MOTIVES FOR CONSOLIDATION IN INDIAN BANKING SECTOR

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ABSTRACT

Consolidation is a buzzword nowadays, pronouncements made by finance minister, Mr.Pranab Mukerjee as well as some senior bankers are keen on having mergers among banks , especially public sector banks as the banking sector will be opened for international competition and foreign banks will have the opportunity to own 74 % of Indian private banks, secondly, because of Basel lI norms, there is requirement for more capital . In this paper an attempt is made to study the structure of Indian banking sector and its effect on competition by Concentration ratios of top three, five and ten banks from 1995-96 to 2007-08 for all the four variables. As the concentration ratio has declined in all the four variables namely assets, deposits, advances and income, and CR ratio is one among the lowest in cross country analysis. Hence, strategy of consolidation among banks leaving the top five is suggested as it will enhance more competition and efficiency and will lead to synergies of cost reduction, risk management, technology upgradation and economies of scale and scope and efforts should be made to achieve optimum size, as too large banks leads to diseconomies and this strategy will strengthen the banking sector as over competition can kill.

Key Words : Banking, Indian, Competition, Consolidation, Concentration ratios,

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Section I

Introduction

Advancement in technology, deregulation, globalization and rapid growth of international trade have led to greater integration of world economies. The financial service industry, particularly, the banking industry has witnessed the greatest changes which has transformed the whole country. Globalization of financial markets has led to intense competition and has encouraged growth of massive financial institutions.

The financial sector reforms set in motion in 1991 have greatly changed the face of Indian banking. While the banking system in India has done fairly well in adjusting to the new market dynamics, survived the global sub-prime financial crisis and is fairly sound and stable due to strong regulatory framework, it would not be clichéd to say again that greater challenges lie ahead.

The financial sector would be open to international competition once the tone for the rules of the game is set under the WTO. Banks will have to gear up to meet stringent prudential capital adequacy norms under Basel-II and Basel III as they compete with banks with greater financial strength. In the past, mergers were initiated by regulators to protect the interest of depositors of weak banks. But, it is now expected that market led mergers may gain momentum in the coming years.

This paper examines the structure of Indian banking sector and the extent of competition prevailing in the sector and vast literature on the subject is also examined. The paper is divided in to sections, Section 1 introduction, Section II describes the trends in consolidation world over , Section III describes the research methodology, Section IV examines the imperatives of consolidation in Indian banking sector and Section V ,then analyses the structure of Indian banking sector through various concentration ratios and its effect on competition and efficiency. Further, it suggests what the effective strategy for Indian Banking sector is. Next in section VI, discussion is done regarding what are the perquisites for merger to be effective and safeguards needed and in the end conclusion.

Section II

Review of literature

The motives of consolidation have depended on firm characteristics such as size or organisational structure across segments, or even across lines of business within a segment **(BIS, 2001).** M&As in developed countries are mainly driven by market forces whereas in many emerging market economies (EMEs), mergers and amalgamations have often been driven by governments in order to restructure the banking systems in the aftermath of crisis .

In the late 1990s, the banking systems of many emerging market economies were highly fragmented in terms of the number and size of institutions, ownership patterns, profitability ,competitiveness, use of modern technology, and other structural features. Very often, three or four large commercial banks coexisted with a large number of smaller urban and rural banks, many of them family-owned (especially in Asia) or under the influence of the public sector (as in Latin America and central Europe). In general, few commercial banks, even larger ones, were listed on a stock exchange. Profitability varied widely, with some banks earning high gross returns but operating very inefficiently, and others competing fiercely for a narrow segment of the market. Likewise, while some banks used advanced technology and financial innovation, many were still struggling with basic operations such as credit risk assessment and liquidity management.

In this environment, bank mergers were considered to be a potentially important vehicle for improving the structure and efficiency of the banking industry. They were expected to derive both cost reductions (from economies of scale, improved organisational efficiency, lower cost of funding, greater risk diversification, and economizing on capital) and revenue gains (by exploiting economies of scope, making large deals possible, etc). In many crisis-hit countries, mergers and acquisitions were seen as an exit strategy for weak banks; while in others, officials wanted domestic banks to be large enough to compete with foreign entrants. In Indonesia, Malaysia and Thailand the trend emerged because of post –crisis weeding out of financial institutions.

