BANKING SECTOR REFORMS AND ITS IMPACT ON BANKING INDUSTRY

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ABSTRACT

The banking reforms also led to increase in the number of banks due to the entry of new private and foreign banks, increase in the transparency of the banks' balance sheets through the introduction of prudential norms and increase in the role of the market forces due to the deregulated interest rates. These have significantly affected the operational environment of the Indian banking sector.

To encourage speedy recovery of non-performing assets, the Narasimham committee laid directions to introduce Special Tribunals and also lead to the creation of an Asset Reconstruction Fund. For revival of weak banks, the Verma Committee recommendations have laid the foundation. Lastly, to maintain macroeconomic stability, RBI has introduced the Asset Liability Management System.

Introduction

The financial sector reforms have brought about significant improvements in the financial strength and the competitiveness of the Indian banking system. The efforts on the part of the Reserve Bank of India to adopt and refine regulatory and supervisory standards on a par with international best practices, competition from new players, gradual disinvestments of government equity in state banks coupled with functional autonomy, adoption of modern technology, etc are expected to serve as the major forces for change. New businesses, new customers, and new products beckon, but bring increased risks and competition. To attract and retain customers, the banks need to optimize their networks, speed up decision-making, cut down on bureaucratic layers, and sharpen response times.

The period immediately after independence posed a major challenge to the country. Due to centuries of exploitation at the hands of foreign powers, there were very high levels of deprivation in the economy—both social as well as economic. To take up the Herculean task of rapid growth with socio-economic justice, the country adopted the system of planned economic development after independence. Due to paucity of economic resources and limitations of availability of capital for investment, the government also came up with the policy of setting up public enterprises in almost every field.

The fiscal activism adopted by the government resulted in large doses of public expenditures for which not only the revenues of the government were utilized but the government also resorted to borrowing at concessional rates, which kept the financial markets underdeveloped. The growth of fiscal deficit also continued unabated year after year. Complex structure of interest rates was a resultant outcome of this system.

Nationalization of major commercial banks in the late sixties and early seventies provided the government with virtually the complete control over the direction of the bank credit. The emphasis was mainly on control and regulation and the market forces had very limited role to play.

The economic system was working to the satisfaction of the government. The social indicators were gradually improving and the number of people below poverty line also declined steadily. The only problem area had been that the growth rate of the economy had been very low, and till late seventies, the growth rate of the GDP was hovering around 3.5 per cent per annum. It was only during mid-eighties that the growth rate touched 5 percentage points.

The situation became difficult by the eighties. Financial system was considerably stretched and artificially directed and concessional availability of credit with respect to certain sectors resulted in distorting the interest rate mechanism. Lack of professionalism and transparency in the functioning of the public sector banks led to increasing burden of non-performance of their assets.

Late eighties and early nineties were characterized by fluid economic situation in the country. War in the Middle East had put tremendous pressure on the dwindling foreign exchange reserves of the country. The country witnessed the worst shortages of the petroleum products. High rate of inflation was another area of serious concern. Most of the economic ailments had resulted due to over regulation of the economy. The international lending and assisting agencies were ready to extend assistance but with the condition that the country went in for structural reforms, decontrols and deregulation, allowing increased role for the market forces of demand and supply. The precarious economic conditions left the country with no alternative other than acceptance of the conditions for introducing the reforms.

A retrospect of the events clearly indicates that the Indian banking sector has come far away from the days of nationalization. The Narasimham Committee laid the foundation for the reformation of the Indian banking sector, constituted in 1991, the committee submitted two reports, in 1992 and 1998, which laid significant thrust on enhancing the efficiency and viability of the banking sector. As the international standards became prevalent, banks had to unlearn their traditional operational methods of directed credit, directed investments and fixed interest rates, all of which led to deterioration in the quality of loan portfolios, inadequacy of capital and the erosion of profitability.

The recent international consensus on preserving the soundness of the banking system has veered around certain core themes. These are: effective risk management systems, adequate capital provision, sound practices of supervision and regulation, transparency of operation, conducive public policy intervention and maintenance of macroeconomic stability in the economy. Until recently, the lack of competitiveness vis-à-vis global standards, low technological level in operations, over staffing, high NPAs and low levels of motivation had shackled the performance of the banking industry.

