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BANKING SECTOR REFORMS IN INDIA

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ABSTRACT

In India, most of the commercial banks have been nationalized in 1969 and 1080. These banks have acquired a place of prominence in the banking structure over the years. Banking sector is treated as to be the back bone of the Indian economy. The task of banking industry is vital as the one of the leading and most essential service sector. Today the banking industry in our country is strong and capable of withstanding the pressures of competitions. In the era of globalization banking sector in Indi is rapidly changing due to technological innovations, financial liberalization with entry of new private and foreign banks and regulatory changes in the corporate sector. Bank in India have made significant progress in the expanding geographical coverage by opening a large number of branches especially in rural areas and semi-urban areas, mobilizing savings and providing funds for investment with special emphasis on the priority sector of economy. A number of public sector banks were plagued with poor profitability. Most of them were undercapitalized with a higher proportion of NPA. The poor financial condition of banks made it necessary for the government to provide large subsidies and raise the interest rates. These maladies of Indian banking system necessitated the programmes to reform the banking sector. This paper is an attempt to study the recent developments in banking sector reforms in India like deregulation of interest rates, introduction of capital adequacy norms etc and this paper also tells about the impact of banking sector reforms on the performance of banks, technology, customer services, interest rate trends etc.

KEY WORDS : *Liberalization, Globalization, ATMs, Technology, NPA, Capital Adequacy, Reforms etc.*

INTRODUCTION

Since 1991, the Indian financial system has undergone radical transformation. Banking sector reforms have altered the organizational structure, ownership pattern and domain of operations of banks, financial institutions and non-banking financial companies (NBFCs). The main thrust of reforms in the financial sector was the creation of efficient and stable financial institutions and markets. Reforms in the banking and non-banking sectors focused on creating a deregulated environment, strengthening the prudential norms and the supervisory system, changing the ownership pattern and increasing competition. Competition has been infused into financial system by licensing new private banks since 1993. Foreign banks have also been given more liberal entry. The present chapters highlights different reforms majors taken by the government for the banking sector since 1991.

RECENT DEVELOPMENTS IN BANKING IN INDIA/BANKING SECTOR REFORMS IN INDIA

- After the reforms, interest rates have been deregularised. Prior to 1992, interest rates were

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completely administered by the RBI and were highly complex and rigid. Since 1992, interest rates have been be regulated in a phased manner and by July 1996, banks were allowed to set interest rates on all term deposits and on all advances. In October 2011, RBI deregulated interest on saving bank accounts. Now, banks are free to fix interest rate offered on saving bank accounts. The flexibility of interest rate will promote competition among banks and the depositors/borrowers will be benefitted.

- Along with the introduction of capital adequacy norms, new norms of income recognition, asset classification and provisioning have also been introduced. Asset classification means that the assets of a bank are classified for making proviasions. Assets can be standard assets or non-performing assets (NPA). In India, standard are defined as debts on which interest or principal or both are received by due date or within 90 days of due date. On the other hand, non-performing assets (NPA) is that debt on which interest or principal amount has not been received for a period of more than 90 days from its due date. New norms of income recognition and asset classification will reflect the true picture of the financial situation of each bank.

- In 1992-93, the entry of private sector banks and foreign banks was allowed. It was done to increase competition, attracting more capital and promoting the use of latest technology in the banking sector. At present, 26 private sector banks are operating in India. Besides, 43 foreign banks have opened their branches for providing banking services in India. Government has allowed 49% FDI in private sector banking under the automatic route and up to 74% FDI under the approval route. Joint ventures between foreign banks and Indian banks are also permitted.

- Government of India appointed Narasimham committee on financial system reforms in 1991 and on banking sectors reforms in 1998. This committee recommended that capital adequacy norms should be adopted as per international standards so as to strengthen the capital base of banking sector. It recommended the introduction of capital adequacy norm of 8%, i.e., all commercial n=banks should be required to maintain capital to risk weighted asset ratio (CRAR) of at least 8%. It is the ratio of capital of the bank with the risk weighted assets of bank. It indicates the margin of protection available to both depositor and creditors against unanticipated losses that may be experienced by a bank. As per base II recommendation, the reserve banks of India raised the minimum capital to risk-weighted asset ratio (CRAR) to 9%. Now RBI has directed to all banks in India to follow base III norms by 2019. As per base III norms, minimum capital to risk-weighted asset ratio (CRAR) will be 11.5%.

