

## BANKING REFORMS: AN ANALYTICAL REVIEW

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### ABSTRACT

Banking sector is the pillar of an economy. These pillars should be very strong to ensure Uninterrupted flow of funds into the economic system. In the context of economic liberalization and growing trends towards globalization, various banking sectors reforms have been introduced in India to improve the efficiency of Indian banks so that they can meet the

Internationally accepted standards of performances. Indian banking system continues to deal with improvement in asset quality, implementation of sensible risk management practices and capital adequacy. In this paper an analytical review on banking sector reforms in India have been done. The main objective of the paper is to understand and check the effectiveness of banking sector reforms in India.

**KEYWORDS:** Banking Sector Reforms, Liberalization, Globalization

### INTRODUCTION

Banks play an important role in the financial system and the economy. As a key component of the financial system, banks transforms funds from saving into investment in an efficient manner, thereby making the overall economy more efficient. India requires stability, efficient service delivery, inclusion and a monetary policy transmission from our banking system. Recognizing this need, the Government has, over the years, introduced various reforms to strengthen the banking system and make it stouter. The main objective of the financial sector reforms in India initiated in the early 1990s was to create an efficient, competitive and stable financial sector that could then contribute in greater measure to encourage growth.

### REVIEW OF LITERATURE

Title	Author	Year	objective	Tools and Technique	Findings
Banking Sector Reforms in Indai	Dr.SK.Ma bunni, Prof.T. Sreenivas	2020	To present the structure of Indian banking sector and to understand various reforms of i		
Banking Sector Reforms in Indai	Nalla Bala kalyan	2017	To have a brief overview of the reforms initiated after 1991 in Indian banking sector and to study the performance of		Developing countries like India, still has a huge number of people who do not have access to banking services due to geological fragmented locations

			banking industry in India		and those people who are availing banking services, their expectations are raising as the level of services are increasing due to the emergence of Information Technology and competition.
An Analytical Study of Reforms and their Impact on Indian Banking Sector	Neha Chahdha	2017	To study the banking reforms in India and their impact on Indian Banking System	Tables	The banking system, which was over-regulated and over administered, was freed from all restrictions and entered into an era of competition since 1992. The entry of modern private banks and foreign banks enhanced competition. Deregulation of interest rates had also intensified competition.
Impact of Banking Sector Reforms in India in the Post-Reforms Era	Dr. A. Arumugam and G. Sevalakshmi	2014	To analyze the major reforms of the Indian banking sector and to find out the impacts of these reforms.	Augmented Dickey-Fuller test, Co-integration test, financial data analysis, CRAR, and Bank Efficiency Scores are the statistical tools employed for the study	The overall findings inform that banking reforms in India has adequately and positively impacted on the performance of economy. Performance of all bank groups during the sample period is found satisfactory. Efficiency of banks and credit disbursement has been systematized since the implementation of banking reforms in India
Report of The Committee to Review	Chairman- P.J Nayak	2014	To Review Governance of Boards of Banks in India	Tables and graphs	Various Recommendations regarding strengthening the Private Sector banks were given ,

Governance of Boards of Banks in India					There are seven critical themes which bank boards are typically concerned with: business strategy, risk mitigation, financial reports and their integrity, compliance, customer protection, financial inclusion, and human resource related issues.
Performance of the Indian Banking Industry over the Last Ten Years	Saumya Lohia	2011	To analyze the performance of Indian banks over the period of the last ten years		This paper finds that private banks perform better than public banks overall based on the CAMEL Framework. In addition to it also finds that the Indian banks share price performance is dependent on the share price performance of Hong Kong and European banks, and it has a significant positive relationship with the overall Hong Kong stock market, and this relationship strengthens after 2007.

## OBJECTIVES

1. The objective of the paper is to understand and check the effectiveness of banking sector reforms in India.
2. To portray the new look of Indian banking System after reforms.

## RESEARCH METHODOLOGY

The research design of the present study is descriptive. Data is collected from the secondary sources. The sources of the secondary data are RBI publications, published data of banks, research publications of various renowned scholars in the field.

## BANKING SECTOR REFORMS IN INDIA

The new developments in the Indian banking sector is not a spontaneous change rather it's a result of collective efforts of various committees created during a period of time. The different committees formed for banking reformation are:

1. Narasimhan Committee (1991)
2. Narasimhan Committee (1998)
3. Nachiket Mor Committee P J Nayak Committee

## **BANKING SECTOR REFORMS**

### **1. Narasimhan Committee Report – 1991**

To prop up the healthy development of the financial sector, the Narasimhan committee has made following recommendations.

