FINANCIAL SECTOR REFORMS IN INDIA AND ITS IMPACT

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ABSTRACT

The Indian financial sector reforms launched a decade ago have transformed the operating environment of the financial sector from an administered regime to a competitive market based system. The reforms are an on-going process. There is increasing evidence of strong inter-linkages between markets. In the macro economic and financial spheres, inflation has been contained, external debt indicators have vastly improved, the exchange rate is flexible and the country is free of financial repression. The trade account is open and India has become much more integrated with the world economy. The economy has also become more resilient to shocks, both domestic and external. In this paper an analysis has been made to identify evolutions and progress of commercial banks in rural area. The study is based on secondary data collected form annual reports of the banks, district credit plans, block development office records, statistical table, district plans, various five year plans prepared by the planning commission India, reports of various committees and commissions set up by the government, RBI reports- trends and progress of banking in India, monthly and annual reports of various banks, various research articles, journals, magazines and news papers.

Keywords: *Financial Sector Reforms, Indian Economy, Reforms in India, Indian Banking, Rural Development.*

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I. INTRODUCTION

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

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

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

Financial Sector reforms included:

(a) Measures for liberalization, like dismantling the complex system of interest rate controls, eliminating prior approval of the Reserve Bank of India for large loans, and reducing the statutory requirements to invest in government securities;

(b) Measures designed to increase financial soundness, like introducing capital adequacy requirements and other prudential norms for banks and strengthening banking supervision

(c) Measures for increasing competition like more liberal licensing of private banks and freer expansion by foreign banks. These steps have produced some positive outcomes.

As the real sector reforms began in 1992, the need was felt to restructure the Indian banking industry. The reforms measures necessitated the deregulation of the financial sector, particularly the Financial Sector. The Financial Sector reforms highlighted the weaknesses in the Indian banking system and suggested reforms measures based on the Basle norms.

- ✓ The main recommendation of the committee were:-
- ✓ Reduction of statutory liquidity ratio to 25 percent over a period of five year.
- ✓ Progressive reduction in cash reserve ratio.
- ✓ Deregulation of interest rates so as to reflect emerging market condition.
- ✓ Phasing out of directed credit programmes and redefinition of the priority sector.

Impact on Indian economy

India's economic performance in the post-reforms period has many positive features. The average growth rate in the ten year period from 1992-93 to 2001-02 was around 6.0 percent, which puts India among the fastest growing developing countries in the 1990s. This growth record is only slightly better than the annual average of 5.7 percent in the 1980s, but it can be argued that the 1980s growth was unsustainable, fuelled by a buildup of external debt which culminated in the crisis of 1991.

Reforms in Industrial and Trade Policy

Reforms in industrial and trade policy were a central focus of much of India's reform effort in the early stages. Industrial policy prior to the reforms was characterized by multiple controls over private investment which limited the areas in which private investors were allowed to operate, and often also determined the scale of operations, the location of new investment, and even the technology to be used.

The list of industries reserved solely for the public sector -- which used to cover 18 industries, including iron and steel, heavy plant and machinery, telecommunications and telecom equipment, minerals, oil, mining, air transport services and electricity generation and distribution -- has been drastically reduced to three: defense aircrafts and warships, atomic energy generation, and railway transport.

II. LITERATURE REVIEW AND RESEARCH METHODOLOGY

Mr. Besant kalian (1989) :- The paper makes an effort to first gather the major reforms measures and policies regarding the banking industry by the govt. of India and the Central Bank of India (Reserve Bank of India) during the last fifteen years. Secondly, the paper will try to study the major impacts of those reforms upon the banking industry. A positive responds is seen in the field of enhancing the role of market forces, regarding prudential regulations norms, introduction of CAMELS supervisory rating system, reduction of NPAs and regarding the up gradation of technology. But at the same time the reform has failed to bring up a banking system which is at par with the international level and still the Indian

Financial Sector is mainly controlled by the govt. as public sector banks being the leader in all the spheres of the banking network in the country.

