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Banking Sector Reforms in India

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Introduction

In India the banking and financial sector reforms were initiated during the last decade of the 20th century as a part of general economic reforms with a view to improving the soundness of the public sector banks and other financial institutions. Public sector banks achieved spectacular success during the post nationalization period but such spectacular progress was witnessed in the spread of branch network of banks, mobilization of savings and in creating employment opportunities rather than in the improvement of the services to the customers. Frauds, corruption and misutilisation of public money were this covered. The vast expansion and spread banking sector resulted in surfacing of several internal deficiencies in the system. Due to these deficiencies the customer service was attached badly, work technology remained stagnant and the transactions cost kept on increasing over the years.

Meaning of Banking

1) Banking Regulation Act, 1949 was the state act enacted to control and regulate the activities of the banking companies, it defines the term BANKING as, "Accepting for the purpose of tending or investment of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque draft, order or otherwise."
2) Britannica Encyclopedia, "Bank is an institution that deals in money and its substitutes and provides other financial services. Banks accepts deposits and makes loans and drives a profit from the difference in the interest rates paid and charged, respectively. Some banks also have the power to create money."
3) Greek History, "Bank means a bench or table for changing money."

Functions of the Bank

1. Acceptance of deposit.
2. Lending money.
3. Investing funds.
4. Rendering various services customers.
5. Credit creation.
6. Remittance of funds.
7. Dealing in foreign Exchange.
8. Dealing in securities.
9. Accepting safe custody of valuables or providing lockers .
10. Acting agents.
11. Contracting & Negotiating loans.
12. Managing issue of shares / debentures.
13. Carrying on business.
14. Dealing with property in possession.
15. Dealing with security.
16. Undertaking and executing trust.
17. As a executor, trustee of estate.
18. Managing building / work necessary of bank.
19. Dealing with rights of bank.
20. Promotion of banking business.

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Financial Sector Reforms

Financial Sector Reforms were necessary for the successful implementation of new economic policy pursued in India since 1991. Under this policy deregulation of industries, privatization of public undertaking and reduction of tariff on exports and imports have been extensively adopted. The financial sector reform was the rise to county's productive capabilities in the global competition. The policy makers thought that under deregulated atmosphere, the competitive growth of private enterprises will induce the necessary efficiency and the rate of growth.

The Banking Sector Reforms are based on Chakraborty committee, Narasimham committee I & II and Vaghul Committee reports.

The recommendation can be classified as under.

1. Ownership of financial institutions and banking structure.
2. Functional improvements of banks.
3. Structural and functional change from, lower level of co-operative of the money market.
4. Global participation, and
5. Supervision and regulation.

Why financial sector reforms were necessary?

The economic crises and financial sector crises of 1991 gave birth to the reforms. The Narasimham committee had proposed a wide of banking secor reforms for-

- Improving the financial viability of the banks.
- Creasing their autonomy from government directions.
- Restructuring unviable banks.
- To allow the entry of the private sector in banking.
- To intensity operational flexibility and competition among the financial institution.
- Liberalizing the capital markets and
- Setting up of proper supervisory system.

The committee made separates recommendations for all the financial segments. i.e. The banking sector, The public sector financial institutions and The money and capital markets. The following major recommendations are given by the committee.

The committee on banking sector reforms under the chairmanship of Mr. M. Narasimham was constituted on December 26, 1997 to review the record of financial sector in 1991, and to suggest remedial measure for strengthening the banking system, covering areas of banking policy, institutional structure, and supervisory system, legislative and technological changes. The report of this committee, which was submitted to the government on April 23, 1998, sets the pace for the second phase of banking sector reforms.

The major recommendations of the (Narasimham Committee – I) committee are-

- Reduction of Statutory Liquidity Ratio (SLR) 25% over a period of five years.
- Progressive reduction in Cash Reserve Ratio. (CRR).
- Phasing out of directed credit programmes and redefinition of the priority sector.
- Deregulation of inter interest rates so as to reflect emerging market conditions.
- Stipulation of minimum capital adequacy ratio of 4% to risk weighted assets by March 1993, 8% by March 1996, and 8% by those banks having international operations by March 1994.
- Adoption of uniform accounting practices in regard to income recognition, asset classification and provisioning against bad and doubtful debts.
- Imparting transparency to bank balance sheet and making more disclosures.
- Setting of special tribunals to speed of the process of recovery of loans.
- Sitting of assets reconstruction funds (ARFs) to take over from banks a portion their bad and doubtful advances at a discount.
- Setting up one or more rural banking subsidiaries by public sector banks.

- Permitting RRBs to engage in all types of banking business.
- Abolition of branch licensing.
- Liberalizing the policy with regard to allowing foreign banks to open offices in India.
- Rationalization of foreign operations of Indian banks.
- Giving freedom to individual banks to recruit officers.
- Inspection by supervisory authorities based essentially on the internal audit and inspection reports.
- Ending duality of control over banking system by banking division and RBI.
- A separate authority for supervision of banks and financial institutions which would be a semi – autonomous body under RBI.
- Revised procedure for selection of chief executives and directors of boards of public sector banks.
- Obtaining resources from the market on competitive terms by DFIs.
- Speedy liberalization of capital market.

