Regulation, Competition & Government Ownership: A case study of Banking Sector in India

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Abstract

Though competition is necessary for efficiency and growth in real sectors, the role for appropriate & effective regulation of financial sector to ensure macro-economic stability and protect investor interests is well accepted. Moreover, competition is also seen to facilitate effective regulation. Link between ownership and profitability is well researched though the channel through which government ownership may adversely affect profitability and efficiency does not get enough attention. Impact of ownership is generally studied in the context of privatization and allowing foreign entry.

The role of government ownership needs to be re-examined from a competition perspective. If the desired objectives of government ownership could be achieved through other means, competition could be enhanced for effective regulation. The hypothesis underling this paper is that ownership rights may not be necessary for adequate and proper regulation of firms in financial sector. This paper seeks to identify the balance between competition and of regulation in financial services sector so as to ensure stability of the system and safeguard interests of the investor/ depositors. The analysis presented in this paper indicate that in absence of proper HR policies, government owned banks may not be able to attract, motivate & retain talent. Without motivated and efficient staff Public Sector Banks would find it difficult to maintain their significant presence. Unless banking industry has several efficient players the market may not remain competitive, which is essential even for proper regulation of banks.

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Executive Summary

Though competition is considered important for efficiency and growth in real sectors, the necessity for appropriate & effective regulation of financial sector to ensure macro-economic stability and provide investor protection is well accepted. Moreover,

competition is seen to be a facilitator of effective regulation. Link between ownership and profitability is well researched though the channel through which government ownership may adversely affect profitability and efficiency does not get enough attention. Impact of ownership is generally studied in the context of privatization and allowing foreign entry.

Regulation & Competition In Financial Sector

Both policy & technology is favouring competition in the financial sector. Removal of direct controls on interest rates, or fees & commission and lines of business and the improvements in computing & communication are changing financial landscape. The mainstay of regulation is through prudential measures such as stipulation of capital requirements and strengthening of risk management processes to achieve financial stability. Risk taking by commercial banks is curbed mainly through stipulating minimum regulatory capital. Though policy stance in general is favourable to deregulation, could increase competition, simultaneously due to structural, changes in technology and less trade restrictions bank mergers and consolidation is an international phenomenon, which may have adverse effect on competition.

In several developing countries statutory/legislative mechanism to preserve competition is quite recent and evolving. Moreover, the issue of competition in several sectors-particularly in the financial sector is intertwined with government ownership. While privatization is often seen as a mechanism to improve performance of public sector units, policy alternatives to privatization viz. competition and deregulation could be equally important. The issue of competition is indeed important, as competition would be the channel through benefits from privatization would flow. Several studies enquiring the role of ownership factor choose profit, cost or stock market returns as a proxy for firm performance and the hypothesis is tested empirically. But these studies, more often than not, treat ownership as a black box while linking performance to ownership. Therefore, there is a need to focus on channels through which government ownership may impact competition

Banking Reforms in India

On the eve of banking reforms in 1991, government predominantly owned commercial banks. Besides their lending rates & deposit rates were controlled by RBI,

banks were also subjected to elaborate operational controls from the RBI. A large proportion of deposits mobilized by banks were preempted through high level of SLR & CRR stipulated for commercial banks. Despite such controls banks were not regulated effectively. There was no competition among banks. Banks were not strong; their profitability was low; so was the level of technology developed. GOI (1991) recommended a slew of measures to strengthen the banks by introducing an element of competition and effective regulation. GOI (1998) presents an assessment of banking sector reforms and recommends further measures to enable Indian financial system becomes stronger & withstand competition in the global markets. It suggested a strategy to consolidate Indian banks so that Indian banks gain in size & get a scale comparable to leading international banks. It recommended reduction of government holding to 33% and complete operational autonomy to public sector banks. These recommendations are yet to be implemented due to lack of broad consensus on desirability of mergers among public sector banks as also reducing the extent of government holding at a lower cap.

Relationship between Ownership & Performance

The mixed findings of existing empirical studies may be explained in terms of different contexts (technology, development, competition) affecting performance of banks. Moreover, the dimensions of publicly available information inevitably shape empirical studies. This paper therefore, instead of making another empirical attempt of studying ownership & profitability, focuses on identifying the channels through which government ownership is likely to affect performance.

Government ownership in banks is hypothesized to impact bank performance through deposit mobilization, portfolio quality & risk management. While deposit mobilization would be easier if government ownership is seen as implicit guarantee for safety of deposits. But such assured access to deposits may turn managers complacent about portfolio quality. Portfolio choice is most crucial in risk management & incentives to managers and employees are necessary to ensure individual incentives are aligned with corporate objectives. Though it may be difficult to recommend indiscriminate use of performance linked pay in public sector units it is necessary to consider unit/sector

specific factors in such cases. Current practice of following human resource policies & practices is hardly conducive to motivate employees.

Human resource management policies are important in financial services particularly as these become more competitive. Focus on customer satisfaction provides competitive advantage. It becomes necessary that employers have freedom to choose required skills and at performance-linked compensation packages. With introduction of new technology, the types of skills required become more diverse & varied and should be reflected in compensation packages. Human resource practices would be another channel through which impact of government ownership would affect performance of banks. In fact HR policies through employee motivation would transmit its impact mainly through portfolio choice and risk management.

Regulation and Competition

The competition unleashed by reform policies has resulted to a decline in public sector banks' market share. New private banks have improved their market share at the cost of nationalized banks. Competition from foreign banks could intensify after March 2009 and as Indian rupee becomes convertible on capital account. It is important that public sector banks are able to compete with new private & foreign banks. But in the absence of proper HR policies banks may not be able to attract, motivate & retain talent. Without motivated and efficient staff PSBs would find it difficult to maintain their significant presence. Unless banking industry has several efficient players the market may not remain competitive, which is essential even for proper regulation of banks.

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Though presence of competition is considered important for ensuring efficiency and growth in several real sectors**,** the necessity for appropriate & effective regulation of financial sector to ensure macro-economic stability and provide investor protection is

fairly obvious and well accepted. Moreover, of late, competition is seen to be a facilitator of effective regulation (Whittaker, 2001). Changes in communication and computation technology are changing the face of industry affecting, inter alia, structure and competition. (Wharton Financial Institution Center, 2001) This is also affecting the trends in regulation of financial sector, making it more elaborate and internationally convergent. These trends are clearly reflected in the latest proposals from Basel Committee on Banking Supervision (commonly known as Basel II). Thus while interplay between regulation and competition is well recognized it is not clear whether government ownership would facilitate either competition or regulation of the financial system. Even though governments, at times, have promoted financial institutions, government ownership in financial sectors is broadly a developing country phenomenon. [1]

Government of India has sizeable ownership in major segments of financial system viz. banking, insurance, fund management and pensions. How does government ownership affects competition and regulation in financial sector is an important issue. Profit is important objective for private businesses but it is also an enabler for survival in a competitive environment for all business entities. Government owned entities are not driven by profit motive alone. Even in the case of government owned commercial enterprises, profit may be subservient to other socially more important objectives (strategic control, natural monopolies, providing goods & services to target segments etc). In absence of profit motive how would they run efficiently? This link between ownership and profitability is well researched though the channel through which government ownership may adversely affect profitability and efficiency does not get attention. Impact of ownership is generally studied in the context of privatization and allowing foreign entry. (Bart, et al, 2000, Clarke et al, 2005).