Rajesh Chakrabarti:- The Financial Sector as a whole and particularly the public sector banks still suffer from considerable NPAs, but the situation has improved over time. New legal developments like the SARFAESI Act provide new options to banks in their struggle against NPAs. The adoption of Basel-II norms however imply new challenges for Indian banks as well as regulators. Over time, the Indian banking industry has become more competitive and less concentrated. The new private sector banks have been the most efficient though the recent collapse of Global Trust bank has raised issues about efficiency and regulatory effectiveness.

B.Sathish Kumar (2002) :-This paper analyze that economic reforms totally have changed the Financial Sector. RBI permitted new banks to be started in the private sector as per the recommendation of Narashiman committee. The Indian banking industry was dominated by public sector banks. But now the situations have changed new generation banks with used of technology and professional management has gained a reasonable position in the banking industry. The main idea of this article is to make an evaluation of the financial performance of Indian private sector banks.

Ben Naceura and Mohammed Omran (1989):-In this paper, we examine the influence of bank regulation, concentration, and financial and institutional development on commercial bank margins and profitability across a broad selection of Middle East and North Africa (MENA) countries. We cover the 1989-2005 period and control for a wide array of macroeconomic, financial, and bank characteristics. The empirical results suggest that bank-specific characteristics, in particular bank capitalization and credit risk, have a positive and significant impact on banks' net interest margin, cost efficiency, and profitability. As for the impact macroeconomic and financial development indicators bear on bank performance, we conclude that these variables have no significant impact on net interest margins, except for inflation. However, inflation shocks seem to be passed mainly through the deposit rates and this type of transmission means that banks bear the entire negative cost of inflation.

III. IMPACT OF BANKING REFORMS ON RURAL DEVELOPMENT

Rural banking was a neglected subject before nationalization of banks. Since the day of antinational significant reforms have taken place in the area of rural banking with the introduction of the lead bank scheme in India, establishment of regional rural banks and potential linked plans of NABARD etc. All these reforms both in terms of credit will evolve with a view to redress some specific problems that were being faced in the area of rural finance.

Evolution of Commercial Banks in Rural Area

The foundation for building a broad base of agricultural credit structure was laid by the Report of the All-India Rural Credit Survey (AIRCS) of 1954. The provision of cultivator credit in 1951-52 was less than 1% for commercial banks. In the report it was observed that agricultural credit fell short of the right quantity, was not of the right type, did not fit the right purpose and often failed to go to the right people. With a view to give an impetus to commercial banks, particularly, in the sphere of investment credit, the nationalization of the Imperial Bank of India and its redesignation as the State Bank of India (SBI) was recommended. From the position prevalent in 1951-52, commercial banks came a long way with a substantial spread of 32,224 branches in rural and semi-urban areas comprising 68% of their total outlets as on 31 March 1991. The outstanding deposits of such branches at Rs.67,855 crore as on the same date constituted around 35% of their total deposits, while loans outstanding at Rs. 43,797 crore comprised 36% of outstanding credit. The agricultural advances of the commercial banking system aggregated Rs. 16,687 crore and constituted 14% of total advances in March 1991. The rural and semi-urban branches of commercial banks covered 17.6 crore deposit accounts while the number of loan accounts serviced aggregated 3.7 crore.

Growth during 1991-92 to 2003-04

The period since 1991-92 has seen a fairly rapid expansion of credit to agriculture. Available data indicate that the flow of credit to agriculture by commercial banks and RRBs taken together increased to Rs. 60,022 crore in 2003-04. This implies a compounded annual growth rate of 22.2%. In fact, as compared with commercial banks (including RRBs), the flow of credit from the cooperative sector was much slower through this period. The compounded annual growth rate of credit for agriculture from cooperative institutions was only 13.7%. Further, the proportion of agriculture credit to total credit came down because of the rapid growth in nonagriculture credit.

