Reforms In Indian Banking Sector - Review, Challenges And Government Efforts

Dr. Kailashpati

Lecturer, Economics Program, School of Social Science
Sherubtse College, Kanglung, Royal University of Bhutan

Abstract: An important dimension of economic liberalization is related to banking reforms that the banking sector of the country is still dominated by the state-owned banks, but despite this, these banks are facing the problem of bad loans for a long time. The government has also made some efforts in the direction of reforming the banks. In order to bring into effect the new shape in India's banking crisis and the impact of development, three policies should be prioritized in terms of structural reforms at the global level. The first priority is to improve the condition of the corporate and banking sector, for this there will be reconstruction of capital surplus in non-performing public sector banks and capital surplus in banks and improving the recovery of banks. In the second priority, India will have to continue the process of its fiscal integration by taking revenue and related steps. India's third priority should be to maintain the pace of structural reforms to bridge the infrastructure gap and expand the capacity of labor and product markets, as well as pursue agricultural reforms. Therefore, for the time being, no asset of despair can be considered, although the challenges and concerns of development in a country of 125 crore countrymen like India are and will remain many.

Key Words: Banking Reforms, Fiscal Efforts, CRR, SLR, NPAs.

Introduction

Initially, like other sectors of the economy, the government used to do banking activities through the Reserve Bank, due to which many problems emerged in the banking sector. Banks were placed under government control. They had to work according to the priority set by the government, which had an impact on their profitability and the limited capital-base of the banks due to the restriction on entry of the private sector as well as cash reserve ratio (CRR) statutory ease (SLR) priority sector lending policy And government interference in interest rates has a negative impact on the efficiency, competitiveness and profitability of banks.

By the year 1990, due to political pressures and government interference, Non-Performing Assets (NPAs) became serious, making customer service inefficient and inadequate. The government controlled the interest rates through the Reserve Bank. The consolidated result of this was in the form of poor economic condition of the banks. The Narasimham Committee (1991) committee was formed to improve this sector after studying the condition of banks in India. After the study, the committee made its recommendations to develop the financial system in the country before the full conversion of rupee into the capital account, improve the quality of banks, reduce non-performing assets (NPAs), increase the capital adequacy ratio, Emphasizing on setting up of an Assets Reconstruction Fund for acquisition of bad assets of the Bank and proper investigation before taking any action against the bank employees. In view of the above situation, the Government of India appointed a committee under the chairmanship of former Governor of Reserve Bank of India (RBI) and Narasimham to examine all aspects of the financial system, structure, system and strategy, this committee submitted its report in November 1991.

History of Banking Sector Reforms in India

1. First Round of Banking Reforms (First Narasimham Committee Formation, 1991): Keeping in view the failures of nationalization of public commercial banks, the Government of India on 14 August 1991 constituted a committee under the chairmanship of Shri M. Narasimham to make necessary suggestions to improve the functioning of the country and the structure of the financial system. The report was submitted on 20 November 1991.

The committee has attributed the falling profitability of commercial banks to the ever-increasing operating cost of banks due to falling interest income being tied to public obligations. The committee has also blamed the political and administrative interference in the meeting system for the declining profitability of the banks. The main recommendations of the committee are to bring about fundamental changes in the banking structure of the country, giving full autonomy to the banks in their activities, highest liquidity ratio for the bank. It has been recommended to gradually reduce it to 25 per cent, do away with concessional interest rates, re-fix the primary targets for credit and limit it to 10 per cent of the total credit.

The committee has recommended for quick and effective liberalization of capital markets. In relation to financial institutions related to development, it has been said that these institutions should raise resources from the market itself at competitive rates.

The committee did not impose any control on the expansion of new banks under the private sector. By revamping the structure of banks, it was suggested that public sector banks which carry out profitable activities should be allowed to enter the capital market without any restriction to increase their capital.

The committee has recommended the abolition of the system of dual control of the Reserve Bank and the Department of Banking of the Ministry of Finance over the banking system and a public institution to control the banking system. It is necessary to have a representative of the government on the board of management of a public sector bank.

However, keeping in mind the recommendations of the Narasimham Committee, the Central Government has included many financial changes under the budget. Under the financial sector, there are signs of change from the budgets of previous years of beneficial effects.

