"INDIAN BANKS AGAINST GLOBAL BANKS: AN EMPIRICAL STUDY ON SOME KEY INDICATORS AND THE ROAD AHEAD"

By Dr. PRAKASH SINGH
Assistant Professor in Finance & Accounting
Indian Institute of Management, Lucknow.

ABSTRACT

Few years after the independence, the old Imperial Bank of India was ten times bigger than the Hong Kong & / Shanghai Bank (HSBC). Since then, the Imperial Bank has morphed into the State Bank of India (SBI), our domestic baking behemoth which towers over its competitors here. Yet, SBI is today a mere tenth of the modern HSBC's size. This paper tries to give an insight about how Indian banks - just like their peers in manufacturing - have lost out in the quest for global scale. Despite having achieved a lot over the past few decades, from expanding their rural reach to cleaning their balance sheets, Indian banks continue to be pygmies in the land of giants. With the increasing levels of globalization of the Indian banking industry, evolution of universal banks and bundling of financial services, competition in the industry is set to intensify further. The industry has the potential and the ability to rise to the occasion as demonstrated by the rapid pace of automation, which has already had a profound impact on raising the standard of banking services. However, the author also observe through this paper that on the positive side, the policy developments during 2005indicated willingness, both on the part of the government and the banking entities, to meet the challenges of global competition and at the same time capitalize on the business opportunities and technological support. However, in parallel terms, competitive pressures and loss of market share led to banks compromising on their margins. Nevertheless, their keenness to compete with their global peers by acquiring size and scale, setting up franchises overseas and getting overseas listing, accentuated the desire to benchmark themselves to global standards. The article concludes that the Indian banking sector compares well with the global benchmarks, thanks to prudential supervision and the measures undertaken by the Reserve Bank of India and the Government. The paper is divided into three parts. In the first part we make a comparison of Indian banks with their global counterparts by looking at some key indicators, the second part deals with the micro analysis of recent trends in the banking industry and finally the third section deals with future challenges.

Key Words: Global banking, International benchmarks, supervision

BACKGROUND

The relationship between financial-sector development and economic growth has long been the subject of much debate. However, a growing body of recent empirical work strongly supports the proposition that financial development contributes to long-term growth. Moreover, there is evidence to suggest that the intermediation-growth link is stronger for less financially developed countries, such as India. There are thus good reasons to believe that the development of the banking system in particular will be critical in sustaining the growth of investment and output in Indian over the longer term. Given the limits on its current ability to attract foreign investment and on the capacity of firms outside the resource sectors to finance investment from retained earnings, India's growth will depend to a great extent on the effective mobilization and intermediation of domestic savings. A more efficient financial system could also play a role in fostering the diversification of economic activity in India.

INTRODUCTION

At the very outset, It is useful to bring out some telling facts about the status of the Indian banking industry juxtaposed with other countries, recognizing the difference between

the developed and the emerging economies. In the world's top 1000 banks, there are many more large and medium-sized domestic banks from the developed countries than from the emerging economies. Illustratively, according to The Banker 2004, out of the top 1000 banks globally, over 200 are located in USA, just above 100 in Japan, over 80 in Germany, over 40 in Spain and around 40 in the UK. Even China has as many as 16 banks within the top 1000, out of which, as many as 14 are in the top 500. India, on the other hand, had 20 banks within the top 1000 out of which only 6 were within the top 500 banks. This is perhaps reflective of differences in size of economies and of the financial sectors.

Further, in most emerging markets, banking sector assets comprise well over 80 percent of total financial sector assets, where as these figures are much lower in the developed economies. Furthermore, deposits as a share of total bank liabilities have declined since 1990 in many developed countries, while in developing countries public deposits continue to be dominant in banks. In India, the share of banking assets in total financial sector assets is around 75 per cent, as of end-March 2004. The dominant role of banks in financial intermediation in emerging economies and particularly in India will continue in the medium-term; and the banks will continue to be '"special" for a long time.

If we look at the internationalization aspect of banking operations or foreign banks presence in our country and their track record, we observe that the foreign banks in India, which are present in the form of branches, seem to enjoy greater freedom in their operations, including retail banking, in the country on par with domestic banks, as compared with most of the other developing countries. Furthermore, the profitability of their operations in India is considerable higher than that of the domestically owned banks and, in fact, is higher than the foreign banks' operations in most other developing countries.

