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 Stainer¹, 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. Bhole². 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 Taci³ 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 Pandey 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. Phillips 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. Rangarajan. 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 Gellix, 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\(^9\). 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\(^10\) 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\(^11\), 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\(^12\), 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\textsuperscript{19} 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\textsuperscript{20}. 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 an international banking outfit.

The commercial banks in India are far behind in the area of mechanisation observed Dr. Hem Chandralal Das\textsuperscript{21}. 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 important 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 over time.

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, 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 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. 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\textsuperscript{27} 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 Guitian\textsuperscript{29} 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 professionals need to keep their 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. The non-bank companies have understood even before customers did, that fast, accessible, cost-effective service would become highly valued in the fast-paced information-loaded culture according to him.

Bub Curley 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. 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 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 Weinstein, 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 Tanja 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 Swarup. 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 Akhtar. 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".\(^{(a)}\)

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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Reforms in the Banking Sector
CHAPTER - III

REFORMS IN THE BANKING SECTOR

3.1 DEVELOPMENT OF BANKING

Banks constitute an important segment of the financial infrastructure of any country. Commercial banking in India began in 1770 with the establishment of the first joint stock bank, named the Bank of Hindustan, by an English agency in Kolkata and this bank failed to function from 1832. The real beginning of the modern commercial banking in the country began with the establishment of the Bank of Bengal in 1806. Following this the Bank of Bombay and Bank of Madras were also set up in 1840 and 1843. These banks were called the presidency banks, and were partly financed by East India company. They were given the right of note issue in their own regions.¹

In 1881, the first purely Indian bank, i.e., Oudh Commercial bank came into existence followed by the Punjab National bank in 1894 and the peoples bank in 1901. The emergence of commercial banks in India was during 1905 by the Swadeshi movement. It was followed by bank crisis during 1913 and in 1948. The pre-independence history of Indian commercial banking had a very slow pace of growth. It had a long period of slow growth intervened by short periods of rapid growth, but followed by great banking crisis.²
Development banking in India had an important role in terms of the promotional or innovative functions in their operations. Development banks in India since 1969-70 had been playing a positive role towards industrial development. The essential elements of development banking included:

1) Development of backward regions.
2) Encouragement of a class of small entrepreneurs and enterprises and
3) Rehabilitation of sick units.

3.2 STRUCTURE OF INDIAN COMMERCIAL BANKS

The most important source of institutional credit in India had been the Commercial banks. The figure shows a detailed structure of Commercial banks in India.³

Types of Banks

- Indian Banks
- Foreign Banks
- Private Sector Banks
- Public Sector Banks
- Nationalised banks (Including SBI and its 7 Associates)
- RRB’s
The two essential functions which make a financial institution a bank are: Acceptance of Chequable deposits from the public and Lending. Acceptance of Chequable deposits is the most distinctive function and they have the following features:

- These are deposits of money and not financial assets.
- Deposits are accepted from public at large
- Deposits are repayable on demand and withdrawal by cheque.

The second essential function relates to the use of deposits. Lending includes direct lending to borrowers and indirect lending through investment in open market securities.

**TYPES OF BANKS**

1. **Indian Banks:**

   The bulk of the banking business in India is done by the commercial banks owned and operated from India. Some Indian banks also operate in a few foreign countries. The Indian banks constitute both public and private sector banks.

   a) **Public Sector Banks**

      They constitute the dominant part of Commercial banking in India. The public sector banks constitute both nationalized commercial banks and regional rural banks. The public sector banks may also have some private by-owned shares.
b) Nationalized Banks

Nationalization began in 1955, when the imperial bank of India was converted into State Bank of India. In addition to this, it has seven other state banks as its subsidiaries. Twenty eight banks were nationalized by April 1980, and they control more than 90% of bank deposits.

c) Regional Rural Banks

Regional Rural banks are the new form of banks that have been set up in the country on the sponsorship of individual Nationalized Commercial Banks. They were set up with the objective of developing the rural economy by providing credit and other facilities for agriculture and other productive activities in rural areas.

2. Foreign Banks

Foreign banks were incorporated and have their head offices outside India. They occupy a place of importance in the Indian banking industry, especially in financing foreign trade and in the field of merchant banking.

3. Co-operative Banks

Co-operative Banks have been organized under the provisions of the cooperative societies law of the state. The major beneficiary of this bank are the agricultural sector in particular and the rural sector in general.
Dramatic changes have occurred in the banking sector in India after the enactment of the Banking Regulation Act of 1949. A major developmental objective of the country was the building up of a financial infrastructure geographically wide and functionally diverse to help in the process of resource mobilisation and to meet the expanding and emerging needs of a developing economy.4

3.3 CHANGING ROLE OF COMMERCIAL BANKS

The development of the Banking system in India, since independence particularly after the bank nationalization in 1969, was with numerous diversification's and innovations introduced in the functioning of banks with a view to expand and improve their performance with the changing needs of the economy. The change in role of banks started with Nationalisation, Socialisation, followed by various reform measures and the monetary policy of RBI.

NATIONALIZATION OF BANKS

The progressive nationalization of banks had increased the role of public sector banking in the country. The government of India through an ordinance nationalized 14 major commercial banks in the country on July 19th 1969, with deposits exceeding Rs 50 crores each. The State bank of India and its subsidiaries also had been nationalized. Thus about 90% of the country's commercial banking system is now in the public sector.
The main objectives of Nationalization were:

1. Removal of control by few

2. Provision of adequate credit for agriculture, small industries and exports.

3. Giving a professional bent to bank management.

4. Encouragement to new class of entrepreneur's.

5. Provision of adequate training as well as reasonable terms of services for bank staff.

6. To redress the imbalance as between the comparatively developed and less advanced states on the one hand and between backward regions and the rest of the state on the other hand.

7. To prevent the diversion of bank finance to anti social less productive or low priority ventures.

Two decades since nationalisation had seen progress with respect to its objectives. The profile of the Indian Banking System underwent a radical change, to subserve national priorities and larger social objectives. There was a structural transformation in both qualitative and quantitative terms. Moreover, the 1980's proved to be more of a period of consolidation for the banking industry for strengthening the internal control and operational efficiency and induction of technology in a phased manner. This was followed by the social orientation programmes adopted by the RBI.
SOCIAL BANKING

After nationalization, the commercial banks in India, adopted a new policy orientation to meet the socio-economic obligations of the country. The important aspects of this social orientation included:

1. Alignment of credit policy with the overall objectives of the government.

2. Allocation of credit in accordance with the requirements of the planned economic development of the country,

3. Reduction of regional disparities in the spread of banking to achieve the balanced development of the country.

4. A lead role in the development of credit at the district level.

5. Greater financial assistance to the priority sectors of the economy and weaker sections of the society on easy and convenient terms.

