banks’ performance and prospects. Broadly, banks whose businesses are concentrated in Western Europe are expected to see lower growth than those with a significant market share in the growing BRIC (Brazil, Russia, India and China) economies· This is reflected in the fact that whereas Lloyds and RBS are continuing the deleveraging process, banks with global retail and commercial operations, such as HSBC and Standard Chartered, with exposure to the growing markets of Asia and Latin America, are not.[28]

A quick review of the banking sector progress has shown that in many ways than one, the process of development of the guidelines that govern the institutions and the accompanying fundamental principles has overtaken the demand of the real economy and the process of restructuring itself. This is evident in the various achievements in several areas of the banking sector. The introduction of the BIC (Bank Identifier Code) principles coupled with the legislation of the central bank’s independence and the introduction of transparency and accountability

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mechanisms into the financial framework have all added up in the list of achievements.

Over the last few years, all the below countries of "New Europe", guided by the anchor of a potential future EU (European Union) membership, took advantage of the favorable global economic environment to restructure their economies and address chronic problems of the past. As a result, they were able to achieve high rates of real GDP (Gross Domestic Product) growth, improve their fiscal position and other macro-economic fundamentals, increase the purchasing power of households and, hence, private consumption. These improved prospects resulted in a substantial decline of country risk premia-sovereign spreads are now at record lows over benchmark Euro-Area yields enabling the governments to borrow cheaply in order to finance their expansion plans. Of course, problems continue to linger as, for example, in some countries the inflow of FDI (Foreign Direct investment) is not sufficient to cover the large current account deficits, or in others the rate of inflation has difficulty declining beyond a certain point. [29]

Sayilgan **and** ***Yildirim*** (2009) explore bank profitability in Turkey over the period 2002-2007 using monthly data and aggregate balance sheet of the banks, through multi-variable single-equation regression method. Results showed that consumer price index inflation and ratio of off-balance sheet transactions to total assets affect profitability indicators negatively in a statistically significant manner, while industrial production index, the ratio of budget balance to industrial production index and the ratio of equity to total assets affect profitability indicators positively in a statistically significant way.

Aburime (2006) examine bank profitability in Nigeria using a panel data set comprising 91 observations of 33 banks over the period 2000-2004. The findings of this study revealed that capital size, size of credit-portfolio and extent of ownership concentration are significant company-level determinants of bank profitability in Nigeria. Size of deposit liabilities, labor productivity, ownership, control-ownership

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disparity and structural affiliation are insignificant while the relationship between bank risk and profitability is inconclusive.[30]

Samy Ben Naceur (2003) investigates the impact of bank's characteristics, financial structure and macro-economic indicators of bank's net interest margins and profitability in the Tunisian banking industry for the 1980-2000 period. The study finds that bank characteristics explain a substantial part of the within-country variation of bank interest margins and profitability. High net interest margin and profitability tend to be associated with banks that hold a relatively high amount of capital, and with large overheads. Other important internal determinants of bank's interest margins bank loans which have a positive and significant impact. The size has mostly negative and significant coefficients on the net interest margins. This latter result may simply reflect scale inefficiencies. Finally, the paper finds that the macroeconomic indicators such inflation and growth rates have no impact on bank's interest margins and profitability.[31]

Bashir (2000) examines the determinants of Islamic bank's performance across eight Middle Eastern countries for the period of 1993-1998. A number of internal and external factor were used to predict profitability and efficiencies. Controlling for macroeconomic environment, financial market situation and taxation, the results show that higher leverage and large loans to asset ratios, lead to higher profitability. The paper also reports that foreign-owned banks are more profitable that the domestic one. There is also evidence that taxation impacts negatively bank profitability. Finally, macroeconomic setting and stock market development have a positive impact on profitability.[32]

In their study ***Demerguc-Kunt*** **and** ***Huizingha*** (1999) examine the determinants of bank interest margins and profitability using a bank level data for 80 countries in the period of 1988-1995. The set of variables includes several factors accounting for bank characteristics, macro-economic conditions, taxation, regulations, financial structure

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and legal indicators. They report that a larger ratio of bank assets to GDP and a lower market concentration ratio lead to lower margins and profits. Foreign banks have higher margins and profits than domestic banks on developing countries, while the opposite prevail in developed countries.

