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BANKING SECTOR REFORMS IN INDIA
(WITH REFERENCE TO CURRENT SCENARIO IN BANKING SECTOR)

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ABSTRACT

Growth of Non Performing Assets in Indian banks shows question mark on credit system and disrupt the growth prospects in the future. Decrease in profitability and return on assets is another challenge before Indian banking system. Indian banking system is facing problem of corruption in financial transactions. Reforms in the banking sector are required to face the challenges of banking sector. Main focus of reforms includes NPA, Capital adequacy and Diversification of operations. There is an urgent need to revise guidelines which is uniform, simplified, non-discriminatory and non-discriminatory mechanism for the recovery of NPA's. Banking sector also require capital adequacy norms. To improve profitability of banking industry, it is needed that banks should work with economy of scale, enlarging customer base, providing various type of banking services in one umbrella such as mutual funds, hire purchase, lease financing etc. Top management should take decision of advances on the basis of evaluation results of both credit rating agencies. Responsibility of auditors should be fixed in case of NPA's. Responsibility oriented system audit and assets quality should be established apart from financial audit. Norms of advances and recovery should be objective. Bank management should be separated from political intervention especially in case of advances.

***KEYWORDS**: Non-Performing Assets, System Audit, Prudential Norms, Cash Reserve Ratio.*

Introduction

"The Indian banking system consists of 26 public sector banks, 20 private sector banks, 43 foreign banks, 56 regional rural banks, 1589 urban cooperative banks and 93550 rural cooperative banks. The Indian banking sector's assets reached more than 22 trillion US dollars with 70% share of public sector banks." [1] The expected growth rate of banking sector is more than 20% in lending, deposits, housing and personal finance sector. The Indian banks have successfully adopted the Basel II norms of international banking supervision and it is expected that Basel III norms have been adopted by majority of banks in near future. It is expected that Indian banking sector will develop with universal banking system including savings, savings, insurance, investment, assets management etc. Indian banking sector is facing many challenges. Growth of Non Performing Assets in Indian banks shows question mark on credit system and disrupt the growth prospects in the future. Decrease in profitability and return on assets is another challenge before Indian banking system. Indian banking system is facing problem of corruption in financial transactions. "In the year 2011, CBI revealed that certain banks such as Bank of Maharashtra, OBC, and IDBI created more than 10000 fictitious accounts and loan of RS 1500 crores was transferred in these accounts. In 2014, Vijai Mallya declared defaulter by Union Bank of India, SBI and PNB. In 2016, a fraud case is detected in Syndicate Bank in which 380 fraud accounts are opened by four people who defrauded Rs 10 billion using fake LIC policies and other securities. IN 2017, CBI arrested Nilesh Parekh, a promoter of Shree Ganesh Jewellery, in a scam of 22 billion with 20 indian banks. In 2018, a fraud of 11450 crores is

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detected in which dimond merchant Niray Modi is involved using 150 letter of understanding." [2] All these fraud cases shows question mark on the credit policy and credit security of the banking system.

Reforms in Banking Sector

Reforms in the banking sector are required to face the challenges of banking sector. A committee headed M. Narasimham[3] was set up by Government of India to examine countries financial system. Major recommendations of the committee were:

- Establishment of a four tier banking system
- 4 to 5 banks of international standard
- 8 to 10 national banks having nationwide network
- Small bans for specific regions
- Rural banks
- Abolition of branch licensing system. Banks themselves would be allowed to open or close branches.
- Entry of private banks, easing of restrictions on foreign banks and full stop on further nationalization of banks.
- Allowing nationalized banks to issue fresh capital to the public through the capital market.
- Phased reduction of statutory liquidity ratio, reduction of cash reserve ratio (CRR), and payment of interest on CRR to commercial banks.
- Tightening of prudential norms and strengthening of banking supervision.
- Issue of prudential guidelines governing the financing of financial institutions.
- Proper classification of assets and full disclosure and transparency of accounts of banks and other financial institutions.
- Attainment of a minimum 4 p.c. capital adequacy ratio in relation to risk weighted assets within three years.
- Increased competition in lending between 'development financial institutions' and banks.
- Setting up of an institution to be called Asset Reconstruction

The Government of India has taken many decisions to follow recommendations of Narasimham Committee. CRR and SLR were reduced. In the name of structural reforms, the Government of India has been allowing the entry of private sector banks and foreign banks. Prudential norms for income recognition, classification of assets and provisioning of bad debts have been introduced. Earlier, no uniform practices for income recognition, asset classification into performing and non-performing ones, provisioning for non-performing assets (NPAs), valuation for securities held in the banks' portfolio had been followed by the Indian banking industry. The concept of capital to risk weighted assets ratio (CRAR) has been developed to ensure that banks can absorb a reasonable level of losses. The RBI issued prudential norms. The major objective of setting such norms was to ensure financial safety, soundness and solvency of banks. These norms are directed toward ensuring that banks carry on their operations as prudent entities, are free from undue risk-taking, and do not violate banking regulations in pursuit of profit.