The Government took some major initiatives during the period to boost agriculture production and productivity through enhanced credit flow and by way of building agricultural infrastructure, particularly irrigation and connectivity in rural areas. Special Agricultural Credit Plan (SACP) was introduced by RBI for Public Sector Commercial Banks in 1994-95. Credit growth for agriculture and allied sectors under this caption reflected a CAGR of

36.45% during 2001-02 to 2005-06. SACP has since been extended to Private Sector Commercial Banks from 2005-06. The SHG – Bank Linkage Programme was started as a pilot project by NABARD in 1992. It led to the evolution of a set of RBI approved guidelines to banks to enable SHGs to transact with banks. Initially there was slow progress in the programme up to 1999 as only 32,995 groups were credit linked during the period 1992 to 1999. Since then the programme has been growing rapidly and the cumulative number of SHGs financed increased from 4.61 lakhs on 31 March 2002 to 10.73 lakhs on 31 March 2004 and further to 29.25 lakh groups as on 31 March 2007. Rural Infrastructure Development Fund (RIDF) was set-up in NABARD by GoI during 1995-96 with an initial corpus of Rs.2000 crore, to accelerate the completion of on-going projects of rural infrastructure. Banks which did not fulfill the priority sector credit requirement and agriculture credit mandate were required to contribute to this Fund. The fund has been strengthened every year with additional allocations in the Union Budget. A large number of irrigation and rural connectivity projects could get completed under RIDF. RBI scaled down its contribution to the Rural Credit funds with NABARD to a token amount of Rs.1 crore per annum since 1993-94. However to enable NABARD to have reasonably strong leverage for accessing market funds, the share capital of 54NABARD was strengthened and increased to Rs.2000 crore (paid up) from Rs.100 crore at the time of its formation in 1982. Contributions to enhanced share capital have come from GoI and RBI. By prudent funds management, the institution has also built a strong base of reserves and has been using it in its business operations judiciously to keep lending rates to rural financial institutions at significantly lower than market costs.

Targets for rural / semi-urban branches

Currently, there are 33,478 commercial bank branches in rural and semi-urban centres in the country. Out of these, there are about 12,340 branches in the rural and semi urban areas of the Central, Eastern and North-Eastern Regions, where the majority of the financially excluded population live. It is understood that each branch of Grameen Bank in Bangladesh services at least 4,000-5,000 borrowers, with 6-7 field officers per branch. Given the existing staff strength, it should be possible for commercial banks (including RRBs) to provide access to credit to at least 250 hitherto excluded households per annum at each of their existing rural and semi-urban branches. For this, banks will have to strengthen their staff and use a variety of delivery mechanisms.

In several districts, the population per branch office is much higher than the national average, particularly in rural and semi urban areas. The list of such districts has already been circulated by RBI among banks. The DLCCs in these districts may identify centres for opening branches by commercial banks and RRBs. in the next three years.

For the North-Eastern Region, the financial sector plan has already identified such centres and branch expansion plan as laid out therein may be implemented. SLBC may monitor the branch expansion plan for each State.

Promoting Rural Entrepreneurship :

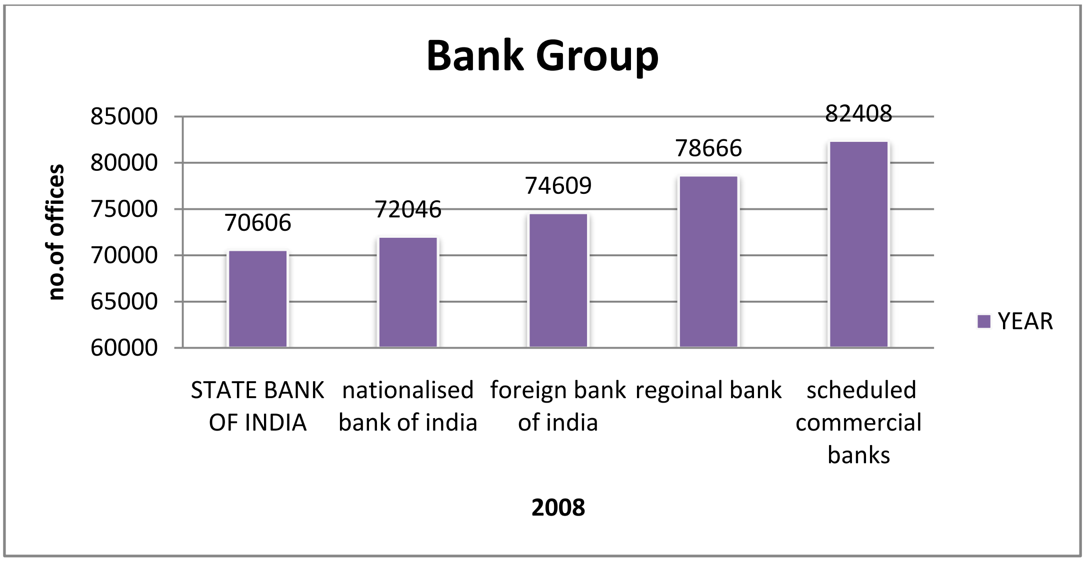
Commercial banks may consider setting up institutions like farmer training centres and Rural Development and Self Employment Training Institutes (RUDSETI) for developing skills among farmers / rural entrepreneurs for effectively managing the assets financed.