On an another linked paper, ***Demerguc-Kunt* and *Huizingha*** (2001) present evidence on the impact of financial development and structure on bank profitability using bank level data for a large number of developed and developing countries over the 1990-1997 period. The paper finds that financial development has a very important impact on bank performance. Specifically, the paper reports that higher bank development is related to lower bank performance (Tougher competition explains the decrease of profitability). Stock market development on the other hand, leads to increased profits and margins for banks especially at lower levels of financial development, indicating complementarities between bank and stock-market.[33]

In **PERFORMANCE AND DEVELOPMENT OF BANKING SECTOR IN THE SOUTH EASTERN EUROPE by Nikolas P Vlastarakos** (December 2009) It was the objective of the research paper to critically highlight the effects of certain bank-specific variables on the profitability of the South-Eastern banking sector. The variables are also related to specific industries. The countries under study include the following; (Albania, Serbia, Fyrom, Bulgaria, Romania, Turkey, Croatia and Moldova).The study focuses on the period of 6 years (2002-2007).This paper considers two main points of study. The initial proposition is based on the examination of the effects of both the internal and the external determinants that affect the banking profitability in the SEE (South Eastern European) countries. The second proposition however examines the direct and indirect influence of the banking sector reforms in the profitability gap of the SEE countries. A brief description of the bank performance and development in the countries of SEE under study, over the period 2002-2007, is also presented.

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Based on the results of the empirical analysis, the researcher concluded that credit risk, capital size and liquidity significantly determine bank profitability in the selected countries of SEE. Credit risk is one of the main determinants of banking sector's performance showing that SEE banks should focus more on credit risk management which has been proved problematic in the recent past. Serious banking problems may arise from the failure of banks to evaluate credit risk more effectively. An immense help towards these problems would be provided by retaining credit expansion as financial deepening continues. Capital strength is another main determinant of bank profitability providing support to the argument that well-capitalized banks face lower costs of going bankrupt, which reduces their cost of funding. Liquidity has a significant impact on profitability in SEE banking sector but as the current global environment is unstable, liquidity risks are higher. State ownership is negatively correlated with bank profitability indicating that state owned banks in the region must focus on profit maximization rather than serving governments' macroeconomic policies. Bank profits in the region are significantly affected by GDP growth supporting the argument of the association between economic growth and the banking sector performance. The estimated effect of banking sector's size does not provide evidence of economies of scale in banking industry of the region. Likewise, the foreign ownership status of the banks and inflation rate are insignificant in explaining profitability. Finally, market concentration and unemployment rate are not conclusive and further research is required. [34]

In general, SEE financial sector achieved remarkable progress over the examined period 2002-2007. The increasing level of financial reforms (closely related to general economic growth) and the improvement in structure and management of the credit institutions contributed to the strengthening of the banking system. However, banks are by no means, immune to risks and should remain vigilant in keeping up their credit standards, liquidity and capital adequacy, becoming aware to limit their exposure in lending. The approach followed in this paper may well have considerable potential as a tool for exploring bank profitability

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determinants with the purpose of suggesting optimal policies to bank management.[35]

Supporters of foreign direct investment (FDI) state that increased foreign banks entry rise competition in the banking market thus stimulating the decrease of costs, increasing the quality of banking services, and bringing more efficient banking techniques **(Terrell, 1986; Bhattacharaya, 1993; Levine, 1996; Buch, 1997; Berger and Hannan, 1998, Claessens and Jansen, 2000; Claessens *et al*., 2001, Hermes and Lesnik, 2004).**

Foreign banks have a more highly developed technology base that can allow for lower overhead costs or they have usually better credit risk management techniques that increases the quality of loan portfolio **(Claessens *et al*., 2001; Uiboupin, 2004,).** At the same time, greater presence of foreign banks enhances the efficiency of banking system by decreasing banks' overhead costs, incomes and profitability, banks are forced to decrease prices and cut on their expenses**.**

Opening domestic financial sector and allowing for foreign banks entry is generally seen as contribution to the efficiency and stability of the domestic banking system. Several arguments presented below by **Glaessner and Oks (1994), Levine (1996), Dages *et al*. (2000), Hermes and Lesnik (2004)** support the liberalization of financial markets highlighting the benefits of foreign bank entry.[36]