By implementing the policies relating to de-regulation and liberalisation, the country could achieve higher rate of economic growth. Inspite of repeated restructuring and revitalising the Indian banking from time to time, the system is criticised for its inefficiency and ineffectiveness. Productivity, profitability, quality of credit appraisal and supervision, management practices, systems and customer services of banks showed a low profile and it was identified that nationalisation gains could not obtained without substantial cost to the economy. This realisation laid down the ground for the process of deregulation and liberalisation of the financial system.
Liberalisation of the Indian economy, brought a profound change in the socio-economic scenario. One of the main agenda of the liberalised economic policy undertaken by the Government was the Banking Sector Reforms.  

3.4 THE PRE-REFORM PHASE

The banking system prior to 1991-92 was dominated by public sector banks, whose operations were dictated by the norms of nationalisation and were totally socialistic. The emphasis then was on priority sector lending, branch proliferation, indifferent accounting policies, low focus on loan recoveries. The public sector banks were informally in debt and covered by accounting policies or rather losses. Banks were not performing better and banks did not receive interest in time. It was identified that importance was laid on "quantity" and "distribution of funds" rather than on "quality". This created an environment for change in the banking sector.

THE NEED FOR REFORMS

Financial reforms are looked at in the context of overall economic reforms. Economic reforms were built to a western model of development having liberalisation and competition as the key role players. This was reinforced by the spread of globalisation as capital inflow from the developed countries dominate the world of finance and were directed by the countries which were outward looking. In order to get the benefits it was essential to have the financial system in order. The prevalent chaotic state of the banking system provided justification for financial reforms.
3.5 REFORMS IN THE BANKING SECTOR

A well functioning and efficient financial system is important for promoting rapid industrial development in a market economy. By providing relatively liquid assets with reasonable returns on savings, it encourages people to save and keep their savings in the form of financial assets through the intermediation of the financial system, these savings are routed to firms for undertaking investments. The financial system pools savings and distributes risks of investments across a large number of people, thereby making possible large investments projects that may not have been otherwise undertaken. Thus the more efficient the financial system of an economy, the higher would be the investment rate, and hence the output and employment growth rates of the economy. In a developing country like India, the banking sector is the most important part of the financial system. It has remained highly regulated since banks were nationalized. 7

The banking sector reform began in our country with the conception of first plan but took more rapid stride after the nationalization of 14 major banks in 1969. By the end of the eighties, the Indian banking sector had registered tremendous growth in volume and variety. This included stock market, mutual funds, NBFCs and other institution.

The important financial institutions were all state owned and were subject to central direction and central bank enjoyed little autonomy as both lending and deposit rates were controlled until the end of eighties. Although the nationalization of banks improved banking to the rural and uncovered area
by 1991, the country's financial system was saddled with an inefficient and financially unsound banking sector. The financial sector reform even though was said to have been initiated in the mid eighties, it was only in 1991 that the reforms actually began.\(^8\)

The term financial sector reform is a process of removal or reduction of financial market distortions which are mainly created by Government or Central bank's intervention in the setting of interest rates and allocation of credit. The financial sector reform formed part of the core strategy of the government to bring about efficiency in the system and make banks internally viable and internationally competitive. The thrust was on improving productivity, profitability, efficiency and financial health of the banking system.

There are four building blocks which have formed part of the banking sector reforms.\(^9\)

- a) Modifying the policy frame work.
- b) Improving the financial soundness and credibility of banks.
- c) Creating a competitive environment and
- d) Strengthening of the institutional frame work.

a) **Policy Frame Work**

The improvements in the policy frame work were aimed at removing and reducing the external constraints bearing on the profitability and functioning of commercial banks. Reforms made an attempt to bring down very
substantially, the pre-emption's in the form of reserve requirements and to give greater freedom to banks in the determination of interest rates. The reductions in the reserve requirements have been very substantial. This effected both expanding the laudable resources of banks as well as improved the profitability.

b) Improvement In Financial Health

The introduction of prudential norms and regulations aimed at ensuring the safety and soundness of the banking system, imparting greater transparency and accountability in operations and restoring the credibility of and confidence in the Indian banking system was a major element of the banking sector reforms.

Prudential norms introduced by the reforms serve two primary purposes. First, they bring out the true position of a bank's loan portfolio and secondly, they help to arrest deterioration. In the absence of an effective prudential frame work, the reform process can run into difficulties. Introduction of prudential regulations as part of the reform process was considered necessary. Prudential reform introduced in India related to income recognition, asset classification, provisioning for bad and doubtful debts and capital adequacy.

c) Creating a competitive environment

The two major steps taken with regard to creating a competitive environment included -
a) Allowing the nationalized banks access to capital markets and thereby reduce share of the government in the total equity.

b) New banks in the private sector were allowed to be set up in the current provisions of the Banking Regulation Act.

c) Institutional Strengthening

Relaxing of the external constraints and introducing the prudential norms, helped to strengthen the banking system in general and public sector banks in particular through appropriate institution building measures like recapitalisation, improving the quality of loan portfolio, instilling a greater element of competition and strengthening the supervisory process.

The financial sector plays a major role in the mobilization and allocation of savings in the economy. Financial institutions, instruments and markets which constitute the financial sector act as a conduit for the transfer of financial resources from net savers to net borrowers i.e. from those who spend less than they earn to those who earn less than they spend. The financial sector performs this basic economic function of intermediation essentially through four transformation mechanisms.10

1) Liability asset transformation (i.e. accepting deposits as a liability and converting them into assets such as loans.)

2) Size transformation (i.e. providing large loans on the basis of numerous small deposits)
3) **Maturity transformation** (i.e. offering savers alternate form of deposits according to their liquidity preferences while providing borrowers with loans of desired maturities) and

4) **Risk transformation** (i.e. distributing risks through diversification which substantially reduces risks for savers which would prevail while lending directly in the absence of financial intermediation)

**Strengths and weakness of the Banking Sector**

**Strengths**

Over the last four decades, the strong points of banking sector include

1) The banking sector has demonstrated its ability for mobilizing financial savings.