Historically, ownership was considered essential for effective regulation / development of industries. In a globalising world, the role of government ownership needs to be re-examined from a competition perspective. If the desired objectives of government ownership could be achieved through other means, competition could be enhanced for effective regulation. The hypothesis underling this paper is that ownership

[1] Barth et al (2000) reported that out of 66 countries they studied in 9 countries government owned banks owned more than 50% of total banking assets. Of the 4 Asian countries 3 were from Indian Subcontinent (India, Pakistan & Sri Lanka) In contrast, in 17 other countries Banking assets were fully privately owned

rights may not be necessary for adequate and proper regulation of firms in financial sector. This paper seeks to identify the balance between competition and of regulation in financial services sector so as to ensure stability of the system and safeguard interests of the investor-depositors.

The paper is divided in five sections**.** In section I links between regulation and competition are studied in the context of financial sector. Compatibility between competition and government ownership is also examined therein. Section II takes a synoptic view of the process of financial sector reforms in India. In Section III a review of the literature that studies impact of ownership on profit and efficiency of financial institutions is presented. After reviewing the role of incentives in public sector units it also hypothesizes the potential links between ownership and performance of financial institutions. Section IV identifies mechanisms through which human resource policies and practice would affect working of public sector banks. Concluding observations and implications for improving regulatory efficacy are presented in the last i.e. section V.

Section I
Regulation & Competition In Financial Sector

Although the need for prudential regulation of financial sector is well accepted, regulation and competition are not always and inevitably regarded in conflict. As the market for financial services is becoming increasingly global, maintaining competition is becoming a vital objective of financial regulators even as an element of competition enters in regulation of global financial entities. At the global level, direct controls on interest rates, or fees & commission and lines of business have been relaxed. The mainstay of regulation is through prudential measures such as stipulation of capital requirements and strengthening of risk management processes to achieve financial stability, which has always been the overriding objective of financial regulators and supervisors. Risk taking by commercial banks is curbed mainly through stipulating minimum regulatory capital. The proposed Basel II arrangements would permit banks to use their internal risk rating models to compute capital requirements provided banks satisfy the regulators about suitability and accuracy of these models. Besides stringent supervision by supervisors, stipulation of norms for information disclosure would also

encourage monitoring by depositors and/or equity investors There is also a trend towards enhancing corporate governance mechanism in banks, which also introduces an element of competition among banks to win confidence of customers and investors. Competition in product markets is seen to help maintain high standards of corporate governance, which in its turn is helpful for prudential regulation of banks. (Stiglitz,1999; Allen & Gale,1998). Most of the OECD countries apply competition law to banking sector without exception or exemption. (OECD, 1998) While FSA in the UK considers that competitive financial service industry would be helpful in achieving its objectives of maintaining market confidence, public awareness, consumer protection and reduction of financial crime.

While policy stance in several countries is favourable to deregulation which would help competition, simultaneously due to structural changes in technology and less trade restrictions bank mergers and consolidation is an international phenomenon, which may have adverse effect on competition. Besides, there are situations wherein banks have co-operative arrangements among themselves, which may also give rise to competition concerns. But in several developing countries statutory/legislative mechanism to preserve competition is quite recent and evolving. Moreover, the issue of competition in several sectors-particularly in the financial sector is intertwined with government ownership if not monopoly. The issue of continuance of governmental ownership is indeed important in the context of introducing / enhancing market competition. Issue of continuance or otherwise of government ownership often becomes a political economy issue because its impact on the interests of bank employees and having inclusive financial system i.e. easy access to finance for agriculturists and entrepreneurs from weaker, poor sections.

Like India, in some other countries government involvement is not limited to regulation/ supervision; it either owns banks or provides guarantees. The *raison de tre* for government ownership is to achieve certain social objectives viz. providing finance to preferred sectors, regions or group of borrowers. While mechanism of deposit insurance may provide implicit guarantee for banks against failure, direct government ownership may distort the competition if perceived protection for private banks is considered less secure.

While possibility of market failure may lead to a case for government intervention it is often contested that actually existing governments are all knowing and benevolent, thus making possibility of politicians and bureaucrats might instead use state control to secure political office, accumulate power or seek rents very real. The under performance of public sector units could be due to:

i) Political interference
ii) Corporate governance problems
iii) Problems associated with competition

While privatization is increasingly seen as a mechanism to improve performance of public sector units, Megginson & Netter (2001), in a survey of empirical studies of privatization, has highlighted policy alternatives to privatization viz. competition and deregulation to be equally, if not more, important than privatization or governance changes in improving firm performance. Majumdar (1996) concludes with Indian data that reforms can improve performance of state owned enterprises. Several studies have been carried out to assess the role of ownership in determinants of performance of firms in several sectors. The issue of competition is indeed important, as competition would be the channel through which benefits from privatization would flow. Foreign firms' access provided to domestic market is an important barometer of openness , competition and efficiency. Foreign entry is seen as quick route to enhance competition in the domestic markets. Clarke, Cull & Shirley (2005) conclude that efficiency gains arising from bank privatization are significant when "government fully relinquishes control, when banks are privatized to strategic investors, when foreign banks are allowed to participate in the privatisation process and government does not restrict competition."

Several studies enquiring the role of ownership factor choose profit, cost or stock market returns as a proxy for firm performance and the hypothesis is tested empirically. These studies more often than not treat ownership as a black box while linking performance to ownership. But certain issues such as organizational issues in large sized firms would be common irrespective of ownership are ignored. Hence there is a need to focus on channels through which government ownership may impact competition.

