CHAPTER - II

REVIEW OF LITERATURE

The banking and financial system in India has entered into a new phase with the introduction of deregulation and globalisation. With the worldwide globalisation and liberalisation our banking and financial sectors are bound to meet the challenge of increasing competition. Consequently the quality has become essential.

After the recommendations of Narasimham Committee the banking and financial sector have placed the Indian banks in an unenviable position where profitability and efficiency are under severe pressure. These areas have been facing tough competition both within and outside the system. The entry of private and foreign banks has created a more tough base for competition. The viability of the banking institutions has been of concern. There is also deterioration in the quality of services provided by banks. To find a solution to these problems the Financial Sector Reforms were initiated.

The impact of banking sector reforms has been studied by several authors in India and other countries. Therefore an attempt is made in this chapter to explore the available literature on the research topic

* Financial Sector Reforms
* Autonomy to Reserve Bank of India
* Liberalisation
* Customer Services
FINANCIAL SECTOR REFORMS

According to Mark Carrington, Philip Longguth and Thomas Stainer, banks urgently need to improve their ability to think strategically about information technology investment. They opined that only those banks that use their technology resources effectively have the opportunity to secure real competitive advantage in the fast changing industry through real product or service differentiation. Besides, the financial sector has been identified as the most advanced and dynamic sector of the British economic portfolio.

The financial sector reforms have quickened the pace of Structural Transformation of the Indian Financial System observed Dr. L.M. Bhole. According to him the need for financial reforms had arisen because the financial institutions and markets were in a bad shape. Financial Sector Reforms have been necessitated by an increase in the sickness of the Indian Financial System which has been caused by the State policy - induced rigidities, directed credit allocation and investments, and politicisation of the working of financial institutions.

Steven Fries and Anita Taci have stated that development of sound, market oriented banking system is fundamental to the transition. But, bank intermediation remains stunted after a decade or more of reform and although banking reforms have advanced with liberalisation of interest rates and development of prudential regulation and supervision, the real expansion of banks has failed. They felt that reforms point out the need for policies that can
strengthen supply response of banks effective regulation of the entry and exit of banks, improvement in their corporate governance and removal of obstacles to foreign entry.

Sridhar Pandey⁴ has viewed that the economic development of agriculture to a great extent depends on the credits provided by banks and financial institutions. Meeting the credit requirements of backward states and regions of the country, providing credit to the priority sectors, improving the customer services and efficiency of banking system including profitability position are the challenges before the banking system. He stated that the social and economic revival of our country through the banking services is through reforms in the financial system suitably and quickly.

Ronnie, J. Phillips⁵ presented the functional approach to report for the financial system. This approach according to him advocates the separation of the depository and lending functions of banks. As a result of the structural separation of bank’s functions, monetary and credit policy undergo a parallel separation and government supervision and regulation of the banking industry is modified. Phillips asserted that narrow banking not only meets the safety and soundness goals of bank regulation, but also maintains an institutional structure that accommodates market forces and technological innovation.

Banks will have to prepare a corporate plan over the years taking into account the strengths and weakness said Dr.C. Rangarajan⁶. The first phase of financial sector reforms has laid the base for a sound and viable banking
system. In the future the banks should not expect customers to walk in but should seek customers. The trends insisted by him is on greater specialisation by banks, more product coverage between commercial banks and non-bank financial inter-mediaries and also greater financial intermediation with large companies.

It may be necessary for the banks to make changes to the structure of their organisations and the training of their staff in order to get rid of old fashioned practices which hold the business back observed Narasimham. According to him, the banks should develop and reward behaviour which encourage innovation - and discourage behaviour which is conservative and over-complacent. The need to analyse competitor's strengths and weaknesses, to exploit their weaknesses and try to 'second guess' the competitor's strategies, was also stressed by him. Banks must promote and market their services effectively, constantly refining bank to meet changing customer demands.

Ramesh Gelli, stated that the financial sector reforms, should carry clarity on the process of reform, strength of existing institutions and also budgetary impact of financial sector reforms. He opined that "Financial Sector Reforms to be successful will depend upon financially healthy institutions with adequate skills to respond to changing policy framework, economic conditions and market competition".
The pre-reform stage created a competitive environment with banks facing competition from non-banking financial companies, foreign banks, financial institutions such as mutual funds on lending and deposit side portrayed Jarkar J. Agarwal. Public Sector banks need to gear themselves to meet the challenge as banks are also facing competition within their industry. While the existing banks has been allowed greater flexibility to expand operation, new banks are also now being set up in the private sector. Although these new banks are concentrating on selected areas and selected segments, stiff competition on the market may be realised. He stressed that improvement in the overall efficiency of public sector banks will have to come from within and from the need to improve their profitability.