However, the banking sector reforms have provided the necessary platform for the Indian banks to operate on the basis of operational flexibility and functional autonomy, thereby enhancing efficiency, productivity and profitability. The reforms also brought about structural changes in the financial sector and succeeded in easing external constraints on its operation, i.e. reduction in CRR and SLR reserves, capital adequacy norms, restructuring and recapitulating banks and enhancing the competitive element in the market through the entry of new banks.

The banking reforms also led to increase in the number of banks due to the entry of new private and foreign banks, increase in the transparency of the banks' balance sheets through the introduction of prudential norms and increase in the role of the market forces due to the deregulated interest rates. These have significantly affected the operational environment of the Indian banking sector.

To encourage speedy recovery of non-performing assets, the Narasimham committee laid directions to introduce Special Tribunals and also lead to the creation of an Asset Reconstruction Fund. For revival of weak banks, the Verma Committee recommendations have laid the foundation. Lastly, to maintain macroeconomic stability, RBI has introduced the Asset Liability Management System.

Literature Review

M.J. Nayak (2005) stated that modern Foods and BALCO generated some controversy, not so much on the principle of privatization, but on the transparency of the bidding process and the fairness of the price realized. Subsequent sales have been much less problematic and although the policy continues to be criticized by the unions, it appears to have been accepted by the public, especially for public sector enterprises that are making losses or not doing well. However, there is little public support for selling public sector enterprises that are making large profits such as those in the petroleum and domestic telecommunications sectors, although these are precisely the companies where privatization can generate large revenues. These companies are unlikely to be privatized in the near future, but even so, there are several companies in the pipeline for privatization which are likely to be sold and this will reduce resistance to privatizing.

Dr. Seibel Dieter Hans (2005) states that micro finance is:-

- Included among the institutions eligible for support formal, semi-formal and informal financial institutions.
- In private, cooperative, public, community or mixed ownership.
- Place a special emphasis on support to small institutions which include people from the lower segments of the population as owners.

- Support the development of sustainable BDS apex organizations in private ownership or in the hands of business associations of rural entrepreneurs.

Sanyang E.Saikov and Huang Wen Chi (2005) states that micro finance does not improve roads, housing, water sourly, education and health services, it can also play an important role in making these indicators and other sustainable contributions to community. As micro finance becomes more widely accepted and move in to the mainstream, the supply of services to the poor women may likewise increase, improving efficiency and outreach, awhile improving costs. This, in turn, can have a multiplier impact on the people's standard of living especially the women's group.

Bahar Habibullah (2006) states that although micro credit is not the panacea for poverty alleviation and rural upliftment in a developing country, the supportive services of microfinance institutions for primary requisites (such as health, education, and infrastructure) and financial services (such as savings schemes, consumption, investment and insurance services) are essential for the smooth operation of micro credit. In order to improve the performance of the microfinance institutions and micro credit for targeting the poor, the following measures have been suggested:

- Commercial banks should establish separate functional relations with the microfinance institutions to provide the required guidelines, supervision and financial assistance.
- Close cooperation among the microfinance institutions, banks and organs of the government for social welfare activities is essential for the effective coordination of their activities.
- An initiative should also be considered to establish a link among the medium sized, small and cottage industries and the corporate sector through the development of subcontracting. Banks and non-bank financial institutions could create funds for the development of subcontracting enterprises.

Vetrivel S.C.and Mangalam Kumar Chandra (2006) state that micro finance can contribute to solving the problem of inadequate housing and rural services as an integral part of poverty alleviation programmes. The challenge lies in finding the level of flexibility in the credit instrument that could make it match the multiple credit requirements of low income borrowers with out imposing unbearably high cost of monitoring its end-use upon the lenders.

A promising solution is to provide multi-purpose loans for income generation, housing improvement and consumption support. Eventually it would be ideal to enhance the credit worthiness of the poor and to make them more 'Bankable' to financial institutions and enable them to qualify for long-term credit from the formal sector. Micro finance institutions have a lot to contribute to this by building financial discipline and educating borrowers about repayment requirements.