It is argued that presence of foreign banks intensifies competition that stimulates domestic banks to reduce costs, improve efficiency and increase the diversity of financial services. **Levine (1996, p. 238)** argues that entry of foreign banks will lead to improvements of the quality, pricing and availability of financial services, both directly by bringing enhanced banking technology, new products, management know-how and training procedures, as well as indirectly by stimulating competition and forcing domestic institutions to improve the quality of their services in order to stay competitive. At the same time, increased competition may lead to lower interest rate margins and profitability. The new products and services may provide better opportunities for portfolio diversification, while more sophisticated systems for estimating and

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pricing credit risk may improve the allocation of credit, so that improving the quality of financial services and contributing to more efficient domestic banking practices

Presence of foreign banks may also increase the quality of human capital in the domestic banking system either by importing high-skilled bank managers to work in their foreign branches or by investing in training of local employees. The increase in the quality of available human capital for the domestic system may lead to improved efficiency of domestic banks as well, which may help to reduce costs. Yet, these costs reductions may only occur in the longer term, since first banks have to incur costs by investing in their employees' training **(Hermes and Lesnik, 2004).**[37]

As argued **by Glaessner** and Oks (1994), foreign bank entry may spur improvements in the financial system infrastructure, including accounting and transparency, financial regulation, supervision and supervisory skills, and through stimulating the increased presence of such supporting agents as rating agencies, auditors and credit bureaus, which in turn will promote the development of the domestic financial system. Improvement of domestic bank regulation has several beneficial effects on economic development. Firstly, it will reduce the chances for systematic bank failures; and secondly, it will lead to sustained provision of growth-enhancing financial services, such as risk diversification, transaction facilitation, resource allocation, and corporate governance, making financial system more stable **(Levine, 1996, p. 244).**[38]

Levine (1996) argues that foreign bank presence increase the amount of funding available to domestic projects by facilitating capital inflows, hence promoting capital formation and economic growth. It has been also argued that entry of foreign banks may improve the overall stability of the domestic banking system by being a stable source of credit **(Dages *et al*., 2000)**. It is assumed that foreign banks have access to more diversified sources of liquidity than domestic banks, thus foreign bank lending should be less affected during periods of stress in the host country. Moreover, branches and subsidiaries of large international

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banks can draw on their parent for financial support, if they experience any difficulties.[39]

There are numerous concerns about liberalizing financial market for foreign banks entry. Some scholars argue that foreign participation may actually stymie financial development instead of contributing to the efficiency and stability of domestic banking sector. Several arguments on the costs and disadvantages of foreign bank entry are discussed.

Arguments against foreign bank entry in part mirrors the benefits of financial liberalization discussed earlier. One concern is that the presence of foreign banks may weaken the domestic banks due to increased competition; they may also make domestic banks more vulnerable to adverse foreign shocks. Moreover, it is argued, that by gradually increasing their market share, foreign banks may dominate the entire local market forcing domestic banks out of the market due to their inefficiency or weaker market position.

Levine (1996) and Dages *et al.* (2000) argue that increasing presence of foreign banks will in fact decrease the stability of domestic bank credit, as through closer ties to international financial markets than domestic banks, foreign banks facilitate capital outflows. Moreover, foreign banks may "cut and run" in terms of crisis or financial difficulties (Dages *et al.* 2000) and thus could not be considered a stable source of funding for domestic market.[40]

Another arguments against foreign bank entry state that foreign banks may face difficulties when transferring some of the credit evaluation methods used in developed markets due to informational constraints in developing markets **(Garber and Weisbrod, 1993).** According to the theory, this may result in reducing the availability of credit to small and medium-size firms, as foreign banks will choose among large companies whose information is widely available.