Section II

Banking Reforms in India

Banking reforms were an important dimension of economic reforms programme initiated since June 1991. GOI (1991) provided philosophy behind financial sector reforms as also an agenda for reforms. GOI (1998) presents an assessment of banking reforms and defines steps required for "second generation" reforms. On the eve of banking reforms in 1991, government predominantly owned commercial banks. Banks were also subjected to elaborate operational controls from RBI; their lending rates & deposit rates too were administered by the RBI. A large proportion of deposits mobilized by banks were preempted due to high level of SLR & CRR stipulated for banks. Of the balance, 40% of the credit was earmarked for certain priority sectors. Despite such controls banks were not regulated effectively. There was no competition among banks. Banks were not strong; their profitability was low; so was the level of technology developed. GOI (1991) recommended a slew of measures to strengthen the banks by introducing an element of competition and effective regulation. Statement 1 presents a status report on implementation of banking reform. These measures have a visible impact on banking sector. Banking sector is now more competitive, diversified, customer oriented & using higher technology.

GOI (1998) presents an assessment of banking sector reforms and recommends further measures to enable Indian financial systems becomes stronger & withstand competition in the global markets.

Statement 1 : Progress of Banking Reforms in India	
1.Lowering of CRR & SLR	Both SLR & CRR have been progressively reduced from their peak levels of 38.5% and 15%. These are currently at 25% and 5.5% respectively. Legislative changes initiated to reduce the statutory minimum level of SLR. This has increased the quantum of funds banks could lend at their discretion
2. Deregulation of interest rates	Both deposit and loan rates have been deregulated. Presently RBI stipulates only two rates viz. (i) interest rate on saving bank deposits and (ii) interest rates on loans smaller than Rs. 2 lakhs . Banks are free to charge / offer interest rates on other categories of advances & deposits.

	Moreover Government is now offering market related interest rates on gilt securities Hence investment in government Securities also get a market related return and offers profit earning opportunity in line with changes in market rates.
3. Accounting and provisioning norms and minimum capital adequacy norms.	Most significant step to improve transparency in bank balance sheets & bringing regulatory practices in line with international norms. Measures have been taken to improve disclosures in bank balance sheets. Minimum Capital is prescribed for credit & market risks. Banks would required to be compliant with more elaborate capital standards under Basel II over a period of time
4. Entry of new private Banks	New private banks were permitted. These could start on a clean slate with modern technology. At present, 7 such banks are functioning. Moreover many government owned banks have raised equity capital without bringing government holding below 51%.
5.Operational freedom	Banks enjoy more operational freedom as rationalization of branch network is permitted. System of obtaining prior clearance from RBI for sanctioning large credit limits is dispensed with.
6.Enhanced competition	More avenues for price & non- price competition among different banks on the one hand & banks and non-banks on the other. Banks entered into funds management, broking, insurance, primary dealership in government securities etc. through subsidiaries to diversify business activities
7. Restriction on voting rights from bank ownership	Cap on maximum voting rights by individual shareholders (irrespective of level of holding) increased from 1 % to 5%. This would facilitate M & A in banks
8. Entry of foreign Banks	Foreign banks would get more access to domestic market after March 2009.

The committee felt that banks in India could become stronger through a consolidation process. It suggested creation of a structure that consists a couple of large banks that are comparable to and capable to successfully compete with international banks, five / six large banks operating at national level & several others that are confined

to a particular region. It recommended reduction of government holding to 33% and complete operational autonomy to public sector banks. Both these recommendations are yet to be implemented due to lack of broad consensus on desirability of mergers among public sector banks as also reducing the extent of government holding at a lower cap.

Section III

Relationship between Ownership and Performance

Several studies evaluating performance of financial system have treated ownership as an independent variable in explaining growth and efficiency of banks. The issue of ownership (public vs. private or domestic vs. foreign) becomes important in the context of financial sector reforms wherein deregulation and enhanced competition are considered necessary to improve efficiency and stability of the financial system.

It is hardly surprising that the results from these studies are mixed; given the differences in methodologies, time period, sample composition and the manner in which the ownership issue is articulated. Significantly, very rarely the channels through which ownership may affect performance are explicitly studied.

Barth, Caprio and Levine (2000), found *inter alia* state owned banks are, in practice, associated with poorly operating financial system, though in theory state ownership is expected to overcome informational problems and allocate scarce funds to more productive projects/ sectors. La Porta et al (2002) reported state ownership to be negatively associated with both financial development and economic growth. Claessens & Laeven (2003), studying impact of competition & growth in the financial system, found that the degree of financial development is as important as competition. If the financial system is well developed, the extent of competition has a direct impact on growth while competition is less important in an underdeveloped financial system. Bonin et al (2003) using frontier estimation technique found that privatization itself is not sufficient, as government owned banks are not necessarily inefficient. But it found that foreign banks are more cost efficient and better service provider.

In the Indian context, Das, Nag & Ray (2005) noticed that increased competition in terms of reduced concentration in the banking sector following banking sector reforms.

The study did not find much difference between public and private banks regarding input/output efficiency though differences existed as regards profit / income efficiency. Moreover, along with ownership differences asset sizes, and level of technology were also important. It was, in fact, found that "old " private banks faring badly devoid of these positive factors. Sensarma (2005) using Stochastic Frontier Analysis in a time series setting reported, that public sector banks have shown higher cost efficiency than private banks whereas it has been the other way around in the case of profit efficiency. It thus appears that privately owned banks are more focused on profit earning than their counterparts in the public sector. Banerjee, Cole and Duflo (2004) specifically considered non-profit aspect of the objectives of government owned banks viz. increased lending to socially productive sectors - that are supposedly not catered to by credit markets- but found evidence of under lending in the case of publicly owned banks. The study suggests privatisation coupled with better enforcement of social lending norms. It also recommends internal, bureaucratic reforms in both private and government owned banks by giving more freedom to lending officers.

These mixed findings of available empirical studies could be due to different contexts (technology, development, competition) as also methodologies. Moreover, the dimensions of publicly available information inevitably shape empirical studies. This paper therefore, instead of making another empirical attempt of studying ownership & profitability, focuses on identifying the channels through which government ownership is likely to affect performance.

Effect of Ownership on Performance

The impact of government ownership could be reflected in the objective function pursued by the government owned banks. If the objects pursued by public and private sector banks are different their measured performance would understandably be different. It is generally recognized that government owned entities do not try to maximize profits but seek to achieve multiple objectives, which are stated in very general terms. Such a situation may limit autonomy of management, as achievement of multiple objectives would restrict their degrees of freedom. A competitive market environment would force government to consider the implications of other objectives on overall profitability. It

would need to modify such other objectives or provide an explicit subsidy. In either case competition would increase the transparency of the objectives set for government owned enterprises. The published objectives of banks are stated in very general terms e.g. enhancement in shareholder value, practicing business ethics, meeting supervisory norms. These are quite similar for private & public sector banks. Deposit mobilization & portfolio risk management are most important banking activities. Impact of government ownership if any would impact through these activities. Moreover, in any service industry quality & motivation of employee is important because it would indirectly affect efficacy of all operating activities.

