CHAPTER - 9
CONCLUSIONS, SUMMARY AND RECOMMENDATIONS

From the analysis of data in previous chapter, it reveals that the banking sector in India has made significant progress in all financial indicators of performance measurement during the post liberalization period. The deposits of the banking system have been increased up to Rs 5132602 Crores and the bank credit increased up to Rs 3850202.63 Crores and the investment of the Indian banking system increased up to Rs 1532830 Crores at the end of March 2011. The summery of the financial reforms and its impact on the banking sector in India have been summarized as under.

9.1. PERFORMANCE OF BANKING IN THE PRE-REFORM PERIOD

As per the analysis made in chapter four to seven, it is revealed that the Indian financial system in the pre-reform period, i.e., upto the end of 1980s, essentially catered to the needs of planned development in a mixed economy framework where the government sector had a domineering role in economic activity. The strategy of planned economic development required huge development expenditures, which was met thorough thedominance of government ownership of banks, automatic monetization of fiscal deficit and subjecting the banking sector to large pre-emplations – both in terms of the statutory holding of Government securities (statutory liquidity ratio, or SLR) and administrative direction of credit to preferred sectors. Furthermore, a complex structure of administered interest rates prevailed, guided more by social priorities, necessitating cross-subsidization to sustain commercial viability of institutions. These not only distorted the interest rate mechanism
but also adversely affected financial market development. All the signs of
financial repression' were found in the system.

9.1.1 FIRST BANKING SECTOR REFORMS (1991)
The study shows Indian banking has come a long way since India embarked on
the reforms path about almost two decade ago in 1991-92. The reforms have
unleashed tremendous change in the banking sector. Today, Indian banks are as
technology-savvy as their counterparts in developed countries. On the
networking front, branch banking – the traditional forte, coupled with ATM
networks-the now imperative, have evolved to place the banking services on a
new trajectory. The competitive forces have led to the emergence of Internet
and mobile banking too, to let banks attract and retain customers. The banking
sector is also gearing up to embrace the Basel II regime, to benchmark with the
global standards.
Similarly, retail lending has emerged as another major opportunity for banks. All
these factors are driving up competition, which in turn forcing banks to innovate.
A slew of innovative products, which could not be imagined even a couple of
years ago, are a reality now. Even mundane products like Saving Account,
Personal Loans and Home Loans have become subjects of innovation.
The Narasimham Committee had proposed wide-ranging reforms for:
1. Improving the financial viability of the banks;
2. Improving the macroeconomic policy framework for banks;
3. Increasing their autonomy from government directions;
4. Allowing a greater entry to the private sector in banking;
5. Liberalizing the capital markets;
6. Improvement in the financial health and competitive position of the banks;
7. Furthering operational flexibility and competition among the financial
institutions.

A number of reforms initiatives have been taken to remove or minimize the
distortions impinging upon the efficient and profitable functioning of banks. These
include the followings:
1. Reduction in SLR & CRR
2. Transparent guidelines or norms for entry and exit of private sector banks
3. Public sector banks have been allowed for direct access to capital markets
4. The regulated interest rates have been rationalized and simplified.
5. Branch licensing policy has been liberalized
6. A board for Financial Bank Supervision has been established to strengthen the supervisory system of the RBI.

These and other measures that have been taken would help the highly regulated and directed banking system to transform itself into one characterized by openness, competition, prudential and supervisory discipline. They will also make the new challenges particularly the growing demands from customers for high quality services. The objective of this is to study, describe and analyze the impact of banking sector reforms on the performance of commercial banks. On the basis of the impact of these reforms, to suggest third new modified reforms, in the changing scenario is the need.

Hypothesis Testing

“The reform measures brought a paradigm shift in the banking industry and enhanced the overall performance of the banks”.

The chapter V and VI of the research study revealed that the financial reforms was carried out and it has created the efficient, productive and profitable banking sector to function with operational flexibility and functional autonomy and the banking sector has made tremendous progress in terms of all financial parameters including deposit mobilization, loans and advances, reduction in NPAs, increasing of CRAR etc.

Thus the above hypothesis has been accepted.

9.1.2 SECOND BANKING SECTOR REFORMS (1998)

By mid-1997, the RBI reported that the reform process had started yielding results. But as observed by the NC in its second report, the improvement has
arrested the deterioration of the system earlier but there is still a considerable distance to traverse. There has been improvement in several of the quantitative indices but there are many areas in which weaknesses still persist. These include customer service, technological upgradation, improvement in housekeeping in terms of reconciliation of entries and balancing of books.

The second report was submitted on 23rd April, 1998, which sets the pace for the second generation of banking sector reforms. These include:

1. Merge strong banks, close weak banks unviable ones
2. Two or three banks with international orientation, 8 to 10 national banks and a large number of local banks
3. Increase Capital Adequacy to match enhanced banking risk
4. Rationalize branches and staff, review recruitment
5. De-politicize Bank Boards under RBI supervision
6. Integrate NBFCs activities with banks.

But many cities saw no purpose in setting up the second NC on banking sector reforms within six years and before the full implementation of the recommendations of the first report of 1991. Strictly speaking, there were no new recommendations made in the second report except two on:

1. Mereger of strong units of banks
2. Adaptation of the “narrow banking” concept to rehabilitate the weak banks.

9.1.3 THIRD GENERATION BANKING REFORMS

The process of implementing Basel II norms in India is being carried out in phases. Phase I has been carried out for foreign banks operating in India and Indian banks having operational presence outside India with effect from March 31, 2008.

In phase II, all other scheduled commercial banks (except Local Area Banks and RRBs) will have to adhere to Basel II guidelines by March 31, 2009. With the deadline of March 31, 2009 for full implementation of Basel II norms fast approaching, banks are looking to maintain a cushion in their respective capital reserves. The minimum capital to risk-weighted asset ratio (CRAR) in India is
placed at 9%, one percentage point above the Basel II requirement. All the banks have their Capital to Risk Weighted Assets Ratio (CRAR) above the stipulated requirement of Basel guidelines (8%) and RBI guidelines (9%). As per Basel II norms, Indian banks should maintain tier I capital of at least 6%.

The Government of India has emphasized that public sector banks should maintain CRAR of 12%. For this, it announced measures to re-capitalize most of the public sector banks, as these banks cannot dilute stake further, as the Government is required to maintain a stake of minimum 51% in these banks.

Various reform measures introduced in India have indeed strengthened the Indian banking system in preparation for the global challenges ahead. Some of the reforms introduced and their impact on banks and furnished in the table (Indian banking on the reforms path)

The study was conducted to assess the impact of financial reforms on the banking sector and the strategic response given by the banks to the financial reforms during the period of last ten years.

In the study it is seen that the India has presently entered a high-growth phase of 8-9 per cent per annum, from an intermediate phase of 6 per cent since the early 1990s. The growth rate of real GDP averaged 8.5 per cent for the last ten year period from 2001-02 to 2009-10; if we consider the last two years, the growth rates are even higher at over 9 per cent. The analysis of the study predicts that the growth rates will remain at elevated levels for several years to come. This strengthening of economic activity has been supported by higher rates of savings and investment. While the financial sector reforms helped strengthening institutions, developing markets and promoting greater integration with the rest of the world, the recent growth phase suggests that if the present growth rates are to be sustained, the financial sector will have to intermediate larger and increasing volume of funds than is presently the case. It must acquire further sophistication to address the new dimensions of risks.
It is widely recognised that financial intermediation is essential to the promotion of both extensive and intensive growth. Efficient intermediation of funds from savers to users enables the productive application of available resources. The greater the efficiency of the financial system in such resource generation and allocation, the higher is its likely contribution to economic growth. Improved allocative efficiency creates a virtuous cycle of higher real rates of return and increasing savings, resulting, in turn, in higher resource generation. Thus, development of the financial system is essential to sustaining higher economic growth. The summery of the study on financial reform and its impact is divided in different phases as under.