Gopalakrishnan said that Indian banks, despite many deficiencies, have inherent strength to withstand shocks which are not exclusive to them alone. The excessive attentions given to the present problems has already caused enough damage, he said.

The Government should sequence the reforms properly and implement them expeditiously to enable the financial system to be healthy and viable to compete more effectively on the economy said M.N. Goiporia, Former, Chairman, IBA and SBI. He stated that the slow paced reforms would be rendered meaningless if the financial sector reforms are not implemented.

The most challenging task ahead of the banking industry would be to face all the rigours of implementation observed B.B. Shetty, Chairman and
Managing Director, Vysya Bank. Due to implementation of bank reforms, the balance sheets of banks may become trimmer, income levels may deplete, profits may erode, at the initial stage but this will give a good scope to restart and evolve banking on the lines of what the market determines and demands.

According to Dr. N.P. Kurup, Deputy General Manager, Punjab National Bank, New Delhi many major recommendations of the Committee are implemented or under implementation, but the progress is very slow. If there is resistance in case of implementation of any recommendation, it is prudent to find out some alternative to it, he said.

Reserve Bank of India is also considering the setting up of an advisory committee to suggest the reforms necessary to redefine and strengthen the legal infrastructure for the financial sector, taking into account the long term challenges of Financial Sector Reforms.

Prof. M. Datta Chaudhari and Shri. M.R. Shroff have stated that "The committees approach to the issue of financial sector reform is to ensure that the financial service industry operates on the basis of operational flexibility and functional autonomy with a view to enhancing efficiency, productivity and profitability. A vibrant and competitive financial system is also necessary to sustain the ongoing reform in the structural aspects of the real economy. The integrity and autonomy of operations of banks and DFIs is far more relevant than the question of their ownership".
In order to develop the capital market, not only new institutions and instruments are introduced but financial institutions have also reoriented and diversified their activities observed R.M. Srivatsava. The New Economic Reforms undertaken in 1991 has substantially effected the working of financial institutions also according to him. They are now operating on market oriented principle, while formerly they were working to attain the plan priorities like backward area development, development of Small Scale Sector and Small Entrepreneurs.

According to Dr.C. Rangarajan, the reforms introduced are comprehensive, covering financial sector reforms and other components of economic policy including liberalisation and deregulation. For achieving organisational transformation and dramatic improvements in performance, banks must accord the highest priority to human resource development. The foundation for an efficient and well functioning financial system has been laid by the reform measures. He said that the past experience however showed that the reforms are leading the banks in the right direction and even though the reforms have enabled to go ahead in many areas, it has also shown the weakness in the Financial System.

S.S. Tarapore has commented that, the Indian Financial Sector would face considerable change in the years to come and there will be changes in the functions of the banks which would create pressures in the system. It would also augment greater integration with the international economy and ensure
that macro-economic policies are pursued, to make the financial sector more attractive he added.

In analysing the second phase of banking reforms, C. Rangarajan said, the areas of importance were policy framework, financial soundness and health, competitive environment, interest rates etc. The special areas of attention were asset liability management, technology upgradation and organisational improvement.

The future course of financial sector reforms should be to remove the hurdles in the working of the financial system viewed Tarapore. The conditions in the economy vary from time to time and so the specific reforms too have to be modified. According to him the first stage of financial sector reforms is over and the economy moves to the result stage of reforms. The innovation process should provide the better and best ways to implement the reforms in the future.

The country will have to face the problems and provide the best of solutions. Indian Banking System should absorb changes, face difficulties and convert it into a international banking outfit.

The commercial banks in India are far behind in the area of mechanisation observed Dr.Hem Chandralal Das. The pace of computerisation is also very slow and has many bottlenecks in the implementation process. The unending problems has slowed down the process
of mechanisation. Despite these problems, the reform process in the banking sector has come into play.

An import ingredient of Financial Sector Reforms - Autonomy to Reserve Bank of India

Narasimham\textsuperscript{22} said that the law enjoins on and the public expects that RBI would perform its role as the guardian of monetary and exchange stability in a professional manner. However, one may not expect a totally independent central bank, we ought to have a much greater measure of autonomy with in the government. According to him, Financial Sector Reforms would not be complete without giving Reserve Bank of India full autonomy and control over the financial systems. But unless the financial market is reasonably well developed and liberalised, and the Central Bank is empowered to use appropriate instruments without restraint, there can be no basis for independence.

The legal status of central banks in terms of their relationship to government varies from country to country. The exact relationship between a central bank and the government in any country is identified by their historical situations and practices which have developed overtime.