Impact on Rural Development

Table 1 Offices of commercial banks in india

Bank Group	2005	2006	2007	2008	2009
State Bank of India and its Associates	14006	14294	14651	15814	16731
Nationalised Banks	35096	35848	37413	39204	40786
Foreign Banks	242	259	272	279	295
Regional Rural Banks	14763	14776	14812	15029	15384
Other Scheduled Commercial Banks	6462	6828	7415	8294	9186
Non- Scheduled Commercial Banks	37	41	46	46	46
Total	70606	72046	74609	78666	82408

Source:- RBI Survey



Source:- RBI Survey

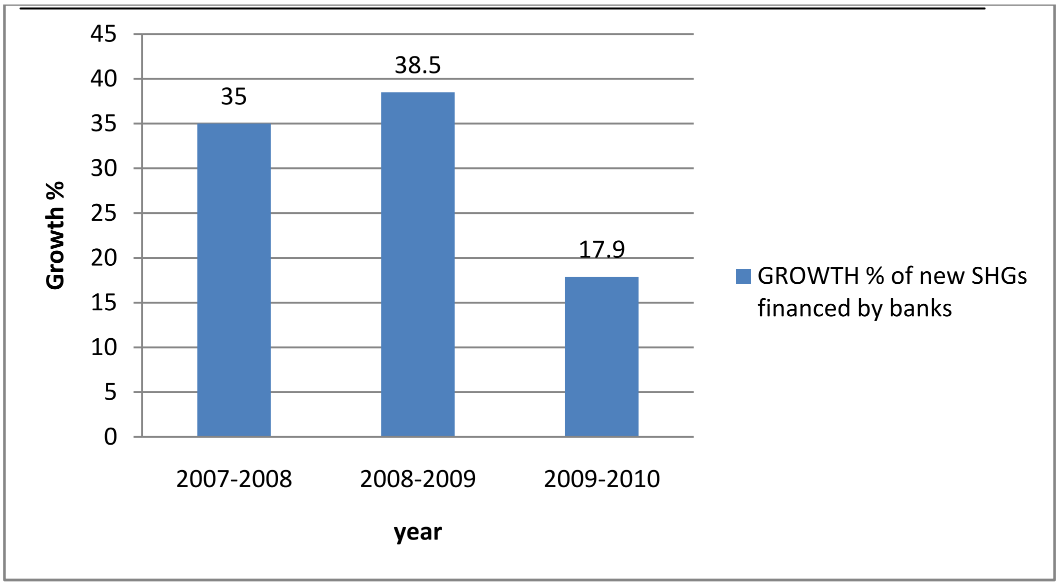
INTERPRETATION:-

The offices of commercial banks in India 2005-2006 are shown in table. The state banks of India and its associates were 14006 in 2005, but this increased to 16731 in 2009. But our main consideration in this paper is rural development which reflects in the above table that regional rural banks were 14763 in 2005 but this increase to 14776 in the year 2006, 14812 in year 2007, 15029 in year 2008 and 15384 in the year 2009. This change in regional rural banks reflects upward trends since 2005 to 2009. It means the period of 2005-2009 reflects that there is a rural development iin in context of the Financial Sectors reforms in India.

TABLE 2 PROGRESS OF MICRO FINANCE PROGRAMME

Year	New SHGs financed by Banks					Bank Loan Rs.(crore)
	During the year		Cumulative during the year			
	No.(lakh)	Growth(%)	No.(lakh)	Amt.(Rs.crore)	Growth(%)	Cumulative
2006-2007	11.06	10.00%	28.94	6,570.39		12,366.49
2007-2008	12.28	11.00	36.26	8,849.26	35.00	16,999.90
2008-2009	16.09	31.10	42.24	12,256.51	38.50	22,679.85
2009-2010	15.87	(-)1.40	48.52	14,453.30	17.90	28,038.28

Source : Deposits and Credit of Scheduled Commercial Banks, March 2008 & 2009, RBI.