**Hypothesis Testing**

“The reforms in banking sector transformed the regulated environment into a market-oriented one and induced competitiveness in banking industry”

The study revealed that the financial reforms has provided space to open the banking sector for Indian as well as foreign banks and thus created efficient, productive and competitive environment resulted into the betterment of banking services for the customers.

**Therefore, the above hypothesis has been accepted.**

**9.2. OUTLINE OF REFORMS**

The study was related to find out the financial reforms and its impact on banks and the strategic response given by the banking sector to this financial reform.

1. As the financial sector reforms encompassed broadly institutions especially banking, development of financial markets, monetary fiscal and external sector management and legal and institutional infrastructure. Reform measures in India were sequenced to create an enabling environment for banks to overcome the external constraints and operate with greater flexibility. Such measures related to dismantling of administered structure of
interest rates, removal of several preemptions in the form of reserve requirements and credit allocation to certain sectors. Interest rate deregulation was in stages and allowed build up of sufficient resilience in the system. This is an important component of the reform process which has imparted greater efficiency in resource allocation. Parallel strengthening of prudential regulation, improved market behaviour, gradual financial opening and, above all, the underlying improvements in macroeconomic management helped the liberalisation process to run smooth.

2. As a part of financial reforms, the interest rates have been largely deregulated except for certain specific classes, these are: savings deposit accounts, non-resident Indian (NRI) deposits, small loans up to Rs.2 lakh and export credit. Without the dismantling of the administered interest rate structure, the rest of the financial sector reforms could not have meant much.

3. As regards the policy environment on public ownership, the major share of financial intermediation has been on account of public sector during the pre-reform period.

4. As a part of the reforms programme, initially there was infusion of capital by Government in public sector banks, which was subsequently followed by expanding the capital base with equity participation by private investors up to a limit of 49 per cent. The share of the public sector banks in total banking assets has come down from 90 per cent in 1991 to around 70 per cent in 2010: a decline of about one percentage point every year over a fifteen-year period.

5. As a policy reform the diversification of ownership was one of the major reform. During the policy reform, it was found that, while retaining public sector character of these banks has led to greater market accountability and improved efficiency without loss of public confidence and safety. It is significant that the infusion of funds by government since the initiation of
reforms into the public sector banks amounted to less than 1 per cent of India’s GDP, a figure much lower than that for many other countries.

6. Another major objective of banking sector reforms has been to enhance efficiency and productivity through increased competition. Establishment of new banks was allowed in the private sector and foreign banks were also permitted more liberal entry. Nine new private banks are in operation at present, accounting for around 10-12 per cent of commercial banking assets. The major step towards enhancing competition was allowing foreign direct investment in private sector banks up to 74 per cent from all sources. From 2009, foreign banks have been allowed banking presence in India either through establishment of subsidiaries incorporated in India or through branches.

7. Impressive institutional reforms have also helped in reshaping the financial marketplace. A high-powered Board for Financial Supervision (BFS), constituted in 1994, exercise the powers of supervision and inspection in relation to the banking companies, financial institutions and non-banking companies, creating an arms-length relationship between regulation and supervision. On similar lines, a Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) prescribes policies relating to the regulation and supervision of all types of payment and settlement systems, set standards for existing and future systems, authorise the payment and settlement systems and determine criteria for membership to these systems.

8. The system has also progressed with the transparency and disclosure standards as prescribed under international best practices in a phased manner. Disclosure requirements on capital adequacy, NPLs, profitability ratios and details of provisions and contingencies have been expanded to include several areas such as foreign currency assets and liabilities, movements in NPLs and lending to sensitive sectors. The range of disclosures has gradually been increased. In view of the increased focus on
undertaking consolidated supervision of bank groups, preparation of consolidated financial statements (CFS) has been mandated by the Reserve Bank for all groups where the controlling entity is a bank.

9. The legal environment for conducting banking business has also been strengthened. Debt recovery tribunals were part of the early reforms process for adjudication of delinquent loans. More recently, the Securitisation Act was enacted in 2003 to enhance protection of creditor rights. To combat the abuse of financial system for crime-related activities, the Prevention of Money Laundering Act was enacted in 2003 to provide the enabling legal framework. The Negotiable Instruments (Amendments and Miscellaneous Provisions) Act 2002 expands the erstwhile definition of 'cheque' by introducing the concept of 'electronic money' and 'cheque truncation'. The Credit Information Companies (Regulation) Bill 2004 has been enacted by the Parliament which is expected to enhance the quality of credit decisions and facilitate faster credit delivery.

10. Improvements in the regulatory and supervisory framework encompassed a greater degree of compliance with Basel Core Principles. Some recent initiatives in this regard include consolidated accounting for banks along with a system of Risk-Based Supervision (RBS) for intensified monitoring of vulnerabilities.

11. The structural break in the wake of financial sector reforms and opening up of the economy necessitated changes in the monetary policy framework. The relationship between the central bank and the Government witnessed a salutary development in September 1994 in terms of supplemental agreements limiting initially the net issuance of ad hoc treasury Bills. This initiative culminated in the abolition of the ad hoc Treasury Bills effective April 1997 replaced by a limited ways and means advances. The phasing out of automatic monetization of budget deficit has, thus, strengthened monetary authority by imparting flexibility and operational autonomy. With the passage
of the Fiscal Responsibility and Budget Management Act in 2003, from April 1, 2006 the Reserve Bank has withdrawn from participating in the primary issues of Central Government securities.

**Hypothesis Testing**

**The Information technology in banking business has a visible impact on the quality of customer service.**

Banking Sector Reforms also taken care of the Technology upgradation and its Related Measures . The RBI has started RTGS, Core Banking solution, INFINET as the communication backbone for the banking sector. The Negotiated Dealing System (NDS) for screen-based trading in government securities and Real Time Gross Settlement (RTGS) System have been the boon for the customers and bankers. All the success stories of banks and innovative services being offered by the banks are the gift of financial reforms.

The above analysis proves that the Information technology in banking business has a visible impact on the quality of customer service and hence the above hypothesis also accepted.

12. Reforms in the Government securities market were aimed at imparting liquidity and depth by broadening the investor base and ensuring market-related interest rate mechanism. The important initiatives introduced included a market-related government borrowing and consequently, a phased elimination of automatic monetization of Central Government budget deficits. This, in turn, provided a fillip to switch from direct to indirect tools of monetary regulation, activating open market operations and enabled the development of an active secondary market. The gamut of changes in market development included introduction of newer instruments, establishment of new institutions
and technological developments, along with concomitant improvements in transparency and the legal framework.

9.3. PROCESSES OF REFORMS

1. After evaluation of the reforms and its impact on Indian banking system, it is found that the process reform has been considered as unique features of Indian banking reform. First, financial sector reform was undertaken early in the reform cycle in India. Second, the banking sector reforms were not driven by any immediate crisis as has often been the case in several emerging economies. Third, the design and detail of the reform were evolved by domestic expertise, while taking on board the international experience in this regard. Fourth, enough space was created for the growth and healthy competition among public and private sectors as well as foreign and domestic sectors.

