International Journal on Arts, Management and Humanities **6**(1): 51-53(2017)

ISSN No. (Online): 2319–5231

Critical Analysis of Banking Sector Reforms in India

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(Received 09 May, 2017, Accepted 05 June, 2017)
(Published by Research Trend, Website: www.researchtrend.net)

ABSTRACT: Banking sector is an important component of the financial health of the economy. Banking reform process is also crucial to transform the sector according to the changing needs of the time. Indian banking sector has gone through various reforms since independence as according to changing requirements of the economy. The paper provides an insight to the reform process of the Indian Banking System and analyzes the impact of new government schemes.

Key Words: Indian Banking System, Banking Reforms, PMJDY, Indradhanush Plan, Big Data

I. INTRODUCTION

Banking system plays a crucial role in the growth process of a economy. It acts as a resource mobilizer and shapes the development process. The Indian Banking System has gone through a reform process over time since independence and has played an important role in providing a direction to the growth trajectory. The paper tries to analyze how the reform process has modified the Indian Banking System over time and provides an insight to the new government schemes launched by the Government of India to make the banking system more robust.

II. METHODOLOGY

This research evaluates the banking sector reforms in the Indian economy which were put in place in the pre 1991 and post 1991 period. The researcher has tried to derive meaningful results from the reforms process and the new government schemes. The available data was analysed during the research and a brief account is provided. Also, a brief account of the literature review along with the suggestions to improve the banking sector has been presented to make the research work stronger.

III. ANALYSIS

A. The pre-reform period

During the decades between independence and the 1991 LPG reforms, the Indian Banking System was mainly focused on fulfilling the needs of the planned development under the Five Year Plans framework where the public sector played a dominant role. Indian economy inherited a banking system from the colonial government which was focused only on the needs of the government, traders and rich individuals. There was a strong need for reorganization and consolidation of the prevailing banking system to cater to the needs of the economy. An institutional framework was required to provide long-term finance to the agriculture and the industry sector.

In 1969, the banks with deposits more than Rs. 50 crore were nationalized by the Government of India, where regulations were based on classical pattern, more or less [1]. Detailed procedural guidelines, inspection and supervision of banks, initialization of priority sector lending, fixed lending and borrowing rates, tight seperation between banks and non banks were some of the regulations put in place. After nationalization almost 80% of the banking sector came under the ambit of Government of India. Reform process was further intensified in 1980 when more private banks were nationalized to extend banking sector to rural areas and vulnerable sections. Nationalization in 1980 brought more than 90% of the sector under government.

B. The 1991 reforms

The comprehensive economic policy reform program of 1991 came as an answer to the Persian Gulf crisis and the unprecedented Balance of Payment problem in India. The process was framed under the Structural Adjustment Operation of the World Bank. Most of the sectors were completely transfromed under the reforms. Government also undertook banking reforms while liberalizing the economy. Main objectives were to promote a diversified, efficient and competitive financial system with the ultimate goal of improving the allocate efficiency of resources through operational flexibility, improved financial viability and institutional strengthening [2]. In August 1991, a committee was established under the chairmanship of M. Narasimham with the aim to enhance the profitability, productivity, efficiency and financial autonomy of the banking sector. The committee recommended to establish a four-tier hierarchy for the banking sector, equal treatment of private and public sector banks, abolishment of branch expansion licensing policy, progressive reduction of the Statutory Liquidity Ratio and the Cash Reserve Ratio, deregulation of interest rate according to the market conditions, establishment of prudential norms for the commercial banks, strengthening of banking supervision, guidelines to govern the financing of financial institutions, transparency in banking system, enhanced competition.

In 1998, M. Narsimham Committee II was established which favoured the merger of strong public sector banks and closure of some¬ weaker banks if their rehabilitation was not possible. It further recommended recapitalization process for weak banks, establishment of Asset Reconstruction Fund, improved payments and settlement mechanism [2].

The reform process led to expansion of branches and credit growth. Interest rate structure was simplified, prime lending rate was introduced. The main aim, to enhance the flexibility, efficiency, stability, financial deepening and competition in the banking sector, was achieved because of priority sector liberalization and prudential norms framework.

Based on the recommendations of the Andhyarujina Committee, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, was put in place which provided enforcement of the security factor without recourse to civil suits. The aim was to enable the banks and financial institutions to realise long-term assets, manage the problem of liquidity, reduce asset liability mismatches and improve recovery by taking possession of securities, selling them and reducing NPAs [3].

Further gradual reforms were put in place by the government with the establishment of P.J. Nayak commitee which focused on enhancement of governance and management of public sector banks.

C. The Current situation

India's banking system is characterized by the presence of rising Non-performing assets (NPAs) especially in public sector banks. NPAs in the priority sector is higher than that of the non-priority sector [3]. The stressed assets in the Public sector banks is nearly 3 times than in the private sector (Table 1). The proportion of stressed assets in the total advances has increased in the overall banking sector by many folds.

Table 1: Stressed Advances of Banks as a Share of Total Advances (per cent).

	March 2008	March 2017
Public Sector Banks	3.5	15.6
Private Sector Banks	4.2	4.6
Foreign Banks	3.0	4.5
All Banks	3.5	12.1

Source: Reserve Bank of India

The Pradhan Mantri Jan Dhan Yojna (PMJDY), which focuses providing atleast one bank account to every household, has led to siginificant rise in the consumer base for the banking sector [4]. The expansion is much higher in rural areas as compared to urban areas which is in-line with the earlier reforms which emphasized on extension of banking servises to unbanked areas. The scheme also led to expansion of credit to rural areas through Rupay Debit cards and enhanced the overall financial inclusion.

Table 2 : No of Accounts opened under PMJDY as on 31.01.2015 (Summary).

	Rural	Urban	No of Accounts	No of Rupay Debit Card	Balance in Accounts(In Lacs)
Public Sector Bank	53300249	45147276	98447525	91232024	817463.04
Rural Regional Bank	18489448	3297833	21787281	14967614	159948.08
Private Banks	3226397	2012086	5238483	4593161	72551.50
Grand Total	75016094	50457195	125473289	110792799	1049962.62

Source: PMJDY progress report

To deal with the challenges like inadequate infrastucture financing, delay in land acquistion, low domestic demand and profitbility, Government in 2015 launched the Indradhanush Plan. The Plan focuses on the capitalization in the banking sector, empowernment of the banks to take independent decisions with no government intereference, governence reforms in the Public sector banks, accountability framework and establishment on Bank Boards Bureau to formulate strategies for bank growth and development.

D. Role of big data

Banks collect and generates large volume of data as compared to other sector but are still not able to use it generouly because of absence of adeqaue techniques. Big data analytics can play an important role in improving the growth process of the banking sector by providing meaingful insights from the raw data. It can enhance the delivery of banking services such as internet and mobile banking and can also help in widening the consumer base for the banks.

IV. CONCLUSION

The reform process in the Indian banking system has led to the formation of a vibrant and dynamic sector. But the sector still lacks adequate infrastructure and technology and is struggling with the problem of rising Non-performing Assets. There is a need of robust banking system with improved supervision, efficient debt recovery systems, enhanced credit expansion and lower entry barriers that can encourage competition. Bond markets must be developed to cater to the need of capitalization in the banking sector. Government schemes such as PMJDY and Indradhanush Plan answers to some of the problems of the sector but proper implementation must be ensured. Big data analytics and implementation of new technology in the banking sector can play a dynamic role in taking the Indian banking to a new level.

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