Since there has been transparency in the working of the banks and their actual financial condition is also studied but the Indian banking sector is still suffering from many weaknesses due to which it is neither healthy development nor quick settlement of transactions in the level. The challenge before the nationalized banks is to complete the activities related to the recovery of loans and services of high quality.

2. Second Round of Banking Reforms (Second Narasimham Committee Formation, 1998): The Second Narasimham Committee constituted for Banking Reforms in the context of globalization submitted its report to the Union Finance Minister on 23 April 1998. According to the Economic Survey, emphasizing on the need to reform the Indian banking system, it was said that despite significant achievements, our banking system needs reforms to come in the competition of international level.

For this there is a need to adopt measures to enhance financial performance and achieve higher potential. The committee suggested developing a strong and effective financial system in the country before the full convertibility of rupee into the capital account.

Apart from this, efforts have been started in the direction of strengthening the banking sector in the context of improving the quality of banks' assets, reduction in non-performing assets, increase in capital adequacy ratio, freeing banks from politics, etc.

Similarly, in order to strengthen the banking system, the capital adequacy requirements have taken into account the market risk in addition to the credit risks. The comprehensive reforms undertaken in the financial sector over the years have been a part of the overall economic reforms. The overall rationale of finance was to improve the efficiency and efficiency of the financial system and to develop a competitive system that could pave the way for development.

In this context, to some extent, the banking sector is providing ample opportunities to common consumers to invest their money in optimum resources. Apart from the public sector, mutual fund schemes in the banking sector are also being operated by the private sector.

Presently there are about 42 Mutual Funds operating in our country. These funds act as portfolio managers. Income and dividends received from mutual funds were made tax-free in the budget of 1999-2000. Internationally has entered the credit card business in the Indian banking sector.

At present, more than 1.5 million people in India have MasterCard and in the year 1997-98 it did a business of 967 million dollars, while in the year 2006-07 it did a business of 1356 million dollars. The total branches of commercial banks including Regional Rural Banks are 109811 in the year 2013-14, out of which about 50 percent are in rural areas.

With regard to rural credit, the Reserve Bank has devised a strategy to give a special loan at a concessional rate. It is clear from the data in the Reserve Bank of India that 79.9 percent of the deposits with commercial banks are with the public sector banks and the rest with the State Banks and their associate banks.

Banking Laws Amendment Bill 2011

The banking system of that country plays an important role in the economy of any country. Banks have a central role in economic development. In recent years, it was seen that Indian banks are not able to function in line with the rapidly changing global economy. For this the need for some changes in Indian banking was felt. Keeping this in mind, the Government introduced and passed the Banking Laws-Amendment Bill, 2011 in the Lok Sabha. After the new law of banking was made, the opening of private banks in the country became easy. The Reserve Bank of India has been given more powers to supervise banks. This will help in protecting the wealth of investors and depositors. As per the new provisions, the minimum capital requirement for starting a new bank has been raised to Rs 500 crore as against Rs 1,000 crore earlier. Apart from this, foreign nationals can be included in the board of directors of banks. The base capital of a banking company can be 49 percent foreign capital in the first five years. However, the management of the bank should be in Indian hands. The investment limit in private banks has been increased from 10 per cent to 26 per cent. It is believed that with this new provision, new companies will come in the banking sector and capital will be available for small and medium industries. This will increase industrial activities in the country and employment opportunities will emerge. Also, in the new banking law, it has been said that the person or company starting a new bank should have an honest and sound image and should have at least 10 years of business experience. RBI may take over the control of any bank or issue separate directions to any bank in case of any breach of banking service, prejudicial to the interests of investors or depositors. The Reserve Bank of India was empowered to fix the Cash Reserve Ratio (CRR) for certain banks such as co-operative banks. Also, under the direction of the Reserve Bank of India, a provision has been made to set up a "Depositor Education and Awareness Fund". Apart from this, the public sector banks were given the right to reduce or increase their base capital as per the requirement, to issue bonus shares and rights issues to receive capital and the voting rights of investors in these banks were increased from one percent to 10 percent. In this amendment, the permission of the Reserve Bank of India has been made necessary for taking five percent or more shares in any bank.

