

BANKING & FINANCIAL REFORMS

INTRODUCTION –

Broad Based reforms touching Every Sector :

- ✓ Financial Sector
- ✓ Monetary and Fiscal Policy
- ✓ Capital Market
- ✓ Foreign Exchange Market
- ✓ Money & Government securities market
- ✓ Banking Reforms

IN EARLY 1990 s –

Financial Repression :

- ✓ Extensive Regulation
- ✓ Administered Interest rates
- ✓ Directed Credit Programmes
- ✓ Weak Banking structure
- ✓ Lack of proper accounting & Risk management system
- ✓ Lack of transparency in operations
- ✓ Pre-exemption of resources from the banking system by the government to finance its fiscal deficits
- ✓ Excessive structural and micro regulation that inhibit financial innovations and increased transactions costs
- ✓ Poorly developed debt and money market
- ✓ Outdated technologies and institutional structures that made the capital market and the rest of the financial system highly inefficient .
- ✓ Government regulated the price at which firms could issue equity , the rate of interest which they could offer on their bonds , and the debt equity ratio that was permissible in different Industries

- ✓ Working capital management was even more constrained with detailed regulations on how much inventory the firms could carry or how much credit they could give to their customers
- ✓ Working capital was financed almost entirely by banks at interest rates laid down by central banks
- ✓ Working capital was related more to the credit needs of the borrower than creditworthiness .

MAJOR CONTOURS OF REFORMS –

- Removal of existing financial repression
- Creation of an efficient , productivity and profitability sector
- Enabling the process of price discovery by the market determination of interest rates that improves allocative efficiency of resources
- Providing operational and functional autonomy to institutions
- Preparing the financial system for increasing international competition
- Opening the external sector in a calibrated manner
- Promoting financial stability in the wake of domestic and external shocks

MAJOR SECTOR OF REFORMS –

- Banking Sector
- Monetary Sector
- Financial Sector
- Forex Market

GROWTH PHASES IN BANKING SECTOR –

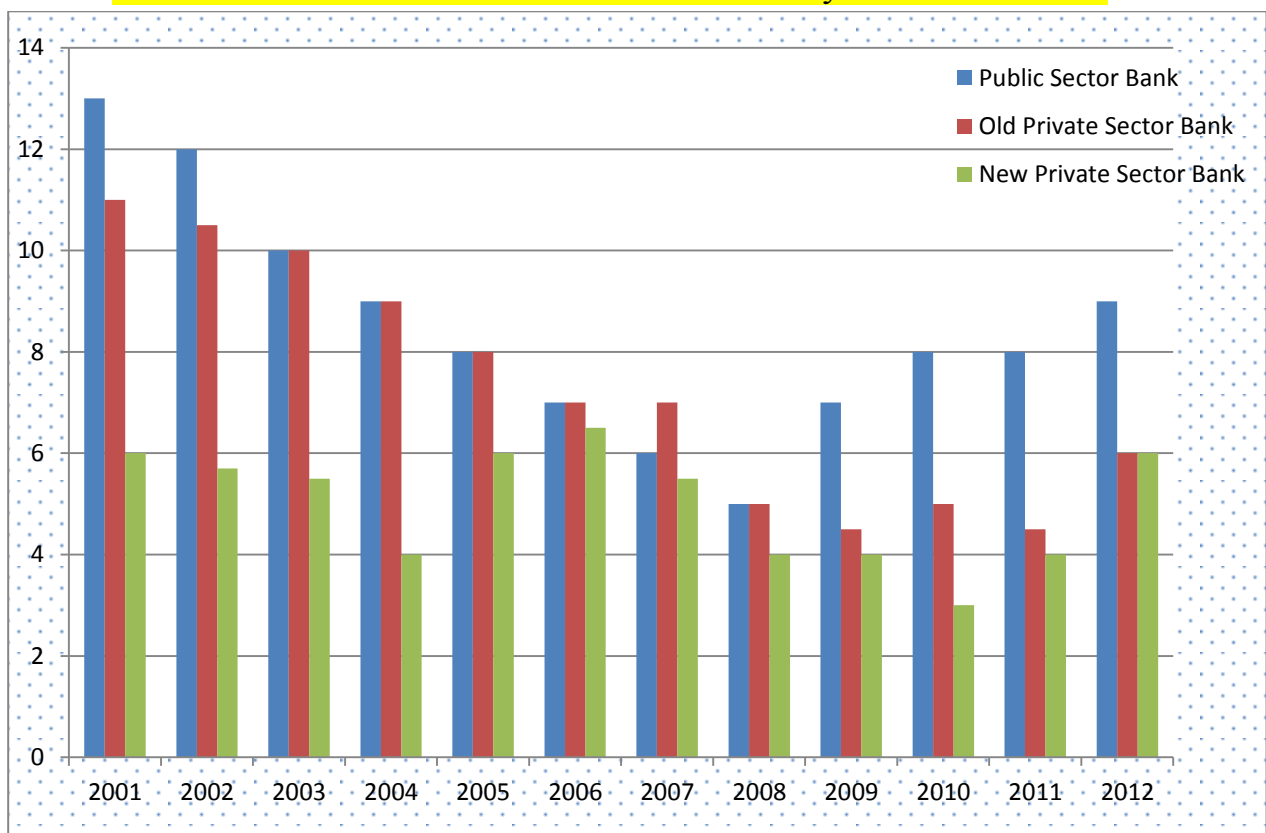
In over five decades since independence , banking system in India has passed through five distinct phases .