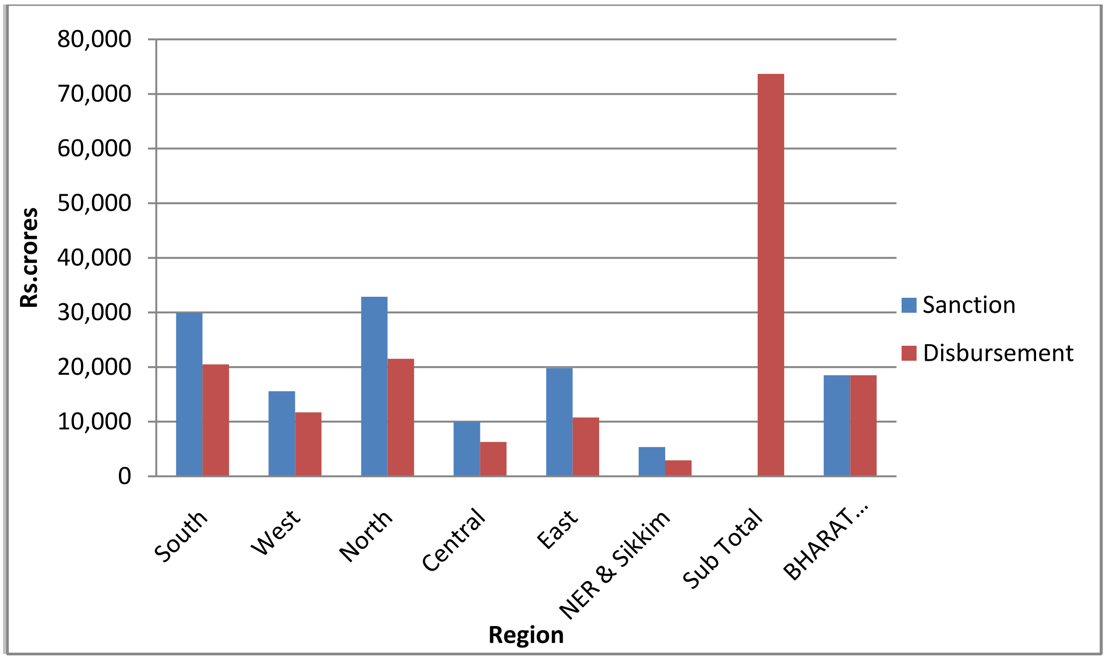
Source : Deposits and Credit of Scheduled Commercial Banks, March 2008 & 2009, RBI

The above table , it can be interpreted that the number of SHGs financed by Banks have increased over the years from 11.06 lakh to 15.87 lakh from 2006 to 2010. Which was 11.o6 lakh was in 2006-2007 and 12.28 lakh in 2007-2008 increase with 1.22 lakh in 2007-2008. There is positive change in the year 16.09 lakh with the increase of 4.81 lakh in 2008-2009. The amount financed has increased from 6,570.39 crore to 14,4530 crore from 2006 to 2010. Till 2009-2010 SHGs have been financed up to the tune of 28,038.28 core.

Table 3 Sanctions and disbursements under the Ridf and Bharat Nirman

	(As on 30 Nov. 2010)		(Rs. Crore)
Region	Sanction	Disbursement	Disbursements as % of sanction
South	29,912	20,502	68.54
West	15,567	11,697	75.14
North	32,880	21,502	65.40
Central	9,944	6,290	63.25
East	19,788	10,767	54.41
NER & Sikkim	5,346	2,929	54.79
Sub Total	1,13,437	73,687	64.96
BHARAT NIRMAN	18,500	18,500	100.00
Total	1,31,937	92,187	69.87

Source:- Status of micro finance in India 2009-2010 (www.nabard.org)



Source:- Status of micro finance in India 2009-2010 (www.nabard.org)

From the above table, it can be interpreted that to contribute to rural development there has been a lot of disbursements under the RIDF and BHARAT NIRMAN Schemes. The maximum sanctioned amount is for North Region which amounts to the tune of 32,880 crore out of which 21,502 crore have been sanctioned till now.