Singapore has pursued a different, facilitative approach, the authorities launched a phased opening-up of the domestic financial market in 1999; to grab the opportunity to become an Asian

financial hub. The policy involved encouraging the local banks to engage in mergers and takeovers in a bid to realize economies of scale, as well as to strengthen their capability to invest in technology and management systems and to attract talent. However, the authorities did not seek to influence the outcome of mergers and takeovers, letting the new configuration be determined by market forces **(BIS Papers No 28 47).**

In US, about 25 -30 % of the banks have closed or merged due to consolidation in the last two or three decades **(Nitsure,2008)** In emerging market economies, there is more inclination towards private and foreign owned structures, with fewer commercial banks and often smaller number of branches.

It was widely believed that consolidation would enable banks to enhance efficiencies and increase revenues through expansion. Globalisation and deregulation led to decline in bank spreads, and consequently, profitability. In order to offset the decline in profitability and the need to grow volumes, there were mergers between banks and between banks and non-banks to reap the benefit of economies of scale and scope. For example in US restrictions have been removed on interstate and intrastate banking and deregulation of interest rates in 1980s and early 1990s, provided an impetus to merge across geographies. **Jones et al. (2005)** showed that consolidation in US banking industry led to a reduction in number of banks and thrift organizations over the last 20 years. In Japan little consolidation took place in 1990s and there was modest reduction in banks in 1990s following some bank failures.

Section III

Research Methodology

The market structure of Indian banks has been examined on the basis of following:

1. K-Concentration ratio, of total banking industry, measured in terms of share of *top three, five, and ten* banks in terms of total assets, deposits, advances and income from 1995-96 to 2007-08.The K –bank concentration ratio has been calculated in the following manner:

The K-bank Concentration Ratio

K-bank concentration ratio is the most commonly used measure of concentration because of its simplicity and limited data requirements. It is a very popular measure of banking literature (Bikker, 2004). It sums up the market shares of K largest banks. It gives equal weight to K leading banks, but neglects smaller banks. It varies between 0 and one (if market shares are measured in fractional form instead of percentage form).

$$CR_k = \sum_{i=1}^{K} S_i \qquad S_i = X_1 / \sum X_1$$

where Si = market share of the ith bank

Where $\sum X_1$= total of all assets/ deposits/ advances/income of all commercial Banks in the year and i=1,2,3 ---- K(No. of banks).

Section IV

MOTIVES FOR CONSOLIDATION IN INDIAN BANKING

The reasons for consolidation in India are the following:

As suggested by Narasimhan Committee Report II, "M & A" Government & RBI have to monitor the process carefully. The Narasimhan Committee has recommended a three-tier banking structure with 2 or 3 large banks of international character, 8 or 10 national banks and a few large local area banks. The committee recommended that Mergers should ideally be among the listed entities, so that they can offer scope to indicate post-merger market parameters like "market capitalization" after merger, etc.

The report on 'Indian Banks' association (IBA) 'Banking Industry: Vision 2010" stressed that "Mergers and acquisitions will gather momentum as management will strive to achieve the expectation of shareholders. This could see the emergence of 4-5 world class Indian banks. As banks seek niche areas, we could see emergence of some national banks of global scale and number of regional players". The problem however is not only the small size of Indian banks but also the lack of depth in investment and other financial services and human resource capabilities. Let us take a look at the progress of Indian Banking sector in the next paragraph.