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In addition, it has been argued that foreign banks "cherry pick" the most profitable market segments, leaving less competitive domestic banks to serve other customers with worse ratings, so that increasing the overall riskiness of domestic banks' portfolios that may result in domestic banks' collapses (**Levine 1996, Dages *et al.,* 2000).**

Another concern regarding entry of foreign banks is whether they will be adequately supervised. International banks undertake complex cross-border financial transactions that may be difficult to supervise by either the host or the home country supervisors (see IMF by Mathieson and Schinasi, 2000, p. 165). The presence of foreign banks may also weaken the ability of local regulatory and monetary authorities to influence the banking sector behavior as well as the economy, since foreign banks are less sensitive to their desires **(Clarke *et al*., 2001).**[41]

To conclude, **Levine** (1996), in his research of the role foreign banks play in economic development, states that concerns about foreign presence should not forbid liberalizing entry restrictions on foreign banks. He debates that foreign banks are unlikely to increase capital outflows significantly, and that countries should avoid capital flight by enhancing the investment climate, instead of closing economies for foreign entry. Moreover, in most countries, foreign banks are minor participants; therefore some easing of entry restrictions should not create fears of foreign banks dominating the domestic market. Although foreign banks try to exploit market positions where they have proven their success in other countries, it is a natural business tactic that will lead to competitive improvements of financial services in the domestic market. Furthermore, as foreign banks gain more experience about the domestic market, they may expand to broader segments. Thus, the argument that foreign bank "cherry pick" some segments of the market should not deter from financial liberalization**.**[42]

The most comprehensive study on the efficiency and competition effects of foreign entry was made by **Claessens, Demirguc-Kunt and Huzinga** (2001). Using a large data set of 80 developed and developing countries in the period from 1988 to 1995, they investigate whether there is any difference in net interest margins, overhead costs, taxes paid and

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profitability between foreign and domestic banks. It was found that foreign banks tend to have higher interest margins, profitability, and tax payments than domestic banks in developing countries, while the opposite is true for developed countries. They also show that increased presence of foreign banks is associated with reductions in profitability, non-interest income, and overhead expenses of domestically owned banks.

The efficiency effects of foreign bank presence occur immediately upon entry and do not depend on gaining a substantial market share. Claessens *et al.* conclude that foreign bank entry promotes efficiency and improves the functioning of domestic banking markets.

Terrell (1986) likened the banking markets of 14 developed countries for 1976 and 1977 and derived to similar assumption: countries that allowed foreign entry experienced lower interest margins, pre-tax profits and operating costs.[43]

Hermes and Lesnik (2004) repeat the study of Claessens *et al.* (2001) on the effects of foreign access on the efficiency of domestic banking system, developing further the model by including a level of economic development as an important factor determining the effects of foreign banks presence on domestic banks. The study employs a bank level data for 48 countries for the period 1990-1996 concluding that, at least in the short term, at lower levels of economic development foreign bank entry is associated with higher costs and margins of domestic banks, while at higher levels of economic development the results appear to be somehow contradictory: costs and margins are either insignificantly associated with foreign bank entry or have negative association. Non-interest income was found to be negatively and significantly related with rise in foreign bank entry in the developing countries, while in developed countries it is either positive or minor. The results also indicate that at high levels of economic development the fall of overhead expenses is stronger than the fall of margins, leading to increased profits, while at low levels of economic development the rise of costs is stronger than the rise of margins, resulting in reduced profits.

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Hermes and Lesnik interpret their conclusions as follows: at lower levels of economic development there is a large gap between the development of foreign and domestic banks, therefore domestic banks' costs significantly increase due to investments in modern techniques and practices. Since domestic banks still have a strong market share in the local market, they are able to raise the fees for their services in order to pay for new investments, so that raising interest rate margin as well as non-interest income. At the higher level of financial development the gap between domestic and foreign banks is smaller and banking markets are extra competitive, therefore domestic banks are forced to cut their expenses and become more efficient. This supports the argument that foreign banks put competitive pressure and contribute to higher efficiency of domestic banking market.