#### **Recommendations of Narasimhan Committee**

1. Establishment of 4 tier hierarchy for banking structure with 3 to 4 large banks (including SBI) at the top and at bottom rural banks engaged in agricultural activities.
2. The supervisory functions over banks and financial institutions can be assigned to a quasi-autonomous body sponsored by RBI.
3. A phased reduction in statutory liquidity ratio.
4. Phased achievement of 8% capital adequacy ratio.
5. Elimination of branch licensing policy.
6. Proper classification of assets and full disclosure of accounts of banks and financial institutions.
7. Deregulation of Interest rates.
8. Delegation of direct lending activity of IDBI to a separate corporate body.
9. Competition among financial institutions on participating approach.
10. Setting up Asset Reconstruction fund to take over a portion of the loan portfolio of banks whose recovery has become difficult.

## **BANKING REFORM MEASURES OF GOVERNMENT**

On the recommendations of Narasimhan Committee, following measures were undertaken by government since 1991: –

### **1. Lowering SLR and CRR**

1. The high SLR and CRR were reducing the profits of the banks so the SLR had been reduced from 38.5% in 1991 to 25% in 1997. This has left more funds with banks for allocation to agriculture, industry, trade etc.
2. The CRR had been brought down from 15% in 1991 to 4.1% in June 2003. The main purpose was to increase the credit creation by RBI

### **2. Prudential Norms**

1. Prudential norms have been started by RBI in order to impart professionalism in commercial banks. The purpose of prudential norms includes proper disclosure of

income, classification of assets and provision for Bad debts so as to ensure that the books of commercial banks reflect the accurate and correct picture of financial position.

2. Prudential norms required banks to make 100% provision for all Non-performing Assets (NPAs).

### **3. Capital Adequacy Norms (CAN)**

1. Capital Adequacy ratio is the ratio of minimum capital to risk asset ratio. In April 1992 RBI fixed CAN at 8%. By March 1996, all public sector banks had attained the ratio of 8%. It was also attained by foreign banks.

### **4. Deregulation of Interest Rates**

1. The Narasimhan Committee advocated that interest rates should be allowed to be determined by market forces. Scheduled Commercial banks have now the freedom to set interest rates on their deposits subject to minimum floor rates and maximum ceiling rates.
2. The interest rate on domestic term deposits has been decontrolled.
3. The prime lending rate of SBI and other banks on general advances of over Rs. 2 lakhs has been reduced.
4. The rate of Interest on bank loans above Rs. 2 lakhs has been fully decontrolled.
5. The interest rates on deposits and advances of all Co-operative banks have been deregulated subject to a minimum lending rate of 13%.

### **5. Recovery of Debts**

The Government of India passed the “Recovery of debts due to Banks and Financial Institutions Act 1993” in order to facilitate and pace up the recovery of debts due to banks and financial institutions. Six Special Recovery Tribunals have been set up. An Appellate Tribunal has also been set up in Mumbai.

### **6. Competition from New Private Sector Banks**

1. Banking is open to the private sector.
2. New private sector banks have already started functioning. These new private sector banks are allowed to raise capital contribution from foreign institutional investors up to 20% and from NRIs up to 40%. This has led to increased competition.

### **7. Access to Capital Market**

The Banking Companies (Acquisition and Transfer of Undertakings) Act was amended to enable the banks to raise capital through public issues. This is subject to the provision that the holding of Central Government would not fall below 51% of paid-up-capital. SBI has already raised a substantial amount of funds through equity and bonds.

## **8. Freedom of Operation**

Scheduled Commercial Banks are given freedom to open new branches and upgrade extension counters, after attaining capital adequacy ratio and prudential accounting norms. The banks are also permitted to close non-viable branches other than in rural areas.

## **9. Local Area Banks (LABs)**

In 1996, RBI issued guidelines for setting up of Local Area Banks, and it gave its approval for setting up of 7 LABs in private sector. LABs will help in mobilizing rural savings and convert them into investment in local areas.

## **10. Supervision of Commercial Banks**

The RBI has set up a Board of financial Supervision with an advisory Council to strengthen the supervision of banks and financial institutions. In 1993, RBI established a new department known as Department of Supervision as an independent unit for supervision of commercial banks.

## **2. NARASIMHAM COMMITTEE REPORT II – 1998**

In 1998 the government appointed yet another committee under the chairmanship of Mr Narsimham. It is better known as the Banking Sector Committee. It was told to review the banking reform progress and design a programme for further strengthening the banking system of India. The committee focused on various areas such as capital adequacy, bank mergers, bank legislation, etc. It submitted its report to the Government in April 1998 with the following recommendations.