- **Basel Norms**: Basel III requires banks to meet tougher and higher capital adequacy norms such as capital allocation towards operational risk, in addition to credit and market risks. Firstly, many Indian banks, especially public sector banks, cooperative banks and regional rural banks are unprepared for this implementation due to capital inadequacy. According to the Reserve Bank of India's report on " Currency and Finance '' released on September 4, 2008, the banking sector would require an additional capital of Rs 5,68,744 cr in the next five years. This is based on the assumption that banks would maintain Capital –to Risk –weighted Assets ratio (CRAR) at 12. 5%. Over the next five years, PSBs would require Rs 3,69,115 cr (64.9% of total requirements , old private sector banks Rs 23,319 cr (4.1%). New private sector banks Rs 113,180 cr (19.9%), and foreign banks Rs 63,131 cr(11.1%). To maintain the 51 per cent minimum government share, PSBs cannot collect additional capital directly from the public and with this view it promotes bank mergers. Table1.1 depicts that out of 21 nationalized banks 9 banks have Government shareholding in equity capital close to 51 %.In many banks; the government holds a stake just above this limit, restricting its scope to dilute the stake further and reinforce their capital base. Table 1.2 also reveals that Dena bank and Oriental Bank of Commerce have government shareholding of 51.19 only, hence in future they cannot raise capital from the market as it will reduce the government shareholding to below 51 %.The pace at which the Indian economy is growing and transforming itself, consolidation is inevitable as beyond a point banks can grow only inorganically. Consolidation may be a route for smaller banks to infuse funds to strengthen their capital base.

Table 1.1

Sl.No.	Name of the Bank	Total paid-up equity capital	Government shareholding
1	Vijaya Bank	433.52	53.87
2	IDBI Ltd.	724.78	52.67

3	Allahabad Bank	446.70	55.23
4	Andhra Bank	485.00	51.55
5	Bank of Baroda	364.27	53.81
6	**Dena Bank**	**286.82**	**51.19**
7	**Oriental Bank of Commerce**	**250.54**	**51.09**
8	Union Bank of India	505.12	55.43
9	Corporation Bank	143.44	57.17

Source: Ministry of Finance ,2010

- **Fragmented Size**

It is felt that India has many commercial banks that are very small. That is of the 53 domestic banks (both public and private), the size of 16 banks at end March 2007 individually was less than 0.5 percent of size of the banking sector.(RBI, Report on Currency and Finance, 2006-08) Indian banking industry is highly skewed and almost 67 banks have a less than 2.0% market share in India. "In the long run it is advisable that consolidation should happen in both the private and public sector," HDFC Chairman Deepak Parekh told Reuters on the sidelines of the St. Gallen Symposium Parekh said there should be a small number of large banks rather than a large number of small banks so that Indian banks could keep up with the growing balance sheets of large Indian companies and play a role in big takeover deals(Fri May 8, 2009) Which Indian bank has that kind of reserves, capital, manpower to go and open many branches in the US, even if they get permission?(29 Dec,2)

- **To Attain Global Competitiveness**: Indian banks are not able to compete globally in terms of fund mobilisation, credit disbursal, investment and rendering of financial services. The main reason behind it is the size of the industry. In 2008, there was only one Indian lender - SBI, at eighth place among the top 25 Asian banks. Industrial and Commercial Bank of China, the biggest Asian bank and the world's eighth biggest bank, is four times bigger than SBI, both in terms of tier-I capital as well as assets. Another recent study 'Report on Currency and Finance' released by the RBI reveals that the combined assets of the five largest Indian banks - SBI, ICICI Bank, Punjab National

Bank, Canara Bank and Bank of Baroda are just about half the asset size of the largest Chinese bank, Bank of China. The bank is 3.6 times larger than SBI in terms of assets, branches and profits.

Table 1.2shows that Indian Banks though may not be bankers to the world but they certainly have improved their position due to strict regulatory regime by Reserve Bank of India in the worst recession for the global banking industry. There are 20 Indian banks in the Brand Finance Global Banking 500, an annual international ranking by UK-based Brand Finance Plc, this year. In terms of assets, SBI was the world's 70th largest bank in 2009, but due to global financial crises, several big daddies collapsed paving way for the sound and resilient Indian banks in the Top 500 list. SBI's brand value more than tripled to $4,551 million, up from $1,448 million in 2009 helping it grab the 36th spot in the list. On the other hand, ICICI Bank Ltd, the largest private sector lender was at the 110th position in 2009, joined in the top 100 list with 130 % jump in brand value. HSBC retained its top slot for the third year in a row. The number of Indian banks in the global list had more than tripled last year to 19 from six in 2007 but still, as was the case last year, the Asian top 10 banks are dominated by Chinese banks with the gap between the major Chinese banks and the rest widening (The Economic Times, February 1, 2010). The Finance Ministry had pitched for consolidation, stating that it would be "immensely beneficial" to the SBI Group as it would bring in economies of scale, reduce administrative overheads, help re-deploy and channelise trained manpower to business development. Hence, Indian banks can certainly do better by enhancing their size as well as efficiency, to emerge as a global power.

