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Performance of Indian banks in the post-reform period: an analysis of efficiency of Public sector banks

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Abstract

Financial sector plays an important role in the growth and development of an economy by acting as the bridge between the ultimate savors and the borrowers. Like other economies, Indian financial sector too is dominated by the banks. Among the banks it's always been the public sector banks which have overtopped the banking industry in India. This has been partly because of India being on the path of development and banks being used for its attainment. In the Pre-Reform period (before 1992) banks were marred with the high SLR, CRR, directed credit and priority sector lending. This led to the sharp decline in the profitability and efficiency and hence, the banks remained stagnant. Reforms were undertaken in 1992, to liberalise the industry by dismantling of directed credit programme to some extent, decrease in statutory ratios, liberal entry of the domestic and foreign private banks, exposure of the banks to non-traditional activities etc. The sector has been deregulated in a phased manner rather in one go. Since, bank efficiency is the most essential parameter of the performance of banks; it would be insightful to examine whether the Reforms improved the efficiency of Indian banks during the post-reform period. Indian banking being heavily dominated by the Public sector, the paper analyses the Technical and Cost efficiency of the public sector banks from 1992 to 2014 using DEA. In this period, it was found that the overall technical efficiency declined on account of the scale inefficiency and there was only marginal increase in the cost efficiency owing to the high allocative inefficiency.

Keywords: Public sector banks, Efficiency, Post-reform period, Cost and Technical efficiency

Introduction

Banking system is an important constituent of overall economic system. It plays a crucial role in the attainment of macro-economic objective. It acts, as a vehicle for socio economic transformation and also as a catalyst to economic growth. It plays an important role in mobilizing the nation's savings and in channelizing them into high investment priorities and better utilization of available resources. In India, banking is an important segment of tertiary sector. It acts as a backbone of our economic progress and prosperity. It plays a pervasive role of a catalyst in development. Within the banking institutions, the role of public sector banks has occupied a new meaning and significance, in view of the changing structure and requirement of a developing economy. The increased prospect of public sector banks indentifies itself, with the problems and responsibilities, for making banking an instrument in bringing about social and economic transformation of a developing country. Social responsibilities have undergone far-reaching changes. Banks have become the prime movers and pace setters for the achievements of socio-economic objective of the country.

There are number of reasons responsible for financial chaos in the commercial banks, which for a long period of time had been affecting the overall business and earning capacity of the banks. For example the high rate of 38.5 % statutory liquidity ratio (S.L.R) and cash reserve ratio (C.R.R) as high as 15% in the past to a large extent reduced the business capacity of the commercial banks. Apart from this banks were further required to invest 10 percent of total demand and time liabilities accumulated in the banking system during a specific period, as impound reserve. The statutory provisions left the banks with only 36.5 percent of aggregate deposit to look into the interest of other competing sector. Because of these investments, banks earned very little rate of interest, which led to poor profit earnings by the banks.

The public sector banks have also been investing in shares, debentures and bonds of governments and quasi- government bodies. The poor performance of several corporations and delay in payment of loans by them further affected earning capacity of the banks. These investments not only reduced the availability of funds in the hands of banks but also failed to meet growing needs of the borrowers engaged in productive activities. Very often the R. B. I. decision to reduce interest rate on loans in harmony with the lower deposits rates also affected income earning capacity of the banks. Thus, the un-competitive environment, operational inflexibility, managerial weakness and more important lack of autonomy in decision making have been the major reasons of the poor performance of the public sector banks.

It is observed that due to directed credit programme also, resources available with the