Narasimham Committee – II

This committee constituted in January 1998 submitted its report in April 1998. The major recommendations are-

- Capital adequacy requirements should take into account market risk also.
- In the next three years entire portfolio of government securities should be marked to market.
- Risk weight for a government guaranteed account must be 100% .
- CAR to be raised to 10% from the percent 8 %, 9% by 2000 and 10% by 2002.
- Banks should avoid ever greening of their advances.
- Their should be no further recapitalization by the government.
- NPA level should be brought down to 5% by 2000 and 3% by 2002.
- A provision of 1% on standard assets is required.
- Government guaranteed accounts must also be categorized as NPAs under the usual norms.
- Banks should update their operational manuals which should form the basic document of internal control system.
- Recruitment of skilled man power directly from the market be gives argent consideration.
- To rationalize staff strengths an appropriate VRS must be introduced.

The government accepted all the major recommendations of the committee despite the opposition from trade unions, political parties and the finance ministry officials. Government of India set up the Narasimham committee in August 1991, which submitted its report within three months. The following were the major problems / issues before the committee.

1. Productivity and efficiency of the system has suffered.
2. Their portfolio quality has badly deteriorated
3. Several public sector banks and other financial institutions have become weak financially.
4. Their profitability has been eroded.
5. Some public sector bank has been incurring losses year after year.
6. Their customer service was poor.
7. Their work technology was outmoded.
8. They were unable to meet the challenges of a competitive environment.

Banking Sector Reforms

I] First Phase Reforms: 1991-1996

The government of India implemented the following reforms in the banking sector.

1. The deregulation of entry of new private sector banks, both domestic and foreign in 1992-1993.

2. Liberalization of branch licensing policy allowing banks more freedom of plan branch expansion in response to market needs, subject to certain minimum performance requirements.
3. Phase wise deregulation of interest rates on both deposits and advances.
4. Introduction of capital adequacy norms of 8% in line with the norms set the Banks for International Settlement. (BIS).
5. Institution of transparent prudential and income recognition norms.
6. Allowing public sector banks to access the capital market to raise equity.
7. Gradual reduction of CRR and SLR.

Second Phase Reforms--1997-2000

The major changes in macro – economic environment and institutional structures called for a critical evaluation of policy initiatives already undertaken. Accordingly, the Government implemented the following reforms.

1. Strengthening of capital adequacy including explicit capital of market risk.
2. Tightening of the prudential and disclosure standards in line with international best practices.
3. Consolidation of banking system. (Mergers and Acquisition)
4. Restructuring of weak public sector banks.
5. Dilution of government equity in public sector banks of 33% and providing functional autonomy to government banks.
6. Technology improvements to modernize Indian banking.
7. Adoption of scientific tools for management of risk emphasis on management asset / liability and NPAS.
8. Legal reforms for expedite recovery of banks dues.

Third Phase Reforms: 2000-2001

The segment – wise status of the reforms is provided as under-

1. Capital Adequacy and providing.
2. Exposure norms.
3. Prudential Accounting Norms.
4. Entry Norms for new Private Sector Banks.
5. Norms for Banks and NBFCs Entering Insurance.
6. International standards.
7. Technological Developments.

Success of Indian Banking

A) Banking Sector comes under a Competitive Environment.
B) Territory Sector Records Higher GDP Growth.

Contribution to various sectors to GDP

Sector	**1980-81**	**1985-86**	**1991-92**	**1995-96**	**2004-05**
Agriculture	38.10	34.83	29.86	27.64	26.83
Industry	20.91	23.02	24.68	22.27	22.01
Service	40.99	42.35	45.86	50.09	51.16

C) Mergers:

Mergers in the Banking Sector – 1984 to 2000

Year	**Bank**	**Merged with**
1984	Lakshmi commercial bank	Canara bank
1984	Bank of cochin	State bank of India
1984	Miraj state bank	Union bank of India
1985	Hindustan commercial	Punjab national bank
1987	Traders bank	Bank of Baroda

1988-89	United industrial bank	Allahabad bank
1988-89	Bank of Tamil Nadu	Indian overseas bank
1988-89	Bank of Thanjavur	Indian bank
1988-89	Parur central bank	Bank of India
1990	Purbachal Bank	Central bank of India
1993	New bank of India	Punjab national bank
1993	BCCI	State bank of India
1994	Bank of Karad	Bank of India
1995	Kashinath Seth bank	State bank of India
1997	Ban Doab Bank and Punjab cooperative bank	Oriental bank of commerce
1999	Bareilly corporation bank	Bank of Baroda
1999	Sikkim bank	Union bank of India
1999	Times bank	HDFC bank
2000	Bank of Madura	ICICI bank

Source: Bank Economist conference (2002)

Conclusion

Banking sector reforms is a part and parcel of financial sector reforms, which initiated in 1991 to remove the deficiencies in financial sector, particularly in the banking sector to strengthen the economic reforms.

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