2) Meeting the deficit sector needs

3) It's vast geographical and functional reach and institutional diversity

4) The share of the loans to agriculture, small industry and small business in total bank credit has increased remarkably. Banking is within the reach of vast majority of Indian population.

5) The entrepreneurial base of the country has been widened by the banking system
6) The new areas of service are gaining wider acceptability like credit cards, merchant banking, lease, financial services, mutual funds, venture capital funds, financial advisory services, rating agencies housing finance, factoring etc. have come into existence.

7) Because of increasing monetisation in rural and semi urban areas, their share in the growth of deposits is going more.

Indian banking industry caters much more than their global counterparts to service which do not fall necessarily in the banking core areas. To narrate a few, payment of taxes, payment of electricity and telephone bills, payment of pensions, payment of tuition fees/examination and college fees etc., at marginal or no cost. Banks creditable record in branch expansion, encouragement of saving and service to the weak and the neglected has its own merit.

Weaknesses

As for as banking sector is concerned, the weaknesses of the system have been extensively analyzed by the committee on financial sector reforms and have also been revealed subsequently in the securities scam. It is clear that banking system has been over regulated and under-governed. The major deficiencies of the banking sector are

1) Banking sectors low profitability and consequent inability of several banks to provide adequately for loan losses and to build their capital.
2) There are besides organizational inadequacies with in banks due, interalia, to their rapid expansion (a) weakening of management and control functions (b) Excessive staff, (c) growth of restrictive practices and some erosion in work culture, (d) flaws in credit management, and (e) the lag in introducing computer technology to handle the massive growth of banking transactions. However the position varied considerably from institution to institution and many banks are financially sound.

3) A major strain on the financial performance of banks emanated from official policy. The automatic monetisation of the central governments budgetary deficit by the reserve bank creates excessive liquidity to counter which banks are required to place cash deposits with the reserve bank at unremunerative rates of interest through high cash reserve requirements (CRR).

4) The growing borrowing needs of the centre and the states have also been met by directing banks, through an increasing statutory liquidity ratio (SLR) to invest in government and government guaranteed securities carrying below market coupon rates.

5) Banks were also directed to provide 40% of their lendable resources at concessional rates of interest to the priority sectors, namely, agriculture, small and tiny industries, small businesses and weaker sections of the society.

6) Priority sector credit suffered from a measure of politization which damaged the quality of lending as well as the culture of repaying bank loans.
7) As official policy discouraged closure of large and medium sick industrial units which banks continued financing including many non viable units under repetitive rehabilitation programs.

8) The recovery of dues through courts had become a very difficult task for banks. Litigation was found time consuming and frequently court decrees obtained after years of efforts were not effectively executed due to erosion in the value of collateral.

9) Apart from damaging profitability of banks, excessive pre-emption of their resources at low interest rates led to several distortions in the economy. Availability of credit to productive sector got reduced and has affected investment and production.

10) To compensate bank for the strain associated with directed investments and loans, bank deposit rates were depressed and interest on larger loans to industries were also affected.

11) Credit management within banks had weakened due to deficient credit appraisals and supervision. It was the result of an environment in which some bankers did not resist external pressures for loans to influential parties.

12) Adequacy of capital and even profitability of banks were not emphasized. There was a tendency on the part of weaker banks to make optimistic assumptions regarding approval of interest income and under provide for loan losses in order to show better than actual profits.
3.6 COMMITTEE REPORTS

The banking scenario is undergoing radical transformation in the wake of liberalisation and has affected the all round functioning of bank, in the country. It has thrown open a variety of threats, challenges and opportunities for all existing Indian banks as the banks are now required to adhere to international standards in respect of capital adequacy, income recognition, asset classification provisioning, investment management, accounting practices and procedures which are very essential in the emerging environment of competitions and globalisation.¹²

Banking sector reforms are necessary for the faster growth of the economy. The Government has appointed expert committees to examine the inadequacies pertaining to policy of the banking sector and to come out with suitable suggestions. These recommendations/suggestions are implemented in the form of reforms. The various committee reports are:

SUKHAMOY CHAKRAVARTHI COMMITTEE REPORT

This committee was appointed in December 1982 under the chairmanship of Sukhamoy Chakravarthi to undertake a review of the working of monetary system and suggest measures for improving the effectiveness of monetary policy. The committee recommended the following measures:

1) To maintain reasonable coordination between production and credit plan, an aggregate annual monetary budget and for the period covered by the five year plan to be drawn up.
2) **To simplify interest rate structure and to give away with administered interest rates.**

3) **New monetary instruments like treasury bills of various maturity and inter bank participation certificates to be introduced.**

4) **Government to borrow at market rates and interest rates to be deregulated.**

5) **To improve credit delivery system.**

6) **To rationalize priority sector lending with greater stress on recovery.**

7) **To develop secondary money market.**

8) **To reduce SLR / CRR.**

9) **To use open market operations as an instrument of monetary control.**

**Most of the recommendations of the committee are implemented.**

**VAGHUL COMMITTEE**

**To recommend reform measures in money market a committee headed by Sri N.Vaghul was appointed.**

1) **To allow call money rates to be determined by market forces.**

2) **To facilitate a genuine bill culture.**

3) **To introduce commercial paper**

4) **To extend inter-bank transactions in dated securities on a buy back basis.**

5) **To reintroduce inter bank participation certificates.**
GOIPORIA COMMITTEE REPORT

In September 1990, reserve bank of India set up a committee under the chairmanship of Sri. M.N. Goiporia to examine the problem of customer service in banks and improve the situation.

Objectives of the committee were:

1) To examine the reasons for below par customer service in banks.
2) To identify structural and operational rigidities in the system.
3) To pave ways and means to upgrade technology in banks.
4) Deficiencies in bank service to be corrected.
5) Suggest ways to improve work culture among bank employees.