Table 1.2 Rank of Indian Banks in Top 500 Global List

2010	2009	Indian Bank
36	70	State Bank of India
70	110	ICICI Bank
141	153	HDFC

Source: The Economic Times, Feb.1, 2010

Though the empirical evidence shows that size does not lead to efficiency, and there is no direct relationship between size and profitability, for instance though SBI, is the largest bank in India but its return on assets is 1.04% for the year 2009 -10 below the national average of 1.16% and

new private sector banks 1.70 % and its spread as % of assets is also less than the average of nationalized banks not to talk about private and foreign banks.(IBA,2009)

Table 1.3

In 2009-10	**Return on Assets**	**Spread as % Assets**
Nationalised banks	1.16%	**2**.21%
SBI	1.04%	**2**.16%

Source: IBA

Therefore, the Indian banks have yet to attain optimum size, so as to enjoy economies of scale and scope and they can invest in latest technology and MIS ,systems& processes and can adopt appropriate strategies to compete in the globalised world.

Hence, enormous opportunities exist in the future. India's financial sector is going to boom in a growing economy where millions of people will join the workforce and need bank accounts. 700 million people are financially excluded, banks will, therefore, need to plan for all this and learn basic survival skills. In a globalised economy, Indian banks need size as well as efficiency not only to compete with foreign banks but also going abroad and competing in other markets. One useful prerequisite for that is size.

One measure for judging how competitive is the banking structure in India, share of top five and ten banks in assets can be considered. The competitiveness in the system has been improving in the post reform period as indicated by declining share in assets, deposits and income of the top five and ten banks. State bank of India which has 24 % share in assets in 1995-96 declined to 16 % due to the emergence of private banks like ICICI and HDFC, other public sector banks like Central bank of India and Union bank of India, Bank of India, have lost their position in first five ranks.

- **Analysis of Data and Findings : K–bank Concentration ratio of All Commercial Banks**

The evidence in Tables (1.4) presents the trends in various concentration measures during 1995-96 to 2007-08 amongst the Indian commercial banks. It reflects the changes in the structure of Indian banking. We estimated the measures of concentration at industry level with respect to total assets, deposits, advances and total income of all commercial banks.

The K Concentration ratio depicts the market share of *K* big participants. Table 1.6 shows that the market shares of the biggest three, five and ten banks in terms of total assets of all commercial banks have declined over the last 12 years. This decrease in concentration is visible in all the four major variables of the banking sector namely assets, deposits, advances and income. Table (1.4 and Figure 1.1(annexure) shows that the asset share of the top five banks has declined from **45.76 percent in 1995 to 37.0 percent by the end of 2008**. The asset, loan and deposit shares of the top 10 banks also fell from close to 62% to 52%, a decline of 10%. All this shows that because of deregulation, liberalization, privatization and globalization, competition increased which led to reduction of concentration ratio in terms of four selected variables. In general if the CR-5 measure is less than 50 (indicating that the five largest firms own less than 50% share of the market) then the industry is considered to be competitive, with a number of other firms competing, but none owing a large chunk of market. Hence, it clearly emerges that concentration index have declined in the post reform (GATS) period. This clearly establishes the role of financial liberalisation in lowering concentration, despite the number of bank mergers and acquisitions, during the post reform period.