One of the recent cross-country studies on the impact of foreign bank entry was performed by **Uiboupin** (2004). Uiboupin empirically estimates the short-term effects of foreign banks entry on bank performance in Central and Eastern European (CEE, CEE countries used in the analysis are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and Slovakia) countries. Unlike previous studies, both domestic and foreign banks were included into the sample, as they intended to analyze foreign bank entry impact on the whole banking market and also due to clear domination of foreign banks in many CEE countries. It was found that foreign banks entry is negatively related to revenues from interest-earning assets, non-interest income, loan loss provisions and profitability. Limited evidence was found suggesting that foreign entry can also raise bank's overhead costs. A negative relationship with profitability measures proves that foreign presence enhances competition in the host country. Uiboupin also analyzed the role of the banking sector development. Results show that in more developed banking markets foreign entry is less associated with declining incomes and loan loss provisions than in less developed markets supporting the technology gap hypothesis.[44]

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In countries with higher level of financial development overhead costs are less likely to increase, because the banking system is already well developed and fewer additional investments are needed. **Zajc** (2003) performed an analysis of foreign bank entry in transition countries (Chezk Republic, Estonia, Hungary, Poland, Slovakia, and Slovenia), confirming the results of Uiboupin that foreign entry reduces non-interest revenues and profits, at the same time raising the costs of CEE domestic banks.

Another study for Central and Eastern European countries (CEE) was performed by **Dubauskas *et al.*** (2005) that analyzed the influence of foreign banks on the banking sectors of Estonia, Lithuania, Poland and Romania. The study is based on a special survey results obtained by the authors from domestic and foreign banks in these countries. Dubauskas *et al.* (2005) concluded that foreign banks presence increased significantly the overall competition in the banking sector and reduced profitability of domestic banks. The survey results also indicated that foreign banks enhanced service quality and innovation in the host country's banking sector, like developing Internet banking services and bringing more effective risk management techniques. Moreover, foreign banks entry has made bank more reliable, and borrowing from international markets has become less expensive both for banks and their customers.

Denizer (2000) analyzed foreign bank entry in Turkey's banking sector concluding that net interest margins, returns on assets and overhead expenses of domestic banks fell after foreign bank entry, and interpreting this as evidence that foreign entry increased efficiency.[45]

Analyzing the Colombian banking system, **Barajas *et al.*** (2000) found that foreign presence resulted in increased competition, deteriorated loan quality and lowered intermediation spreads of domestic banks.

Single country evidence provide also **Unite and Sullivan** (2001), they investigate the impact of great reform that allowed foreign banks to enter Philippines in 1994. The analysis includes 16 Philippine's commercial banks covering the period from 1990 to 1998. The authors find that liberalization of financial market is associated with the decrease

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in interest spreads and banks profit, but only for domestic banks affiliated to family business group.

Peria and Mody (2004) analyzed the impact of foreign participation on banks spreads in five Latin American countries in late 1990s and found that foreign bank presence is associated with greater competition, lower costs and lower spreads. [Studies of Argentina (Clarke et al., 1999) and Asian countries (Claessens and Glaessner, 1999) support these findings.

Kim (2005) investigated the impact of foreign banks penetration into the banking market of Korea studying the period 1999-2004. Empirical results show that increased market penetration by foreign banks puts competitive pressure on domestic banks to reduce net interest margins and profitability while increasing their operational efficiency through reduced overhead expenses. Findings are statistically significant and consistent with reviewed cross-country evidence (Claessens *et al*. 2001, Terrell 1986, Denizer 2000 and others).[46]

One of the recent studies was conducted by **Kalluru and Bhat** (2009) who analyzed whether foreign bank entry affects the operations of public sector banks in India for the period 1996-2007. The results show that increasing foreign bank entry raise profitability, overhead expenses and non-performing loans, that is contradictory to Denizer (2000) and Kim (2005) results. This suggests that foreign participation in the Indian banking sector adversely affects the operations of public sector banks.

Sabi (1996) performed an analysis of the impact of financial liberalization in Hungary and found no evidence to support that foreign bank presence improves performance of domestic banking market.

Polish domestic banking sector was studied by **Weller** (1999) and it was found that foreign banks entry brought greater competition in the Polish banking market that led banks to reduce the total credit supply to the economy, thereby adversely affecting the business environment of the country.