Recommendations of the committee are as follows:

1) Banking hours for all transactions except cash to be extended.
2) Modernization of banks
3) Extension of tellers duties
4) Enhancement of interest rate on savings account.
5) Introduction of tax benefits against bank deposits.
6) Change in the commencement of working hours for bank staff to facilitate timely opening of bank counters.
7) Immediate credit of outstation cheques upto Rs.5000 as against Rs.2500 at present.
8) Enhancement of interest rate on savings account.
9) Introduction of tax benefits against bank deposits.
10) Full use of discretionary powers vested in the bank staff at all levels.
11) **Expeditious despatch of documents lodged for collection and regular follow up with foreign bank to facilitate timely realization of export proceeds in the case of export finance.**

12) **Opening of specialization branches.**

**NARASIMHAM COMMITTEE REPORT**

India had witnessed a phenomenal expansion in the geographical coverage and functional spread of the banking and financial system since bank nationalization in 1969. Despite impressive quantitative achievements in resource mobilization and in extending the credit several distortions had, over the years, crept into the banking and financial system. As a result, productivity and efficiency of the system had suffered.

Quality had badly deteriorated and profitability had eroded. Several public sector banks and financial institutions had become weak financially and some public sector banks had been incurring losses year after year. Their customer service was poor, their work technology outdated and they were unable to meet the challenges of a competitive environment. It was under these circumstances that the government of India set up a High Level Committee with Mr. M. Narasimham, a former Governor of the Reserve Bank of India as Chairman to examine all aspects relating to the structure, organisation, functions and procedures of the financial system. This committee on the Financial System submitted its report in November 1991 and many of its recommendations proved controversial.
Approach of the Committee

The Narasimham committee (1991) was primarily interested in improving the financial health of public sector banks and development of financial institutions so as to make them viable and efficient and meet fully the emerging needs of the real economy.

1) The spirit of efficiency, which is sought to be brought about in the real sectors of the economy, should also cover financial sector.

2) It should perform the task effectively in an environment of competitive efficiency, the financial system should be healthy and profitable.

3) Financial sector to operate on an efficient basis it would need to have operational flexibility, autonomy in decision making and professionalism in credit and investment decision.

Recommendations: The main recommendations of the committee are:

1) Establishment of four tier hierarchy for the banking structure.

2) Abolition of branch licensing policy

3) Setting up of assets reconstruction fund to take over all doubtful debts.

4) SLR to be reduced to 25% of the total deposits over a period and likewise, CRR to be reduced to 3 to 5% of the total deposits of the banks; this would leave more funds with the banks for profitable deployment as per the recommendation.
5) Higher interest rates to be offered to the banks by the government and semi-government securities coming under SLR arrangements;

6) Banks to get more freedom to fix minimum lending rates of interest;

7) Priority sector lending to be reduced to 10% instead of the 40% of the total bank credit;

8) All concessional rates of interest.

9) Banks to go for new sources of funds like certificates of deposits.

10) Treasury bills with higher rates of interest to be introduced.

11) Commercial principles to be followed for branch expansion and banks be permitted to swap branches among themselves.

Narasimham Committee on Banking Sector Reforms (1998)

The Finance Ministry of the Government of India appointed Mr. Narasimham as Chairman of the committee on Banking Sector Reforms (1998). The committee was asked to "Review the progress of Banking Sector Reforms to date and chart a program on Financial Sector Reforms necessary to strengthen India's financial system and make it internationally competitive". The Narasimham committee on the Banking Sector Reforms submitted its report to the Government in April 1998. The recommendations of this committee are

Access to capital market has been provided to State Bank of India (SBI) and other nationalised banks for debt equity. Equity and bonds worth Rs.3200 crores was raised by State Bank of India through public issue. State Bank of India Act had been amended to allow 10% voting rights to shareholders. Followed by State Bank of India was the Oriental Bank of Commerce. Other banks too had raised funds from the market.
1) **Need for a strong banking system**

It made out a strong policy for stronger banking system in the country especially with regard to capital account convertibility (CAC) which would involve large inflows and outflows of capital. It also recommended the merger of strong banks which will have a good impact on industry. However, it is likely to have negative impact on the asset quality of the stronger bank.

2) **Narrow Banking**

The committee laid down certain aspects for rehabilitation of weak public sector banks with high non-paying assets (NPA's). The narrow banking was found to be non applicable to rehabilitate weak banks, the issue of closure was also examined, according to the committee.

3) **Small Local Banks**

The committee suggested the setting up of small, local banks which would be confined to states or cluster of districts in order to serve local trade, small industry and agriculture. At the same time, these banks should have strong corresponding relationship with the larger national and international banks.

4) **Capital Adequacy Ratio**

The Narasimham Committee (1998) also suggested that the government should consider raising the prescribed capital adequacy ratio to improve the
inherent strength of banks and to improve their risk absorption capacity. The committee suggested higher capital adequacy requirements for banks and the setting up of an asset reconstruction fund (ARF) to take over the bad debt of the banks.

5) Public Ownership and Real Autonomy

Narasimham Committee (1998) had argued that government ownership and management of banks does not enhance autonomy and flexibility in the working of public sector banks. In this connection, the committee recommended a review of the functions so that they (the bank boards) remain responsible for enhancing shareholder value through formulation of corporate strategy.

The Narasimham committee (1998) considered the issue of 'autonomous status' for the board for financial supervision of RBI and the need to segregate regulatory and supervisory functions of RBI. The committee expressed the need for RBI to maintain an arms length from those being regulated and hints at the need for withdrawing RBI nominee from bank boards. The committee stated: "Regulation should be concerned with laying down procedural and disclosure norms and sound procedures and ensure adherence to these and not get into the day-to-day management of banks".

6) Review and update Banking laws

The Narasimham committee (1998) suggested the urgent need to review and amend the provisions of RBI Act, Banking Regulation Act, State Bank of
India Act, Bank Nationalization Act, etc. so as to bring them in line with the current needs of the banking industry.

Other recommendations related to the need for computerization process in public sector banks, professionalising and depoliticising bank boards, review of recruitment procedures, training and remuneration policies etc.