It is significant to note that the concentration declined even after 1999-2000 when the number of operating banks declined because bank mergers took place among small banks which have little impact on market structure indicators, besides many new private and foreign banks were also set up. The same trend is also seen from K-concentration ratio measured in terms of deposits (Table 1.4) and Figure 1.2, advances (Table 1.5) and and income (Table 1.6) .

Table 1.4: K- Bank Concentration Ratios of All Commercial Banks

Total Assets (in percent) **Deposits (in percent)**

Year	C3	C5	C10	**C3**	**C5**	**C10**
1995-96	35.33	45.76	61.62	33.28	44.94	62.04

1996-97	34.42	44.90	59.92	32.68	44.31	60.82
1997-98	34.05	44.42	59.03	32.72	44.15	59.92
1998-99	35.26	45.39	59.73	33.66	44.45	59.80
1999-00	33.68	43.39	57.34	32.90	43.48	58.71
2000-01	34.23	43.67	56.89	34.19	44.29	58.96
2001-02	33.98	43.24	58.41	33.38	43.55	58.56
2002-03	33.15	42.39	57.60	32.80	42.46	58.13
2003-04	31.78	41.02	56.08	31.32	40.47	56.91
2004-05	31.52	40.10	55.64	31.12	40.86	57.17
2005-06	31.97	40.81	56.54	30.71	40.45	56.37
2006-07	31.10	39.92	55.30	29.98	39.79	55.93
2007-08	29.20	37.17	52.45	28.56	37.	54.65
Average	**33.05**	**42.38**	**57.46**	**32.10**	**42.38**	**58.30**

Table 1.5: K- Bank Concentration Ratios of All Commercial Banks in case of ADVANCES and Income

Advances **Income**

Years	C3	C5	C10	C3	C5	C10
1995-96	35.89	46.00	61.05	36.80	47.47	62.59
1996-97	31.89	41.25	53.70	33.58	43.78	57.92
1997-98	32.56	41.78	54.08	32.83	43.30	56.96
1998-99	31.09	40.54	53.00	33.26	43.46	57.22
1999-00	29.59	38.83	51.55	32.50	42.21	56.07
2000-01	32.99	43.50	57.51	36.24	44.73	60.52
2001-02	31.93	42.46	58.85	31.36	40.55	53.28
2002-03	31.61	42.52	58.45	31.72	40.90	57.02
2003-04	30.72	41.40	56.21	32.58	41.81	56.78
2004-05	30.79	40.91	56.89	33.03	41.93	56.81
2005-06	32.13	41.35	57.23	32.97	41.24	56.06
2006-07	3 1.88	41.05	56.80	31.27	39.75	54.57

2007-08	30.75	39.66	55.82	30.81	39.14	54.12
Average	**31. 83**	**41.64**	**56.25**	**33.00**	**42.33**	**56.92**

In order to maintain competitiveness of the banking sector, consolidation must not involve top five banks, it must involve the rest, so that the merged entities from among the smaller banks pose effective competition for the ones at the top. Rest of the public sector banks has market share of 1 %to 3%. Most of the old private sector banks have share of less than 1% except Federal Bank of India and ING Vyasa. Therefore, there is an urgent need to consolidate these banks in order to make the banking sector more competitive and to reap the economies of scale and scope. As depicted in table **1.6** that the concentration ratio is low, compared to emerging market economies and many advanced countries like (France, Spain, U.k). In fact the degree of concentration in 2006 was one among the lowest in India. Hence, consolidation would not weaken competition. In fact, mergers between banks which are not in the top five positions would enhance competition. Hence in the first phase, mergers should be among the banks which are not in the top five positions. Next phase mergers can be with top five in order to realize economies of scale and scope and to attain global competitiveness.