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Kosimidou et al. (2004) analyzed the performance of banking system in UK and found that domestic banks have higher net interest margins, pre-tax profits and loan loss provisions comparing to foreign banks. Such results suggest that foreign banks operating in a developed country may not have much impact over domestic banks operations because of certain barriers such as organizational disadvantages of managing or maintaining institution from a distance, difference in languages, etc.[47]

Dina Civikova (August 2012) in **An Empirical Study of the Impact of Foreign Bank Entry on the Bank Performance in the Baltic Countries** analyzed the performance of banking system in Baltic countries (3 northern European countries east of Baltic Sea: Estonia, Latvia and Lithuania) for the period of 1997-2007.Researcher studied that with the liberalization of financial markets Baltic countries experienced a substantial influx of foreign investors in local banking markets. Gradually Baltic banking sectors ended up highly concentrated and largely foreign-owned. The purpose of this thesis was to investigate the effects of growing presence of foreign banks on the performance of banking sector of the Baltic Countries: Lithuania, Latvia and Estonia. Particularly, it was studied how net interest margin, non-interest income, profitability, overhead expenses and loan loss provisions of local banks were affected due to the entry of foreign banks.

The general conclusion of this research is that the increasing foreign banks presence has been beneficial for Baltic banking markets. The empirical results reveal that greater foreign bank entry is negatively associated with non-interest income, net interest income, pre-tax profits and overhead expenses, while loan loss provisions are increasing with greater foreign entry. Interpretation was made that: lower profits and incomes reflect that foreign presence enhances competition in the Baltic countries, while drop in overhead costs reflects greater managerial and cost efficiency. An increase in loan loss provisions is also a consequence of greater competitive pressure; however it is only valid in the short term. It can therefore be concluded, that greater foreign banks presence enhances competition and contributes to higher efficiency of the local banking sector, as is evidenced by the results.

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Further the conclusion was made that government's intent of the financial liberalization, to make local banking sectors more competitive and efficient, has worked effectively for Baltic countries. Hence, the policy implication for governments and central banks of the Baltic States is to continue their liberalized market policy allowing for foreign entry. The ultimate beneficiary is the final consumer who stands to benefit from improved services, more efficient banking operations and lower prices. It should be noted, however, that researcher at this point does not have sufficient information to tell when there would be a break-even point or when additional increase in foreign banks presence would adversely affect the performance of local banks.[48]

The nationalized banks have introduced innovative schemes in the mobilization of resources as well as its disbursement. Nationalization resulted in a comprehensive programme of branch expansion, innovations in mobilization of savings, lending to priority sectors and weaker sections of the society and so on**.**

Karkal in his book 'Perspectives of Indian Banking' has dealt with the various problems and difficulties of the banking activities after the introduction of the new social policy in banking. He analyses the implications of the changed situation in the organization and functions of banks and the techniques the banks should adopt for achieving optimum efficiency.[49]

Hussain in 'A Study of New Roles of the Public Sector Commercial Banking in India' analyses the major problems faced by the public sector banks in India. As national public sector institutions, they are required to face new challenges. How can the new developmental, organizational, managerial and functional problems be solved? How best can they serve the priority sectors for economic regeneration and what should be the strategy for dynamic commercial banking policy in India - were some of the basic problems discussed in the book.

Giridhari in his paper has narrated the growth of private sector banks and public sector banks as a whole for a three year period - 1989 to 1991. The growth is narrated both figure-wise and percentage wise. The important variables considered in the study include - paid up capital,

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49 Performance Effectiveness Of Nationalised Banks: A Case Study Of Syndicate Bank By Zacharias Thomas

deposits, advances, priority sector credit, investment, income, expenditure, profit as also per employee deposits, advances, profit, investment, branch, expenditure etc. Though the study is empirical in nature, the individual performance of the banks is outside the purview of the study. An integrated picture of the performance of the two sectors too is beyond the scope of the study.[50]

Banking reforms in India allowed the entry of private banks. It, in turn, increased competition, leading to growth in the industry's performance.

Cook *et al*. (2005) studied Indian and Thai banks, applying Data Envelopment Analysis (DEA), to find if private foreign banks have higher efficiency than the private Indian or Thai banks during the post-reform period. On the other hand, **Usai and Vannini** (2005) studied Italian banks and concluded that smaller and less complex banking institutions were usually better equipped than the large hierarchical banking corporations. Their main motive was to find which sized banks (large or small) affect the economic development of the country more. They concluded that small banks affect more than the large banks. Therefore, there is an important relationship between size and efficiency in the banking sector**.** **Sanjeev** (2006b), using DEA, tested the relationship between size and efficiency (in terms of profitability) in the Indian banks. He also concluded that large banks perform better.