The Macro Picture

In its report on Trends and Progresses of Banking in India 2004-05, the RBI has compared the Indian scheduled commercial banks (SCBs) to banks in other countries on various financial and soundness indicators. These parameters include funding volatility ratio, return on assets, net interest margin, cost-income ratio, non-performing loans ratio and capital adequacy ratio. The return on total assets (RoA) of banks, defined as ratio of net profit to total assets, was 0.9 per cent for SCBs in India in 2004-05, as compared to the global RoA of between - 1.2 per cent and 6.2 per cent, said the RBI in its report. The RoA was the highest for foreign banks at 1.3 per cent, followed by new private sector banks at 1.1 per cent. For public sector banks, it was 0.9 per cent. RoA is one of the most widely employed measures of profitability. With regard to funding volatility ratio (FVR), which measures the extent to which banks rely on volatile liabilities to finance their assets, the ratio for various bank groups was in the range of -0.11 to -0.23 per cent. This compares favorably with the global range, which was in the range of -0.71 and 0.11 per cent, the ratio being primarily negative for most countries.

Most countries in developed and even several emerging economies have net interest margin (NIM) of around 2 per cent of total assets. In India, the Nim for scheduled commercial banks was 2.9 per cent in 2004-05, with the new private banks having the lowest NIM in 2004-05, at 2.2 per cent. The cost-income ratio (CIR) for Indian banks was 0.5 per cent, with the global range being 0.46 to 0.68 per cent. The ratio of non performing loans (NPL) to total assets vary from 0.2 per cent to 3 per cent in developed economies to over 10 per cent in several Latin America

economies, said the report. In the case of Indian banks, the NPL has declined to 5.2 per cent by end-March 2005. Provisioning to NPLs ratio was 60.3 per cent for Indian banks, which was within the global range. Globally, the provisioning ration varies from less than 10 per cent to over 200 per cent.

Broader Asset composition

One of the distinctive features of lending during FY05 was that a substantial part of the banks' lending in this fiscal was at sub-PLR rates. Such loans comprised Nearly 50% of the total corporate lending by the sector. This was the result of the cutthroat competition being faced by banks

and was not very reflective of the prevailing risk return tradeoff. While the RBI, in its mid-year review, highlighted the down sides of such lending, bank themselves have also contemplated fixing floor rates for long term AAA lending. Another striking feature on the assets side was the broad-based lending to agriculture, SMEs and retail segments. While the broad-based credit disbursement is a healthy sign as far as risk diversification is concerned. It also reduces the slippage vulnerability due to sector-specific issues. The highest growth in credit off take was registered by real estate loans at 90.3% YoY (as against a decline of 5.4% YoY in Fy04) followed by retail housing at 36% YoY (10% YoY in Fy04)and priority sector at 31% YoY (24% YoY in Fy04)

On sound footing

The soundness measures for the sector were reasonably satisfying for 2005. In terms of safety mechanism, banks were able to maintain CAR of 12.8% despite a sharp jump in the risk weighed assets. While foreign banks had the highest ratio of 14%, the PSUs were also at a comfortable 13.2%. Most private banks, however, faced capital crunch with an average CAR of 12.1%. This led to several entities tapping the capital markets (domestic and overseas) during this year. Total resource mobilization by banks by way of domestic public issues was Rs 14.7 billion in FY05. The sector's asset quality has also shown significant improvement over the years. The net NPA to capital ratio for the sector declined from 71% in FY99 to 16% in FY05.

Based on key parameters, outlined below are some key indicators of the Indian banking industry in 2005.

- Cost to income ratio :The cost to income ratio of scheduled commercial banks in the country hovered around 40% and was in line with their global counterparts.
- Non-performing assets: The gross NPA to advances ratio for the sector declined from 16 % in FY97 5% in FY05. Although this was above the range of 0.3% to 3% for the developed economies, it was well below the average of 10% for several Latin American economies. In fact, Indian banks fare much better in this respect than their Chinese counterparts (having average NPA levels of 15% to 20%)
- Capital adequacy ratio (CAR): The sector's average capital adequacy ratio of 12.8% also compares very favorable against the regulatory minimum of 9% for global majors. Interestingly, the global range for capital adequacy ranges between 9% and 37%

One to one comparison

Before we move to the detailed analysis of the banking sector and the challenges ahead, let us end this section by making a direct comparison between one of the largest bank in the Indian banking sector, the State Bank of India and put it directly against the global averages of the best performing banks. We try to compare them on some interesting ratios and try to interpret the numbers.