2. The financial liberalization process in India towards improving the functioning of institutions and markets found very much useful to all, including banking institutions, public and policy makers. Prudential regulation and supervision has improved; the combination of regulation, supervision and safety nets has limited the impact of unforeseen shocks on the financial system. In addition, the role of market forces in enabling price discovery has enhanced. The dismantling of the erstwhile administered interest rate structure has permitted financial intermediaries to pursue lending and deposit taking based on commercial considerations and their asset-liability profiles. The financial liberalisation process has also enabled to reduce the overhang of non-performing loans: this entailed both a ‘stock’ (restoration of net worth) solution as well as a ‘flow’ (improving future profitability) solution.

3. Financial entities have become increasingly conscious about risk management practices and have instituted risk management models based on their product profiles, business philosophy and customer orientation.
Additionally, access to credit has improved, through newly established domestic banks, foreign banks and bank-like intermediaries. Government debt markets have developed, enabling greater operational independence in monetary policy making. The growth of government debt markets has also provided a benchmark for private debt markets to develop.

4. There have also been significant improvements in the information infrastructure. The accounting and auditing of intermediaries has improved. Information on small borrowers has improved and information sharing through operationalization of credit information bureaus has helped to reduce information asymmetry. The technological infrastructure has developed in tandem with modern-day requirements in information technology and communications networking.

5. The improvements in the performance of the financial system over the decade-and-a-half of reforms are also reflected in the improvement in a number of indicators. Capital adequacy of the banking sector recorded a marked improvement and stood between 11 to 13 % during 2005 to 2010.

6. On the asset quality front, notwithstanding the gradual tightening of prudential norms, non-performing advances (NPA) to total loans of commercial banks which was at a high of 15.7 per cent at end-March 1997 declined to 3.5 per cent at end-March 2010. Net NPAs also witnessed a significant decline and stood at 1.5 per cent of net advances at end-March 2010, driven by the improvements in loan loss provisioning, which comprises over half of the total provisions and contingencies. The proportion of net NPA to net worth, sometimes called the solvency ratio of public sector banks has dropped from 57.9 per cent in 1998-99 to 11.7 per cent in 2009-10. The private sector bank are having better position than the public sector banks.

7. Operating expenses of banks in India are also much more aligned to those prevailing internationally, hovering around 2.1 per cent during 2008-09 and
2009-10. These numbers are comparable to those obtaining for leading
developed countries which were range-bound between 1.4-3.3 per cent in
2010.

8. Bank profitability levels in India have also trended upwards and gross profits
stood at 2.0 per cent during 2009-10 (2.2 per cent during 2008-09) and net
profits trending at around 1 per cent of assets. Available information suggests
that for developed countries, at end-2009, gross profit ratios were of the order
of 2.1 per cent for the US and 0.6 per cent for France.

9. The extent of penetration of our banking system in our country as measured
by the proportion of bank assets to GDP has increased from 50 per cent in
the second half of nineties to over 80 per cent a decade later.

9.4. CONCLUDING OBSERVATIONS

Based on analysis and major findings' listed in a summarized way, here is a
list of concluding observations:

I. The reform measures laid the basis for sound banking system and
considerable progress has been made in implementing the reforms.
The response of the banks to the reforms has been impressive. The
banks have been adjusting very well to the new environment, though
gradually.

II. The need for restructuring the banking industry in tune with reforms
was felt greater with the initiation of the reforms measures in 1992.
The reforms have enhanced the opportunities and challenges for the
commercial banks making them operate in a market-led competitive
environment.

III. As a result of entry of new generation private sector banks, the
competitive pressures are constantly on the increase. This has led to
the increased customer orientation and customer focus on the part of banks in post-reform period. Banks and now launching new products and new services. Banks are now competing in providing anywhere banking, net banking, phone banking, ATM facility, etc. Product innovation is given a lot of importance.

IV. As a consequence of ref<9rms, several new trends have been emerging in Indian banking. Earlier deposits mobilized and outstanding figures of deposits were yardsticks for measuring performance. Today, strength of balance sheet is considered important. Return on assets, per employee productivity, quantum of profits and per employee profits, low ratio of NPAs and net NPA rate and earnings per share are considered parameters today.

V. The competitive environment has resulted in new challenges for the public sector banks to retain their share. Ongoing changes in the structure of Indian banking are clearly visible. While the share of public sector banks in the total assets of the banking sector has shown a steady decline, the new private sector banks have succeeded in enhancing their position.

VI. In the face of the growing competition, the policy changes and the operational environment in respect of the Indian banking system there has been an increased focus on profitability, although social objectives continue to be important. Consequently, most of the banks in the public sector have shown a significant improvement in their profit performance. While private sector banks continue to earn higher profit, the difference in the profit performance among different bank groups has appeared to be narrowed down.

VII. The profit performance has been varied among different bank groups with respect of individual banks as well. The banks covered under
study have enhanced their share in the total business but majority witnessed deterioration in the profit performance. This was especially so in the case of new private sector banks. Generally, new private sector banks have fared better than public sector banks and old private sector banks. This reflects the favourable effect of the adoption of new technology.

VIII. There is shift of focus from process-based management to risk-based management. Now risks have to be identified categorized and appropriately priced, based on risk perception. The banking industry had reengineered its operational policies to accommodate these aspects into their operational activities.

IX. The Interest rate spread has elicited a decline over the years in the case of different groups of public sector banks and Indian private sector banks. The spread was the lowest in the case of new private sector banks. The differences among different bank groups continue to be high.

X. Due to competition the banks recognized the need to undertake cost reduction, particularly, the public sector banks made every effort to cut down its wage bill by adopting downsizing and restructuring of the workforce. The banking industry had to reengineer its operational policies. In the case of new private sector banks, these costs registered a moderate increase due to use of highly qualified human resources.

XI. The level of Non-Performing Assets (NPA) of public sector banks remained high: a noteworthy development has been their significant reduction in relation to net advances in recent years. Nonperforming Assets are not confined to Public Sector Banks alone but are present in Private Sector Banks as well. The incidence of Non-Performing Assets is higher in the case of Public Sector Banks than other bank
groups. The increased NPAs forced the banking sector to come up with innovative ideas for deployment of funds with least credit and risk.

XII. The expectations of consumer have been growing. Broadly, these expectations are swift service with minimal response time, efficient service delivery, tailor made and value-added products to suit specific needs, hassle-free procedures and minimum transaction costs, and pleasant and personalized service.

XIII. The Non-interest income of both public and private sector banks exhibited an increase during the period under study due to softening of interest rates and delivering a portfolio of fee-based services in accordance with the growing consumer needs. But the non-interest income is still lagging behind interest income of all groups of banks. The New Private Sector Banks, which have from their very start rendering various types of fee-based services are able to earn a higher percentage of non-interest income when compared to not only to their counterparts but also to different groups of Public Sector Banks.

XIV. The financial health of banks improved due to prescribed prudential norms. Almost all banks improved their Capital adequacy and Asset quality (measured by the net NPAs as a percentage of net advances) during the period of the study.

The analysis of observations presented in the study confirms substantially, the hypothesis formulated. As stated, the reform measures have a positive impact on efficiency, profitability and overall performance of all groups of banks. It may safely be said that the Indian banking system emerged stronger one after the reform measures are being implemented.
9.5. FUTURE AHEAD (CHALLENGES AHEAD)

The study reveals that though the Indian banks have responded to the financial reforms positively, and made significant progress, there are several challenges for them in future.