Sanjeev (2006a), based on ownership, computed efficiency scores for the performance of banks. He reveals that foreign banks show greater performance than Indian private sector and public sector banks. A similar study for general businesses, done by **Bhattacharya and Rahman** (2003), concluded that the big businesses or conglomerates did not perform as well as small individual businesses.

Kamath *et al*. (2003) argue that during the evolutionary phase of the Indian banking sector, enormous opportunities are available. In this kind of situation, these banks can enter new businesses and new markets. They can also develop new ways of working.[51]

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50 Performance Effectiveness Of Nationalised Banks: A Case Study Of Syndicate Bank By Zacharias Thomas

51 Effect of Size and Age on the Performance of Indian Banks under Different Ownership Forms by Harsh Arora

In **Foreign Acquisition of Banks by Henricus Bogaard** (2009) for the period of 2003-2007, describe structural economic change in emerging markets as a process that makes a portion of the know-how of banks obsolete. This creates an opening for the acquisition of banks by foreign owners from advanced economies that can provide emerging market banks with access to knowledge that is relevant to rebuilding their operations. The papers provide empirical evidence describing this process form inside a bank as well as at the market level and develop a dynamic theoretical framework to study the access-to-knowledge motivation for foreign acquisition of banks in relation to structural economic change in the host country.[52]

Mukherjee *et al*. (2002) explored the technical efficiency and benchmark performance of 68 commercial banks using data envelopment analysis. The study period was from 1996 to 1999. Their study revealed that in India, PSBs were more efficient than both private and foreign banks. It also revealed that the performance of PSBs improved over the study period. Besides this, publicly-owned banks were rated uniformly in terms of self-appraisal as well as peer group appraisal.

Noulas and Katkar (1996) analyzed the technical and scale efficiency of public sector banks using data envelopment analysis by utilizing cross-sectional data of 18 banks for the year 1993. It has been observed that the overall technical inefficiency was approximately 3.75%, of which only 1.5% was on account of pure technical inefficiency and 2.25% was due to scale inefficiency and a majority of the PSBs were found to be operating under increasing returns to scale.

Swami and Subrahmanyam (1994) applied 'Taxonomic Method' to study the inter-bank differences in the performance of PSBs in India. It has been found that many banks showed wide disparities in their measures of performance, especially with differential weighting of individual indicators of business activity. No bank has shown a measure of performance close to the ideal of respective group of banks. Almost every bank in the study has never attained even 50% efficiency measure in both periods (1971-73 and 1987-89).[53]

52 Foreign Acquisition of Banks by Henricus Bogaard (2009)
53 Indian Banking: Emerging Issues and Enhancing Competitive Efficiency by R K Uppal

Arora and Verma (2005) studied the performance evolution of PSBs in the post-reforms period on the basis of four parameters, i.e., financial parameters, operational parameters, profitability parameters and productivity parameters and found the performance of PSBs quite satisfactory during the study period.

Padwal (2004) laid more emphasis on technology in banks. Technology has been the main facilitator in the process of transformation. The use of new technology means revolutionary innovation of products and services and delivering them to customers covering aspects such as how, where, when and at what price they want. The banks and customers are now receptive to new ways and types of approaches to delivering services and facilities. His study concluded that the future of banking depends on technology.[54]

In **Indian Banking: Emerging Issues and Enhancing Competitive Efficiency by R K Uppal** focuses on the comparative performance of public, private and foreign sector banks. Therefore, for the purpose of the study, based on the highest net profit (2006-07) three banks were selected—one each from the respective bank groups, i.e., SBI from PSBs, ICICI Bank from new private sector banks and Standard Charted Bank (SCB) from foreign banks. The study period is from 1997 to 2008.