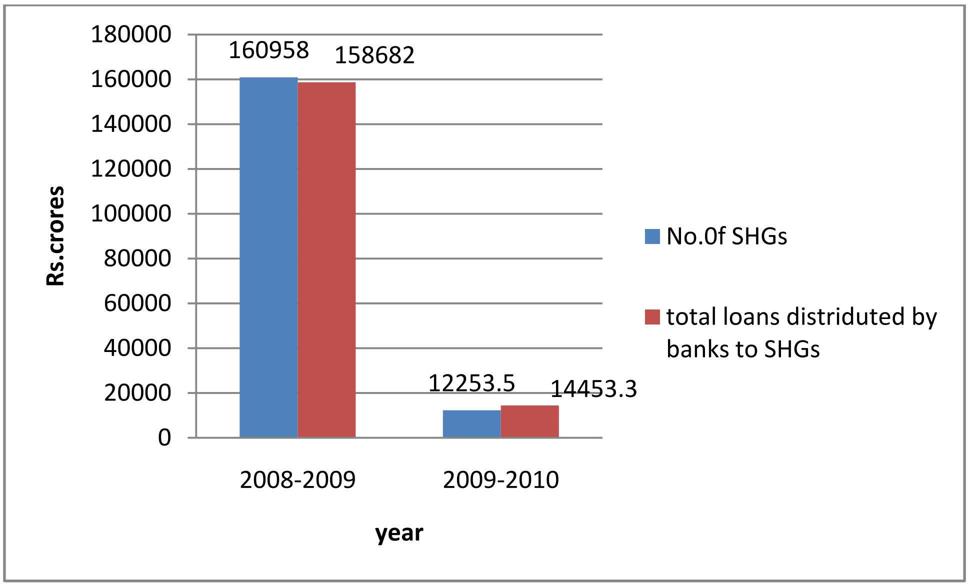
Table 4 Loans disbursed by different rural banks to SHGs

(Rs. Crores)

Agency	During The Year	Total loans disbursed by **banks** to SHGs during the year			
		No. of SHGs	% share	Amount	% share
Commercial Banks(public & private sector)	2008-2009 2009-2010 % growth	10,4,587 9,77,521 (2.7)	62.4 61.6	8,060.53 9,780.18 21.3	65.8 67.7
Regional Rural Banks	2008-2009 2009-2010 % growth	4,05,569 3,76,797 (7.1)	25.2 23.7	3,193.49 3,333.20 4.4	26.1 23.1
Cooperative Banks	2008-2009 2009-2010	1,99,430 2,32,504 (16.6)	12.4 14.7	999.49 1,339.92 34.1	8.2 9.3

	% growth				
Total	2008-2009 2009-2010 % growth	16,09,586 15,86,822 (1.4)	100.0 100.0	12,253.514,453.3 17.9	100.0 100.0

Source:- Status of micro finance in India 2009-2010 (www.nabard.org)



Source:- Status of micro finance in India 2009-2010 (www.nabard.org)

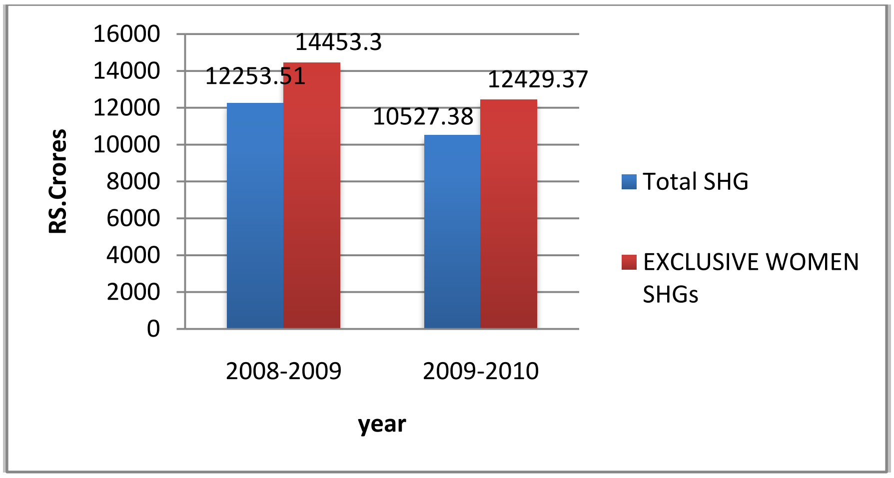
The amount of loan disbursed by Commercial Banks to SHGs in 2008-2009 was 8,060.53crores and in 2009-2010 it was increased to 9,780 crores and % share was decreased from 62.4 in 2008-2009 to 61.6 in 2009-2010. The amount of loan disbursed under SGSY in 2008-2009 was 1,102.38 crore and in 2009-2010 it was increased to 1,215.50 crore.