1. The first challenge for the banks is the consolidation of banks and branches. The emergence of titans has been one of the noticeable trends in the banking industry at the global level. These banking entities are expected to drive the growth and volume of business in the global segment. In the Indian banking sector also, consolidation is likely to gain prominence in the near future. Despite the liberalization process, state-owned banks dominate the industry, accounting for three-quarter of bank assets. The consolidation process in recent years has primarily been confined to a few mergers in the private sector segment, although some recent consolidation in the state-owned segment is evident as well. These mergers have been based on the need to attain a meaningful balance sheet size and market share in the face of increased competition, driven largely by synergies and locational and business-specific complementarities.

Efforts have been initiated to iron out the legal impediments inherent in the consolidation process. As the bottom lines of domestic banks come under increasing pressure and the options for organic growth exhaust themselves, banks in India will need to explore ways for inorganic expansion. This, in turn, is likely to unleash the forces of consolidation in Indian banking. However, there are two caveats. First, any process of consolidation must come out of a felt need for merger rather than as an imposition from outside. The synergic benefits must be felt by the entities themselves. The process of consolidation that is driven by fiat is much less likely to be successful, particularly if the decision by fiat is accompanied by restrictions on the normal avenues for reducing costs in the merged entity. Thus, any meaningful consolidation among the public sector banks must be driven by commercial motivation by individual banks, with the
government and the regulator playing at best a facilitating role. Second, the process of consolidation does not mean that small or medium sized banks will have no future. Many of the Indian banks are of appropriate size in relation to the Indian situation. Actual experience shows that small and medium sized banks even in advanced countries have been able to survive and remain profitable. These banks have survived along with very large financial conglomerates. Small banks may be the more natural lenders to small businesses.

2. The second challenge is related to maintain the capital adequacy. Basel I standards have been successfully implemented in India and the authorities are presently moving towards adoption of Basel II tailored to country’s specific considerations. Adoption of Base II norms will enhance the required capital. Besides, banks’ assets will grow or will have to grow in tandem with the growth of the real sectors of the economy.

3. It is found that the public sector banks’ ability to meet the growing needs, will be inhibited, unless the government is willing to bring in more capital. At present, the share of the government in the public sector banks cannot go below 51 per cent. While there is some scope for expanding capital through various modalities, tier-I capital, that is equity, is still critical. While this constraint may not be binding immediately, sooner or later it will be. If growth is modest, retained earnings may form an adequate source of supply. However, when growth is rapid which is likely to be the case, there is need for injection of equity, enlarging the shareholding.

4. In this situation, the government will have to make up its mind either to bring in additional capital or move towards reducing its share from 51 per cent through appropriate statutory changes. A third alternative could, however, be to include in the definition of government such entities as the Life Insurance Corporation that are quasi-government in nature and are likely to remain to be fully owned or an integral part of the government system in the future. However, even to do this an amendment is needed in the statute.
5. The third aspect concerns risk management. The most important facet of risk in India or for that matter in most developing countries markets remains the credit risk. Management of credit risks is an area which has received considerable attention in recent years. The new Basle accord, rests on the assumption that an internal assessment of risks by a financial institution will be a better measure than an externally imposed formula. The economic structure is undergoing a change.

6. The service sector has emerged as major sector. Assessing credit risk in lending to service sectors needs a methodology different from assessing risks while lending to manufacturing. There are other areas of lending such as housing and consumer credit which will need new approaches.

7. The management of exchange risk is one of the most important area. Besides enabling customers to adopt appropriate exchange cover, banks themselves will have to ensure that their exposure is within acceptable limits and is properly hedged. The entire area of risk management encompassing all aspects of risk including credit risk, market risk and operational risk will have to receive prime attention.

8. The fourth concern I want to refer to is improvement in customer service. Banks exist to provide service to customers. With the introduction of technology, there has been a significant change in the way banks operate. This is a far cry from the situation that existed even 15 years ago. The induction of technology has enabled several transactions to be processed in a shorter period of time. Transmission of funds to customers takes less time now. ATMs provide easy access to cash. Nevertheless, it is not very clear whether the customers as depositors and users of other banking services are fully satisfied with the services provided when they come to a bank. This is an area, which must receive continuous attention. The interface with the customers needs to improve.
9. Provision of credit is a basic function of banks. The effective discharge of this function is part of the intermediation process. The sectoral deployment of credit must keep pace with the changes in the structure of the economy. The banking industry in India must equip itself to be able to assess and meet the credit needs of the emerging segments of the economy. In this context, two aspects require special attention.

10. First, as the Indian economy gets increasingly integrated with the rest of the world, the demands of the corporate sector for banking services will change not only in size but also in composition and quality. The growing foreign trade in goods and services will have to be financed. Apart from production credit, financing capital requirements from the cheapest sources will become necessary. Provision of credit in foreign currency will require in turn a management of foreign exchange risk. Thus, the provision of a whole gamut of services related to integration with the rest of the world will be a challenge. Foreign banks operating in India will be the competitors to Indian banks in this regard.

11. The foreign banks have access to much larger resources and have presence in many parts of the world. Therefore, Indian banks will have to evolve appropriate strategies in enabling Indian firms to accessing funds at competitive rates.

12. It is also seen that the global financial strategy is more relates to the presence of Indian banks in foreign countries. Indian banks will have to be selective in this regard. Here again the focus may be on how to help Indian firms acquire funds at internationally competitive rates and how to promote trade and investment between India and other countries. We must recognize that in foreign lands, Indian banks will be relatively smaller players. The motivation to build up an international presence must be guided by the route Indian entities take in the global business.
13. Despite the faster rate of growth of manufacturing and service sectors, bulk of the population still depends on agriculture and allied activities for its livelihood. In this background, one cannot over-emphasize the need for expanding credit to agricultural and allied activities. While banks have achieved a higher growth in provision of credit to agriculture and allied activities last year, this momentum has to be carried further.

14. The credit for agriculture is not a single market now and there is a need to provide more credit for high-tech agriculture. But banks are considering the Hi-tech agriculture as industry and thus the high tech agri. Is not getting desirable momentum. Thus there is a need to change the policy in this regard.

15. It is found in the study that the commercial banks were aggressive in providing credit to manufacturing and service segments where the normal calculation of risk and return applies.

16. But there is need to made more provision of credit to small and marginal farmers. They constitute a bulk of the farmers and accounting for a significant proportion of the total output.

17. The National Sample Survey Organization has recently released a Report entitled, “Indebtedness of Farmer Households”. This Report contains a wealth of data relating to the extent and nature of indebtedness. As per NSSO data 51.4 per cent of the total farm households did not have access to credit. Another fact that emerges is that there is a substantial difference between marginal and sub-marginal farmers on the one hand and the rest of the farmer households on the other regarding the purpose for which loans are obtained and the sources of credit. For all farmer households taken together, at the all-India level, institutional sources were responsible for providing 57.5 per cent of the total credit. But as far as farmer households owning one hectare and less, this proportion is only 39.6 per cent. For all farmer
households, the proportion of loan going for production purposes is 65.1 per cent as against 40.2 per cent for marginal and sub-marginal farmer households. Thus, for sub-marginal and marginal farmers, the proportion of production loan is lower than for all farmers.

18. Similarly, the proportion of institutional credit is lower for sub-marginal and marginal farmers than for all farmers. This, in fact, is true of every state of the country. Thus, a critical issue is how to meet the credit requirements of marginal and sub-marginal farmers. What changes do we need to introduce so that credit can flow to this class of farmer households? Can the banking system through its present mode of distribution of credit meet this challenge? Should we think in terms of banks supporting other institutions who are in a better position to lend to marginal and sub-marginal farmers? Banks need to think hard on how to effectively use the ‘facilitator and correspondent’ models. These models have great potential to reach out to small borrowers and depositors. In any case, a re-look at the organizational structure of our rural branches is called for. Banks need to think deeply on how to meet this challenge of meeting the credit needs of marginal farmers. Financial inclusion is no longer an option; it is a compulsion.