The study reveals that comparative efficiency of new private sector and foreign banks was much better as compared to PSBs. In some aspects, the new private sector banks performed better than the foreign banks. Productivity of foreign banks was the highest, although they have the highest costs, whereas the new private sector banks followed these banks with excellent growth and record the highest profitability with lower operating costs and the maximum provisions for contingencies. Although PSBs have the lowest levels of costs, there was greater decrease in their interest income and expenditure mainly due to deregulation that created competition in the market and these banks have to change the interest rates to sustain in the market. The decline in interest income and expenditure further resulted in decrease in their spread and brought down their profitability as compared to the new private sector banks and foreign banks. To gain a sound position and compete in the global market, the PSBs have to change their ways of working and dealing with customers and hence need to adopt

54 Indian Banking: Emerging Issues and Enhancing Competitive Efficiency by R K Uppal

competitive strategies along with the latest technology and change their mindset.[55]

In **Ownership Structure, Performance and Risk in Indian Commercial Banks Siva Reddy Kalluru** for the period of 1995-2007, here researcher's study reveals that significant difference exists in the performance and risk of commercial banks in India. Moreover, FBs (Foreign Banks) seem to be more profitable than both DPBs (Domestic Private Banks) and SOBs (State-Owned Banks). This better performance results from well capitalization and higher low cost funds. However, we do not find any significant difference between SOBs and DPBs except in their size. Regression results reveal that bank capital and demand deposits are positively associated and loans are negatively associated with bank profitability. As far as risk-taking is concerned, FBs seem to have higher non-performing loans than other banks. Regression results reveal that increasing size of the banks and higher growth rate of the economy reduce non-performing loans, and increasing demand deposits increase risky loans.[56]

The process of deregulation and globalization of financial markets gained momentum in the 1990s, and expanded the choices for investors, and helped to improve the prospects of reducing the costs of financial transactions and improving operational and allocative efficiency of the financial system. A number of developing countries especially in Asia, which moved early on to the path of economic liberalization, had experienced large capital inflows through the 1980s and the first half of the 1990s. Large capital- inflows, however, carried the risk of financial sector vulnerability, where the use of such flows is not supported by application of appropriate mix of macroeconomic and structural policy measures. The recent currency and financial crises in Mexico and Thailand, followed by Korea and Indonesia, provide many insights about the problems that would arise when exchange rates are inflexible, and banking and financial systems are weak.

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55 Indian Banking: Emerging Issues and Enhancing Competitive Efficiency by R K Uppal

56 Ownership Structure, Performance and Risk in Indian Commercial Banks Siva Reddy Kalluru

The experience of the crisis-affected countries highlights the need for setting in place regulatory and supervisory frameworks to ensure the safety and stability of financial systems. Their experience also underscored the premise that financial development is only a necessary condition for sustainable growth, and by no means sufficient. In fact, with the incidence of the costs of financial crises falling on the sovereign governments, financial stability has come to occupy a centre-stage in public policy making along with the requirement of ensuring that the efficiency of the financial sector is high.[57]

A number of studies have examined the determinants of bank's profits and margins in many countries around the world. In the literature, bank performance is usually expressed as a function of internal and external determinants. The internal determinants originate from bank accounts (balance sheets and/or profit and loss accounts) and therefore could be termed bank-specific determinants of performance. The external determinants both industry-related and macro-economic are variables that are not related to bank management but reflect the economic and legal environment that affect the operation and performance of credit institutions.

From the above literature it can be reviewed that many research have been done around the world in many countries related to this topic. From the above study it can be said that many researchers have concluded their study with different suggestions. Some say Public Banks perform well, some say Private Banks performs well, and some say Foreign Banks perform well. We also come across some studies where researchers are either in favour or against the entry of foreign banks in host countries. This is the reason I took up this subject to know how banks work in Indian scenario and what is more favourable for Indian economy.

There are people with different mindset in India for e.g. co-operative banks are more active in rural areas, major class of people in India go for public banks and Indian private banks and higher class of co-operative business sector prefer foreign banks (this again depends on the facilities by the banks).

57 Banking Developments in India 1947 to 2007 Growth Reforms and Outlook Book by Niti Bhasin

This study is based on census of nationalized, private and foreign banks in India for the period of twelve years from 2001-02 to 2012-2013. It covers the evaluation of financial performance regarding profitability, credit efficiency, operational efficiency and productivity of banks. The study is limited for only financial performance.

The reason I chose this topic for study is that earlier there were no foreign banks in India so there was no tough competition among banks in India. Slowly and gradually foreign banks started entering the market in India. Intense competition increased for Indian banks. 21st century is the phase where almost all the banks from around the world have entered Indian market. So in that case what steps are taken by Indian banks for their survival will be the area of my study.