International Journal for Research in Engineering Application & Management (IJREAM)
ISSN : 2454-9150 Vol-05, Issue-06, Sep 2019

Banking Sector Reforms: Ensuring Growth

Dr. Chatar Singh Negi, Associate Professor, Department of Commerce, Govt. (P.G) College, Rishikesh (Uttarakhand), India.

Dr. Sanjay Kumar, Assistant Professor, Department of Commerce, Govt. Degree College, Narendra Nagar (Uttarakhand), India. drsanjay.kumar55@gmail.com

Abstracts - The need of the hour is to boost both consumption and investment demand and this necessitates strengthening the entire banking sector which comprises mainly scheduled commercial banks and Non-Banking Financial Companies (including housing finance companies). The Union Budget 2019-20 has tried to provide impetus for all three. Most important aspect is that the provisions contained in the Budget address liquidity and regulation issues together. India should strive to have a more robust and capitalised banking system, with enhanced capacity to extend credit and an incentive structure suitable for productive allocation of resources. To build a robust banking system, recapitalisation will have to be complemented by a host of other measures including corporate governance reforms, lower entry barriers, improved financial supervision, development of a dynamic corporate debt market and efficient debt recovery mechanism,Thus ushering comprehensive reform in the entire banking sector.

Key Words-PSBs, Liquidity, NPA, Governance, Reforms, Comprehensive, mechanism.

I. INTRODUCTION

The banking system is one of the most important sources of credit For firms and households in India. The size, resilience and level of capitalization of banks are critical for the smooth functioning of financial markets. India's banking sector has been characterized by a high proportion of publicly controlled banks. Key challenges to the banking system include low financial depth, a high share of nonperforming assets (NPAs) and a high concentration of public sector banks (PSBs). These issues constrain industrial credit and banks' ability to meet international capital requirements. Existing measures have not been enough to tackle these challenges. Looking ahead, we need to focus on three areas to stimulate the banking sector: improving governance of banks, enhancing competition in the Sector and developing corporate bond markets to relieve pressure from banks as lending sources.

Scheduled Commercial Banks (SCBs) and especially Public Sector Banks are passing through transformation. Credit growth is in double digit for last two successive years (13.34% in 2018-19 and 10.42 % in 2017-18). At the same time as a result of Government's 4r's strategy of recognition, resolution, recapitalisation and reforms, Non Performing assets (NPA) of all SCBs (Public and private) has declined by Rs. 1,02,562 crore to Rs. 9,33,625 crore as on 31st March, 2019.

According to RBI's financial stability report (FSR), published in June, 2019, growth of gross NPA has decelerated across all bank groups, including Public Sector Banks (PSBs). Now, due to regulatory mechanism for recognition of stressed assets, NPAs declined to 9.3% in March 2019. The report has projected further decrease in the gross NPA ratio of all Scheduled Commercial Banks to 9% by next March, driven by a decline in the gross NPA ratios of PSBs to 12% from 12.6% during this period.

The Budget speech emphasised that financial gains from cleaning of the banking system are now amply visible. NPAs of commercial banks have reduced by over Rs. 1 lakh crore over the last year, record recovery of over Rs. 4 lakh crore due to Insolvency and Bankruptcy Code (IBC) and other measures have been effected over the last four years, provisions coverage ratio is now at its highest in seven years, and domestic credit growth has risen to 13.8%. Govt. has smoothly carried out consolidation, reducing the number of Public Sector Banks by eight. At the same time, as many as six Public Sector Banks have been enabled to come out of Prompt corrective action framework.

Apart from capital infusion by the Govt., PSBs source capital through internal capital generation and mobilisation of capital from markets. In fact, capital infusion by the Govt. complements PSB's internal capital generation and mobilisation of capital from markets. During 2008-09 to 2018-19, Govt. infused Rs. 3,15,721 crore in PSBs while during the same period they mobilised Rs. 2,81,616 crores of capital through other sources and posted net profit of Rs. 98,373 crores, of which a sizeable proportion has contributed to internal capital generation. Now, PSBs can leverage capital infusion by the Government for more capital generation and in turn push credit growth.

 DOI : 10.35291/2454-9150.2019.0441 © 2019, IJREAM All Rights Reserved.

RBI Governor, Mr. Shaktikanta Das, feels that the provision of Rs. 70,000 crore of additional recapitalisation is a very positive development because it not only enables banks to maintain the capital they need to comply with the regulatory requirements, but it will also give enough capital to the a banks to step up their lending and credit disbursement. It will auger well for the n banking system. experts hope that PSBS are likely to see a turnaround in profitability given that most of the pain has been recognised and NPAs and credit costs are peaking out. This will lead to an improvement in return ratios.