19. The task to be fulfilled by the Indian banks is truly formidable. At one end we expect banks to be able to lend billions of rupees to large borrowers. At the same time we want them to be able to deliver extremely small loans to meet the requirements of the small borrowers. We must reflect on the kind of organizational structure and human talent that we need in order to achieve these twin goals which are at the two extreme ends of the spectrum of lending.

20. The first phase of banking sector reform has come to a close and the Indian banking is moving on to the second phase. In the years to come, the Indian financial system will grow not only in size but also in complexity as the forces
of competition gain further momentum and as financial markets get more and more integrated.

21. Globalisation – a challenge as well as an opportunity

The waves of globalization are sweeping across the world, and have thrown up several opportunities accompanied by concomitant risks. Integration of domestic market with international financial markets has been facilitated by tremendous advancement in information and communications technology. There is a growing realization that the ability of countries to conduct business across national borders and the ability to cope with the possible downside risks would depend, inter alia, on the soundness of the financial system. This has necessitated convergence of prudential norms with international best practices as well consistent refinement of the technological and institutional framework in the financial sector through a non-disruptive and consultative process.

22. Improving risk management systems

Basel II has brought into focus the need for a more comprehensive risk management framework to deal with various risks, including credit and market risk and their inter-linkages. Banks in India are also moving from the individual silo system to an enterprise-wide risk management system. While the first milestone would be risk integration across the entity, the next step would entail risk aggregation across the group both in the specific risk areas as also across the risks. Banks would, therefore, be required to allocate significant resources towards this endeavour. In India, the risk-based approach to supervision is also serving as a catalyst to banks’ migration to the integrated risk management systems. However, taking into account the diversity in the Indian banking system, stabilizing the RBS as an effective supervisory mechanism is another challenge.
23. Corporate governance

To a large extent, many risk management failures reflect a breakdown in corporate governance which arise due to poor management of conflict of interest, inadequate understanding of key banking risks, and poor Board oversight of the mechanisms for risk management and internal audit. Corporate governance is, therefore, the foundation for effective risk managements in banks and, thus, the foundation for a sound financial system. Therefore, the choices which banks make when they establish their risk management and corporate governance systems have important ramifications for financial stability. Banks may have to cultivate a good governance culture building in appropriate checks and balances in their operations. There are four important forms of oversight that should be included in the organizational structure of any bank in order to ensure appropriate checks and balances: (i) oversight by the board of directors or supervisory board; (ii) oversight by individuals not involved in the day-to-day running of the various business areas; (iii) direct line supervision of different business areas; and (iv) independent risk management, compliance and audit functions. In addition, it is important that key personnel are fit and proper for their jobs. Furthermore, the general principles of sound corporate governance should also be applied to all banks, irrespective of their unique ownership structures.

24. Implementation of new accounting standards

Derivative activity in banks has been increasing at a brisk pace. While the risk management framework for derivative trading, which is a relatively new area for Indian banks (particularly in the more structured products) is an essential pre-requisite, the absence of clear accounting guidelines in this area is a matter of significant concern. The World Bank’s ROSC on Accounting and Auditing in India has commented on the absence of an accounting standard which deals with recognition, measurement and disclosures pertaining to
financial instruments. The Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) is considering issue of Accounting Standards in respect of financial instruments. These will be the Indian parallel to International Accounting Standards 32 and 39. The proposed Accounting Standards will be of considerable significance for financial entities and could, therefore, have implications for the financial sector. The formal introduction of these Accounting Standards by the ICAI is likely to take some time in view of the processes involved. In the meanwhile, the Reserve Bank is considering the need for banks and financial entities adopting the broad underlying principles of IAS 39. Since this is likely to give rise to some regulatory/prudential issues, all relevant aspects are being comprehensively examined. The proposals in this regard would, as is normal, be discussed with the market participants before introduction. Adoption and implementation of these principles are likely to pose a great challenge to both the banks and the Reserve Bank.

25. Supervision of financial conglomerates

The financial landscape is increasingly witnessing entry of some of the bigger banks into other financial segments like merchant banking, insurance etc. Emergence of several new players with diversified presence across major segments, make it imperative for supervision to be spread across various segments of the financial sector. In this direction, an inter-regulatory Working Group was constituted with members from RBI, SEBI and IRDA. The framework proposed by the Group is complementary to the existing regulatory structure wherein the individual entities are regulated by the respective regulators and the identified financial conglomerates are subjected to focused regulatory oversight through a mechanism of inter-regulatory exchange of information. As a first step in this direction, an inter-agency Working Group on Financial Conglomerates (FC) comprising the above three supervisory bodies identified 23 FCs and a pilot process for obtaining information from these conglomerates has been initiated. The complexities involved in the
supervision of financial conglomerates are a challenge not only to the Reserve Bank of India but also to the other regulatory agencies, which need to have a close and continued coordination on an on-going basis.

In view of increased focus on empowering supervisors to undertake consolidated supervision of bank groups and since the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision have underscored consolidated supervision as an independent principle, the Reserve Bank had introduced, as an initial step, consolidated accounting and other quantitative methods to facilitate consolidated supervision. The components of consolidated supervision include, consolidated financial statements intended for public disclosure, consolidated prudential reports intended for supervisory assessment of risks and application of certain prudential regulations on group basis. In due course, consolidated supervision as introduced above would evolve to cover banks in mixed conglomerates, where the parent may be non-financial entities or parents may be financial entities coming under the jurisdiction of other regulators.

26. Application of advanced technology

The role of technology in banking in creating new business models and processes, in maintaining competitive advantage, in enhancing quality of risk management systems in banks, and in revolutionizing distribution channels, cannot be overemphasized. Recognizing the benefits of modernizing their technology infrastructure, banks are taking the right initiatives. While doing so, banks have four options to choose from: they can build a new system themselves, or buy best of the modules, or buy a comprehensive solution, or outsource. A further challenge which banks face in this regard is to ensure that they derive maximum advantage from their investments in technology and avoid wasteful expenditure which might arise on account of uncoordinated and piecemeal adoption of technology; adoption of
inappropriate/ inconsistent technology and adoption of obsolete technology. A case in point is the implementation of core banking solution by some banks without assessing its scalability or adaptability to meet Basel II requirements.

27. Financial inclusion

While banks are focusing on the methodologies of meeting the increasing demands placed on them, there are legitimate concerns with regard to the banking practices that tend to exclude rather than attract vast sections of population, in particular pensioners, self-employed and those employed in unorganized sector. While commercial considerations are no doubt important, banks have been bestowed with several privileges, especially of seeking public deposits on a highly leveraged basis, and consequently they should be obliged to provide banking services to all segments of the population, on equitable basis. Further, experience has shown that consumers’ interests are at times not accorded full protection and their grievances are not properly attended to. Feedback received reveals recent trends of levying unreasonably high service/user charges and enhancement of user charges without proper and prior intimation. It is in this context that the Governor, Reserve Bank of India had mentioned in the Annual Policy Statement 2005-06 that RBI will take initiatives to encourage greater degree of financial inclusion in the country; setting up of a mechanism for ensuring fair treatment of consumers; and effective redressal of customer grievances.

Hypothesis Testing

The introduction of prudential norms improved the financial health and credibility of banks.