Deposit Mobilisation & Portfolio Quality

Impact of government ownership on depositors is particularly significant because government ownership may be seen as additional security, over and above the safety net in the form of deposit insurance. This may put privately owned banks at a disadvantage but there are issues such access, service quality wherein private players could get an edge. However, such security (from government ownership) to depositors can come about-without imposing any burden on taxpayers - only if risk adjusted portfolio returns are commensurately higher than the deposit rates and other costs. However, if returns on asset portfolio were low, the resulting losses would be higher partly due to extra deposits generated and lend by government banks.

The impact of ownership on portfolio management would be more crucial. Instances are abound wherein privately owned banks have lend indiscriminately to related parties and suffered portfolio losses causing hardship to depositors. However, in the case of privately owned banks possibility of depositors shifting en mass to other banks may limit the extent of related lending (or straight looting). In the case of government owned banks, it is probable that banks would be directed to offer credit to certain clients / sectors where social returns are supposedly high. Moreover if depositors have a preference for government ownership, such assured access to deposits would mean the restraining factors applicable in the case of private banks might not be effective because even portfolio managers would be less worried about potential portfolio losses due to implicit guarantee arising from government ownership.

It may be argued that as sole (or even majority) owner, government could decide the objective function of the banks it owns. If government, like other shareholders, decides to maximize profits and if the management gets full operational freedom to achieve the stated objective, the fact of government ownership by itself would be irrelevant.

However, the objective function could be different from just profit maximization. It could be argued that government (read politicians) would use such additional objectives to distribute loans to "preferred" clients (read voters). But even if government does not have such unstated (ulterior) objectives, in an environment where deviations from profit maximization strategies are tolerated if not encouraged, mangers may be temped to use this milieu to fund clients / projects of doubtful quality under the garb of achieving stated objective of extending banking services to preferred sectors/client segments. If private banks were to pursue such objectives, it would start making losses and eventually forced out of business if panicky depositors force a run on the bank. This would put a limit on private managers deviating from profit maximizing strategies. Similarly if even employee were to treat their employment contract as "permanent" i.e. unaffected by the state of bank business / portfolio quality, disciplining effect of motivation factor would get weakened in the case of government owned banks.

Risk Management

Banks' ability to earn decent return from their portfolio depends, among other things, on the manner in which risks are assessed and managed. Admittedly risk management becomes more important, as domestic economy is opened up for competition though the same factors also renders this task more difficult. The chosen portfolio risk profile determines to a large extent realized portfolio returns.

It is important that lenders decide acceptable risk profile and choose projects / clients that are in conformity with their risk appetite. The risk of default could arise from several factors, which can be put under following broad heads:
i) Entrepreneur ii) Market iii) Technology and iv) Macro- environment.

Each of first three factors could be (a) New, (b) Maturing or (c) Established. The associated risks would be progressively low though expected returns too would tend to correspondingly decline over time from established technologies and markets, though not from established entrepreneurs. The choice of sectors / clients is thus important and needs to be performed in a dynamic context. In making such choices, possibilities of making wrong decisions are inevitable and the lending organization should develop institutional mechanisms to distinguish between genuine commercial decisions gone wrong and deliberate malafide decisions intended to maximize private returns. Devising mechanism that enables identification of acceptable clienteles with a clear focus on risk-adjusted returns is the cornerstone of a proper risk management system. To achieve this, it would be necessary to motivate employees with a clear focus on outcome/performance measurement and linking compensation / career path with it. It is not certain that private managements would always try to devise such systems or they would always be successful. But in the case of government owned banks the focus is likely to be static - on input or procedure linked and accord importance to follow pre set conditions on acceptable risk profile. In such a situation, private banks are likely to be quick identifying new profitable lending opportunities exploit them early and take quick exit decisions to maintain better portfolio risk profile.

Incentives in Public Sector

The main purpose of incentives is to bring interests of individual employees in alignment with corporate goals. The relevant literature notices agrees that incentives are effective i.e. these result in higher output or performance. But whether contracts are in fact drawn as predicted by the theory is not so certain. (Prendergast, 1999). But situations where measurement of individual effort / output is possible or output is determined mainly, if not solely, by individual efforts are few. Piece rate contracts provide direct link between individual efforts and output (and wages received). These prove useful in motivating for employees to put in maximum efforts. But in these cases individuals bears the risk of variation in output due to other factors that affect the measured output but are

beyond the control of employees. In such situations criterion of relative performance could be one way out to nullify the effect of external environmental factors.

Alternatively, incentives could be liked to aggregate or group output. But this may give rise to the problem of free riding. There may be situations where individuals have to undertake several tasks (multi-tasking) but all of these may not be equally amenable to measurement. In such cases individuals may tend to devote their time and efforts on those tasks that are measurable and the crucial-but-difficult-to-measure tasks may get neglected.

Yet another alternative is to measure overall performance in a discretionary subjective manner. Supervisors may be able to take an overall view of the performance but it may not be verifiable by any third party. Further even in these cases distortions like leniency bias (supervisors would avoid giving low ratings) or centrality bias (ratings are centered at "respectable " levels which fails to separate good performers) may arise. Besides pay, other aspects like promotions (and the resulting higher pay), training or placements could also be used to provide proper incentives.

Linking performance with pay thus depends on how focused are objectives of a firm. If the sole objective is profit, providing a link with profits may be easier. But in the case of not for profit companies or where objectives are multiple as is the case with public sector firms, providing individual or group based incentives to motivate workers may become tricky. Dixit (2002) and Dewatripont et al (1999 (a) and 1999 (b)} have described peculiarities of public sector agencies in terms of multiple objectives, multiple principals and multiple tires of principals. The goals are often vague. Situations where in where actions are unverifiable but outputs are verifiable are as likely as those wherein reverse is true. Sometimes neither outputs nor inputs can be verified. Dixit has questioned the suitability of prescribing performance-linked payments in all public sector institutions without considering the special situations of these organizations. He however prescribes clear specification of goals and organization designs whereby institutions are structured in a manner so that (multiple) objectives are complementary.

Traditionally public sector enterprises have been operating in business environment devoid of competition. In such situations public sector organization may

operate wherein implicit incentives like carrier concerns may play a paramount role. Alternatively attracting motivated people who value or share higher institutional goals may also prove useful. However several sectors traditionally characterised by public monopolies have now, due to technological advances, been transformed where private sector participants are competing with public sectors enterprises. In such situations providing appropriate incentives become extremely important, as attracting and retaining talent is important in a competitive arena.