Many Committees, saw no purpose in setting up the second Narasimham Committee on Banking Sector Reforms even before the decade had elapsed for the full implementation of the First Committee Report (submitted in 1991). Comparison of some of the major recommendations of the 1991 and 1998 reports of the committees presided over by Mr. Narasimham were

<table>
<thead>
<tr>
<th>1998 Recommendations</th>
<th>1991 Recommendations</th>
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</thead>
<tbody>
<tr>
<td>More Strong Banks</td>
<td>Merge Banks to reduce numbers</td>
</tr>
<tr>
<td>Free Bank boards from Government interference</td>
<td>Free Bank Boards from Government interference</td>
</tr>
<tr>
<td>Move to Three tier</td>
<td>Move to Three tier</td>
</tr>
<tr>
<td>Structure</td>
<td>Structure</td>
</tr>
<tr>
<td>Review Capital Adequacy Norms</td>
<td>Fix capital adequacy at 8%</td>
</tr>
<tr>
<td>Consider whether autonomy is consistent with public ownership</td>
<td>Ensure autonomy of banks wind-up banking division of the finance ministry.</td>
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</table>

Despite stiff opposition from bank unions and political parties in the country, the Government of India accepted all the major recommendations of Narasimham committee and started implementing them straight-away. The following measures had been taken between 1991-92 - 2000-2001 as part of banking reforms:

1) **Statutory Liquidity Ratio (SLR)** on incremental demand and time liabilities (DTL) had been reduced from 38.5% to 25% and SLR on outstanding net domestic demand and time liabilities were reduced gradually from 38.5% to 27% in March 1997 and 25% in October 1997; this was the minimum stipulated under section 24 of Banking Regulation Act, 1949.

2) **Cash Reserve Ratio (CRR)** It was the intention of RBI to bring down the cash reserve ratio (CRR) from the statutory 15%; and it was brought down to 14% in May 1993. At the same time, the incremental cash reserve ratio (ICRR) of 10% was abolished.

When conditions eased and money growth started slowing down during 1995-96 and 1996-97, RBI reduced CRR gradually from 15% to 10% by March 1997 and 7.55 in May 2001. The purpose of reducing CRR was to release funds locked up with RBI for lending to the industrial and other sectors which were starved of bank credit.
3) **Interest rate** slabs were gradually reduced. Deregulation of interest rates was introduced to stimulate healthy competition among the banks and thus improve efficiency. Banks now have been given the freedom to set **interest rates** on their deposits subject to minimum and maximum **ceiling rates**.

The important changes in interest rates were:

a) Interest rate on domestic term deposits above two years and on **non-resident non repatriable (NRNR)** rupee deposits had been **decontrolled**.

b) **The prime lending rate** of SBI and most other banks on general advances of over Rs.2 lakhs had come down.

c) **Interest rate** on bank loans above Rs.2 lakhs fully decontrolled.

d) **The interest rates** on deposits and advances of all co-operative **banks** (except urban co-operative banks) had been deregulated. Deregulation of interest rates on the high slab of bank advances **was to stimulate** healthy competition among banks and encourage their operational efficiency.

4) **Prudential Norms:** RBI as part of the reformative process had started with **Prudential norms.** The purpose of prudential system of recognition of **income**, **classification** of assets and provisioning of bad debts was to ensure that the books of the commercial banks reflect their financial
position more accurately and in accordance with accepted accounting practices. It would improve supervision of banks. Prudential norms required banks to make 100% provision for all non-performing assets (NPA's).

Because of the new norms, scheduled commercial banks were to make large provisions amounting to Rs.10,000 crores for bad and doubtful advances in their portfolios. Banks expected the losses to erode the inadequate capital of banks and to compensate this the viability and financial health of the banking system was promoted by Government of India through:

a) **Budgetary** support of Rs.14,990/- crores by the Union Government till 1994-95 for the purpose of recapitalisation of ten strong public sector banks, the banks will simultaneously try to strengthen bank management and improve efficiency.

b) **Amendment** of the Banking companies (Acquisition and transfer of undertaking Act 1970/1980) authorising SBI and other nationalised banks to approach the capital market to raise fresh equity to meet short falls in this capital requirements. Public sector banks were under the effective control of the Government of India.

5) **Capital Adequacy Norms:** were fixed at 8% by RBI in April 1992 and banks had to comply with them over a three-year period. By end of March 1996 all public sector banks had attained capital to risk weighted
assets ratio of 8%. The full norm of 8% was also attained by foreign banks in India and by some Indian banks.

6) **Freedom of Operation**: Scheduled commercial banks were given freedom to open new branches and upgrade extension counters, after obtaining capital adequacy norms and prudential accounting standards. They were also given permission to close non-viable branches other than in rural areas. Lending norms had been liberalized and bank were given freedom to decide levels of holding individual items of inventories and receivable.

7) **New Private Sector Banks**: RBI issued guidelines for setting up new banks. Already ten private sector banks started functioning and the Government also approved three proposals to set up new private sector banks.

8) **Supervision of Commercial Banks**: After the securities scam of 1992, supervision of commercial banks was tightened by RBI. Board of financial supervision with an advisory council under the chairmanship of the Governor to strengthen the supervisory and surveillance system of banks and financial institutions was set up by the RBI.

9) **Recovery of Debts**: The Government of India laid down, "Recovery of Debts due to banks and Financial Institutions Act, 1993", in order to facilitate and speed up the recovery of debts due to banks and financial
institutions. Six special recovery tribunals have been set up at Kolkata, Chennai, New Delhi, Jaipur, Ahmedabad and Bangalore to facilitate quicker recoveries of loan arrears and an appellate tribunal had also been set up in Mumbai.

RANGARAJAN COMMITTEE ON COMPUTERISATION (1985-89)

The Reserve Bank of India set up a committee in the year 1983 under the Chairmanship of Dr. C. Rangarajan, Deputy Governor, RBI to look into the modalities of mechanisation of the banking industry covering the period 1985-89. The Committee submitted its report in the year 1984 and recommended introduction of mechanisation / computerisation at the Branch, Regional / Zonal Office and Head Office levels, with variations at different level.

The committee felt that some degree of mechanisation was essential for bringing about positive changes in the basic functions of banks like customer services, maintenance of various accounts and reconciliation of transactions among branches and generation of required data for control and monitoring purposes. The committee recommended two models for branch mechanisation. The model I of branch mechanisation was based on use of microprocessor based ALPMS (Advanced Ledger posting machines) with limited memory capacity for certain functions like maintenance of primary ledgers, working out products and interests at periodical intervals, preparation of account statements and listing of standing instructions to be executed in the accounts.
The alternate model for branch mechanisation was with the use of single microprocessor based system of large capacity. Under this model, the vouchers are first posted in primary ledgers and then the information is entered in the microprocessor based system to generate supplementaries, day book, general ledger and other returns.¹⁹

At the early stages there were few bottlenecks in the utilisation of technology and the attitude of workmen unions, so the progress was slow, but the recommendations of the committee put the banking industry on the firm path of using modern tools for its operations. The committee’s recommendation helped banks to improve housekeeping at branch level and provide some better services to customers. Employees were also benefitted by better work environment.