According to a research report by state Bank of India, additional capital is likely to lay the basis for growth capital during current fiscal i.e. 2019-20 or FY 20. "Assuming a 12-13 percent credit growth in FY 20 with credit risk weighted assets of 70%. PSBs may be requiring around Rs. 50,000 crore growth capital in FY 20." it said. However, as stated in the report, this requirement also depends upon some major variables i.e. alternate long term investor, recoveries from NCLT (National Co0mpany Law Tribunal), investment environment, out of NCLT settlements/auctions, treasury gains/loss, MTM (Mark to Market) provisioning of investments and additional or provision write back.

The budget also talks about a new way to do banking for common citizens. This is called interoperability of services for account holders across PSU banks. "To further improve ease of living, they will leverage technology, offering online personal loans and doorstep banking, and enabling customers of one Public Sector Bank to access services across all Public Sector Banks, "The Finance Minister said that the Govt. will initiate steps to empower account holders to remedy the current situation in which they do not have control over deposit of cash by others in their accounts.

This means one can walk into a branch of a PSB and avail the services even if his/her account is with another PSB. This is similar to what is presently available among branches of one bank and through ATMs of various banks. One can check his/her balance from ATM of different bank where he/she does not have an account. Now, the same thing will be made available at branch level.

New provision will also give persons control over who deposits money in their accounts or even also may allow them to authenticate before receiving payments. All these will become clear once RBI releases the road map to implement the budget announcement.

Objectives of the study- the following are the specific objectives of the study.

- To brief an overview of the reforms initiated after 1991 in PSBs.
- To evaluate the overall scenario of PSBs.
- To provide some suggestions for strengthening the Indian PSBs.

Data Collection- The sources of the secondary data are bank's balance sheet, RBI Publications, published data of banks, economic survey, magazine and other reports of Government of India.

History of Bank Reforms in India

INDIAN BANKING SYSTEM

Reserve Bank of India

Commercial Banks **Cooperative Banks**
Development Banks **Nationalized Private**
Short-term credit **Long-term credit**

Agricultural Credit **Urban Credit**
EXIM Agricultural

Before 1991, India had been nationalizing a large share of its banking sector. In 1969, the government nationalized banks with deposits greater than Rs. 50 crore. It controlled more than 80% of bank branches. In 1980, the government brought an additional number of banks under its control, nationalizing banks with country-wide deposits more than Rs. 200 crore. About 90% of all banks were controlled by the government and this share remained fairly steady during this period. Between 1969 and 1991, the geographical penetration, density of coverage and number of bank branches grew significantly. Banks also witnessed large deposit and credit growth. Priority sector lending grew from 14 to 41 percent.

However, by 1991, banks' efficiency and productivity had declined, customer service quality was poor and profitability was low. n 1991, when the government liberalized the economy, it also undertook a number of banking reforms. The Committee on Financial Systems, chaired by Mr. M. Narasimham in 1991, recommended reducing the Statutory Liquidity ratio (SLR) and Cash Reserve ratio (CRR) to free up bank resources, relying on market forces to determine interest rates, making it easier for private and foreign banks to enter to enhance competition and reducing substantially the number of public sector banks (PSBs). Many of the committee's recommendations were implemented, including the reduction in SLR and CRR, having a market determinate interest rate and opening of new private sector and foreign banks.

In 1998, the Committee on Banking Sector Reforms, also chaired by Mr. Narsimbham, recommended a further set of measures to strengthen the banking sector. It reviewed progress in existing measures and proposed further measures related to legislation, capital adequacy and bank mergers. Beyond these, the 1998 Committee also recommended steps relating to grater technology use, skills

 DOI : 10.35291/2454-9150.2019.0441 © 2019, IJREAM All Rights Reserved.

training and professional management of banks. Many of these reforms put in place since 1991 improved the performance and strength of India's banking sector. For example, the amount of credit extended by the banking system as a share of GDP increased, from 51.5 % in 1990 to 53.4 % in 2000. However, it remained less than half of the credit to GDP ratio in other countries. In 2000, the ratio was 133% in China, 143% in Malaysia and 122% in Thailand.