Table 5 To examine how micro finance helps in women empowerment.

Amount of loan disbursed to women SHGs (Rs. Crores)

Particulars	2008-2009	2009-2010
Total SHG	12,253.51	10,527.38
Exclusive Women SHGs	14,453.30	12,429.37

Source:- Status of micro finance in India 2009-2010 (www.nabard.org ● e-mail: mcid@nabard.org)



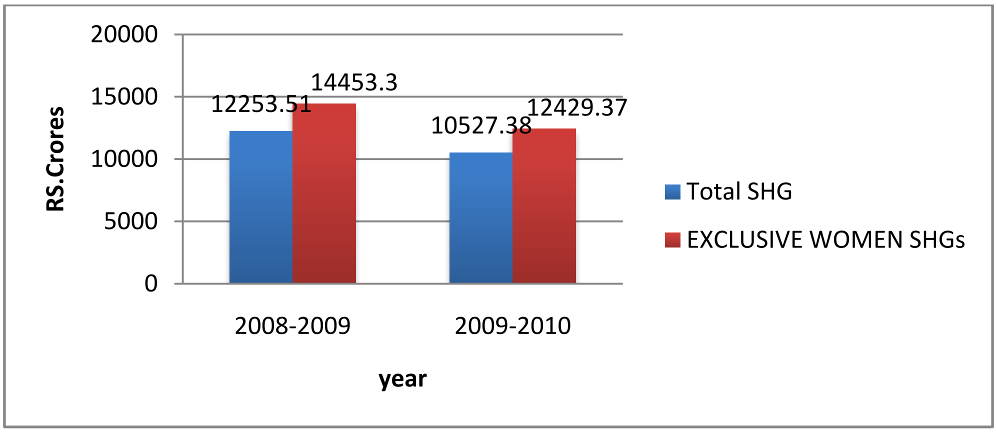
Source:- Status of micro finance in India 2009-2010 (www.nabard.org ● e-mail: mcid@nabard.org)

From the above table, it has been intrepreted that in 2008-2009 loan disbursed to SHGs was 12,253.51 crore and in 2009-2010 it was 10,527.38 crore. So, there has been a decrease in loan disbursement in 2009-2010. On the other hand, the loan disbursed to Exclusive Women SHGs in 2008-2009 was 14,453.30 crore and in 2009-2010 it has been decreased to 12,429.37 crore.

Table 6 TOTAL NUMBER OF LOANS DISBURSED TO SHGs

Particulars	2008-2009	2009-2010
Total SHG	16,09,586	15,86,822
Exclusive Women SHGs	13,74,579	12,94,476

(Source:- Status of micro finance in India 2009-2010 (www.nabard.org ● e-mail: mcid@nabard.org)