Table 1.6Trends in Banking Concentration Ratio across Countries

Country	**1991**	**1998**	**2006**
1	2	3	4
ADVANCED ECONOMIES			
Singapore	0.86	0.81	0.99
Germany	0.55	0.63	0.72
Spain	0.71	0.74	0.75
France	0.60	0.48	0.68
Australia	0.89	0.62	0.64
Canada	0.71	0.55	0.60

UK	0.56	0.70	0.57
Netherlands	0.55	0.77	0.54
Korea,Rep.	0.58	0.38	0.51
Japan	0.32	0.33	0.41
Italy	0.68	0.48	0.40
US	0.20	0.22	0.33
EMERGING MARKET	**ECONOMIES**		
South Africa	0.99	0.94	0.99
Israel	0.85	0.74	0.81
China	0.91	0.83	0.70
Turkey	0.83	0.53	0.70
Indonesia	0.72	0.40	0.63
Philippines	0.83	0.65	0.60
Brazil	0.94	0.40	0.59
Malaysia	0.42	0.40	0.53
Thailand	0.56	0.51	0.51
Argentina	0.76	0.32	0.37
India	0.49	0.35	0.35
Russian Federation	0.99	0.75	0.20

Source: Report on Currency and Finance, 2006-08, p 364

Mergers and Synergies: By marrying the banks by choice will lead to many synergies like cost reduction, risk management capabilities, human resource development, diversification and enhancement of shareholder value.

- **Cost cutting**: Many branches and ATMs of various banks are flocked in the same areas leading to enormous outlay on premises, manpower and maintenance facilities. For example there is no fundamental difference between Union bank of India and Bank of India. Operating expenses can be reduced by redeployment and rationalization of such infrastructure, human resources and other administrative facilities. Consolidation will

lead to cost efficiency which will enhance profitability. For instance mergers and acquisitions which have taken place in the US on an average in the last five years, 40 per cent of the cost of the target bank was reduced by the merger process. If you look at Asia and Europe, the cost reduction is about 37 per cent.

- **To Enhance Risk Management**: Larger size improves the risk bearing capacity of a bank and strengthens its balance sheet. As per the study by Hannan and Pilloff, 2006 the merger also helps the banks to reduce the bankruptcy risk if the merger is carried over in a controlled manner. Craig and Santos also in their research paper have validated that risk gets reduced due to the diversification in the merger of the banks .This has been validated by the z score test done on default probability and by stock return volatility.

- **Geographical Spread:** Banks can diversify the risk of concentrated lending through mergers. They can also have a greater market access thereby widening the deposit base. The number of branches can also increase which helps the banks increase their spread. For example the case of the HDFC and Centurion Bank merger .Centurion Bank was strong with around 390 branches in North and South of India. And HDFC with around 1100 branches mainly in north and western India has given the new entity a much wider spread. There is wider choice of better suitable human resource for the purpose of doing the job leading to efficiency. Increase in efficiency leads to decrease in cost which may be passed to the customer so as to increase the customer base.

- **Alignment of technology:** The technology infrastructure, system platforms (Finnacle, Bank links etc), network architecture, database vendors and IT-enabled synergies (customer service, payroll, back office operations, risk management, etc) should be compatible in banks desiring to merge .Most of the public sector banks are at similar technology platform and consolidation will not be hindrance for them.

SECTION VII

Prerequisites for Merger

Chairman of the Prime Minister's economic advisory council, C. Rangarajan, says public sector banks should opt for mergers and acquisitions only if they stand to reap commercial gains and should not be compelled into consolidation.

"Any process of consolidation must come out of a felt need for merger rather than as an imposition from outside," Rangarajan, a former governor of the Reserve Bank of India, said at Bancon, the bank industry's annual conference. "The synergic benefits must be felt by the entities themselves." The government and the regulator should only play the role of a facilitator in the commercially-driven process, he added (Jan 12, 2010,Mint).

In future, the Indian banking system will be exposed to higher growth and competition. Firstly, there is a need for single banking legislation and separate legislative framework for public (SBI and Nationalised), private banks should be abolished, so as to encourage market driven consolidation or marriage by choice. Secondly, all the regulatory, accounting, legal and human resource issues must be sorted out. Thirdly, banks to be merged must be listed, so that post merger performance can be tracked. As the value of the merger lies in its synergies and these synergies are not released over a very short period of time but over a considerable period of time, hence, the effect of mergers must be considered after considerable period of time. Adaptability of the system to change is the only way of survival.