- Narasimham committee's recommendation to allow public sector banks to access the capital market to raise equity has been accepted. In order to enable banks to take care of their additional needs of capital, the government of India decided to allow public sector banks to approach the capital market to directly mobilize the equity funds for the public. The public is allowed to subscribe up to 49% of the capital of public sector banks. State Bank of India was the first public sector bank to sell its share in the market. Many Public sector banks have issued their shares to the public.

- Undertaking banking transaction using computer/mobile phones and internet is called e-banking. It includes internet banking, tele -banking, mobile banking. Using internet, e-banking has made the banking transactions possible at any time and from anywhere. Through e-banking ,customer can check balance in his account, can download account statement, pay bills, recharge mobile/DTH connection, can make requisition for cheque book, can transfer funds from one account to another account, can fixed deposits ,etc.

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- The branch licensing policy has been liberalized. The banks are allowed more freedom to plan branch expansion in response to market needs. Branch expansion policy is relaxed to allow more penetration and competition among banks in India from December 2009, banks were permitted to open branches without obtaining prior permission of RBI in rural, semi-urban and urban areas with population less than 50000. In cities with population of 50000 and above banks need prior authorization of RBI for opening branches.
- For bringing easiness in banking, RBI has introduced core banking in India. It makes banking convenient by changing the status of customer from 'Customer of a branch' to 'customer of the bank'. In this system, a customer by opening a bank account in one branch (which has CBS facility) can operate the same account in all CBS (core banking solution) ranches of the same bank anywhere across the country. It is immaterial with which branch of the bank the customer has opened his bank account. The CBS enables the customer of bank to undertake their transactions from any branch of the bank instead of being attached to a particular branch. It ensures batter customer services by the bank. By the end of 2014, almost all branches of commercial banks were covered in CBS.
- RBI has introduced various reforms for the faster and safe transfer of funds from one account to another account. For this, RBI has introduced national electronic fund transfer (NEFT), real time gross settlement (RTGS), electronic clearing services (ECS), etc. For faster clearance of cheques, 'Cheque truncation system' has been introduced. Under this system, the cheque is scanned and its image is sent through e-mail for necessary verification. This system will reduced cheque clearance time for out station cheques. It also avoids risk of loss of cheque in transit.
- The banks are now permitted to invest their deposits in long term fixed income instruments, subject to the condition that these instruments should have an appropriate rating prescribed for the money market instruments. Thus, banks have been given more freedom to invest their money.
- Automated Teller Machine is an electronic banking outlet. Through these machines, the customer can withdraw money, or even deposit money, can make bill payment, effect transfer of fund and get statement of bank balance without the help of branch representative or human teller. Through ATM, the customer can avail banking services on 24*7 bases from nearby ATM booth, without visiting the bank. It provides easy access to banking facilities. Debit card/credit card can also be used to withdraw cash from ATM. The coverage of ATM network and facilities provided by banks through ATMs are increasing. ATM holder of any bank can operate his ATM card at his bank's ATM or at other bank's ATM. The bank also provide online/SMS alert to card holder for all type of ATM transactions irrespective of the amount involved.

OTHER REFORMS

- Cash Reserve Ratio (CRR) Statutory Liquid Ratio (SLR) have been **reduced.** It will increase investible funds of banks.
- Banks have been allowed to issue **Debit Cards, Credit Cards**, Kisan Credit Cards for the benefits of the customers.
- Commercial banks have been allowed to **borrow from overseas** financial markets up to 25% of paid up capital and free reserves. Loans are available at lower interest rates in foreign markets.
- Internal check and control has been strengthened to prevent banking frauds.
- Commercial banks have adopted relationship banking and customer friendly approach. **Customer grievance redressal system** has been strengthened. Customer can lodge their complaints even online.