- ✓ Evolutionary Phase (Prior to 1950)
- ✓ Foundation Phase (1950 - 1968)
- ✓ Expansion Phase (1968 – 1984)
- ✓ Consolidation Phase (1984 – 1990)
- ✓ Reformatory Phase (Since 1990)

BANKING REFORMS IN INDIA –

- The Indian banking sectors is an important constituent of the Indian financial system .
- The banking sectors plays a vital role of promoting business in urban as well as in rural areas in recent years .
- Without in India can not be considered as a healthy economy.
- For the past three decades India's banking system has several outstanding achievements to its credit .

NPA's Have increased since 2011 after a steady decline in 2000's



NON PERFORMING ASSETS (NPA) –

- NPA is any asset of a bank which is not producing any income .
- A lone or lease that is not meetig its stated principle and interest payments
- Bank Usually classify as nonperforming assets any commercial loans which are more than 90 days overdue and any consumer loans which are more than 180 days overdue .

- For agricultural loans , if the interest and/or the instalment or principle remains overdue for two harvest seasons , it is declared as NPA's
- But , this period should not exceed two years . After two years any unpaid loan/instalment will be classified as NPA

TYPES OF NPA -

- SUB-STANDARD - NPA Less than 12 Months
- DOUGHTFUL – NPA more than 12 months
- LOSS ASSETS – When Bank or its auditor have identified the loss , but it has not been written off .

REASONS FOR SUCH A SITUATION -

- EXTERNAL REASON – Global Economic Slowdown
- INTERNAL REASON – Indiscriminate lending and poor recovery

EXTERNAL REASONS –

- Reasons related to the corporate sector
- The global economy has also slowed down
- Continuing uncertainty in the global markets has lead to lower exports of various products like textiles , engineering goods , leather , gems , etc .
- A hurt Corporate sector is finding it difficult to pay loans .

OTHER FACTORS –

- The ban in mining projects , delay in environment related permits affecting power , iron and steel sector , volatility in prices of raw material and the shortage in availability of power .
- Bank in india are highly regulated . Priority sector lending (PSL) is one of these regulations which require the bank to give a certain % of their loans to certain sectors of society

- The sluggish legal system (Judiciary in India) and lack of systematic and constant efforts by the banks make it difficult to recover these loans from corporate and non-corporate .

INTERNAL FACTOR –

- Indiscriminate lending by some state owned banks during the high growth period (2004-2008) is one of the main reasons for the deterioration in assets quality .
- Bankers say there is a lack of rigour in loan appraisal systems and monitoring of warning signals at state run banks
- Poor recovery and use of coercive technique by banks in recovering loans

IMPACT OF NPA's –

There are several impacts due to high NPA :-

- The higher is the amount of NPA , the weaker will be the bank revenue stream
- NPA assets act as dead weight on the balance sheet
- As the NPA of the bank will rise , it will bring a scarcity of funds in the Indian Security Market .
- Few banks will be willing to lend if they are not sure of the recovery of their money
- The shareholder of the banks will lose of money as banks themselves will find it tough to survive in the market
- This will lead to a crisis of confidence in the market .
- The price of loan , i.e the interest rates will shoot up
- Shooting of interest rates will directly impact the investors who wish to take loans for setting up infrastructure , industrial projects , etc .
- This will hurt the overall demand in the indian economy
- Finally it will lead to lower growth rates and higher inflation because of the higher cost of capital
- This trend may continue in a vicious circle and deepen the crisis .