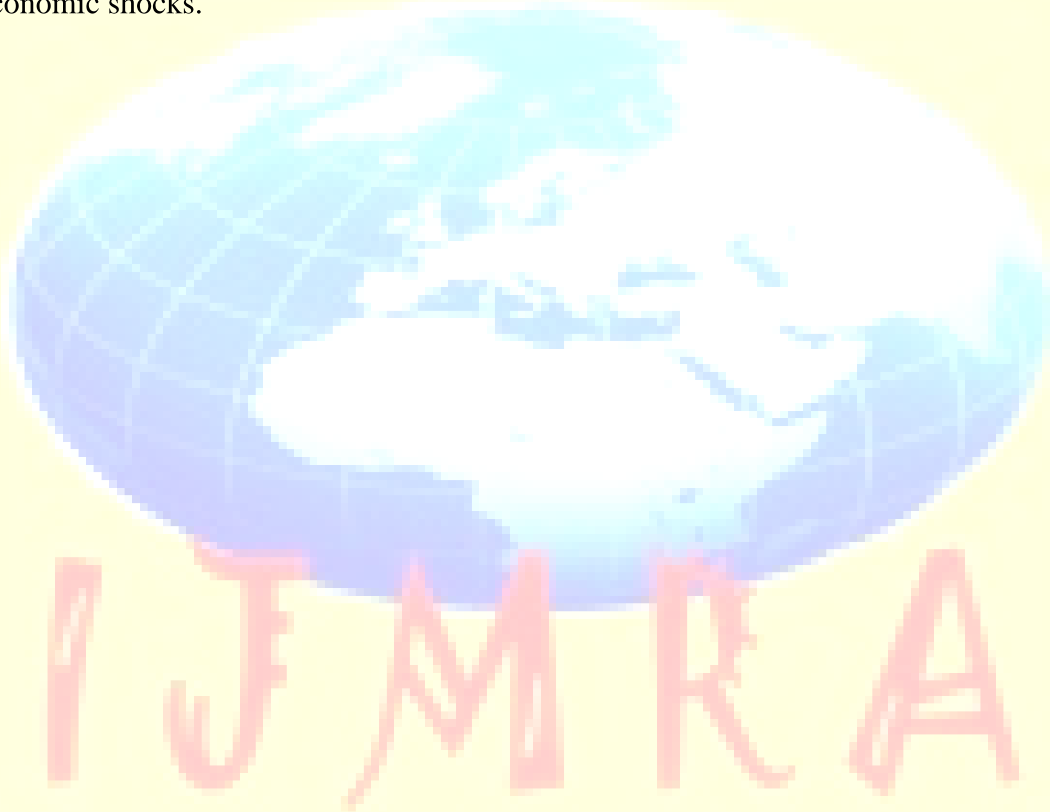
Conclusion

Banking all over the world has witnessed enormous changes over the past two decades. The forces of deregulation, advancement in technology, privatization, globalization, financial crisis have changed the financial landscape. Competition, consolidation and convergence are now the buzzwords. The motives of consolidation have depended on firm characteristics such as size or organisational structure across segments, or even across lines of business within a segment (BIS, 2001). M&As in developed countries are mainly driven by market forces whereas in many emerging market economies (EMEs), mergers and amalgamations have often been driven by governments in order to restructure the banking systems in the aftermath of crisis. Indian banking sector has remained safeguarded at number of occasions from the crisis in the financial markets, be it the 1997 Asian Crisis or be the recent Sub Prime Crisis because of negligible exposure of

the Indian banks and strong regulatory mechanism. In Indian banking sector mergers in the post reform period has been generally market driven, to protect the interest of depositors and to strengthen the banking sector. Thus the Indian approach to merger has been different from many EMEs, wherein the Governments were actively involved in the consolidation process because of financial crisis and viability of banking sector. As the banking sector will be fully opened to foreign competition in the near future, due to WTO commitments. It is utmost important to strengthen the public sector banks and to make them more efficient, consolidation is recommended. At the same time, mergers should be guided carefully, so that competitive pressures are maintained in order to increase the efficiency of the banking sector.