### **1. Strengthening Banks in India**

The committee considered the stronger banking system in the context of the Current Account Convertibility 'CAC'. It thought that Indian banks must be capable of handling problems regarding domestic liquidity and exchange rate management in the light of CAC. Thus, it recommended the merger of strong banks which will have 'multiplier effect' on the industry.

### **2. Narrow Banking**

NPA was the major problem for banks in those days. To remove this problem and for successful rehabilitation of these banks, it recommended 'Narrow Banking Concept' where weak banks will be allowed to place their funds only in the short term and risk-free assets.

### **3. Capital Adequacy Ratio**

The committee recommended that the Government should raise the prescribed capital adequacy norms. This will further improve their absorption capacity also.

### **4. Bank ownership**

As it had earlier mentioned the freedom for banks in its working and bank autonomy, it felt that the government control over the banks in the form of management and ownership and bank autonomy does not go hand in hand and thus it recommended a review of functions of boards and enabled them to adopt professional corporate strategy.

## 5. Review of banking laws

The committee considered that there was an urgent need for reviewing and amending main laws governing Indian Banking Industry like RBI Act, Banking Regulation Act, State Bank of India Act, Bank Nationalization Act, etc. This up gradation will bring them in line with the present needs of the banking sector in India.

Apart from these major recommendations, the committee has also recommended faster computerization, technology up gradation, training of staff, depoliticizing of banks, professionalism in banking, reviewing bank recruitment, etc.

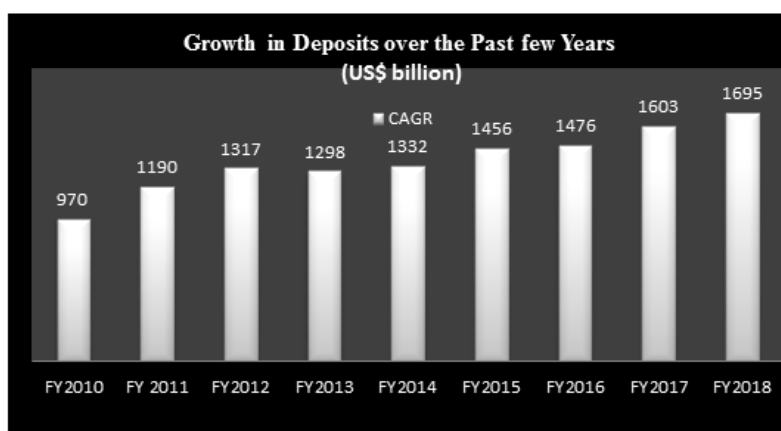
## 3. C.Nachiket Mor committee -2013

The Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households, set up by the Raghuram Rajan in September 2013, was mandated with the task of framing a clear and detailed vision for financial inclusion and financial deepening in India. The panel submitted its final report on 7 January 2014. The panel recommended the formation of new category of banks called payment bank, to reach people and small businesses that don't have access to banking services. These banks would have low entry requirements and existing banks would be allowed to form subsidiaries under this category. But these recommendations were rejected on the ground that we already have RRB's for the same purposes.

The panel also recommended the formation of another category called wholesale banks, to provide liquidity to other banks and financial institutions which are creating assets in the priority Sector. The panel proposed that every adult Indian be granted a Universal Electronic Bank Account (UEBA) by January 2016. It also proposed that all low-income and small businesses be given access to banking services by January 2016. It also proposed that an UEBA be automatically opened for every citizen at the amount he/she receives their Aadhar number. The linkage of account number of customers to Aadhar will finally be implemented by the government.

## POST REFORM GLIMPSES OF INDIAN BANKING SYSTEM

The growth rate of Indian banking Sector over the past few years is shown in the graph.



Source: Reserve Bank of India (RBI), Aranca Research

## ANALYSIS OF GRAPH

In the above graph growth in deposits from FY 2010 to 2108 is shown. The deposits has been grown from US\$970 billion to 1695 billion US\$. Increase in Disposable income level is the major factor influencing deposit growth. At the same time India's banking sector has remained stable despite global upheavals, thereby retaining public confidence over the years. Deposits under Pradhan Mantri Jan Dhan Yojana (PMJDY), have also increased. Rs 72,266.94 crore (US\$ 11.16 billion) were deposited and 308.4 million accounts were opened in India. Access to banking system has also improved over the years due to persistent government efforts to promote banking-technology and promote expansion in unbanked and non-metropolitan region.