The study of financial reforms and its impact on Indian banking sector in its chapters four to eight have categorically proved that the introduction of prudential norms implemented by the RBI and government through the financial reforms process have improved the financial health and credibility of
all Indian banks. Thus the above hypothesis have been proved and accepted.

28. As globalization accelerates, the Indian financial system will also get integrated with the rest of the world.

29. As the task of the banking system expands, there is need to focus on the organizational effectiveness of banks.
30. It is suggested that, corporate planning combined with organizational restructuring become necessary to achieve improvements in productivity and profitability.
31. Issues relating to consolidation, competition and risk management tools are to be adopted by all private commercial as well as public sector banks.

32. Corporate governance and financial inclusion will emerge as key issues for India at this stage of socio-economic development.

9.6. SUGGESTIONS FOR FURTHER DEVELOPMENT OF BANKING SECTOR.

A national priority status will have to be accorded to the financial sector reforms to strengthen the foundations of the Indian financial system and gear it to meet the challenges of globalization. The on-going reforms process and the agenda for the future reforms have to focus on making the financial system viable and efficient so that it could contribute to enhancing the competitiveness of the real economy and face the challenges of an increasingly integrated global financial architecture. The future agenda would certainly have address to the following:

9.6.1 POLICIES AND STRATEGIES TO REDUCE HIGH LEVEL OF NPAS:

High level of NPAs is the most crucial challenge faced by the Indian banking sector. To tackle this problem, different options are available which would include:

1. Reducing the existing NPAs and curbing their further build up
2. Exploring avenues of recovering NPAs such as Lok Adalats for recovering smaller loans
3. Applying and enforcing the Revenue Recovery, which is an expeditious process of adjudicating claims.
4. Strengthening the provisions of the Debt Recovery Act for the recovery of dues of banks and FDIs.
5. Increasing the number of Debt Recovery Tribunals
6. Complete ban on generalized loan waivers

**9.6.2 COMPETITION FROM GLOBAL MAJORS:**

Another challenge is the very large number of un-remunerative branches, low productivity, overstaff and the archaic methods of operations. All these factors have affected the productivity and profitability of public sector banks. Global competition has become threat and motivation for Indian banks. Government should have the way for universal banking with a three-tier structure for the banking system as recommended by the committee (1991) and reiterated in its second report (1998).

**9.6.3 ENTRY OF NEW PRIVATE SECTOR BANKS:**

The government should not put such a number of restrictions for the entry of new private sector banks in Indian banking industry because these banks are generating the element of competition which further improved the quality of services and hence gain importance in foreign markets.

**9.6.4 FURTHER RATIONALIZATION OF INTEREST RATES:**

There is a need for further rationalization of interest rates and in particular it is desirable to evolve a Reserve Reference Rate of interest, which could be the basis for determining the entire gamut of interest rates. While these measures need to be preserved, there is need for a cautious step-by-step approach rather than a rapid deregulation of all interest rates in the system. The experience in a number of countries has been that too rapid a deregulation of interest rates can be destabilizing – something which the Indian banking system can ill-afford to do at this stage.
9.6.5 REVIEWING THE TARGETS FOR PRIORITY SECTOR LENDING:
At present, it is imperative to review the items included in priority sector and targets of this sector. It is imperative to devise a rural credit delivery system which will not require large subvention.

9.6.6 QUALITY OF SERVICES:
Each and every bank should provide efficient quality of services to win the trust of the customers particularly our public sector banks. E-delivery channels should be introduced in a very effective manner.

9.6.7 AUTONOMY IN HRM:
Public sector banks should be given full autonomy in HRM related issues as it is given in private and foreign banks. This will help to face the global competition and increase their efficiency to provide better services to their customers.

9.6.8 STRICT RULES FOR ACCOUNTABILITY:
RBI should make strict rules for the accountability which will help to increase the performance of the employees and hence of branches too as employees with lower performance can be pointed out and that of with good performance can be awarded.

9.6.9 GLOBALIZATION OF INDIAN BANKS:
In the era of IT and WTO, Indian banks should also make their place/image in the foreign countries. They should provide the products/services in foreign countries as per their demands and expectations.

9.7. SUMMARY AND CONCLUSIONS
The study has revealed that the financial reforms was carried out in three major phases i.e. First Generation (Early 1990). In the first phase of financial reforms commenced from the year 1990, it has created the efficient, productive and profitable financial sector to function with operational flexibility and functional autonomy. The Second Generation i.e. Mid 1990 is called as the period of IIInd phase was mainly devoted for Strengthening the financial system and introducing structural improvements which includes the prudential norms and strengthening the financial health of banking sector. The third and last stage of Banking Sector
Reforms could create the keen competition among the banking sector and enhanced the Role of Market Forces to determined the rates of interest. This phase also initiated the review of Prudential Measures and initiated several Institutional and Legal Measures, supervisory Measures and Technology Related Measures to strengthen the banking sector in India. The reforms process has increased the competition, operational autonomy to Public Sector banks as well as private sector banks. The structural changes made by reducing the public ownership of public sector banks and increased the capital from equity market up to 49% of paid up capital. It has also provided more transparent Norms related to entry, mergers /amalgamation and governance issues for Indian private sector, foreign and joint-venture joint-banks, NBFC’s and insurance companies. The reforms provided the access to the foreign investment in the Indian financial sector in the form of Foreign Direct Investment (FDI) as well as portfolio investment and permitted Indian banks to diversify product portfolio and business activities.

The major Prudential Measures taken by the government in the financial reforms were the Introduction and phased implementation of international best practices and norms related to:- CRAR, Income recognition, Provisioning and Exposure. It has also Strengthen risk management system in banks including identification and Assignment of risk-weights to various bank asset classes – Norms on connected lending, risk concentration – Application of marked-to-market principle for investment portfolio and limits on deployment of fund in sensitive activities – 'Know Your Customer' norms – 'Anti Money Laundering' guidelines – Graded provisioning for NPA’s – Capital charge for market risk. It has Provided Guidelines for ownership and governance, securitization and debt restructuring mechanisms norms, etc.

A new Roadmap for Basel II Measures has been initiated by Implementing Basel II in all commercial banks with effect from 2007 and made the Standardized Approach for credit risk and Basic Indicator Approach for operational risk.
In second phase the reforms brought out the Migration to the Internal Rating Based (IRB) Approach after adequate skills are developed. As per the Basel II norms requires more capital for banks in India and Presently CRAR for all Indian banks is over 12 per cent and all Indian banks are complying to it.

Reform process has initiated the Institutional and Legal Measures in banking sector for the benefits of banks and customers. The provisions have made for Setting up of Lok Adalats (people’s courts), debt recovery tribunals, asset reconstruction companies, settlement advisory committees, corporate debt restructuring mechanism, etc. The process also promulgated the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002 to ensure the banks’ rights to their advances. Now Banks have set up of Credit Information Bureau of India Limited (CIBIL) for information sharing on defaulters as also other borrowers and Clearing Corporation of India Limited (CCIL) to act as central counter party for facilitating payments and settlement system relating to fixed income securities and money market instruments.

The reforms also help in making Supervisory Measures including the forming of Board for Financial Supervision as the apex supervisory authority for Risk based supervision, Introduction of CAMELS supervisory rating system (i.e., capital adequacy, asset quality, management, earning, liquidity and system and control), Consolidated supervision of financial conglomerates, Recasting of the role of statutory auditors with increased internal control through strengthening of internal audit, Strengthening corporate governance, to fit and proper tests for directors along-with enhanced due diligence on important shareholders.