SECOND RANGARAJAN COMMITTEE ON COMPUTERISATION (1990-94)

Reserve Bank of India had set up another committee in September 1988 under Chairmanship of Dr.C. Rangarajan, Deputy Governor, RBI with the experiences gained in eighties to draw up a plan of computerisation for the period 1990-94 for Indian Banking.

The basic objective was on overall improvement in customer services, housekeeping, decision-making and productivity / profitability by shifting towards on-line, real time, etc. This was supported by the technological
development with powerful computer systems at affordable costs. The report of this committee set up the pace of competition among banks to use technology. The committee recommended:

1. Adopting Single window concept for branch computerisation.

2. Use of networks for several intra-bank-and interbank applications like transfer of funds, credit cards authentication, economic deployment of bank's funds, statistics, foreign exchange business, inter bank funds transfers and settlements, exchange of credit reports, access to swift etc.

3. Information technology to design new services for customers like ATMs, credit cards, networks etc.

4. Use of office automation equipment like word processors, microfilming equipment etc. to improve office efficiency.

5. The committee observed the need for development of indigenous technology sufficiently advanced to make available cost effective hardware and software solutions for bilingualisation.

6. The need for large workforce of computer trained personnel as a result of rapid computerisation was observed by the committee. It recommended various training plans for deriving maximum benefits.
SARAF COMMITTEE ON TECHNOLOGY ISSUES - 1994

In June 1994, Reserve Bank of India appointed a committee under the chairmanship of Sh.W.S. Saraf, Executive Director, Reserve Bank of India for dealing in technology issues relating to Payment System, Cheque clearing and securities settlement in Banking Industry. The committee critically examined the existing procedures and practices relating to transfer of funds, payment system and settlement procedures and cheque clearing and related work flow.21

The recommendations of the committee include:

1. Setting up of EFT (Electronic Funds Transfer System) and use of Banknet as a carrier of messages. It also suggested necessary steps to enact suitable legislation on the lines of Electronic Fund Transfer Act 1978 in the USA and Data Protection Act 1984 in the UK.

2. Reporting of SGL transactions in Government securities. It suggested setting up of Delivery Vs Payment (DVP) and a screen based reporting of SGL (Subsidiary General Ledger). Transfer forms to be changed to Electronic screens.

3. Making use of computers and communication for electronic reporting of currency chest transactions.

4. MICR clearing at Metropolitan Centres - was introduced in 1987-89. The committee recommended for decentralisation of cheque clearing work,
introduction of a standard size for all MICR instruments, extension of MICR to additional centres etc.

5. **Bank net** is the common data communication network set up by the RBI for facilitating the transfer of interbank messages. The committee examined the reasons for under-utilization of Banknet and recommended several measures for increasing its use and making it effective. Use of RBI-NET for data communications was also recommended.

6. The committee also recommended the use of (1) Swift (Society for Worldwide Interbank Financial Transaction) for overseas transactions. (2) Society of card users to promote card culture in India and to establish proper procedures for prevention of frauds, monitoring of merchant establishments and making card business more profitable. (3) **Electronic Fund Transfer at Point of Sale (EFTPOS)** and use of smart cards to develop a plastic money / electronic money culture.

**SHERE COMMITTEE (1995)**

Reserve Bank of India constituted a committee for proposing legislation on **Electronic Funds Transfer (EFT)** and other electronic payments in August 1995, with **Smt.K.S. Shere**, Principal Legal Adviser, RBI as the Chairperson. The committee made an in detailed study on the legal framework and analysed
the issues on the status of technology and legal provisions in India. The committee made various recommendations which include:

1. A model customer contract which will govern the bank-customer relationship in regard to EFT.

2. A single national level intrabank and interbank funds transfer system to be introduced through regulations be made by central Board of Reserve Bank.

3. A judicial combination of regulatory and contractual models at this stage of development of technology in India and a counting wide EFT system for interbank and intrabank credit transfers.

RECOMMENDATIONS OF THE CHORE COMMITTEE

The Reserve Bank of India constituted a committee in April 1979, under the Chairmanship of Shri K.B. Chore, to review the operation of the cash credit system of lending.

The major recommendations of Chore Committee are:

1. The committee recommended the abolition of the bifurcation of cash credit limits into core and variable portions. This was based on the difficulties experienced in bifurcating the core as this core concept is not applicable to seasonal industries.
2. It recommended the method of lending which requires borrowers to provide 25% of their current assets from their owned funds and the long term borrowing compulsorily for sick industrial units.

3. Separate limits for peak level requirements and non-peak level requirements. Peak level requirements to be met for short periods, and not throughout the year.

4. Borrowers who require any temporary accommodation in excess of the sanctioned limits to be sanctioned only after proper scrutiny and for a pre-determined period of short duration and at a higher rate of interest.

5. Banks to extend at least 50% of the cash credit limit against raw materials by way of bills so as to reduce the dependence by the borrowers on the cash credit system of lending.

RECOMMENDATIONS OF THE TANDON COMMITTEE

The Reserve Bank of India constituted in July 1974 a study group known as Tandon committee for framing guidelines for commercial banks for follow-up and supervision of bank credit for ensuring proper end use of funds.

The study Group suggested a comprehensive information system consisting of quarterly operating and fund flow statements to be submitted by borrowers to banks for follow-up and supervision of credit and ensuring proper
end-use of the funds lent. Banks had to verify whether the assumptions on which the lending decisions was taken continued to hold good both in regard to the borrower's operations and environment. To also verify from the periodical data whether the actual operational results conformed to the expectations.24

Various other committees were established some of which are:25

1. A committee on urban co-operative Banks under the Chairmanship of then Executive Director, Shri.K. Madhava Das to evaluate the role of primary cooperative banks in the Banking system and to indicate the line of their future growth in September 1977.

2. On 9th December, 1991, a committee under the chairmanship of Shri.P.R. Naik, Deputy Governor was appointed to examine the difficulties confronting small scale industries in the country in the matter of securing finance. The committee was required to examine the adequacy of institutional credit for the SSI and institutional credit for the SSI and institutional credit for term finance to the SSI sector etc.