Challenges of Banking Reforms

The performance of commercial banks has been improving continuously since the introduction of banking reforms. Due to changes in domestic and international conditions, universal integration of financial services and other relative factors, there are still some challenges before the commercial banks.

The new Banking Act 2011 seeks to make Indian banks more independent and efficient keeping in mind the challenges faced by them. For this, the participation of investors has been increased and banks have been given more powers. The biggest and pervasive challenge before the Indian banks is the financial adjustment of the vast population. Providing banking services to about 125 crore people is a big challenge. State Bank of India is the oldest and largest bank in the country. There are 26 public sector banks and 17 old private sector banks and 7 new private sector banks in the country. Apart from this, there are also cooperative banks and rural banks. Despite this, there is not a single bank in India among the top 20 banks in the world. However, three Chinese banks are on this list.

The government aims to strengthen banking services and business in the country. The government wants to do financial inclusion across the country. For this, the strength of the existing banks and the participation of the private sector are necessary. In order to strengthen the public sector banks, Finance Minister P. Chidambaram has said that Rs. 15,000 crore will be put in these banks. 6000 NAPI branches of these banks will be opened which will provide employment to thousands of people. The government also needs the help of banks to implement its welfare schemes. MGNREGA is being paid through banks. The recently implemented ambitious 'Direct Benefit Transfer Scheme' will also be implemented through banks. For this it is necessary that every part and corner of the country has access to banks and every person has a bank account.

Meeting the parameters of Bansal-III as per international standards is a challenge for Indian banks. For this, Indian banks will need to increase their capital base. Private sector banks can prove to be helpful for this. The rules for raising capital for banks have been liberalized. Foreign investment avenues have also been opened in banks. Management of Non-Performing Assets (NPAs) is another major problem faced by Indian banks. The NPAs of almost all Indian banks have increased in the current financial year. Banks need to reform their lending rules and also need to look into the levy provisions. There are many such industry groups whose one company is in loss and the other company's profit is flying. Crores of rupees of bank loans are stuck in these industry groups and they are unable to recover it.

Competition in the Indian banking sector is expected to increase after the implementation of the new banking law. This may increase the difficulties for co-operative banks and rural banks. Co-operative banks and rural banks work mainly with social objectives in mind. It is meaningless to wish public interest from private sector banks. On the other hand it is not possible for cooperative and rural banks to survive in competition with private banks. The management of cooperative and rural banks is generally in the hands of social workers whereas the management of private sector banks will be in the hands of skilled personnel. In such a situation, the business of rural and co-operative banks is certain. However, in the new banking law, the Reserve Bank of India has been given more powers in the management of rural and cooperative banks.

In fact, India needs such banks which can do prison keeping in mind the social objectives. It should be noted that the business of Indian banks has grown in terms of establishment of branches and ATMs in the last few years but has not grown significantly in terms of business and profits. The role of banks in the Indian economy should not be as a depositor but as a lender. There is a need of such banks in the country which can provide capital for small industries. For example, banks are reluctant to give loans for the agriculture sector. A recent study showed that most of the loans given to the agriculture sector went to the auto industry. Farmers were not given loans for seeds, fertilizers, irrigation etc. These objectives can be made possible by government and socially controlled banks, but it is not possible to do this with private sector banks.

Technically strengthening Indian banks is also a big challenge. The technical strength of cooperative and rural banks is weak. Even large and commercial banks are not of global standard. The government and the Reserve Bank of India need special attention in this direction. Being technically sound, the banking business will have less cost and work will be done faster. The condition is that so far the core banking system has not been implemented in many branches of many banks.

Government Efforts in Banking Reform

Economic and Financial Stabilization: The Reserve Bank of India (RBI) has presented a picture of the economy where inflation is rising while growth has slowed and is likely to slow further. It is not clear whether the current slowdown was due to transformational factors such as demonetisation and the Goods and Services Tax (GST) or whether it was due to long-term structural factors i.e. bad debt in the banking system and the cash-strapped business sector. The RBI has reiterated the need to intensify private investment and said that with its help, the economy and the overall credit condition can be improved.