Banking Sector Reforms also taken care of the Technology upgradation and its Related Measures. The RBI has started RTGS, Core Banking solution, INFINET as the communication backbone for the banking sector. The Negotiated Dealing System (NDS) for screen-based trading in government securities and Real Time Gross Settlement (RTGS) System have been the boon for the customers and
bankers. All the success stories of banks and innovative services being offered by the banks are the gift of financial reforms.

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From the above discussion, it is proved that the Indian banks have positively responded to the reform policies and procedure of government and they have shown significant progress after the financial reforms. Indian banking system operated for a long time with high reserve requirements both in the form of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). This was mainly to accommodate the high fiscal deficit and its monetisation. The efforts in the recent period have been to lower both the CRR and SLR. The SLR has been gradually reduced from a peak of 38.5 per cent to 25 per cent. The CRR was reduced from its peak level of 15.0 per cent maintained during 1989 to 1992 to 4.5 per cent of NDTL in June 2003. Although the Reserve Bank continues to pursue its medium-term objective of reducing the CRR, in recent years, on a review of macroeconomic and monetary conditions, the CRR has been revised upwards to 6.0 per cent (to be effective from March 3, 2007).

It has been the endeavor of the Reserve Bank to establish an enabling regulatory framework with prompt and effective supervision, and development of legal, technological and institutional infrastructure. Persistent efforts, therefore, have been made towards adoption of international benchmarks, as appropriate to Indian conditions. In 1994, a Board for Financial Supervision (BFS) was constituted comprising select members of the Reserve Bank Board with a variety of professional expertise to exercise 'undivided attention to supervision' and
ensure an integrated approach to supervision of commercial banks and financial institutions. The Reserve Bank had instituted a state-of-the-art Off-site Monitoring and Surveillance (OSMOS) system for banks in 1995 as part of crisis management framework for Early Warning System (EWS) and as a trigger for on-site inspections of vulnerable institutions. The scope and coverage of off-site surveillance has since been widened to capture various facets of efficiency and risk management of banks.

As a part of the financial sector reforms, the regulatory norms with respect to capital adequacy, income recognition, asset classification and provisioning have progressively moved towards convergence with the international best practices. These measures have enhanced transparency of the balance sheet of the banks and infused accountability in their functioning. Besides sub-standard assets, provisioning has also been introduced for the standard assets. Measures to reduce the levels of NPAs concentrated on improved risk management practices and greater recovery efforts facilitated by the enactment of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. Several other channels of NPA management have also been instituted, including Debt Recovery Tribunals, Lok Adalats (People’s court) and corporate debt restructuring mechanism with separate schemes for small and medium industries.

The minimum capital to risk assets ratio (CRAR), which was earlier stipulated at eight per cent was revised to 9 per cent in 1999, which is one percentage point above the international norm. As some banks in the public sector were not able to comply with the CRAR stipulations, there was a need to recapitalise them to augment their capital base. Banks were allowed to raise capital from the market. In line with the amendment to incorporate market risk in Basel I, separate capital charge for market risk was also introduced in 2004.

Accounting standards and disclosure norms were strengthened with a view to improving governance and bringing them in alignment with the international
norms. The disclosure requirements broadly covered capital adequacy, asset quality, maturity distribution of select items of assets and liabilities, profitability, country risk exposure, risk exposures in derivatives, segment reporting, and related party disclosures. In April 2005, commercial banks were advised to put in place business continuity measures, including a robust information risk management system within a fixed time frame.

In view of the increasing degree of deregulation and exposure of banks to various types of risks, the Reserve Bank initiated measures for further strengthening and fine-tuning risk management systems in banks. The guidelines on asset-liability management and risk management systems in banks were issued in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance Note on Operational risk management in 2005. In the Reserve Bank, the risk-based approach to supervision has been adopted since 2003 and about 23 banks have been brought under the fold of risk-based supervision (RBS) on a pilot basis. On the basis of the feedback received from the pilot project, the RBS framework is being reviewed.

As part of the reform programme, due consideration has been given to diversification of ownership of banking institutions for greater market accountability and improved efficiency. The public sector banks expanded their capital base by accessing the capital market, which diluted the Government ownership. To provide banks with additional options for raising capital funds with a view to enabling smooth transition to the Basel II, the Reserve Bank in January 2006, allowed banks to augment their capital funds by issue of additional instruments.

With a view to enhancing efficiency and productivity through competition, guidelines were laid down for establishment of new banks in the private sector and the foreign banks have been allowed more liberal entry. Since 1993, 12 new private sector banks have been set up. As a major step towards enhancing
competition in the banking sector, foreign direct investment in the private sector banks is now allowed up to 74 per cent, subject to conformity with the guidelines issued from time to time. The regulatory framework in India, in addition to prescribing prudential guidelines and encouraging market discipline, is increasingly focusing on ensuring good governance through 'fit and proper' owners, directors and senior managers of the banks. Transfer of shareholding of five per cent and above requires acknowledgement from the Reserve Bank and such significant shareholders are required to meet rigorous ‘fit and proper’ requirements. Banks have also been asked to ensure that the nominated and elected directors are screened by a nomination committee to satisfy ‘fit and proper’ criteria. Directors are also required to sign a covenant indicating their roles and responsibilities. The Reserve Bank has issued detailed guidelines on ownership and governance in private sector banks emphasizing diversified ownership.

The smooth functioning of the payment and settlement system is a pre-requisite for financial stability. The Reserve Bank, therefore, has taken several measures from time to time to develop the payment and settlement system in the country along sound lines. The Board for Regulation and Supervision of Payment and Settlement Systems (BPSS), set up in March 2005 as a committee of the Central Board of the Reserve Bank, is the apex body for giving policy direction in the area of payment and settlement systems. Real time gross settlement (RTGS) was operationalised in 2004. Its usage for transfer of funds, especially for large values and for systemically important purposes, has increased since then. With introduction of RTGS, whereby a final settlement of individual inter-bank fund transfers is effected on a gross real time basis during the processing day, a major source of systemic risk in the financial system has been reduced substantially.

A risk free payments and settlements system in government securities and foreign exchange was established by the Clearing Corporation of India Limited (CCIL), which is set up by banks. CCIL acts as the central counter party (CCP)
for all the transactions and guarantees both the securities and funds legs of the transaction. Under the DvPIII mode of settlement that has been adopted, both the securities leg and the fund leg are settled on a net basis. The settlement through CCIL has thus reduced the gross dollar requirement by more than 90 per cent. A screen-based negotiated quote-driven system for dealings in the call/notice and the term money market (NDS-CALL) has been launched by the CCIL in September 18, 2006. The introduction of NDS-CALL helps in enhancing transparency, improving price discovery and strengthening market microstructure.

The world economy has developed serious difficulties in recent times, with a lapse of banking & financial institutions, and plunging demand. Prospects became very uncertain causing a recession in major economies. However, amidst all this chaos, India’s banking sector has been amongst the few to maintain resilience.

A progressively growing balance sheet, higher pace of credit expansion, expanding profitability and productivity akin to banks in developed markets, lower incidences of non-performing assets and a focus on financial inclusion have contributed to making the Indian banking industry vibrant and strong. Indian banks have begun to revise their growth approach and re-evaluate the prospects on hand to keep the economy rolling. The way forward for Indian banks is to innovate to take advantage of the new business opportunities and at the same time ensure continuous assessment of risks.

A rigorous evaluation of the health of commercial banks, recently undertaken by the Committee on Financial Sector Assessment (CFSA) also shows that the commercial banks are robust and versatile. The single-factor stress tests undertaken by the CFSA divulges that the banking system can endure considerable shocks arising from large possible changes in credit quality, interest rates and liquidity conditions. These stress tests for credit, market and liquidity risk show that Indian banks are by and large resilient.
While deregulation has opened up new opportunities for banks, liberalization has intensified competition in the banking industry by opening the market to new foreign and private sector banks. Declining interest rates and reduced lending margins have thrown up new challenges to banks, particularly public sector banks.