The other challenges include with changing global economic situations, demand for speedy, secure and effective service delivery from beneficiaries, information and communication revolution, big bang long gestation infrastructure projects, the problems of banking system undergone drastic changes

1. Bad loan
2. Cyber Threats
3. Twin balance sheet
4. Bank scam
5. The new Bankruptcy Code
6. Non-Performing Assets
7. Requirements of Reserve Ratio
8. Increasing Competition and funding sources

The major advancements of the Indian banking System after reforms are given below:

<b>Improved Risk management practices</b>	<ul style="list-style-type: none"> <li>Indian banks are increasingly focusing on adopting integrated approach to risk management</li> <li>Banks have already embraced the international banking supervision accord of Basel II.; interestingly, according to RBI, majority of the banks already meet capital requirements of Basel III, which has a deadline of 31 March 2019</li> <li>Most of the banks have put in place the framework for asset-liability match, credit &amp; derivatives risk management</li> </ul>
<b>Diversification of revenue stream</b>	Total lending has increased at a CAGR of 12.38 per cent during FY07-17 and total deposits has increased at a CAGR of 10.08 per cent, during FY07-17 & are further poised for growth, backed by demand for housing and personal finance
<b>Technological innovations</b>	<ul style="list-style-type: none"> <li>As of November 2017, total number of ATMs in India increased to 206,694 and is further expected to increase to 407,000 ATMs in 2021 .</li> <li>The digital payments system in India has evolved the most among 25</li> </ul>



	countries, including UK, China and Japan, with the IMPS being the only system at level 5 in the Faster Payments Innovation Index (FPII).
<b>Focus on Financial Inclusion</b>	<ul style="list-style-type: none"> <li>• RBI has emphasised the need to focus on spreading the reach of banking services to the un-banked population of India</li> <li>• Indian banks are expanding their branch network in the rural areas to capture the new business opportunity. According to RBI, Under 2nd phase of Financial Inclusion Plan (2013-16), 452,151 villages, with population less than 2,000 people, were covered as on June 30, 2016</li> </ul>
<b>Derivative and Risk Management Product</b>	<ul style="list-style-type: none"> <li>• The increasingly dynamic business scenario &amp; financial sophistication has increased the need for customized foreign financial products</li> <li>• Banks are developing innovative financial products &amp; advanced risk management methods to capture the market share</li> <li>• Bank of Maharashtra tied up with Cigna TTK, to market their insurance products across India.</li> </ul>
<b>Consolidation</b>	<ul style="list-style-type: none"> <li>• With entry of foreign banks, competition in the Indian banking sector has intensified</li> <li>• Banks are increasingly looking at consolidation to derive greater benefits such as enhanced synergy, cost take-outs from economies of scale, organizational efficiency &amp; diversification of risks.</li> </ul>
<b>Wide Usability of RTGS and NEFT</b>	<ul style="list-style-type: none"> <li>• Real Time Gross Settlement (RTGS) and National Electronic Funds Transfer (NEFT) are being implemented by Indian banks for fund transaction</li> <li>• Securities Exchange Board of India (SEBI) has included NEFT &amp; RTGS payment system to the existing list of methods that a company can use for payment of dividend or other cash benefits to their shareholders &amp; investors.</li> </ul>
<b>Demonetisation</b>	<ul style="list-style-type: none"> <li>• The effects of demonetisation are also visible in the fact that bank credit plunged by 0.8 per cent from November 8 to November 25, as US\$ 9.85 billion were paid by defaulters. As per RBI, a total of US\$ 237.17 billion was deposited in banks till August 30, 2017.</li> <li>• Debit cards have radically replaced credit cards as the preferred payment mode in India, after demonetisation. As of November 2017, debit cards garnered a share of 87.83 per cent of the total card spending</li> </ul>
<b>Know Your Client</b>	<ul style="list-style-type: none"> <li>• RBI mandated the Know Your Customer (KYC) Standards, wherein all banks are required to put in place a comprehensive policy framework in order to avoid money laundering activities</li> <li>• The KYC policy is now mandatory for opening an account or making any investment such as mutual funds</li> </ul>

<b>Focus Toward Jan Dhan Yojna</b>	<ul style="list-style-type: none"> <li>• Key objective of Pradhan Mantri Jan Dhan Yojana (PMJDY) is to increase the accessibility of financial services such as bank accounts, insurance, pension, credit facilities, etc. mostly to the low income groups.</li> <li>• Under the Jan Dhan Yojana, Rs 72,266.94 crore (US\$ 11.16 billion) were deposited and 308.4 million accounts were opened in India.</li> <li>• 232.7 million 'Rupay' debit cards were issued to users.</li> </ul>
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*Source: Indian Bank's Association, Indian Banking Sector, Aranca Research*

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