Human Resource Policies & Practices

Human resource management policies are extremely important in financial services particularly as these become more competitive. Focus on customer satisfaction provides competitive advantage. It becomes necessary that employers have freedom to choose required skills and offer them performance-linked compensation.

Moreover, with introduction of new technology the types of skills required would become more diverse & varied and should be reflected in compensation packages. In organizations where generalists predominate parity is maintained across functional areas and compensation levels are mainly linked to seniority. In organizations with bureaucratic cultures permitting a situation where wage levels would vary across functions and would be linked to performance is indeed difficult. Banks owned by government tend to replicate HR policies & practices similar to those prevailing in government departments.

Linking performance with compensation would be necessary in a competitive business environment. Firstly, linking compensation with performance helps aligning individual interests with institutional objectives and maintaining risk profile as set by the management. Secondly, attracting and retaining talent would largely depend on level of compensation, and professional work environment.

Moreover, in financial entities, performance monitoring and proper incentive/disincentive structure is required to ensure compliance of prudential norms so that situations of adverse selection and / or moral hazard are avoided. The deterrence from undertaking undue risks should not lead to avoidance of lending. The dividing line

between a wrong business judgment and fraud is not easy but not difficult either if human resource policies maintain a balance between power and accountability through developing strong in house norms of business decision-making.

Thus state of human resource practices would therefore be another channel which impact of government ownership would affect impact their commercial performance. HR policies through employee motivation would transmit its impact mainly through portfolio choice and risk management the other channels that as argued above would also have an independent effect.

Ownership issues in Non-Banking Institutions

Importance of Government ownership & HR issues arising there from is highlighted indirectly through the modernization and reforms experiences in other segments of financial system. Equity markets reforms were relatively smooth partly because government's role was essentially of a regulator. Also government was not a employer; bulk of the employment being in the private sector. Even in the case of insurance, business procurement was through agents, which were in private domain and payments to them were by and large incentive driven.

It is noteworthy that competition was introduced among banks through permitting new entrants and not through privatization of existing banks. Though government owned banks raised fresh capital from market, such ownership dilution was achieved without any dilution of managerial control. The importance of ownership vis-à-vis HR issues is revealed through the fact that several "private" banks were promoted by government owned financial institutions such as ICICI, HDFC, UTI, IDBI etc. These new entities, though directly or indirectly owned by government, were not required to follow HR policies & practices. In fact some of the new banks by " true " private promoters (Global Trust, Times Bank) could not withstand competition and were merged with other public or private banks.

The main reason for success of new (private) banks, even those promoted by government owned entities, was largely due to operational freedom accorded to them. These entities operated without the burden of following public sector HR policies &

practices. They could recruit required skills and experience and offer them performance linked compensation packages.

Several Public Sector Banks have entered activities - like fund management, primary dealership in government securities, capital market related services - where specialized skills such as bond or forex trading, are required by floating separate though subsidiary, entities. The operational advantage of this rout essentially flowed from full operational freedom and adoption of flexible personnel policies.

Given the high initial capital requirements to start new banks it is difficult to find private promoters with integrity & resources. In this context the Tarapore Committee on Fuller Capital Account Convertibility have recommended that reputed industrial houses be permitted to start new commercial banks. This may be a way-out to enhance competition in Indian Banking without privatizing exiting public sector banks and / or giving larger access to foreign banks. While reluctance on the part of government to privatize public sector banks is not difficult to understand, the issue of operational freedom cannot be avoided. As competition from private banks intensifies, the question of public sector banks' ability to compete would come to the fore. While PSBs may be pursing multiple objectives but once these are stated, managements should be free to pursue these objectives like their private sector counter parts.

Section IV
Liberalisation & Competition in Banks in India

Financial sector reforms have resulted in more competition among different segments of financial system as also within different entities within a segment. As described in Section II reforms in banking sector has led to decontrol, competition due to new entrants and stricter prudential regulations. This has resulted in decline in market share of PSBs, particularly to the benefit of new private banks that had no baggage of history and could employ latest technology to improve customer services. At present restriction on voting power (capped at maximum 10%) has restricted the expansion of foreign banks but this could change by March 2009 when foreign banks are set to get more access. Overall performance of banks has improved in terms of asset quality, credit

growth and profitability. The booming economy has led to increased demand for bank credit. Though all banks have benefited from this boom, some (private and foreign) banks who could move fast to spot new business opportunities have benefited most.

Though moved up in recent times, interest rates have came down from very high levels largely due lower inflation and lower rupee depreciation. Banks are competing by offering lower interest rates for better-rated corporate clients. Lower interest rates have, in its turn, fuelled demand for retail loan; a major contributor for current credit boom.

Table 1: Sector wise Distribution of Scheduled Commercial Bank Business

Year Ending March	1990	1995	2000	2005
Deposits				
SBI & Associates	56828	112720	256288	505649
	28.4%	**27.9%**	**28.6%**	**27.8%**
Nationalised Banks	126960	236208	481025	915101
	63.4%	**58.6%**	**53.7%**	**50.2%**
Private Indian Banks	7775	26406	113670	314630
	3.9%	**6.5%**	**12.7%**	**17.3%**
Foreign Banks	8563	28079	45442	86505
	4.3%	**7.0%**	**5.1%**	**4.7%**
All	200126	403413	896425	1821885
Advances				
SBI & Associates	42036	64405	129034	284727
	34.0%	**31.1%**	**29.1%**	**25.8%**
Nationalised Banks	72203	113375	223076	524531
	58.3%	**54.7%**	**50.3%**	**47.4%**
Private Indian Banks	4204	13970	55742	221149
	3.4%	**6.7%**	**12.6%**	**20.0%**
Foreign Banks	5351	15445	35617	75318
	4.3%	**7.5%**	**8.0%**	**6.8%**
All	123794	207195	443469	1105725
Branches				
SBI & Associates	12240	12875	13482	13661
	27.2%	**26.8%**	**26.2%**	**25.4%**
Nationalised Banks	28807	30880	32803	33627
	64.1%	**64.4%**	**63.6%**	**62.6%**
Private Indian Banks	3784	4078	5077	6196
	8.4%	**8.5%**	**9.9%**	**11.5%**
Foreign Banks	137	151	178	242
	0.3%	**0.3%**	**0.3%**	**0.5%**
All	44968	47984	51540	53726
Employees				
SBI & Associates	295352	313003	315546	278269
	32.2%	**32.5%**	**33.1%**	**32.5%**
Nationalised Banks	557394	581788	558158	467983
	60.8%	**60.4%**	**58.5%**	**54.7%**
Private Indian Banks	51185	54760	66377	92411
	5.6%	**5.7%**	**7.0%**	**10.8%**
Foreign Banks	12359	13262	13567	17210