Parameters (%)	SBI (March 2004)	SBI (March 2005)	Best International Banks (The Banker, July '05)
ROA	0.86	0.91	>1
ROE	18.5	19.57	>18
CAR	13.50	14.35	11-12
Gross NPAs	9.34	8.76	>3
Net NPAs	4.50	3.63	0
Expense Ratio	50.53	48.57	>50
Other income to operating income	36.52	38.41	>40
NIM	2.95	3.01	>3.5
Transaction Costs	1.80	1.80	>1

Table 1. Global Bench making

As can be seen from the table above, one of the best performing banks of India has reached quite close to the international standards but they have to do lot of work in some areas like NPA management, global reach, and advanced technology adoption. In the years to come, as global standards, measures of risk containment, deregulation and corporate governance acquire increased significance; Indian banks will have to make increased efforts to enhance their global presence. For this, it must also work on all fronts to safeguard itself from the risks associated with greater integration into global financial markets.

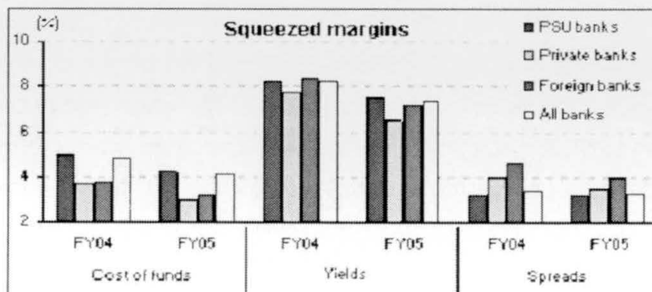
The Micro Picture For Fy05: A Closer Look

The financial strength of individual banks, which are major

participants in the financial system, needs to be the first line of defence against financial risks. In this part of the article, we examine the sector's performance during 2005.

Profits to be driven by core income

Analogous to our expectations, banks witnessed a steady growth in incremental credit disbursements in 2005. As per the RBI's Trends and Progress in Banking (Fy05), the incremental credit off take grew at 28% YoY during FY05m as against 17% in FY 04. Thus, with banks funds focused on 'lending', investments grew by mere 5% YoY against 16% YoY in FY04. Even though lending rates have declined for some time now due to the intense competition among banks to advance loans, deposit rates wee also falling at the same time. Resultantly, banks had not felt the pinch in margins until FY05. In 2005, however, while the deposit rates hardened, the lending rates continued to remain flat. This led to the banks scurry for high yielding retail portfolios and inclusion of the 'SME segment' in its books.



Source: www.indiainfoline.com

Corporate off take to replace retail boom

Credit disbursals to the corporate sector did not take off the way it was expected. Nevertheless, advances to the corporate sector accounted for over 40% of the total advances made by banks. Corporate loan yields, however, shrinked with companies tapping overseas markets for raising funds. Over the last few years, given the steep fall in overseas interest rates and the appreciation of the rupee, companies have begun to tap the global market in increasing numbers. As a result, the share of bank credit in total funds raised by industry (from internal and external sources) stood at just 31% inFy05. This was despite the fact that banks continued to resort to sub-PLR lending thereby compromising on their net interest margins.

Consolidation to drive synergies

The M&A activity that was tipped to be the 'mantra' for the sector in 2005 saw very few takers, thanks to the social and political hurdles. While the example of Centurion Bank of Punjab could be reckoned amongst the selected few consolidation stories, merger amongst PSU banks continued to remain in the backburner due to protests from the labour unions and the Left party.

The Stock Market Performance

The Sensex, in 2005, outdid targets foreseen by every analyst worth his salt! What is even more surprising is that even at 9,000-plus levels, despite being over 16 times PY07 forward earnings; one could still find select stocks offering a decent return on investment. Banking has been one sector that has retained investor confidence throughout the year, thereby delivering exactly the same returns, as one would have garnered by investing the index. While the Sensex gained 44% till December 23, 2005, the BSE Bankex moved in tandem. The sector sustained its atteaction to investors on the back of optimism regarding economic growth. If one looks at the graph, that compares Rs 100 invested in both the Sensex as well as the BSE Bankex during the year 2005, we observe that while initially the Sensex trailed closely behind Bankex,the former caught up in the fag end of the year to generate Rs (144) as in the case of the Bankex.