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- Commercial banks have **diversified their activities** in other areas like insurance, demat accounts, mutual fund, merchant activities (underwriting, issuing letter of credit, collection of trade bills, assistance in public issue of securities), etc. It has widened the scope of activities of banks.

Payment banks have been allowed to operate to provide some banking services.

IMPACT OF REFORMS:-

IMPACT OF REFORMS ON PERFORMANCE OF BAKNS:-

It is important to evaluate the impact of reforms on performance of major bank groups. This impact can be studied under the following heads-

- Before reforms, public sector banks were main components of structure of Indian banking sector. After reforms, the private sector banks have also become an important component of structure of banking sector. Since the advent of reforms, the number of domestic as well as foreign private sector banks have increased substantially. Their working has also improved significantly.
- Since reforms, banks have witnessed high growth in deposits and advances the new private sector banks have registered impressive growth in deposits and advances.
- Non-interest income of banks comes from different services based activities such as credit card transactions, merchant banking, leasing, etc. Since reforms, the proportion of non-interest income out of total income of the public sector banks and domestic banks has increased. The trends in non-interest income indicates that the domestic banks are diversifying their activities.

Since reforms, percentage of non-performing assets as percentage of total loans is declining for all the banks group. In the post reforms period most of the banks have attained the capital adequacy norms fixed by RBI.

TECHNOLOGICAL UPGRADATION:-

The banking industry has witnessed great strides in technical upgradation. Now almost all the branches to public sector banks have been computerized. Banks have adopted information technology in banking transactions. Now many bank's branches are using net banking, mobile banking, computerization, etc. Almost all banks have adopted ATMs in various parts of the nations. Now with the help of ATMs and 'Anywhere Banking', money withdrawal and deposit is possible at any time of day or night. National Electronic Fund Transfer (NEFT) facility has been extended to all parts of the country for transfer of funds in a safe and secure manner.

IMPROVED CUSTOMER SERVICES

Now banks are provided better customer services. The working hours of the banks have been increased. 'Anywhere banking', ATMs, doorstep banking and other services are provided easy access to customers. Now customer can operate their accounts from any branch of the bank under 'Anywhere' banking system. ATM facility has made the life of customer very easy. In doorstep banking, banks provide demat services, mutual funds services, underwriting services, factorizing services, make payment of bills, etc.

INTEREST RATE TRENDS

Interest rate deposit as well as loans and advances have been deregulated. The structure of deposit rates in the reform period points to increasing attempt by RBI to liberalise the term deposit rate

structure and boost the mobilization of both short term and long term deposits. Such attempts have been made with a view to augmenting the resources of the banking system to prevent a liquidity 'crunch'. Similarly interest rates for advances were also deregulated.

COMPETITION

The liberalized entry of private sector banks including the foreign banks has impact on the competition in the banking sector. There has been a change in the market share of public and private sector banks.

It is the sign of increased competition since any changes in favour of private and foreign banks indicated that these banks have been successful by offering better services at lower prices. The market share of public sector banks in both the deposits and advances has fallen while that of private banks has improved. Further, there is rapidly increasing use of computer and telecommunication technology by public sector banks in order to provide improved and faster banking services, similar to those provided by private sector and foreign banks. To promote the customer satisfaction in the face of increased competition, a number of public and private banks have been setting up ATMs, introducing tele-banking, net banking, providing specialized services and introducing credit card operations.

AVAILABILITY OF CREDIT

The availability of credit to priority sector has increased significantly. Availability of credit as a proportion of the total credits of the banking sector is indicated by the credit-deposit ratio i.e., the percentage of bank deposits given as loans. Following the reforms, the credit –deposit ratio (CDR) of commercial banks as whole declined. It is partly because of increased competition among banks and partly because the banks were learning to adjust to the new lending norms under the reforms. There has been increase in the proportion of risk-free government securities in bank's major earning assets, i.e., loans and advances and investments.In other words, during post reform period, the banks are also investing in government securities along with advancing in the form of loans. So credit deposit ratio of banks has decline.