3. KHUSRO COMMITTEE REPORT on review of the Agricultural credit system in India. The Reserve Bank of India, in consultation with the Government of India and the World Bank constituted a committee to review agricultural credit system of India in 1986. The review of the committee was divided into:
a) Agricultural credit in General.

b) Role and effectiveness of lending institutions.

c) Role and functions of the Apex level in agricultural credit.

d) Lending costs and Margins and

e) Organisation and Management of NABARD.

3.7 THE FUTURE FOR REFORMS

Banking infrastructure in our country needs urgent modifications to meet market requirements, legal system, enforcement system and also overhauling in case of disputes. Reforms require a new dispensation, one which rewards and punishes. Banks have to face certain challenges due to reforms in the future.

1. A base for public sector and private banks was identified to enable banks to compete successfully as public sector banks were built up in a wrapped portfolios while private banks have started from scratch. Having the experiences of public sector banks they must not be burdened with the constraints of priority sector lending etc. At the same time private banks must not be separated from public sector banking network. Reserve Bank of India should work out a strategy to get both the sets of banks on a level position before opening the doors for the competition between public and private sector banks.
2. **Diversification in activities.** Banks were given greater freedom to offer new products with greater depth such as factoring, leasing hire purchase, term lending, investment banking etc. Reserve Bank of India created forward atmosphere for banks with many impediments to compete with other financial entities. This helped banks to make better use of their funds and match their maturities of their assets and liabilities. The need to resolve the issue of cash credit which is considered to be inefficient was noticed. The last two credit policies already changed the composition of banks limit into cash credit-and term loans. This was advanced further.

3. **Investments** in corporate shares and debentures was also permitted to banks to make profits in this area. This was a logical end product of financial liberalisation and bank investment was not to be restricted to just government securities.

4. **Banks must be allowed to be more active in the capital market in terms of being able to raise capital.** This will be further increased when banks increase their levels of activity and have to adhere to capital adequacy norms.

5. **Banks have to tap** the rural sector and public sector banks have an advantage over private banks in this respect as they have a wide network of branches in rural areas. Banks should be asked to explore
area like issue culture, aquaculture, floriculture, horticulture etc to broaden their sphere of activity.

6. **Merger of weak banks should be the emphasis of reforms.** This would help in shifting the losses against profits and also cut down on costs as the operations of the merging banks could be optimized. This is possible since banks tend to have regional strength in terms of infrastructure and reduction of activity in the same area could be achieved.

7. **Reforms should work towards bringing about genuine competition among banks through deregulated interest rates.** There is however a tendency for banks to work in union on this issue and instead of competition, deregulation would strengthen the profit lines of banks as all of them follow same structure of interest rates.

8. **Reforms should aim at reducing the ratio of non-performing assets and also improve the capital adequacy ratio.**

9. **Human resources** development in banks need to be taken up at all the levels. The public sector banks must be given autonomy to decide on the recruitment policies as well as compensation packages to get the best human resources. This is very essential as it will help bank to cut cost and increase efficiency.
10. **Reforms** should ultimately aim on the mechanism of implementation as this will decide as to the behaviours of banks in the forth coming years after reforms.

The following are the few new innovations that have taken place in the banking industry in the post reform period.

a. **Automated Teller Machine (ATM)**

The customer can draw from his account, take statement of accounts and cheque books according to his convenience. This banking service is available for all the 24 hours and 365 days.

b. **Asset Vantage System**

The **Hongkong** Bank has introduced Asset Vantage System. The advantage under this system is that the customer will be provided with an exclusive **asset vantage** card that offers recognition in 23 countries world wide, access to ATM in 7 cities in India, enhancing the ATM withdrawal upto Rs.16,000 and 24 hours phone banking facility.

c. **Remote Customer Terminal Services**

**Canara Bank** has introduced this system at Bangalore. The customer can operate his Bank A/c through his computer without visiting the Bank premises ie., the customer requires only a telephone line and computer. The Bank will supply the software to operate the personal computer with the banking computer through the telephone line.
d. **Internet Banking**

The customer requires Computer, Telephone, Modum and subscription made under Videsh Sanchar Nigan Ltd., (VSNL).

e. **Vodophone System**

The Vodophone is an international banking service and is accessible through Satellite. A subscriber to this service can be accessed in 63 countries in the world if he gets hooked on the network through matrix. The requirements under the system are mobile phone and International Credit Card.

f. **Anywhere banking**

Under this system, the customer of a bank can draw cash as well as remit money in anyone of the branches or Head Office of the Bank ie., Head Office and Branches are connected by installing Personal Computers through Satellite.

**PRODUCTS**

Now the word ‘Product’ has become a very familiar in the banking sector. Basically, there are four types of deposits available in the industry viz., Current/Savings Bank Account, Fixed Deposit Account, Recurring Deposit Account, Investment Plan. However, in the modern banking they are using different names for different schemes. The following are the new products introduced in the banking sector.
a. **Multi-option Deposit Scheme**

The customer can choose the Fixed Deposit along with Current Account or S.B. Account.

b. **Two-in-one Deposit**

Fixed Deposit plus S.B. A/c in one scheme.

c. **Flexi Deposit**

Deposit receipts are issued in multiples of thousands. The customer may not lose interest for the entire deposit amount in the event of foreclosure and he can surrender the deposit receipt to the extent of finance required and banker will not close his deposit by enforcing penal clause.

d. **Money Back Policy**

Under the scheme, the customer will remit monthly fixed installments for a particular period say 4 or 5 years. However the customer is entitled to draw money after remitting 12 monthly installments. The amount drawn will not attract any interest. However, the balance available in the account will continue to earn interest.

**NEW CONCEPTS**

a. **Telebanking System**

Banks have introduced Telebanking System. Under the system, the banking services will be rendered at the door steps of the customers as soon as he calls the bank over phone for any services required.
b. Rail Card

The Standard Chartered Bank has issued rail Card to its customers. The customers who are having the Rail Card are entitled to purchase railway tickets without making any payment immediately at the counter for the railway services available under Rajdhani and Sathapthi trains. Another advantage under the system is that the customer need not reserve the tickets two months well in advance. He can purchase the tickets directly from the counter before commencement of the journey ie., the Railway Department has earmarked some seats for the Rail Card holders.

c. Gold Account

Under the system, the customer can deposit gold and draw gold. Even if the customer remits cash that will be converted into gold quantity based on the market price on the date of remittance and credit to the customer's account. Similarly, while withdrawing also, the customer is entitled to draw cash or gold in grams. Interest will be credited to the customers account by means of weight of gold, this is a new concept. This will increase the gold accumulations with Government of India. Further, gold can be used in a more prudent way for the benefit of our country.

d. New Loan Schemes

Educational Loan, Home Needs Loan, Housing Loan Schemes, loans against Shares, NSCs, Executives Loan, Car Loan etc.
3.8 TASK AHEAD

The first stage & second stage of the banking reforms is coming to an end and India is now moving on to the next stage of the reforms. 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 the financial market acquires greater width and depth.