Source:www.equitymaster.com

It would be interesting to note that as against last year, wherein the PSU banks delivered high returns, their private sector counterparts largely outdid them in 2005. Also,

worth noting is the fact that behemoths like SBI and ICICI Bank showed considerable movement and proved to be the market movers during 2005. The reason for the same was the investors confidence in the larger banking stocks that have the potential to capitalize on the credit boom. Banks like Kotak Bank also managed to register appreciable gains due to their diversified business interests. Amongst the laggards, while the 'GTB impact' and treasury losses weighed heavy on banks like OBC and ING Vysya, others that were not able to deliver to their peers were also shunned by the markets.

The Best ......

(Rs)	31-Dec-04	31-Dec-05	% change
Kotak Bank	104	237	127.9%
UTI Bank	173	300	73.4%
Syndicate Bank	50	83	66.0%
ICICI Bank	361	583	61.5%
SBI	594	891	50.0%

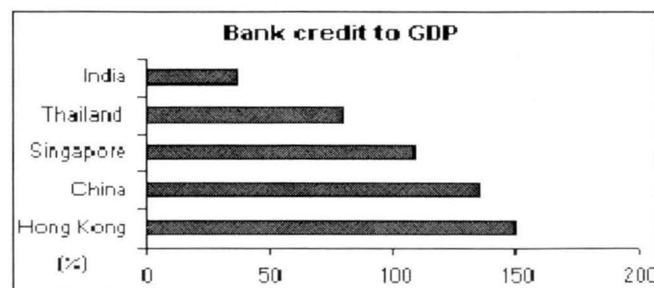
The worst ......

(Rs)	31-Dec-04	31-Dec-05	% change
OBC	327	257	-21.4%
ING Vysya Bank	199	160	-19.6%
Bank of Rajasthan	57	47	-17.5%
IDBI	108	100	-7.4%
Vijaya Bank	65	60	-7.7%

The Future Agenda

Scouting for resources

Despite the credit growth being at all time high levels, the penetration of the same remains very low in India as compared to other developing nations of the world. Besides, the loan to GDP ration in the country being fairly low at 37%, retail loans (consumer credit) as a percentage of GDP in India at 7% is abysmally lower as compared to an average of 45% for other Asian countries (sources: RBI and World Bank). India is still and economy where the corporate sector relies heavily on bank lending. Plus, interest rates in the global markets are rising. This, together with the fact that the rupee is now beginning to depreciate, means that most firms will find it increasingly unviable to raise money form overseas markets. Given this, banks will feel the need to scout for additional resources besides their net owned funds. This in turn suggests that banks will be see vying for a higher share of low cost deposits.



Source:www.indianfoline.com

Infrastructure investments

Besides corporate, the government's thrust on infrastructure investment is expected to be another trigger for credit demand. The current rate of infrastructure investments in India at 3.5% of GDP is well below the target rate of 8.0% proposed by the exert Group on Commercialization of Infrastructure Projects (Source: ADB). Also, the share of private players is expected to rise from 20% to 40% in the next 5 years, thus propelling the incremental credit demand.

'Priority' weighing heavy

The pressure from the finance ministry on banks to hike their exposure to the 'priority sector' may weigh heavy on the sector's margins. PSU banks especially have been asked to concentrate a sizeable portion of their credit portfolio on this segment. Although banks have tied up with credit rating agencies for the risk appraisal of this segment, an overexposure to the same may not augur well for the entities.