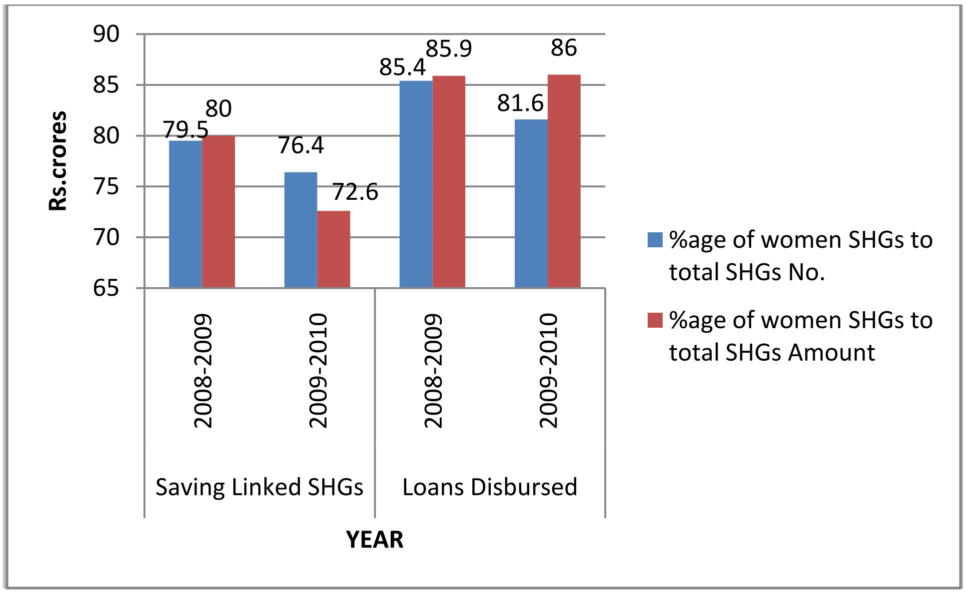
Source:- Status of micro finance in India 2009-2010 (www.nabard.org ● e-mail: mcid@nabard.org)

From the above table, it has been interpreted that in 2008-2009 the total number of loans disbursed to SHGs was 16,09,586 and in 2009-2010 it was 15,86,822. So, there has been decrease in the number of loans disbursement in 2009-2010. The total number of loans disbursed to Exclusive Women SHGs in 2008-2009 was 13,74,579 and it has been reduced to 12,94,476 in 2009-2010.

Table 7 PERCENTAGE OF WOMEN SHGs TO TOTAL SHGs(Rs. Crores)

Particulars	Year	Total SHGs		Exclusive Women SHGs		%age of women SHGs to total SHGs	
		No.	Amount	No.	Amount	No.	Amount
Saving Linked SHGs	2008-2009	.61,21,147	5,545.62	48,63,921	4,434.03	79.5	80.0
	2009-2010	69,53,250	6,198.71	53,10,436	4,498.66	76.4	72.6
Loans Disbursed	2008-2009	16,09,586	12,253.51	13,74,579	10,527.38	85.4	85.9
	2009-2010	15,86,822	14,453.30	12,94,476	12,429.31	81.6	86.0

Source:- Status of micro finance in India 2009-2010 (www.nabard.org ● e-mail: mcid@nabard.org)



Source:- Status of micro finance in India 2009-2010 (www.nabard.org ● e-mail: mcid@nabard.org)

From the above table, it has been interpreted that in Saving Linked SHGs the % of Women SHGs in 2008-2009 was 80% of the Total SHGs and in 2009-2010 it was reduced to 72.6%. The loans disbursed in 2008-2009 to Women SHGs were 85.9% to Total SHGs and in 2009-2010 it was increased to 86%.

CONCLUSION

No doubt, the Financial Sector has been successful in improving the health and efficiency of Financial Sector in India but they have failed in achieving growth with equity. Privatization and globalization have also introduced excessive competition (domestic as well as foreign) before Indian public sector banks which has created an unstable banking environment. After studying banking reform process it can be suggested that the public sector banks must create strategic alliance with the rural regional banks to open up rural branches and increased use of technology for improved products and services for the same. Banks must also strengthen their credit delivery systems for Rural India. Today, finance and banking systems are very strong. Since the financial reforms of 1991, there have been significant favourable changes in India’s highly regulated Financial Sector. It concludes that the financial reforms have had a moderately positive impact on reducing the concentration of the Financial Sector (at the lower end) and improving performance.

The Indian Financial Sector is an important constituent of the Indian financial system. The Financial Sector plays a vital role through promoting business in urban as well as in rural areas in recent years. Without a sound and effective banking system, India can not be considered as a healthy economy. For the past three decades India's banking system has several outstanding achievements to its credit. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process. ‘With total deposits of over Rs. 22 lakh crores in 2007-08, the Indian commercial Financial Sector is one of the largest in the world.

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

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