Banks need to equip themselves sufficiently to operate in such a competitive environment.

GLOBAL CHALLENGES IN BANKING

1. Enhancement of customer service.
2. Innovations in technology.
3. Improvement of risk management systems.
4. Diversifying products.

Globalisation challenges are not restricted only to global banks. Banks in India also need to face them. Overcoming these challenges makes them more competitive and will also equip them to launch themselves as global players.

COMPETITION

Globalisation has brought fierce competition from international banks. In order to compete with new entrants effectively commercial banks need to possess strong balance sheets which indicate the real strength of the bank. The entry of new private sector banks and foreign banks equipped with latest technology and technology-driven product lines have really sensitized the ordinary customers of the banking services to the need for quality in terms of innovative products as well as delivery process. These banks are aggressively targeting the retail business and consequently grabbing the market share of public sector banks.

ELECTRONIC BANKING

In the future, banking will be driven more of technology and telecommunication systems. Aided by improved telecommunication and technology, Public sector
banks have made rapid strides in product innovation and delivery, thereby improving quality of customer service. Technological changes have brought about paradigm shift in the process today's banking may be redefined as 'Triple A.' banking—anytime anywhere, anyhow banking. Internet banking will enable three profit centres, namely treasury, corporate banking and retail banking, to launch new products and provide quality service to a wider customer base.

TECHNOLOGY

With the help of innovative information technology, banks are able to reduce the transaction cost and handle a large number of transactions in no time. Now banks can provide customized products easily and customers could access many services through internet by sitting at home. To provide better services to their customers, banks are embracing Customer Relationship Management [CRM] facilitated by the availability of conductive technology. Innovation in technology is also helping banks to cross-sell the products of insurance and securities firms, which are swelling their fee-based income in the total income.

Innovative technology not only brings benefits, but risks too. Major impediments and risks associated with the implementation of innovative technology are:

> Cost associated with adoption of new technology might not bring cash flows required to cover that cost.

> Increased capacity due to a new technology could result in excess capacity in the financial institution.

> Another problem banks face with implementation of latest technology is integration of existing system with the new one.

> Banks could face cost overrun or cost control problems.

> Innovative technology has brought new risks like daylight overdraft risk
INNOVATIONS IN HOUSING LOANS

Housing loans are one of the products that banks are concentrating more. The booming housing loans market positively affects many industries. So to provide impetus to any economy, booming housing market is vital. Banks benefit from higher security, low risk weights and reasonable margins.

RISK MANAGEMENT

Globalization and liberalization are forcing banks to take more risk to compete effectively in the global market place. One of the important risks is compliance risk. It is the risk to comply with laws, rules and standards such as market conduct, treating customers fairly, etc. To mitigate this risk, banks should develop compliance culture in their organization. It is not only the duty of compliance specialists, but banks can also manage compliance risk by putting in place compliance functions that are in consistence with compliance principles.

Liquidity risk arises when banks unable to meet their obligations when they become due. To manage the mismatch of assets and liabilities, banks should analyse the accounting data both on static as well as dynamic basis. Deposits of higher value are the most important item to be monitored regularly, as sudden withdrawal of these deposits might cause liquidity problem for the bank. Also incentives to these deposits in the time of falling interest rates could create strain on liquidity.

INNOVATIONS IN CUSTOMER SERVICES

Satisfied customer is the best guarantee for stability of the organization in the long-run. Banks can satisfy their customers only by providing customised, cost effective and timely services. With the help of technology banks are able to provide plethora of products and services to their customers which suit them. Major services provided by the Indian banks that are of international standards are Any time banking, Anywhere banking, Global ATM and Credit Cards, Internet banking facility etc.
9.8 CONCLUDING REMARKS:

Given the new environment, Indian banks can't remain unaffected by the changes round and challenges before them. Therefore Indian banks need to restructure themselves. The following practices need to be adopted on urgent basis;

> Greater professionalism.

> Greater emphasis on diversification and sources non interest income.

> Consultancy services.

> Equipping themselves to operate in the deregulated environment.

> Necessary changes in the legal stipulations.

> Cost management.

> Bench marking of service standards to improve productivity and Proficiency.

> A self- regulatory organization to monitor the activities of banking

With the increasing levels of Globalisation Liberalisation, Privatisation and new reforms of the Indian banking sector, competition will intensify further. Therefore, the banks who understand the market dynamics, perceive threats, anticipate volatility, show high degree of professionalism and dynamism in their functioning and respond promptly to the market needs would survive and prosper
ABBREVIATION

AB    ANDHRA BANK
AEBC  AMERICAN EXPRESS BANKING CORPORATION
AEBL  AMERICAN EXPRESS BANK LIMITED
ALCOS ASSET LIABILITIES MANAGEMENT COMMITTEE
ARFs  ASSET RECONSTRUCTION FUNDS
ATM   AUTOMATIC TELLER MACHINE
BOB   BANK OF BARODA
BOI   BANK OF INDIA
BOM   BANK OF MAHARASTRA
CAMELS CAPITAL ADEQUACY, ASSET QUALITY, MANAGEMENT, EARNINGS, LIQUIDITY AND SYSTEM CONTROLS
CB    CENTRAL BANK
CBOI  CENTRAL BANK OF INDIA
CDs   CERTIFICATE OF DEPOSITS
CFS   COMMITTEE ON FINANCIAL SYSTEM
COB   CORPORATION BANK
CRAR  CAPITAL TO RISK ASSET RATIO
CRR   CASH RESERVE RATIO
DB    DEVELOPMENT BANK
DFHI  DISCOUNT AND FINANCE HOUSE OF INDIA
DFIs  DEVELOPMENT FINANCIAL INSTITUTIONS
DICGC DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION
EWS   EARLY WARNING SYSTEM
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<td>ICFAI</td>
<td>INSTITUTE OF CHARTERED FINANCIAL ANALYST OF INDIA</td>
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<td>THE INDIAN FINANCIAL NETWORK</td>
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RBI  RESERVE BANK OF INDIA
ROA  RETURN ON ASSET
ROE  RETURN ON EQUITY
SARFAESI  SECURITIZATION AND RECONSTRUCTION OF FINANCIAL
          ASSETS AND ENFORCEMENT OF SECURITY INTEREST
SB  SYNDICATE BANK
SBBJ  STATE BANK OF BIKANER AND JAIPUR
SBI  STATE BANK OF INDIA
SBOH  STATE BANK OF HYDERABAD
SBOI  STATE BANK OF INDORE
SBOH  STATE BANK OF HYDERABAD
SBOM  STATE BANK OF MYSORE
SBOP  STATE BANK OF PATIALA
SBOS  STATE BANK OF SAURASTRA
SBOT  STATE BANK OF TRAVANKORE
SCBs  SCHEDULED COMMERCIAL BANKS
SEBI  SECURITY AND EXCHANGE BOARD OF INDIA
SLR  STATUTORY LIQUIDITY RATIO
STCI  SECURITY TRADING CORPORATION INDIA
UBOI  UNITED BANK OF INDIA
UCO  UNITED COMMERCIAL BANK
UNBOI  UNION BANK OF INDIA
UTI  UNIT TRUST OF INDIA
VaR  VALUE AT RISK
VB  VIJAYA BANK
WAN  WIDE AREA NETWORK