Guerin Kumar Santosh and Agier I (2007) state that over past decades the idea of "female empowerment" has become extremely popular in development agendas, resulting in multiple and often contradictory discourses on gender and development. Very little attention however has been paid to how specific empowerment discourses are received by those constituted as the "beneficiaries" of such programmes. This under-theorization of microfinance as a "lived experience" means that the wide range of complex and often surprising processes through which the concept of empowerment is received, appropriated, accommodated, and sometimes challenged have often been overshadowed. In an effort to explore how women make microfinance their own, this paper has analyzed how women take socially embedded critical perspectives towards empowerment, and how the idea of "women's empowerment" is given meaning through women's situational constraints, aspirations and expectations.

Performance of Banking Industry

The years 2008-2011 were chosen for the study because of the fact that these years were very crucial for the financial system of India. There were many factors which affected the financial system of India like recession in 2008-2009, European Union financial crisis and anti inflationary fiscal policy of Reserve Bank of India The study has shown the performance of these banks on some financial indicators/variables. The variables considered in the study are as under:

1. Interest Income as percentage of Total Fund (II/TF)
2. Net Interest Income as percentage of Total Fund (NII/TF)
3. Interest Expanded as percentage of Total Fund (IE/TF)
4. Operating Expense as percentage of Total Fund, (OE/ TF)

A comparison has been done on basis of performance of bank during the year 2009-2011 on the basis of above mentioned parameters.

1. Interest Income as percentage of Total Fund (IE/TF): It is an indicator of the rate at which a bank earns by lending funds. The IE/TF shows the performance position of Top banks of 2011 from 2008-2011.

Table: 1: Interest Earned as percentage of Total Funds (2008-2011)

		Interest earned as percentage for the years				Growth Rate				
Sr No.	BANKS	2008	2009	2010	2011	2009	2010	2011	MEAN	S.D
1	Bank of Baroda	8.14	8.16	7.56	7.5	0.246	-7.353	-0.794	7.84	0.359
2	HDFC Bank	11.01	12.5	9.84	9.76	13.533	-21.280	-0.813	10.7775	1.283
3	Axis Bank	9.57	10.53	9.38	9.14	10.031	-10.921	-2.559	9.655	0.609
4	Yes Bank	11.33	12.16	9.7	9.77	7.326	-20.230	0.722	10.74	1.209
5	State Bank of Hyderabad	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
6	Punjab National Bank	4	4.34	4.28	4.35	8.500	-1.382	1.636	4.2425	0.165
7	CANARA Bank	9.08	9.16	8.69	8.2	0.881	-5.131	-5.639	8.7825	0.439
8	Andhra Bank	8.77	9.06	8.85	8.8	3.307	-2.318	-0.565	8.87	0.131
9	Corporation Bank	8.27	8.74	8	7.63	5.683	-8.467	-4.625	8.16	0.467
10	Indian Bank	8.46	8.81	9.37	9.01	4.137	6.356	-3.842	8.9125	0.380
	Banks Average	**8.74**	**9.27**	**8.41**	**8.24**	**5.96**	**-7.86**	**-1.83**	**8.66**	**0.56**

*Mean = a1+a2+a3+a4/n

**Growth rate= current year value- previous year value/ previous year value*100

Source: Dion Global solution limited (www.moneycontrol.com)

Table 1 shows that in 2009, all the banks show positive growth. This ratio shows an upwards trend from 8.74% in 2008 to 9.27% in 2009 and then decline. In 2009, the growth rate was highest in HDFC Bank (13.533%) and It was lowest in Bank of Baroda (0.246%). In 2010, Indian Bank shows highest growth (6.356%) and HDFC Bank shows Lowest growth (-21.280%). In 2011, further decline of growth rate. The growth rate of Punjab National Bank was highest (1.636) and growth rate of Canara bank was lowest (-5.639). HDFC Bank is at the Top with average IE/TF 10.777% and Punjab national Bank at last position with least average 4.24%. All the Banks under study has shown growth immediately after recession. In 2010, there is negative growth of all the banks except Indian Bank. HDFC Bank and yes Bank are less consistent and Andhra & Punjab National Bank is more consistent. The Mean is calculated by taking the average of all the four years from 2008-2011. For example the mean for Bank of Baroda is calculated as 8.14+8.16+7.56+7.5 =31.36 divided by the number of years i.e four. The mean for the bank is 31.36/4 =7.84. Similarly the calculation is done for other Banks.