Central banks are at one end subordinate to the government working as advisor in framing monetary policy like in Bank of England, Bank of Japan and Bank of France opines Helen Coult\textsuperscript{23}. He said recently legislative changes
have been introduced in Bank of France to give greater autonomy and at the other end the central banks are independent of the government such as the Federal Reserve System of USA and Bunder Bank of Germany.

According to Jenifer Piesse, Ken Peasnall, Charles Ward\textsuperscript{24}, the Banking Sector in the UK is a large and important part of the financial sector. Restructuring of domestic banks and entry by foreign banks has changed the industry dramatically. While continuing to provide savings and investment facilities for retail customers, the clearing banks supply a payment system. The retail and wholesale activities are frequently carried on in parallel with, although some specialist institutions still exist performing the banking role said the author. Central Bank thus enjoys independence in taking monetary policy decisions due to autonomy.

C. Rangarajan\textsuperscript{25} said "it is desirable that the control of currency and credit in the country should be in the hands of an independent authority which can act with continuity". According to him the Indian public opinion was strongly in favour of an institution which was not demanded by the British Government.

If the Central Bank is to have defacto independence, its ancillary functions should not be in potential conflict with the primary objective of maintaining price stability said Venkataramanan\textsuperscript{26}. He pointed out, that the Reserve Bank of India though not formally independent, has enjoyed a high degree of operational autonomy. Besides, the recent development is the
agreement of the RBI and the Government to eliminate the automatic and subsidised government access to Central Bank financing.

With regard to autonomy of Reserve Bank of India, I.G. Patel has stated that the new supervisory board of the bank should not be a department of the bank with staff drawn mainly from bank itself. It should have representation of outsiders including those from Commercial banks and other financial institutions. The supervisory body should have a separate board on which the SEBI as well as Deposit Insurance Corporation (DIC) and other interested organisations should be represented.

Manuel Guitián has emphasised down that freeing monetary policy making from political influence would enable the attainment of price stability at little, if any, real economic cost. He also said that, there is remarkable consensus world over that central banks should be given independence in laying down the monetary policy.

High degree of consensus is developing on the funding of the government by the central bank which is an aspect of independence of the Central Bank. In countries such as Germany, Switzerland and Netherlands legislative limits have been set on direct central bank credit to government. In India also, the System of automatic monetisation of deficit is getting phased out.

An autonomous Central Bank is in a distinctly better position to take monetary policy actions. Autonomy in any case is not unrestrained. In a
democratic set up it can always be the subject to policy directives either from the government or the legislature. For the RBI to become really autonomous, a rethinking on the role of the state in the economy, on globalisation, and a significant change in the attitude of the staff are prerequisites as indicated in RBI, Annual Report.

COMMITTEE REPORTS

C. Rangarajan, stated that the growing and persistent inefficiencies of the public sector banks has forced the Government of India to set up Narasimham Committee to examine all aspects of Indian Banking System. The recommendations of the Committee constitute a landmark in the evaluation of banking policy in the country. According to him the main thrust was transforming Indian Banking Sector from highly regulated to a more market oriented system in a phased manner.

Any structural adjustment process needs proper leadership to steer it through a period of transition and banks must be headed by executives with proven integrity and ability, pointed out A. Ghosh. The constitution of appropriate boards with persons of eminence, knowledge and repute, besides being professionalised, have been suggested by him.

D. Thinakaran on examining the Narasimham Committee report has opined that the proposed de-regulation of financial sector and the measures aimed at improving its health and competitive vitality would enable the
institutions to create clear links with global financial markets and enhance India’s ability to competitive advantage of increasing international opportunities for India, trade, industry and finance.

The Financial Sector was at the most important stage of reform process when the committee was set up. Narasimham explained that the approach of the Committee was based on three broad inter related issues like spirit of competitive efficiency which should cover financial sector. The financial system itself should be healthy and profitable for performing the task effectively and efficiently and it should have a measure of operational flexibility and autonomy in decision making.

According to Y.V. Reddy, the Narasimham Committee devoted most attention to legal issues. Significant progress has been made to reforms, liberalise and modernise the structure but still the system and reform processes are rigid. He opined that integration is essential to improve transmission mechanism and if this integration is not rendered possible, monetary policy will have to continue to depend on direct controls like reserve requirements for policy effectiveness.

Narasimham points out that, "while acceptance of some of the major recommendations is welcome they still do not add to the total picture and would not yield the full results of all major recommendations. This clearly is a case where the whole is greater than the sum of its parts".
Majumdar said that, drowned as the Reserve Bank of India is in the Sea of the ritual of banking reforms, its report fails to identify, let alone tackle, the core issue of Public Sector banks. He hoped that this distortion would be corrected soon.