Main focus of reforms includes NPA, Capital adequacy and Diversification of operations. Presently NPA of public and private sector banks are 7.3 lakh crores and 1.03 lakh crores respectively. 77% of total NPA is related to lending to leading business houses. There was a continuous decline of ratio of gross NPA to advances and gross NPA to assets. There is an urgent need to revise guidelines which is uniform, simplified, non-discriminatory and non-discriminatory mechanism for the recovery of NPA's. Banking sector also require capital adequacy norms. Higher capital adequacy will improve efficiency of banks to reduce operating cost and improving long term viability through risk reduction. It is recommended by Narasimham committee that capital to risk weighted assets ratio should be 10 %. To improve profitability of banking industry, it is needed that banks should work with economy of scale, enlarging customer base, providing various type of banking services in one umbrella such as mutual funds, hire purchase, lease financing etc.

Objectives of the Study

Problem of NPA's are increasing and reached at alarming situation. Quality of assets and advances are decreasing. Main objectives of the study are to improve assets quality and to develop better assets management system which will be helpful to reduce NPA's. The study will analyze role of top management and auditors in the growth of NPA's. The study will discuss role of political affiliation, requirement of credit rating agency, procedure of the appointment in the board member and higher positions, requirement of tightening loan recovery mechanism and improvement in credit management.

Hypothesis

The study is based on the hypothesis that:

- Top management is responsible for growth of NPA's in Banks in India.
- Credit rating agency is required for evaluation of proposal of advances.

Research Design

The study is based on the primary data collected from general public, researchers, professionals and economists. The collected data will be analyzed with the help of average results and chi-square test. Suggestions are given after concluding the data.

Review of Literature

The book ***Banking Sector Reforms in India*** *(2007)* is written by Sultan Singh**.** The book deals with impact of banking reforms on general nature of functioning and operating performance of commercial banks in India. It includes management of NPA, capital adequacy, market and operational risk, implication of Basel-II on Indian Banks, mergers and acquisitions in Indian banking, human resources management, payment and settlement system, financing to small scale industry and agriculture.

The book ***Banking and Financial Sector Reform in India*** *(2009)* is written by A Singh. The book is related with requirement of banking and financial sector reforms, lending norms, performance of commercial banks, finance to industries and agriculture sector.

The book ***Banking Reforms & Productivity in India*** *(2010)* is written by Medha P. Tapiawala. The book related with financial stability, global financial crisis, role of RBI, payment and settlement system and recent banking sector reforms in India.

The book ***Economic Reforms and Indian Banking Sector*** *(2014)* is written by N.N.Sharma. It includes planned economic model, tax structure and reforms, development, saving and investment rate.

The book ***Banking Sector Reforms in India: A Review of Post-1991 Development*** is written by R.K.Uppal. The book is related with developments in banking sector, issues in banking sector, efficiency of banking sector, profitability of major banks and private banks, impact of falling rates of interest, human resources management, information technology in banking sector and changing pattern of employment in banks.

Data Analysis, Findings and Discussion

Financial scam in banking sector, continuous growth in NPA's, poor quality of assets, absence of rating agency for project evaluation, poor debt recovery strategy are the major problems in banking sector. Opinion of general public, professionals, researchers and economist regarding responsibility of top management for the growth of NPA's in banking sector and requirement of credit rating agency are as under:

Observed Data

Particulars	Credit rating agency is required for evaluation of proposal of advances	Credit rating agency is not required for evaluation of proposal of advances	Total
Top management is responsible for growth of NPA's in banking industry	82	14	96
Top management is not responsible for growth of NPA's in banking industry	18	06	24
Total	**100**	**20**	**120**

Expected Data

Particulars	Credit rating agency is required for evaluation of proposal of advances	Credit rating agency is not required for evaluation of proposal of advances	Total
Top management is responsible for growth of NPA's in banking industry	80	16	96
Top management is not responsible for growth of NPA's in banking industry	20	04	24
Total	**100**	**20**	**120**

Data collected from primary sources indicates that top management (Board of Directors) is responsible for growth of NPA's. An independent credit rating agency is required for evaluation of lending proposals. To test the significance of the data, chi-square test is applied as under:

Observed Data (O)	Expected Data (E)	(O-E)	$(O-E)^2$	$((O-E)^2/E)$
82	80	4	16	0.2
14	16	(-)4	16	1.0
18	20	(-)4	16	0.8
06	04	4	16	4.0
			χ^2=	6

Table value of chi-square

Degree of Freedom= (c-1) (r-1)

= (2-1) (2-1)

= 1

Table value of chi square at 5% level of significance for d.f. = 1 is 3.841

Calculated value of chi square = 6

Calculated value of chi square is more than table value of chi square hence hypothesis is true. Top management is responsible for the growth of NPA's in banking industry in India. There is a need of credit rating agency for evaluating advances proposals.

Conclusion and Suggestions

Result of data analysis concluded that top management is responsible for NPA's in banks. Internal and external credit rating agency should be established to evaluate advances proposals. Top management should take decision of advances on the basis of evaluation results of both credit rating agencies. Responsibility of auditors should be fixed in case of NPA's. Responsibility oriented system audit and assets quality should be established apart from financial audit. Norms of advances and recovery should be objective. Bank management should be separated from political intervention especially in case of advances. Appointment of higher authorities in banks should be made through independent agency to control political pressure. Implementation of these results will be helpful to improve financial health of the banking industry in India.

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