Strategic Global Challenges Ahead

Globalization has thrown up lot of opportunities but accompanied by concomitant risks. There is a growing realization that the ability of countries to conduct business across national borders and the ability to cope with the possible downside risks would depend, inter-alia, on the soundness of the financial system and the strength of the individual participants. Adoption of appropriate prudential, regulatory, supervisory, and technological framework on par with international best practices enables strengthening of the domestic banking system, which would help in fortifying it against the risks the at

might arise out of globalization. India, which has strengthened its banking sector to a reasonable satisfactory level by adopting the banking sector reforms in a calibrated manner, is evenly poised to face these challenges. We take a look at the five most important challenges here briefly:

- *Comprehensive risk management:*

  Under Basel I banks were focused on credit and market risks. Basel II has brought into focus a large number of risks requiring banks to focus on a larger canvas. Besides the increase in the number of risks, banks are now beginning to focus on their inter-linkages with a view to achieve a more comprehensive risk management framework. Basel II implementation, therefore, is being increasingly seen as a medium through which banks constantly endeavor to upgrade the risk management system to address the changing environment. Further, in the initial stages, banks were managing each risk in isolation. It is no longer adequate to manage each risk independently. Enterprises worldwide are, therefore, now putting in place an integrated framework for risk management which is proactive, systematic and spans across the entire organization.

- *Transition from Capital adequacy to capital efficiency:*

  Basel II prescriptions have ushered in a transition from the traditional regulatory measure of capital adequacy to an evaluation of whether a bank has found the most efficient use of its capital to support its business. In this transition, how effectively capital is used will determine return on equity an a consequent enhancement of shareholder value. In effect, banks may adopt a more dynamic approach to use of capital, in which capital will flow quickly to its most efficient use. This revised efficiency approach is expected to guide the return-on-equity strategy and influence banks business plans.

- *Compliance with International Accounting standards:*

  One of the prime international standards considered relevant for ensuring a safe and sound banking system is the 'core Principles for Effective Banking Supervision' issued by the Basel Committee on Banking Supervision (BCBS). An important challenge, therefore, is to ensure that accounting standards and prudential frameworks are usually consistent. Moreover, Derivative activity in banks in India has been increasing at a brisk pace. While the risk management framework for derivative trading, which is a relatively new area for Indian banks (particularly more in respect of structured products), is an essential pre-requisite, the absence of clear accounting guidelines in this area is matter of significant concern.

- *Outsourcing risks:*

  Banks are increasingly using outsourcing for achieving strategic aims leading to either rationalization of operational costs or tapping specialist expertise which is not available internally. Outsourcing might give rise to several risks including, strategic risk, reputation risk, compliance risk, operational risk, exit strategy risk, counter party risk, county risk, access risk, concentration risk and systemic risk. The failure of a service provider to provide a specified service, ensure security / confidentiality, and comply with legal and regulatory requirements can lead to financial losses / reputation risk for the bank and could also lead to systemic risks for the entire banking system in a country. It would therefore be imperative for the bank outsourcing its activities to ensure effective management of these risks. It is in this background that RBI gas issued draft guidelines on outsourcing, which is intended to provide direction and guidance to banks to effectively manage risks arising from such outsourcing activities.

- *Corporate Governance :*

  Sound corporate governance is not only relevant at the level of the individual bank, but is also a critical ingredient at the system level. Effective risk management systems determine the health of the

financial system and its ability to survive economic shocks. To a large extent, many risk management failures reflect a breakdown in corporate governance which arise due to poor management of conflicts of interest, inadequate understanding of key banking risks, and poor Board oversight of the mechanisms for risk management and internal audit. Corporate governance is, therefore, the foundation for effective risk managements in banks and thus the foundation for a sound financial system.

Conclusion

The banking sector certainly holds credible prospects for investors in the coming year. But it is pertinent to note that, the optimism will hold ground provided the anticipated reforms do not remain on paper. The smaller banks that have significantly run up on the 'reform expectations', will have to deliver with performance. At the same time, the behemoths will have to exhibit resilience to margin pressures and ability to retain asset quality. In all, 2006 will see investors weighing the 'delivered' against the 'deliverables' for the banking sector. The global challenges which banks face are not confined only to the global banks. These aspects are also highly relevant for banks which are part of a globalize banking system. Further, overcoming these challenges by the other banks is expected to not only stand them in good stead during difficult times but also augurs well for the banking system to which they belong and will also equip them to launch themselves as a global bank.

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ABOUT THE AUTHOR

Dr. Prakash Singh is currently working as an Assistant Professor in the Finance & Accounting Area at Indian Institute of Management, Lucknow. He has completed his PhD titled "Analysis of private sector bank operations in India in response to technological and other developments with a view to develop a future banking model" from BITS, Pilani. He has an MBA degree from Lucknow University and B.Tech from HBTI, Kanpur. He has altogether 10 years of experience, 3 years in industry (Escorts Ltd, Kotak Bank Ltd) and the remaining years in academics, (BITS, Pilani, IIM, Lucknow). He can be contacted at p_singh@iiml.ac.in

SUCCESS STORY

25 YEARS OF INFOSYS

INTRODUCTION

Today the name Infosys is a source of great inspiration to the younger tech savvy generation, and the name means a lot to lot of people around the world. Let us look into the success story of this great organization.