While the policy environment will remain supportive of healthy growth and development with account on greater operational flexibility as well as greater prudential regulation and supervision, the thrust of the second phase of reform would have to be on improvement in the organisational effectiveness of banks and other financial entities.

Going by the experience of commercial banks in other countries, the following trends may tend to dominate the future course of banking development in India.26

1. Greater specialisation by banks in different niches of the market such as retail, agriculture, export, small-scale and corporate sector.

2. Greater reliance on non-fund business such as advisory and consultancy services, guarantee and custody services.

3. Greater overlap in product coverage between commercial banks and non bank financial intermediaries and

4. Greater financial intermediation with large companies accepting securitised debt domestically and from financial markets abroad.
Banking Sector Reforms have made the banking sector to face a more resilient period than what it was in 1991-92. In the post reform period, the growth rate of Indian banks was high inspite of extremely low profit due to high interest rate. It was seen that the growth rate of major Indian banks were extremely high both for pre-nationalisation and post-nationalisation periods. The profits of the Indian banks were also extremely low during last few years because of higher rate of SLR and CRR.

The operating profits started showing an increasing trend from 1995-96 and all banks except two met the minimum capital adequacy ratio then. Sixteen Public Sector banks had capital adequacy ratio over 10 percent and few between 9-10 percent. Reduction in NPAs, also acquired importance in the post reform period.

Profitability and efficiency indicators also showed an improvement indicating that banks were taking the challenges of this emerging environment. The growth rate of banks had of late slipped down to 16.23 per annum due to the unnecessary controls which compel banks to purchase government securities. Banks also started facing stiff competition due to large inflows of foreign financial funds.

The Report on Trend and Progress in banking indicates that, as a whole banks have fared well in terms of profitability. The profits for 2001-2002 being
80.7% for all banks and Public Sector Banks doing particularly well with their net profits increasing by more than 92%. Since the basic objective of current liberalisation was to secure the benefits of full integration into the world economy, the liberalisation process through deregulation of interest rates had a positive impact on the economy. Further, by raising independence of RBI, it was expected that banks can adopt better monetary policy along with new reforms.27

3.10 MONETARY POLICY OF RESERVE BANK OF INDIA

Monetary policy is identified as an instrument used by the Central Bank to influence and control variable such as volume of credit, cost of credit and purpose of credit for achieving certain pre-determined objectives. The monetary policy of the Reserve Bank has been characterized as one of controlled monetary expansion. In India, monetary policy is an adjunct of economic policy and aims at controlling inflation by restraining and regulating the secondary expansion of credit. It also regulates the secondary expansion of credit and regulating the supply of money in order to meet the requirements of different sectors of the economy. The Government of India tries to manipulate its monetary policy through the Reserve Bank of India which is the monetary authority in the country.28

The objectives of monetary policy which the Reserve Bank has been aiming at includes price stability, reduction of deficit, improved exports, growth, social justice etc. For implementing the monetary policy, the Reserve
Bank uses both traditional instruments of credit-control like the Bank Rate and the Open Market - Operations and the non-traditional weapons like the Selective Credit Control.

In pursuance of the monetary policy, the RBI affects the quantity, availability and cost of credit by adopting both the qualitative and quantitative methods of credit control. RBI uses monetary policy to bring about economic development of the economy in an important way by giving cheap and easy credit to the priority sector consisting of managerial and small farmers, artisans, unemployed, small traders, village and small industries etc. At the same time, RBI also provides credit to large industries and to exporters to meet their expanding credit requirements so that production may increase and exports expand.30

Despite these achievements, the monetary policy of RBI has not been a success in bringing stability to the economy due to inflationary pressures, excessive government borrowing and budgetary deficits, high CRR and SLR, defective interest rate policy, organised sector uninfluenced by bank credit, little coordination between monetary and fiscal policies, existence of parallel economy and weaknesses of monetary policy of the RBI due to government policies.

It has been accepted that the success of monetary policy is not in a depression when business confidence is at its lowest ebb and is successful against inflation. In India, one of the principal reasons for the failure of
Monetary policy in controlling inflationary pressures has been the growing deficits. Monetary policy can control the secondary effects of excessive budget deficits and therefore it is essential that monetary and fiscal-policies move in tandem.

The structural and other policy measures to strengthen and rationalise the functioning of various segments of the financial system as presented in the annual monetary and credit policy for 2002-03 include:

1. Projection of growth rate at 6.0 to 6.5 percent.
2. RBI to provide adequate liquidity to meet credit growth and support investment demand.
3. Soft interest rate regime to continue and greater flexibility to interest rate structure in the medium term.
4. Reduction in CRR by 50 basis points.
5. Bank Rate to be cut by 50 basis points depending on monetary developments.
6. No change in interest rate on savings Account.
7. Interest rate on export credit in foreign currency lowered.
8. Abolition of minimum lending rate for co-operative banks.
9. Banks to declare maximum and minimum lending rates.
10. Facilities for small scale industries liberalised.
11. Measures to improve flow of credit to housing sector.
12. Measures to improve credit delivery mechanism to priority sectors.

14. Access to call money market to be regulated.

15. CDs to be issued in demat form.


17. Measures to improve technology - EFT facilities to be expanded.

18. Real Time Gross Settlement System to be ready for testing in a year's time.

19. Submission of returns by NBFCs and RBI to penalise delays.

At present, many more challenges are there before our banking and financial system like meeting the credit requirements of backward states and regions of the country, providing credit to the priority sectors, improvements in the customer services and efficiency of the banking system.

The new economic policy and the monetary policy has opened before the banks a multitude of emerging opportunities to enter into new areas of activities to offer new varieties of products and services. Similarly, the future of Indian banking has given a background where challenges should be accepted. Thus, reforming the financial system suitably and quickly is the only alternative for the social and economic revival of the country.
REFERENCES


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