PREVENTION –

➤ Conservatism :

- Bank needs to be more conservative in granting loans to sector that have traditionally found to be contributors in NPA
- The infrastructure sector , instead of getting loan from the banks can be funded from Infrastructure Debt Funds (IDFs) or other specialized funds for infrastructural development in the country .

IMPROVING PROCESSES –

- The credit sanctioning process of bank needs to go much more beyond the traditional analysis statement and analysing the history of promoters
- For example , banks rely more on the information given by credit bureaus . However , it is often noticed that several defaults by some corporate are not registered in their credit history .

REFORMATORY PHASE (1991 Onwards) –

Reasons for the formation of the reforms : -

- Continued financial profligacy of the Government coupled with close monitoring and control
- Decline in productivity and profitability
- Economic crisis of 1991
- Economic suffered from serious inflationary pressures , emerging scarcities of essential commodities and breakdown of fiscal discipline .

FIRST PHASE OF REFORMS (1991) –

- The Narsimhan committee I appointed to restore the financial health of commercial banks and to make their functioning efficient and profitability
- Recommendation aimed at changes according to greater flexibility to bank operations .
- The committee submitted its report in November 1991 with 23 recommendations .

IMPLIMENTED RECOMMENDATIONS –

- Lowering SLR & CRR
- Prudential Norms
- Capital Adequacy Norms
- Recovery of Debts
- Deregulation of Interest Rates
- Competition from New Private Sector Banks .
- Phasing out of Directed Credit
- Access to Capital Market
- Local area banks
- Supervision from commercial banks

SECOND PHASE OF REFORMS (1998) –

- The committee of placed greater importance on structural measures and improvement in standards of disclosures and levels of transparency
- Recommendations of NARASHIMHA COMMITTEE II

IMPLEMENTED RECOMMENDATIONS –

- New areas
- New instruments
- Risk managements
- Customers service
- Universal banking
- Information technology
- Increase in FDI limit

IMPACT ON INDIAN BANKING SECTOR –

- Intense competition
- Lowered pre-emptions
- Broadening the ownership base of PSB's
- Value Added Services .

TECHNOLOGY RELATED MEASURES –

- INFINIT a the communication backbone for the Financial Sector / Banking sector
- Negotiated Dealing System (NDS) for screen based trading in Government securities
- Real Time Gross Settlement (RTGS) System

“True test of the success of the banking reforms would be the extents of NPS’s ”

MONITORY POLICY REFORMS –

- Twin objectives of Maintaining price stability & Ensuring availability of adequate credit to productivity sectors
- Use of broad money (M2) as an intermediates target has been deemphasized and a multiple indicator approach has been adopted
- Development of multiple instruments to transmit liquidity and interest rate signals in the short terms in a flexible and bi-directional manner
- Increase of the inter-linkage between various segments of the financial market including money , government security and forex markets
- Open market operations (OMO) to deal with overall market liquidity situation especially those emanating from capital flows
- Introduction of Market stabilization Scheme (MSS) as an additional instruments to deal with enduring capital inflows without affecting short-term liquidity management role of LAF
- Introduction of Liquidity Adjustment Facility (LAF) , which operates through repo and reserve repo auctions Liquidity Adjustment Facility (LAF)
 - To nudge overnight interest rates within a specific corridor
 - To de-emphasize targeting of banks and focus increasingly on interest rates
 - Reducing the cash reserve ration (CRR) without loss of monetary control

CAPITAL MARKET REFORMS –

Secondary market Regulations :

- Capital adequacy and prudential regulation were introduced for brokers , and other intermediaries
- Dematerialization of Scrips was initiated with the creation of legislative framework and the setting up of the first depository
- Settlement period was reduced to one week
- Carry forward trading was banned
- Tentative move were made towards a rolling settlement system .

OUR VIEW POINT –

- Financial system in India , through a measure , gradual , caution and steady process has undergone substantial transformation
- Reasonably sophisticated , diverse and resilient system through well – sequenced and coordinated policy measures aimed at making the Indian financial sectors competitive , efficient , and stable
- Efficient monetary management has enabled price stability while ensuring availability of credit to support investment demand and growth in the economy .
- The multi-pronged approach towards managing capital account in conjunction with prudent and cautions approach to financial liberalisation has ensure financial stability in contrast to the experience of many developing and emerging economies
- Monetary policy and finance sector reforms in India had to be fine tuned to meet the challenges emanating from all global and domestic shocks
- Viewed in this light , the success in maintaining price and financial stability is all the more creditworthy .
- The overall objective of maintaining price stability in the context of economy growth and financial stability will remain .