How it started

Infosys, one of the most respected companies of the world was started in the year 1981, in the city of Pune, led by the vision of N.R. Narayana Murthy and his six colleagues, who brought into the company their wide experience, having handled projects in various countries. The initial investment of the company was very meagre and they started operations in a small house.

Developmental milestones

In 1983, Infosys got their first client, MICO in Bangalore. By 1984-85, Infosys headquarters was shifted to Bangalore. In the year 1987, the company set up its first international office in the US in Fremont, California, now its US headquarters. It became a public limited company in India in the year 1992 and got ISO 9001 certification in the year 1993. Infosys set up its first European office in Milton Keynes, UK in the year 1996. The company attained SEI-CMM level 4 in the year 1997. In 1999, Infosys attained SEI-CMM level 5. It was the first Indian company to get listed in NASDAQ in the same year. Infosys crossed 400 million $ in revenue in the year 2001 and started Progeon, its BPO (business process outsourcing) subsidiary in 2002. It acquired "Expert Information Services" in Australia to form Infosys Technologies Australia in 2003. In the year 2004, it set up Infosys Consulting Inc., U.S. consulting subsidiary in Texas, U.S., crossed 1 billion $ in revenue and in 2005 it got inducted into the Global MAKE Hall of Fame. On April 14, 2006 Infosys announce a 1:1 bonus to its shareholders, the fifth bonus in 12 years and crossed 2 billion $ in revenue.

Awards and Recognitions

In 2001 and again in 2002, it was rated "Best Employer in India" and "India's Most Respected Company" by the business periodicals, Business Today and Business World respectively, and won a Top Brand with a Conscience award from the Medinge Group of Sweden in the year 2003. Infosys is second, after Tata Consultancy Services, among the Top 20 IT Software and Service exporters in India, according to the National Association of Software and Services Companies.

Present

Infosys Technologies Ltd, currently employs approximately 52,000 software professionals in about 30 offices worldwide, working on varied areas mainly in consulting, software and product development. The headquarters is located at Electronics city, Bangalore, one of the largest IT campuses in the world. But global offices are in: Fremont, California (the US headquarters), Argentina, Australia, Belgium, Canada, France, Germany, Hong Kong, Japan, the Netherlands, Singapore, Sweden, Switzerland, United Kingdom, and United Arab Emirates. Besides its Bangalore and Mysore centres, the company also has development centres at Chennai, Mangalore, Mohali, Pune, Hyderabad, Bhubaneshwar and Trivandrum in India.

Campus programs

The company has launched a 'campus connect' campaign which aims at improving the quality of graduates from engineering colleges in the country to coincide with IT industry requirements. Infosys has committed Rs. 10 crore for Campus Connect in the first phase for training students, faculty and providing industry inputs into the curricula for 30 engineering colleges across the country.

About Infosys Foundation

In 1996, Infosys created the Infosys Foundation in the state of Karnataka, operating in the areas of Health care, social rehabilitation and rural upliftment, education, arts and culture. Since then, this foundation has spread to the Indian states of Tamilnadu, Andhra Pradesh, Maharashtra, Orissa and Punjab. The Infosys Foundation is headed by Mrs. Sudha Murthy, wife of Chairman Narayana Murthy. The foundation got the prestigious ET Corporate Citizens

Award in 2000-2001.

Future Plans

According to N R Narayana Murthy, chairman and chief mentor of Infosys Technologies, it is not enough just to achieve targets, operational goals, innovation, and financial performance. He said he would like Infosys to be a place where people of different genders, nationalities, races, and religious beliefs work together in an environment of intense competition but utmost harmony, courtesy, and dignity, to add more and more value to customers day-after-day.

Conclusion

It is the great vision and the leadership that has helped Infosys reach this level, and today it stands tall as a guiding light to growing software companies and entrepreneurs with it's mission to achieve their objectives in an environment of fairness, honesty and courtesy towards clients, employees, vendors and society at large.

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