BANKING AND NON-BANKING INTERMEDIARIES

Since the financial sector reforms in India, commercial banks have been facing increased competition from term lending institutions like Small Industrial Bank of India, IFCI, NBFCs, Mutual funds, Chit Funds, and the capital market. Such competition was practically absent until recent years owing to various RBI and Government of India regulations which favoured banks in the mobilization of deposits. With the financial sector reforms, non-banking financial intermediaries and the capital market have experienced impressive growth in recent years. Such growth greatly increased the confidence of small investors in non-banking deposits and investments. It has negative effect on bank deposits.

EFFICIENCY

The following indictors are used to judge the extent of improvement in the efficiency of banks-

- The first efficiency indicator is the proportion of operating cost to working fund. It measures a bank ability to economise on total costs. With respect to this indicator, while the domestic private banks have registered a significant improvement in lowering costs in reforms period, the costs of both public sector banks and foreign banks have registered an increase.

- The second efficiency indicator is the proportion of staff expenditure to working fund. With respect to this indicator, the foreign banks have lowest expenditure while the public sector banks have highest expenditure. The domestic private sector banks have registered a significant reduction in such expenditure in the post reforms period.
- Another efficiency indicator is spread or Net interest margin as percentage of working funds. Spread (Net Interest Margin) is the difference between interest income and interest expenditure of bank. The higher spread indicate the fact that the banking may be more capable of mobilizing deposits at low rate of interest or advancing credit at higher interest rates. Foreign banks have the highest spread followed by domestic private banks and then followed by public sector banks. Such differences could indicate significance efficiency differences. However, the comparison is not entirely fair because the public sector banks carry a greater burden of lending to the priority sector at subsidized interest rates..

CONCLUSION

We can conclude that in the post reforms period, public sector banks as a group have not perform well enough to satisfy the primary objective of reform, i.e., improving the performance in term of probability and efficiency. The public sector banks should be run more professionally.

BASEL CAPITAL ADIQUACY NORMS

The Basel committee on banking supervision was established in 1974 in Basel. Switzerland. This committee is represented by Central bank governors of each of the G-10 countries. It issued its first accord named Basel 1in year 1988. This accord was replaced with capital adequacy framework named Basel 2 in year 2004. In India, RBI issued new capital adequacy frame work based on Basel-2 on April 27, 2007. Basel-2 has recommended capital to Risk Weighted Asset Ratio (CRAR) of minimum 8%. The RBI has stated that the Indian banks must have CRAR of minimum 9%. Further in year 2009-10, Government has stated that the public sector banks must have CRAR of minimum 12%. CRAR is also known as Capital Adequacy Ratio which indicates bank's risk bearing ability. Higher CRAR means that bank is meeting its minimum statutory capital requirements and is capable of absorbing reasonable amount of loss. Foreign banks operating in India and Indian banks having branches outside India have adopted these guidelines w.e.f. 31st March, 2008. Other commercial banks (excluding Regional Rural Banks) have adopted these guidelines by 31st March, 2009. Regional Rural Banks have achieved CRAR of 9% by March 2012.

By the end of March 2009, all scheduled commercial banks in India had adopted basel-2 framework and are subjected to the supervisory review and evaluation process for meeting capital adequacy, adopting improved internal control system and better risk management practices. All this is aimed to improve the financial ability of banks. Now Indian banks have strengthened their internal check and control procedure, adopted better practices for risk management and curtailed their non-performing assets.

BASEL-3-NEW CAPITAL ADEQUACY NORMS

Basel committee has prescribed new standard called Basel-3 in December, 2010. The objective of Basel-3 standard is to enhance shock absorbing capacity of each bank in the event of any global

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financial crises. The standard will enhance the risk coverage capacity of banks by raising capital base of the banks. Capital to Risk Weighted Ratio (CRAR) in Basel-3 has been raised to 11.5 % from earlier level of 8%. CRAR of Indian banks as per criterion suggested by Basel-3 is 11.7% which is above the defined standard of 11.5%. It indicates that Indian banks will not face much difficulty in adopting Basel-3 norms. RBI has directed banks in India to adopt Basel-3 norms by March 2019.

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