	1.3%	**1.4%**	**1.4%**	**2.0%**
All	916290	962813	953648	855873
Profits				
SBI & Associates	117.3	846	2677	5676
	22.8%	**40.2%**	**36.6%**	**27.4%**
Nationalised Banks	195	269	2437	9494
	37.8%	**12.8%**	**33.4%**	**45.9%**
Private Indian Banks	23.2	358	1224	3534
	4.5%	**17.0%**	**16.8%**	**17.1%**
Foreign Banks	179.9	631	968	2002
	34.9%	**30.0%**	**13.2%**	**9.7%**
All	515.4	2104	7306	20706

Source: IBA (1999) Database on Indian Banks 1987-98 and
RBI : Statistical Tables Relating to Banks in India various Issues

Table 1 above describes sectoral distribution of scheduled commercial bank business during 1990-2005. The shifts in sectoral shares are quite significant though different. Public sector banks have lost their shares in deposits and advances to private sector banks particularly to new private entrants. Foreign banks have lost their market shares since new private banks entered the scene. The movements in profit shares are more dramatic though volatile. The share of profits made by foreign banks has consistently declined, partly because restrictions placed on their expansion & new private banks are effectively competing with them in terms of technology & service standards. The share of PSBs has remained stable though both PSBs and foreign banks have lost market share moderately to new private banks. The loss in share of profits by PSBs is quite modest in relation to their loss of market share in deposits/advances. The comparative stability in PSBs share in branches and employees reflect slow incremental changes in these parameters. While branch opening / closure is controlled by the RBI, downward adjustments in employees strength can only be slow. Moreover due to changes in technology, both new entrants and existing operators are harnessing alternative channels like ATMs and phone banking / net banking as a result of which new private banks could garner new business with moderate increase in branches and employees. While old public & private banks inherited large branch network, new private & foreign banks moved faster in adopting new technologies like ATMs. As reflected in Table 2

Table 2: SCB: Branches & ATMs
(As at End March 2005)

Category of Banks	Number of Branches	Percentage Share	ATMs			Percentage Share
			On Site	Off Site	Total	
Nationalised Banks	33627	62.6%	3205	1567	4772	27.0%
SBI Group	13661	25.4%	1548	3672	5220	29.6%
Old Private Banks	4511	8.4%	800	441	1241	7.0%
New Private Banks	1685	3.1%	1883	3729	5612	31.8%
Foreign Banks	242	0.5%	218	579	797	4.5%
All SCBs	53726	100.0%	7654	9988	17642	100.0%

Source: RBI: Trends & Progress of Banking in India 2004-05

private and foreign banks have significantly large share in ATMs as compared to nationalised banks which have been rather slow in expanding their ATM network. While SBI group's share in ATMs is comparable to its share in branches, nationalized banks have only 27% total ATMs while they have 63% of total branches. In contrast, foreign & new private banks together account for one third of ATMs while their share in branches is just 3.5%.

The increased competition has led to less concentration at the top though the extent of decline in 5 firm concentration ratios for deposits, credit, income & other income is uneven. (Table 3). It is more pronounced for deposits and credit where new technology has enabled techno savvy banks to offer better services in terms of convenience and improved access to retail and corporate customers. In contrast, changes in income are less dramatic because of relationship considerations. As regards branch network and employees the concentration has not changed much mainly because new banks are using alternative channels (ATMs, phone banking and e-banking). As regards employees, private banks had more flexibility in labour deployment as these could outsource part of the work (marketing, back office), which enable them to control strength of regular employees. Public sector banks could not display equal dynamism though these could shed a part of employee strength through a Voluntary Retirement Scheme.

Due to prevailing competition, performance linked pay offered by private & foreign banks enable them to offer attractive salary packages to the top" creamy layer" of the new entrants. While attrition rates have impacted both private & public sector banks

private banks are able to fill up the vacancies with experienced professionals, PSBs are recruiting at base level. [2]

It is interesting to note that while five firm concentrations indicate decline in business concentration with respect to 1990 or 1995 there is increased concentration since 2000 except for deposit mobilization. Though share of top firm has come down in respect of all six parameters, five firm concentration ratios have increased for all parameters except deposits. On the basis of 10 & 15 firms conenetration appears to have increased since 2000.

Table 3 : Concentration in Scheduled Commercial Bank Business

Year Ending March		1990	1995	2000	2005
Deposits	Top firm	**21.7**	**22**	**23.1**	**21.6**
	5 firm C ratio	**48**	**47.3**	**46**	**44**
	10 firm C Ratio	**68**	**65.5**	**62**	**61.6**
	15 firm C Ratio	**79.3**	**75.9**	**72.2**	**73.9**
Advances	Top firm	**27.9**	**22.9**	**21.6**	**18.4**
	5 firm C ratio	**53.5**	**46.4**	**42.2**	**46.7**
	10 firm C Ratio	**72.6**	**62.6**	**56.2**	**60.4**
	15 firm C Ratio	**81.6**	**71**	**64.2**	**69.5**
Branches	Top firm	**18.7**	**13.8**	**13.3**	**13.1**
	5 firm C ratio	**41.9**	**32.3**	**31.6**	**35**
	10 firm C Ratio	**61.8**	**49.6**	**46.9**	**48.5**
	15 firm C Ratio	**75.5**	**58**	**55.8**	**55.7**
Employees	Top firm	**24.2**	**24.0**	**24.5**	**23.3**
	5 firm C ratio	**46.6**	**48.1**	**47.6**	**48.9**
	10 firm C Ratio	**66.3**	**66.8**	**65.6**	**62.7**
	15 firm C Ratio	**78.3**	**77.8**	**75.6**	**70.1**
Interest Income	Top firm	**24.6**	**24**	**21.5**	**20.8**
	5 firm C ratio	**49.7**	**47.2**	**40.8**	**45.2**
	10 firm C Ratio	**68.2**	**62.8**	**55.9**	**59.1**
	15 firm C Ratio	**78.3**	**72.3**	**64.7**	**67.5**
Other Income	Top firm	**28.3**	**28.2**	**22.2**	**20.8**
	5 firm C ratio	**47**	**48.7**	**40.8**	**47.4**
	10 firm C Ratio	**62.8**	**62.4**	**51.7**	**60.5**
	15 firm C Ratio	**75**	**71.5**	**59.1**	**67.5**

Note: C Ratio is concentration ratio computed from data sources mentioned at Table 1

Risk Management

[2] While recently PSBs have been allowed to recruit expert in select " professional " categories on contract basis, the identified categories are few. Treasury, forex trading, and economists are among permitted several professional categories such as audit & accounts, Human Resource management are hardly being recognized as specialized job.