In the 2000s, a number of committees relating to Banking reforms were constituted and further reforms have been instituted gradually. The Committee on Financial Sector Reforms included recommendations on macro-economic and regulatory frameworks for India, financial inclusion and domestic financial development. In 2014, the Committee to review Governance of Boards of Banks in India (P.J. Nayak Committee) was also constituted. It sky recommendations focused on enhancing the governance and management of public sector banks which continued to have a large presence in India's banking sector.

II. The Current Situation

Even today, India's banking system is characterized by a high share of Public Sector Banks (PSBs). Accounting for over 70% of total assets, PSBs performance inevitably represents the performance of the overall banking system. PSBs are the biggest contributors to the large and rising stock of nonperforming assets (NPAs), with a share of 88% of t he stock as of March 2016. The situation has been worsening over time. Put another way, gross NPAs in PSBs rose from Rs. 2.78 lakh crore in March 2015 to Rs. 7.33 lakh crore in June 2017.

The share of stressed assets in Public Sector Banks (PSBs) is nearly 16%, more than 3 times that in private banks. Rising NPAs have also put a strain on the health of the PSBs, reflected in their declining Return on assets

(ROA) and Return on Equity (ROE) ratios, which turned negative in 2016 for the first time in a decade.

Stressed Advances of Banks as a Share of Total Advances (%)

	March 2008	March 2018
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: RBI

But even private banks have been plagued by a high share of NPAs. The gross non-performing assets of all scheduled commercial banks amounted to Rs. 6.1 Trillion in March 2016. Further, asset quality and profitability have been deteriorating over time. Between March 2008 and March 2018, the stressed advances of banks as a share of total advances of all banks increased from 3.5% to 12.1%. Banks' Profit After Tax (PAT) contracted on a year on year basis during the first half of 2016-17. The decline in banks' profits is largely due to higher growth in risk provisions; loan write offs and decline in net interest income.

The stresses on the banking sector have translated into a slowdown in industrial credit. They also limit banks' ability to meet international capital requirements. in January 2017, credit growth to the industrial sector contracted by 5.1% relative to an increase of 5.6% in January 2016. High NPAs are also likely to impede banks' ability to meet higher capital requirements under Basel III. These requirements will come into force in January, 2019.

The govt. has infused funds to address the challenge. The measures for recapitalization under the Indrabhanush Plan in 2015-16 acknowledge the government's recognition of high NPA ratios and their adverse effects on the economy. The negative effects include further declines in bank credit, low bank profitability and declining capital adequacy ratios. To counter these, the Ministry of Finance announced a Rs. 2.1 lakh crore plan to recapitalize banks on October 24. These funds will not only help Public Sector Banks (PSs) meet their minimum capital requirements but they will also help banks clean up their balance sheets and cover had loans going forward.

III. Global Competition

India's banks lag behind global counterparts in terms of financial depth or the size of banks, other financial institutions and markets relative to economic output. Not only does financial depth matter for capturing the relative size of the banking system, but it is also positively associated with economic growth and poverty reduction. A study using state-level data from India highlights that financial deepening has contributed to poverty alleviation in rural areas. Figure 1 highlights bank assets as a share of GDP in India and selected comparators. India also has low levels of private credit to GDP and credit to deposit ratio, relative to other emerging economics. In 2015, India's private credit to GDP ratio was 50.2% relative to 140 % in China and 71% in Brazil. Similarly Bank credit as a ratio of Bank deposits was 77% in India compared to 119% in Brazil and 312% in China in 2015.

Large banks dominate the banking system with few new entrants. As of March 2016, the top 10 banks (ranked by assets) owned 58% of the total assets in the system. Since 1991, only 14 licenses have been granted for universal banks. In contrast, in the United States, over 130 new Banks were chartered annually on average between 1976 and 2009. The number of foreign banks in India remains small. As of March 2016, foreign banks accounted for 6% of total banking assets.

Looking Ahead

In the future, India should strive to have a more robust and well capitalized banking system, with enhanced capacity to extend credit and an incentive structure suitable for

 DOI : 10.35291/2454-9150.2019.0441 © 2019, IJREAM All Rights Reserved.

ISSN : 2454-9150 Vol-05, Issue-06, Sep 2019

productive allocation of resources. To build a robust banking system, recapitalization will have to be complemented by a host of other measures including corporate governance reforms, lower entry barriers, improved financial supervision, development of a dynamic corporate debt market and efficient debt recovery mechanisms.