Formation of Committee for Merger of Government Banks: Taking another step in the direction of improving the condition of public sector banks, the government has constituted a ministerial level committee under the leadership of Jaitley. This committee will look into the proposal of merger of government banks of the country on February 21. Formation of alternative system is a step in this direction. In the month of August 2017 the Union Council of Ministers had decided to set up an alternate mechanism to fast track the integration of PSU banks. Banks facing the problem of bad capital, which are to be amalgamated, had a total market share of 70 per cent, while their share of bad loans in India's banking system is 80 per cent.

Program of recapitalization for banks: The second part of the fiscal stimulus program proposed by the government is related to recapitalization for banks, the problem of non-performing assets (NPAs) before the banks in India in the last year became very serious At the end of June 2017 Their amount reached up to Rs 7.33 lakh crore, on which interest and principal have not been paid on time, which has adversely affected the financial position of the banks. Nowadays, instead of NPAs, there is talk of stressed asset amount, which is more than six percent because it allows re-arranging of debt to restructure the old debt, which has to be green or refreshed (refreshing the previous debt). The recapitalization mechanism for banks will expand their lending capacity, which had fallen to a mere 7 per cent low at the end of September 2017. Thus, this program of providing capital to the banks of Rs 2.11 lakh crore will go a long way in improving the economy of the country and at the same time will also provide adequate facilities to the banks in meeting the capital norms for Basel-II.

Recap plan for banks: Due to the increasing NPAs of government banks, their performance is being negatively affected, due to which the government recently approved the recapitalization plan for government banks. Under this, Rs 2.11 lakh crore will be given to the banks in 2 years. For bank recapitalization, the government will issue bonds worth 80 thousand crores by the end of the current financial year. In lieu of this, Parliament is giving its approval. The government had sought approval for additional expenditure in Parliament through supplementary demand.

Government's Fiscal Efforts for Economic Slowdown and Reforms in India: There is no doubt that economic reforms have caused many pressures and tensions in the economy in the short run. There has been a situation of uncertainty and short-term instability in the country, which cannot be considered unnatural. This has also had an adverse effect on the growth rate. Demonetization and GST both have been considered as big revolutionary economic steps. They have once shaken the entire economy. Therefore, it is now to be seen what concrete measures should be adopted to overcome the current economic slowdown. To increase the growth rate of GDP, increase the growth rates of private final consumption expenditure, government final consumption expenditure, gross fixed capital formation, net exports, etc., which will lead to higher growth rates in the Indian economy in 2018-19 and subsequent years.

Conclusion

In conclusion, it can be said that the banking sector will have to reorganize itself with complete transparency and efficiency. There is a dire need of overhaul in handling a fast growing business with high profitability. Due to the huge problem of stressed assets in the banking world, a fall in the rate of interest alone does not create a favorable environment for investment growth. To increase private investment, there is an urgent need to increase the enthusiasm and confidence of the entrepreneurs so that private investment can increase in the country. The expected rate of profit in the industries should be high and there should be adequate arrangement of credit from the stock market and financial institutions to the entrepreneurs so that the environment of high growth rate can be found in the country.

References

Arora, Sangeeta and Kaur, Shubpreet (2006). Financial Performance of Indian Banking Sector in Post Reforms Era, The Indian Journal of Commerce, Vol. 59, No. 1, Jan-March, 2006.

Arumugam, Dr. A. and Selvalakshmi, Dr. G. (2014): Impact of Banking Sector Reforms in India in the Post-Reforms Era.

Chellaswamy P. (2010). Modern Banking Management, Himalaya Publishing House. en.wikipedia.org/wiki/Commercial bank

Das, Santosh Kumar (2010): Performance of the Indian Banking Sector: Impact of Reform.

India Banking Sector Report (2014) Presentation Transcript.

Narasimham Committee-I (1991) report and the Narasimham Committee-II (1998) report

RBI Paper: statistical tables relating to banks in India 2012-13

Singh, Gupta and Shandilya (2010). Banking and financial sector reforms in India. Serials Publication, New Delhi, India.

en.wikipedia.org/wiki/Cooperative banking

www.banknetindia.com/banking/boverview.htm

www.ibef.org