Though regulatory prescriptions on risk management are same for all categories of commercial banks, its different implementations are reflected in actual risk faced by different banks. The post facto risk is reflected in quantum of provisions and net profits as also in proportion of Non-performing assets (NPAs). It would be ideal to study risk management systems at individual bank level our assessment would at broad sectoral level. Moreover, macro economic factors that affect quality of portfolio would be same

Table 4: SCB: Profitability & Asset Quality

	1990	1995	2000	2005
Net Profit/Working Funds*				
SBI	0.14	0.59	0.8	0.89
SBI Associates	0.22	0.38		
Nationalised Banks	0.22	0.38	0.44	0.89
Private Banks	0.27	1.16	0.88	0.83
Foreign Bank	1.65	1.7	1.17	1.3
All	**0.22**	**0.41**	**0.66**	**0.91**
Provisions &Contingencies / Total Assets				
		2000	**2004**	**2005**
SBI Associates		0.49%	0.95%	0.22%
Nationalised		0.42%	0.97%	0.39%
Private		0.37%	0.64%	0.18%
Foreign		0.60%	0.66%	0.38%
All		0.45%	0.88%	0.31%
Net NPAs/Net Advances				
		1997	**2000**	**2005**
SBI Associates		17.3	15.3	5.2
Nationalised		21.7	14	5.4
Private		NA	8.5	3.9
Foreign		NA	7	3
All		NA	12.8	4.9

Source: RBI : Trend & progress Of Banks in India 2004-05 and Statistical Tables Relating To Banks in India various issues

among these categories. As a result time trends in asset quality or provisioning in different categories of banks would be similar while cross sectional differences therein would reflect differences in risk appetite and management.(Table 4). While asset quality of all category of banks has improved, higher NPAs in the past for SBI group & nationalized banks vis-à-vis foreign & private counterparts would reflect their different risk appetite and / or efficacy of risk management systems.

Human Resources Management

Table 5 & 6 gives trends in overall employments as also its composition between officers, clerks & sub staff. While the total employment has declined since 1998 both due to voluntary retirement scheme in PSBs and low fresh recruitment. If proportion of officer staff is considered as a proxy for quality of skills there is slow improvement at the aggregate level as share of officers increased steadily from 27% to 35 % over 1995-2005.

Year End March	Officers	Clerks	Sub Staff	Total	Officer Share (%)
1995	270533	505728	221340	997601	27.1%
1998	287701	507577	228693	1023971	28.1%
2000	291389	494081	221161	1006631	28.9%
2001	268239	451062	207217	926518	29.0%
2003	286880	419675	194594	901149	31.8%
2004	289356	401087	191279	881722	32.8%
2005	313863	396812	189758	900433	34.9%
CARG	0.01	-0.02	-0.02	-0.01	

However there are significant differences among different categories of banks; Share of officer staff is lowest at SBI & its associates followed by nationalized banks. Foreign banks have not only maintained their lead but increase in proportion of officer staff has been brisk. The increase in proportion of private banks is largely due to new private banks, which have adopted high technology as also HR policies, which are comparable to foreign banks. It is true that this measure of measuring quality of human resources inputs is very crude for it doesn't measure intensity & diversity of skills. But such measure is useful as it brings out the essential differences across different categories of banks..

Table No.6 Bank Group wise Employee Composition *

Year Ending March	SBI & As--sociates	Nationalised Banks	Foreign Banks	RRBs	Other SCBs	All Banks
1995	24.4%	26.8%	-NA-	40.8%	27.8%	27.1%
1998	24.4%	27.5%	50.5%	40.6%	32.6%	28.1%
2000	24.6%	28.4%	60.8%	40.6%	35.3%	28.9%
2001	24.4%	28.0%	62.0%	40.4%	38.3%	29.0%
2003	27.0%	30.0%	77.0%	41.5%	46.6%	31.8%
2004	27.0%	31.3%	79.2%	42.0%	47.6%	32.8%

* Employee Composition is % share of officers in total Staff.
Source: RBI , Statistical Tables relating to Banks in India (various issues)

Table 7 present average compensation levels, which are influenced both due to qualitative differences as also different productivity levels (reflected in business per employee), which is largely due to level of technology and marketing strategies. It is difficult to obtain detail data, but foreign & private banks do outsource marketing, back-

Table 7: Average Compensation in SCBs

Year Ending March	1995 Emp. Cost (Rs. Crore)	1995 No. of Employee (Lakh)	1995 Avg. Compens. (Rs Lakh)	2000 Emp. Cost (Rs. Crore)	2000 No. of Employee (Lakh)	2000 Avg. Compens. (Rs Lakh)	2005 Emp. Cost (Rs. Crore)	2005 No. of Employee (Lakh)	2005 Avg. Compens. (Rs Lakh)
SBI & Associates	3340	2.97516	1.12	5926	3.06198	1.94	9043	2.54424	3.55
Nationalised Banks	5238	5.6802	0.92	10436	5.55756	1.88	15592	4.26075	3.66
Foreign Banks	314	NA	NA	862	0.14602	5.90	1345	0.17210	7.82
RRBs	503	0.66974	0.75	1243	0.67006	1.86	NA	0.65753	NA
Other SCBs	487	0.65091	0.75	894	0.63069	1.42	2903	0.92411	3.14
Total	9882	9.97601	0.99	19361	10.06631	1.92	28883	7.90120	3.66

Source; RBI , Statistical Tables relating to Banks in India (various issues) .Indian Banking Year book 2005 for Number of employees in 2005.
Note: For sake of comparability Number of employees in PSBs in 2005 have been adjusted for estimated number in RRBs

office & collection activities in different business segments. Outsourcing is an aspect of flexibility in labour usage. Moreover, expenses on these activities are shown else where (other expenses) which results in under estimation of labour expenses and overstates employee productivity vis-à-vis PSBs. Outsourcing in PSBs has just commenced and is slow both due to employee resistance and guidelines from the RBI. Moreover Table 7 represents average remuneration levels and there would be significant difference across employee categories. These are likely to be more dispersed in the private sector as there is a lot more flexibility in differentiating among skill levels & motivation among employees than in their counterparts in PSBs. Despite these caveats, data in Table 6, 7 & 8 reveals less flexibility in HR policies in the public sector banks. Lower entry-level remuneration affects the quality of new recruits and in absence of any direct linkage

between performance and compensation there would be low potential to motivate & reward good performance.