2. Net Interest Income as percentage of Total Fund (NIE/ TF): It is the indicator of the rate by which Banks earn net earnings by deducting payments on deposits from earnings by lending funds.

Table 2 : Net Interest Earned as percentage of Total Funds (2008-2011)

		Net Interest Earned as percentage				Growth Rate				
Sr No.	**BANKS**	**2008**	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**	**MEAN**	**S.D**
1	Bank of Baroda	3.24	3.26	3.3	3.39	0.617	1.227	2.727	3.2975	0.067
2	HDFC Bank	6.66	6.86	6	6.01	3.003	-12.536	0.167	6.3825	0.443
3	Axis Bank	4.74	4.98	5.34	5.08	5.063	7.229	-4.869	5.035	0.248
4	Yes Bank	4.39	4.67	4.37	3.91	6.378	-6.424	-10.526	4.335	0.315
5	State Bank of Hyderabad	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
6	Punjab National Bank	0.13	0.25	0.16	0.19	92.308	-36.000	18.750	0.1825	0.051
7	CANARA Bank	2.84	2.89	3.24	3.09	1.761	12.111	-4.630	3.015	0.185
8	Andhra Bank	3.26	3.07	3.58	3.71	-5.828	16.612	3.631	3.405	0.293
9	Corporation Bank	3.12	3.03	2.88	2.77	-2.885	-4.950	-3.819	2.95	0.156
10	Indian Bank	3.79	3.81	3.85	4.18	3.57	3.65	3.64	3.9075	0.183
	Banks Average				**3.59**	**11.22**	**-2.41**	**1.11**	**3.61**	**0.22**

*Mean = a1+a2+a3+a4/n

**Growth rate= current year value- previous year value/ previous year value*100

Source: Dion Global solution limited (www.moneycontrol com)

Table 2 reveals that in 2009 all the banks show positive growth except Andhra and corporation Bank. This ratio shows an upwards trend from 3.57% in 2008 to 3.65% in 2009 and then decline. In 2009, the net growth rate was highest in Punjab National Bank (92.308%) and it was lowest in Andhra Bank (-5.828%). In 2010, Andhra Bank shows highest growth (16.612%) and Punjab National Bank shows negative growth (-36%). In 2011, the net growth rate of Punjab National Bank was highest (18.750%) and growth rate of Yes bank was lowest (-10.526). HDFC Bank is at the Top with average NIE/TF 6.3825% and Punjab national Bank at last position with least average 0.1825%. All the Banks under study has shown net growth immediately after recession. HDFC Bank and yes Bank are less consistent and Bank of Baroda and Punjab National Bank are more Consistent.

3. Interest Expanded as percentage of Total Fund (IE/TF): Interest Expanded as percentage of Total Funds (2008-2011)

Table 3: Interest Expanded as percentage of Total Funds (2008-2011)

		Interest expanded as percentage for the years				Growth Rate				
Sr No.	**BANKS**	**2008**	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**	**MEAN**	**S.D**
1	Bank of Baroda	4.9	4.9	4.25	4.11	0.000	-13.265	-3.294	4.54	0.420
2	HDFC Bank	4.36	5.63	3.84	3.76	29.128	-31.794	-2.083	4.3975	0.864
3	Axis Bank	4.83	5.56	4.04	4.06	15.114	-27.338	0.495	4.6225	0.725
4	Yes Bank	6.94	7.48	5.34	5.86	7.781	-28.610	9.738	6.405	0.979
5	State Bank of Hyderabad	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
6	Punjab National Bank	4.86	5.55	4.79	4.52	14.198	-13.694	-5.637	4.93	0.439
7	CANARA Bank	6.23	6.27	5.45	5.11	0.642	-13.078	-6.239	5.765	0.577
8	Andhra Bank	5.51	5.99	5.26	5.09	8.711	-12.187	-3.232	5.4625	0.392
9	Corporation Bank	5.15	5.7	5.12	4.86	10.680	-10.175	-5.078	5.2075	0.353
10	Indian Bank	4.67	5.01	5.51	4.83	7.281	9.980	-12.341	5.005	0.364
	Banks Average	**5.27**	**5.79**	**4.84**	**4.69**	**10.39**	**-15.57**	**-3.07**	**5.15**	**0.57**