LIBERALISATION

As the competition and markets is highly dominated at the current phase of Economic Liberalisation, a number of banks are slowly showing awareness about the areas to be covered and are formulating strategies to meet the emerging challenges observed the authors. After nationalisation the Indian Banking System underwent - a radical change and structural transformation in both qualitative and quantitative terms. Indian banks need to be very cautious in the years to come especially for market opportunities due to competition in the banking sector. Future is full of challenges and Reforms should convert the challenge of change into an exciting opportunity.

According to Arjun Sengupta the Indian financial markets due to its characteristics will go to the situation of upward pressure in interest rate. If strong fiscal discipline is not imposed but with deregulated interest rates there will be adverse risk selection and moral hazards with the procedures. The greatest threat comes from half-baked and conceived designs of liberalisation.

According to Cris Prystay, Liberalisation of the ‘Philippines’ banking sector has led to a massive increase in competition and the battle for new
markets is forcing local banks to upgrade both their image and services. He has also identified greater access to a growing number of financial institutions and branches combined with better services.

I.G. Patel stated "the present credit markets are notoriously imperfect and where big banks and financial institutions are not inclined to help simple rural folks nor to take the time and trouble to discover and nurture real investment opportunities among small and weak borrowers, the need for private local banks or institution become necessary. According to him, the new economic policy is opening before the banks new opportunities to identify various new products and services using modern technology and communication in a global scene. Indian banking also promises a future for those who are willing to accept challenges and prepare appropriately but in a fast pace.

CUSTOMER SERVICE

According to Ken Blanchard, superior service is the key to achieving a competitive advantage and creating customers who are so devoted to an organisation is a business strategy. Commitment to service, all out recovery strategy, continuous improvement, listening, changing role of management, definition of playing field, autonomy, cost control measures accountability, desire to improve are the ten fundamental areas according to him which the bank should explore to enhance customer service.
Bank marketing professional need to keep his eyes open and construct a mix of cost-effective products at a faster pace, which is accessible, easy to use for customers as stated by William M. Randle\(^42\). The non bank companies have understood even before customers did, that fast, accessible, cost-effective service would become highly valued in the fast-pace with information loaded culture according to him.

Bub Curley\(^43\) has stated that round the Clock Telephone Banking based on Interactive Voice Response (IVR) System should become an integral part of strategic planning to focus on superior customer service to face competitive local market. On his recommendation, many inquiries were handled without the need for human intervention and those that require the expertise of customer service representative were referred automatically to the centralised customer - service department. He said that telephone banking has a positive impact on customer satisfaction.

The move toward digital storage of vital documents like tax returns, birth certificates, mortgages, bank statements, wills and loan information should keep gaining momentum as opined by Jennifer L. Balifko\(^44\). According to her banks should find opportunity to add value to its product lines, compete with bigger financial institutions, and lure new customers. The system should also allow customers to copy documents on to CD Rom disks, he stated.

About documentation services, Al Burtin\(^45\) said to generate new customers, the banks also should provide the service of consolidating
documents and he added that this service would focus on banks relationship with the customers.

According to Grace Weinstein⁴⁶, private banking is attracting customers with more money. Banks try to expand profitability, by dividing customers into Multimillioners with personal service and customised products and ordinary retail customers to receive little service and off the rack products.

Lian Tanja⁴⁷ has suggested that rewarding selling experience of the bankers would be the resultant of effective communication from the banker to the customer. He felt that the banker should enumerate the varied financial benefits the customers can desire, while they are in need of financial advice, which in turn, increases the sales of the respective banks.

Banks will have to continuously track customer satisfaction level and respond quickly to the fast changing customer needs as stated by Kalyan Swarup⁴⁸. Information Technology will play a crucial role in monitoring customer service at branches and aid the management to respond with focussed strategies for improvement.

The responsiveness of the customers to ten different dimensions has been studied by Javid Akhtar⁴⁹. He opines that customer satisfaction is the key to business success and who else is the best judge of what satisfies the customer than the customer himself. Banks are advised to take care of every
specific needs of customers and give them due recognition, to make an impressionable difference in the banking operations.

The highly regulated and directed banking system of India is being radically changed into one characterised by openness, competition, prudential and supervisory discipline. In the Report on Trend and Progress of Banking in India, RBI clearly stated that "Commercial banks thus need to become conscious that they are entering a challenging environment and will have to redefine their position with the financial industry. New ways and methods will have to be determined in order to successfully respond to the new challenges, particularly, the growing demands from customers for high quality service".74

The gaps in the reviews of different studies on various issues of banking sector reforms provides enough scope for the present research study. In the next chapter an attempt is made to study the development of banking in India, Nationalisation, Changing role of Commercial Banks, Social Banking, Reforms in the Banking Sector and Committee Reports.
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