One measure for judging how competitive is the banking structure in India, share of top five and ten banks in assets can be considered. The market structure of the Indian banking sector is less skewed when compared with most of the advanced and other emerging market economies. The degree of concentration in the Indian banking sector was far lower than that in China, France, Spain, the UK, Singapore and South Africa. The competitiveness in the system has been improving in the post reform period as indicated by declining share in assets, deposits and income of the top five and ten banks. The asset share of the top five banks has declined from **45.76 percent in 1995 to 37.0 percent by the end of 2008**. The asset, loan and deposit shares of the top 10 banks also fell from close to 62% to 52%, a decline of 10%. All this shows that because of deregulation, liberalization, privatization and globalization, competition increased which led to reduction of concentration ratio in terms of four selected variables. In 1995-96 Bank of Baroda occupied the second position which is taken over by ICICI bank in 2007-08. Similarly, another private sector bank, namely HDFC bank, holds seventh position as for as assets and income are concerned and ninth position in deposits. Axis bank is also among the top ten banks in case of Income. This, in turn, means that these few new private sector banks have penetrated into the Indian banking system deeply and have in turn affected the structure of the Indian banking sector, after 2000 for the good. In order to compete at the domestic front also public sector banks and old private sector banks must transform themselves as the new private sector banks have gained substantial share in the previous decade. It is suggested that system would serve better if small banks which are not so efficient merge with larger and efficient banks.

If this strategy is adopted by Indian public sector banks and private sector banks, it can give good competition to foreign banks. Consolidation in Indian banking sector, is best affected by following a bottom –up process because of the 53 domestic banks (both public and private), the size of 16 banks at end March 2007 individually was less than 0.5 percent of size of the banking sector. Indian banking industry is highly skewed and almost 67 banks have a less than 2.0% market share in India. If this is accepted as the guiding principle, for consolidation than definitely it will lead to synergies like cost reduction, enhanced market base, increased geographical spread, technological automation and would strengthen the system and reduce vulnerability to macroeconomic shocks.



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Annexure

Figure 1.1

Concentration Ratio of All Commerical Banks Assets

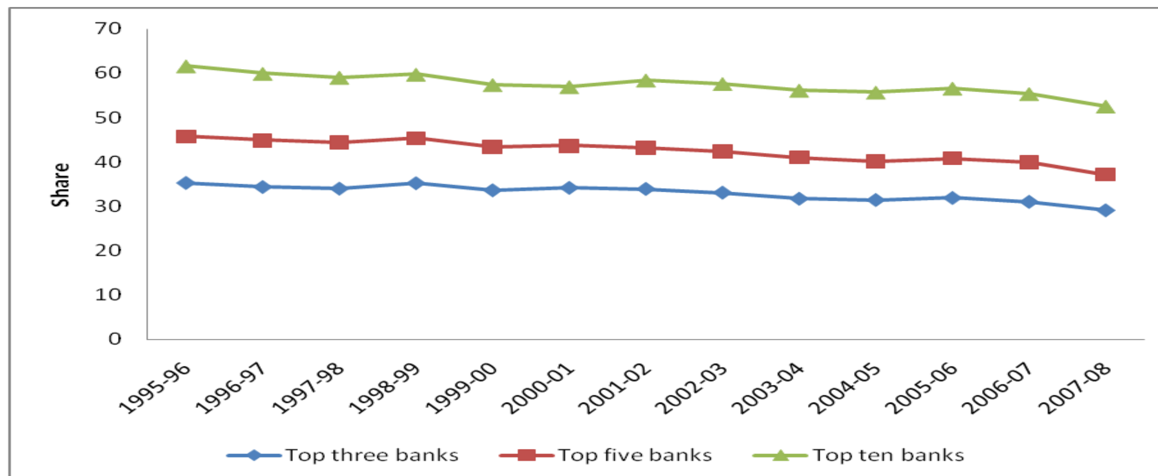

Figure 1.2 K- Bank Concentration Ratio All Commercial Banks Deposits (in percent)