*Mean = a1+a2+a3+a4/n

**Growth rate= current year value- previous year value/ previous year value*100

Source: Dion Global solution limited (www.moneycontrol.com)

It is measure of the cost of funds incurred by the Bank. Greater the Ratio, lesser will be profit margin of company. The IE/TF Ratio of Top 10 Banks of 2011 is depicted in table 3 and discussed below. Banks shows upward trend from 5.27% to 5.79% and then decline of ratio in 2010 (4.84%) and 2011(4.69%) which is a good indicator. The ratio is highest in Yes Bank (7.48%) and lowest in HDFC Bank (3.76%). The Ratio is continuously declined in all the banks except Indian Bank in 2010 and 2011 which is a good indicator of performance.

4. OE/TF: Operating Expenses as percentage of Total Funds (2008-2011)

Table 4: Operating Expenses as percentage of Total Funds (2008-2011)

		Operating expenses as percentage for the years				Growth Rate				
Sr No.	**BANKS**	**2008**	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**	**MEAN**	**S.D**
1	Bank of Baroda	1.94	1.78	1.77	1.7	-8.247	-0.562	-3.955	1.7975	0.101
2	HDFC Bank	3.27	4.38	3.6	3.02	33.945	-17.808	-16.111	3.5675	0.591
3	Axis Bank	2.51	2.64	2.94	2.57	5.179	11.364	-12.585	2.665	0.191
4	Yes Bank	2.4	2.23	1.88	1.43	-7.083	-15.695	-23.936	1.985	0.429
5	State Bank of Hyderabad	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
6	Punjab National Bank	2.08	2.18	2.05	2.41	4.808	-5.963	17.561	2.18	0.163
7	CANARA Bank	2.04	1.92	1.98	1.77	-5.882	3.125	-10.606	1.9275	0.116
8	Andhra Bank	1.89	1.91	1.96	2.07	1.058	2.618	5.612	1.9575	0.081
9	Corporation Bank	1.6	1.45	1.55	1.66	-9.375	6.897	7.097	1.565	0.089
10	Indian Bank	2.47	2.61	1.76	2.33	5.668	-32.567	32.386	2.2925	0.373
	Banks Average	**2.24**	**2.34**	**2.17**	**2.11**	**2.23**	**-5.40**	**-0.50**	**2.22**	**0.24**

*Mean = a1+a2+a3+a4/n

**Growth rate= current year value- previous year value/ previous year value*100

Source: Dion Global solution limited (www.moneycontrol.com)

It is measure of the operating expenses incurred by the Bank. Greater the Ratio, lesser will be profit margin of company. The OE/TF Ratio of Top 10 Banks of 2011 is depicted in table 4 and discussed below. Banks shows upward trend from 2.24% to 2.34% and then decline of ratio in 2010 (2.17%) and 2011(2.11%) which is a good indicator. The ratio is highest in HDFC Bank (4.38%) and lowest in Yes Bank (1.43%). The HDFC Bank has highest average (3.5675%) and Corporation Bank has lowest average.

Conclusion

The year 2008-2009 was very crucial year as the world was facing financial crisis. The Indian Banking sector has shown better performance in almost all the performance indicators under study after the crisis year 2008-2009. Eleven performance indicators were used for measuring performance of top ten banks of 2010-2011. In spite of strict anti inflation fiscal policy of Reserve bank of India, all the top ten banks have shown good performance. HDFC Bank & Yes Bank was the top performers in various financial parameters. Indian Banks has shown performance as per with that of major world banks. Banking industry in India has grown to a great extend over the past few years. The study gives great idea about the efficiency of country's Banking system.

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