Table 8 : Structure of Operating Expenses
(as % of Total Operating Expenses)

Year Ending March	1990	1995	2000	2005
Employee Expenses				
SBI & Associates	67.8%	72.4%	71.6%	67.4%
Nationalised Banks	69.0%	70.0%	73.6%	67.4%
Private Banks	38.1%	46.5%	49.1%	33.7%
Foreign	26.1%	32.7%	33.3%	30.6%
All	64.2%	66.9%	69.2%	58.3%
Depreciation				
SBI & Associates	2.5%	2.0%	5.4%	7.6%
Nationalised Banks	3.3%	2.6%	4.0%	5.4%
Private Banks	2.5%	4.7%	13.5%	13.9%
Foreign	7.8%	8.2%	8.7%	6.0%
All	3.3%	2.9%	5.9%	7.5%
Other Expenses				
SBI & Associates	13.0%	9.0%	10.1%	9.9%
Nationalised Banks	15.1%	12.2%	8.9%	11.2%
Private Banks	14.8%	14.3%	14.4%	24.5%
Foreign	31.3%	34.5%	27.4%	35.4%
All	15.5%	12.9%	11.9%	15.3%

Source: IBA; Data Base on Indian Banks 1987-98 and RBI Statistical Tables Relating to Banks in India

The differing level of technology is reflected in Table 8, which considers composition of technology & pattern of labour usage in different segments of banks. Extent of depreciation is a proxy for usage of computer & other equipment. In the case of foreign banks proportion of depreciation has come down while that in private banks has gone up significantly. Similarly other expenses, that would capture expenses on outsourced activities, have always been significantly different across different category of banks. An option to outsource signals flexibility in labour deployment and intensity of marketing efforts. In the case of private banks it has increased significantly while in the case of PSBs it has increased though less vigorously but in the case of SBI & its associate banks the proportion has declined. Correspondingly share of employee compensation in total operating cost is steady at high levels for maximum for PSBs while it has declined in the case of private banks. Thus technological change in PSBs is at quite steady pace whereas in private banks there is significant change in terms of application of modern

technology & outsourcing of certain activities. These would have a wider bearing on marketing & designing of products, customer services & business growth; in short competitive advantage.

Section V
Concluding Observation

Financial sector reforms have enhanced the degree of competition in the banking sector. Both the entry of new banks and the decline in direct controls on banks have increased the avenues for competition among banks. Though banks have diversified their activities through entering new business activities banks have to compete with other segments of financial system in retaining clients. As domestic market access available to foreign banks is still restricted it's the new private banks that have gained market share. This has largely been because these could start on a clean start without legacy issues (portfolio, manpower or technology). Also, they could introduce latest modern technology and management practices.

New private banks have also been quick to spot new business opportunities and to offer new services at lower cost. These factors have enabled them to increase their portfolio. While concentration has decreased as compared to pre reform period, latest trend signal a reversal. It would be desirable to maintain competition in among banks for its efficient growth, improved customer satisfaction and also for effective regulation, which would facilitate financial stability.

Future trends in competition would depend several factors; foreign banks ' access to domestic market, which is set to increase after March 2009. Transition to Basel II would enable banks to use in-house risk measurement models and compute capital requirements. Banks with better risk management skills & systems would need to maintain lower regulatory capital & get an advantage in attracting "good " clients through attractive pricing. This transition would also improve disclosures by banks and facilitate monitoring by investors/ depositors. Regulatory regime does not distinguish on the basis of ownership (except a different definition of priority sector is applicable to foreign

banks), given the aim of following best international practices is regulatory authorities are likely to strive to maintain competitiveness for better regulation of banking system.

Consolidation of domestic banks is getting increased attention in the context of strengthening of domestic banks by enabling them to increase their size, scope & reach to compete with foreign banks. Though transition to full convertibility is likely to be in a phased manner, competition with foreign banks would intensify as rupee becomes convertible. However the issue of consolidation is linked to government ownership if public sector banks are to participate in the consolidation. While merger of public & private banks are difficult as it may require dilution of government holding. But even consolidation of banks under government ownership has proved to be difficult as it involves realignment of branch network and consolidation of employee pools. Even merger among private entities are linked with foreign banks' access to domestic banks.

But competition would also depend on how effectively government owned banks are able to meet the challenge of competition from new private banks & foreign banks. Government as a shareholder could justifiably pursue non-profit objective(s) but if these are clearly stated and once stated PSBs are operationally free to achieve these objectives, PSBs could capitalize on their reach & size. Their competitive edge would get particularly sharpened if they get flexibility in HR policies & practices by offering performance linked service conditions (pay, promotion & postings). The importance of motivated, skilled staff is important as risk management and customer retention becomes crucial for success in competitive business environment. Even with consolidation of public sector banks the issues of operational autonomy, performance linked service conditions would remain equally valid for larger banks, which would emerge from the process of consolidation.

While some decline in the market shares of public sector banks (deposits & advances) may seem inevitable given their initial dominance, these trends unless reversed in near future could lead to weakening of public sector banks & higher concentration. As noticed above concentration ratios have tended to increase since 2000. Such a development could undermine competition, which is essential for efficiency and better regulation. Privatisation may not be the only alternative if public sector banks can get operational autonomy including flexible HR policies & practices.

Banks were nationalized (in 1969 & 1980) to expand the reach of commercial banks to sectors such as agriculture, small-scale industries etc. However the reach of organized financial system is still low and the need for more "inclusive banking" is still felt. However, unlike in the past new technology offers potential to take organized finance to unorganized sectors. This would need innovative approaches to design & deliver products suitable for varying needs of small customers. Therefore banks would need to experiment & explore alternative ways to reach these customers without undertaking unduly large risks. This is possible only if banks are operationally free and not constrained by uniform norms set by government for all banks to follow.

If government decides to give top priority for "taking banking to unbaked" banks would need more freedom and this is truer for public sector banks, which face more restriction in terms HR policies & practices. Government owned banks with full operational freedom could combine stability from government ownership & efficiency; the later is a must in competitive business environment.

From a competition and regulation perspective it seems the issue of government ownership of banks is crucial for reforms of public sector banks as also future consolidation of Indian banks. While the later would help Indian banks gain in size & scale in order to compete with foreign banks the former is necessary to ensure competition among domestic banks. But consolidation to be meaningful should involve public sector banks. Though RBI has prepared a blueprint to introduce international best practice as regards bank regulation, these would get a dent if competition is not maintained in the banking industry.

The analysis presented in the paper indicate that in absence of proper HR policies public sector banks may not be able to attract, motivate & retain talent. Without motivated and efficient staff PSBs would find it difficult to maintain their significant presence. Unless banking industry has several efficient players the market may not remain competitive, which is essential even for proper regulation of banks.

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