There are three particular areas that can be prioritized:
- The first is improving governance and strengthening institutions, particularly in PSBs. In terms of sequencing, these reforms are as important as recapitalization and will also need to be pursued in parallel. Global examples highlight the importance of undertaking banking sector reforms in tackling NPAs. For example;, in China, besides recapitalization banking sector reforms focused explicitly on strengthening financial regulation and supervision, improving corporate governance and enhancing transparency. Similarly, South Korea created a Financial Supervisory Service (FSS) to ensure supervision in their banks following the East Asian Financial Crisis of the late 1990s. To some extent, the govt. has already acknowledged the need for better governance of banks. The Indradhanush Plan had suggested the creation of independent Bank Board Bureau to oversee the employment of Bank officials. If a truly independent Bureau is created, this can have a profound effect on PSB governance. Greater accountability can ensure that banks' lending practices are in line with the productive allocation of credit. We need to ensure that implementation takes places in a timely manner.

The second area for reform is the development of corporate bond markets. Bond markets need to complement banks as important sources of finance. Liquid and deep bond markets will enable firms to raise debt at low costs. Overtime, ideally, the share of bond markets as the source of corporate debt will increase and the share of banks in lending will decline.

The third area for banking sector reform is continuing to make the banking sector more competitive. India should continue to encourage the entry of private and foreign players to foster greater competition and innovation in the sector. The new policy of "on-tap" licensing of banks is a positive step in this direction. However, the entry requirements could be relaxed further to reduce barriers to entry. Advocating a subsidiary structure will not only encourage foreign banks to enter the Indian Banking sector but it will also help limit exposure to global shocks. In the long run, greater competition will raise the efficiency and profitability of the sector.

Historically, India's banking sector reforms especially in the 1990s – have also focused on enhancing competition, strengthening governance and regulation. Future reforms should also build upon these areas and draw lessons from past experiences.

References

[1] 1998, Report of the Committee on Banking Sector Reforms, Govt. of India.

[2] Demirgic_Kunt, Asli, and Ross Levine, 2008 "Finance, Financial Sector Policies, and Long Run Growth," M. Spence Growth Commission Background Paper 11, World Bank, Washington, DC.

[3] The indicator highlights the ratio of private credit by deposit money banks and other financial institutions to GDP.Source: International Financial statistics, International Monetary Fund (IMF).

[4] Adams, Robert M., and Jacob gramlich, "Where Are All the New Banks? The Role of Regulatory Burden in New Bank Formation." Review of Industrial Organization 48.2 (2016): 181-208.

[5] Pal, Rajesh (2009), "Indian Banking and Globalisation," Adhyayan Publishers and Distributors, New Delhi.

[6] 2009, A Hundred Small Steps: Report of the Committee on Financial sector Reforms SAGE Publications, http://planningcommission.nic.in/ reports/generep/rep_fr/cfsr_all.pdf

[7] Pal, Rajesh (2015), "Issues and Concepts of Economics," Adhyayan Publishers and Distributors, New Delhi.

• Pal, Rajesh (2016), "Economic and Financial Sector Reforms in India," Delta Book World, New Delhi.

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

[9] The Indian Banking Sector: Recent Developments, Growth and Prospects (2013).

[10] Dr Goyal, A. K., Joshi, Vijay- "Indian Banking Industry: Challenges and opportunities", IJBRM, Volume 3:Issue1:2012 pp23-38.

[11] Govt. of India (1998) Report of the Committee on Financial System, Ministry of Finance, (Narasimham Committee-II), April.

[12] Report on Trend and Progress of Banking in India for the year ended June 30, 2011 submitted to

[13] the Central Government in terms of Section 36(2) of the Banking Regulation Act, 1949.

[14] Jalan, B (2001): 'Banking and finance in the New millennium', Lecture delivered at the bank economists conference', New Delhi, January.

[15] Jalan, B (2002):'Strengthening Indian Banking and Finance: Progress and Prospects, Bank Economists conference, Bangalore 27th Dec. 2002.

[16] Rakesh, M (2002), Transforming Indian Banking: In search of a Better Tomorrow', Bank economists Conference 2002, Bengalore, 29th December 29.

[17] Reserve Bank of India, Various Issues. Statistical Tables Relating to Banks in India. Mumbai.

[18] Reserve Bank of India, Various Issues. Report on Trend and Progress of Banking in India. Mumbai.

[19] Tannan, M, 2001. Banking Law and Practice in India. India Law House: New Delhi.

[20] The Hindu, dated: 15-02-2017.

[21] Yojana, A development monthly.

[22] Kurukshetra, A journal of Rural Development.

DOI : 10.35291/2454-9150.2019.0441
© 2019, IJREAM All Rights Reserved.