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# REFORMS IN BANKING SECTOR IN INDIA: AN OVERVIEW

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**ABSTRACT**

*The primary role of banks is to provide financial services to their customers, which includes deposit accounts, loans, and credit cards. Banks also play a crucial role in facilitating international trade and investment by providing foreign exchange services. Nationalized banks are an important part of the banking system in India. They are owned by the government and operate with the objective of promoting economic development and financial inclusion. These banks provide a wide range of services to meet the divergent needs of their clients. In India, apart from nationalized banks, private sector as well as foreign banks are also operative. These banks offer innovative products and services and have been instrumental in driving competition and growth in the banking sector. The role of banks is very crucial in mobilization of savings, allocation of capital, and granting of credit both to individuals and corporates as well. Therefore, the state of the financial system that is controlled by the banks directly affects the state of the economy. Out of the number of factors that have an impact on the performance of the banking system, some key factors are the overall economic growth, inflation rate, interest rates, and government policies and regulations. The purpose of the proposed study is to examine and analyze the various banking sector reforms and their effects. Some of the key initiatives that have been taken by banks in India to strengthen their operations include the adoption of technology and innovation, improving customer experience, and enhancing their digital capabilities. Banks have also worked towards increasing financial inclusion by expanding their reach to underserved areas and offering new products and services to meet the needs of a diverse customer base.*

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***Keywords:*** *Banking, Financial Services, Reforms, Efficiency.*

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## Introduction

The Indian banking sector has gone through several reforms in recent years with the aim of enhancing its overall performance. With economic liberalization and globalization, it has become imperative for banks to improve their operational efficiency. The introduction of various reforms has helped in achieving this objective. The reforms have played a vital role in promoting the financial reliability of Indian banks and bringing them up to international standards of performance. This has not only made them more competitive in the global market, but also encouraged them to play a more active role in accelerating economic growth. These reforms have included measures such as the introduction of new technologies, the adoption of international accounting standards, and the strengthening of regulatory frameworks.

The measures implemented by the reforms aim to ensure that banks are better equipped to manage economic changes and fluctuations. This is important because a stable banking system is essential for the overall health of the economy.

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The banking reforms in India were necessary due to the various challenges faced by the Indian economy. An overall economic slowdown was caused by the unpredictable changes in the political environment, prolonged budged deficit, double digit inflation and the crisis of balance of payments. The Indian government implemented banking reforms to address these problems, enhancing the efficacy and efficiency of the banking sector while also fostering market stability and expanding access to financial services for all Indians. These reforms have included measures such as increasing competition among banks, improving regulation and supervision of banks, enhancing transparency in banking operations, and expanding financial education and literacy programs for consumers. Overall, the banking reforms have played a critical role in stabilizing the Indian economy and promoting sustainable growth over the long term.

**Objectives of Study**

- To analyze current scenario of the banking system.
- To examine various reforms introduced in the banking system.
- To know the impact of various banking sector reforms.
- To make suggestions and recommendations

**Banking Sector Reforms**

Banking sector reforms have been implemented in many countries based on the recommendations of various committees, such as The Basel Committee and the Dodd-Frank Act in United States, among others. These reforms aimed to improve the resilience of the banking system, enhance risk management practices, and promote financial stability. The banking sector reforms were introduced through the recommendations made by various committees:

- The First Narasimham Committee (1991): This committee was set up to examine various aspects of the Indian financial system, including the banking sector. The key recommendations made by this committee were:
  - The reduction of Statutory Liquidity Ratio (SLR) from 38.5 to 25 per cent.
  - The reduction of Cash Reserve Ratio (CRR) from 15to 3–15 per cent.
  - The establishment of prudential standards of asset classification and income recognition.
  - The setting up of Asset Reconstruction Companies (ARCs) to deal with non-performing assets (NPAs)
  - The liberalization of branch licensing policy
- The Verma Committee (1996): This committee was set up to review the progress made in implementing the recommendations of the First Narasimham Committee. The committee made the following key recommendations:
  - The introduction of capital adequacy norms based on the Basel framework.
  - The setting up of Credit Information Bureaus (CIBs) to facilitate credit information sharing among banks.
  - The establishment of a loan recovery mechanism to deal with NPAs.
  - The liberalization of interest rates
- The Khan Committee (1997): This committee was set up to examine the issues related to the banking sector during the Asian Financial Crisis. The committee made several recommendations to strengthen the banking sector and to prevent the recurrence of the financial crisis. The key recommendations made by this committee were:
  - The introduction of risk-based supervision of banks
  - The establishment of (DICGC) a Deposit Insurance and Credit Guarantee Corporation in order to safeguard the interest of depositors.
  - The strengthening of the legal framework to deal with loan recovery.
  - The liberalization of foreign investment in the banking sector
- The Second Narasimhan Committee (1998): This committee was set up to review the progress made in implementing the recommendations of the first Narasimhan Committee and to suggest further reforms. The key recommendations made by this committee were:

- The establishment of a Board for Financial Supervision (BFS) to oversee the functioning of banks and financial institutions.
- The introduction of a system of differentiated banking licenses to encourage competition and innovation in the banking sector.
- The setting up of an Asset Management Company (AMC) to take over the NPAs of banks.
- The liberalization of foreign investment in the banking sector

The recommendations made by various committees were implemented in the following phases:

- **The first phase:** The first phase of the banking sector reforms was initiated in 1990 s and it aimed to enhance the policy framework, institutional framework and the financial health of the banks. The policy framework improvements included the deregulation of interest rates, reducing of CRR to its initial standard, gradually phasing out the SLR and expanding the scope of priority sector lending by linking the interest rates with the quantum of advances. These actions attempted to improve the banking system's effectiveness, competitiveness, and market responsiveness.

Recapitalization, empowering the supervisory system and developing new institutions to control the banking system were the main objectives of the institutional framework modifications. The idea was to improve the governance and risk management practices of banks, enhance the transparency and accountability of the regulatory system, and promote financial stability.

- **The second phase:** The second phase of reforms introduced in the banking system seems to be focused to strengthen the core of banking sector by making advancements in the organizational structure, making investments in HRD and introduction and implementation of modern technology.

During the second phase reforms the government or Central bank contributed towards enhancing the effectiveness and stability of the baking sector by taking initiatives. The purpose of the second phase reforms was to build a solid foundation for the entire banking system. The focus of the Second Phase reforms is to strengthen the foundation of the banking system by undertaking measures such as restructuring the banking industry, enhancing the quality of human resources, and adopting advanced technological solutions. The objective is to make the banking system more robust and responsive to the changing economic conditions and to ensure that it remains resilient to any future financial crises.

**Recent Reforms in Banking Sector**

The four R's suggested by the Ministry of Finance have been instrumental in addressing the issue of NPAs in the Indian banking sector. Recognition refers to the identification of NPAs and acknowledging the extent of the problem. Recapitalization involves infusing capital into banks to improve their financial position. Resolution involves finding a solution to the problem of NPAs, either by restructuring the debt or by liquidation. Reform involves implementing structural changes in the banking sector to prevent the recurrence of NPAs in the future.

- The government's plan to infuse 70,000 crore rupees is a step towards strengthening the PSU banks. However, more funds might be needed in the coming years.
- Mission Indradhanush was launched in August 2015 with the aim of revamping the public sector banks in India. Under this mission, the government proposed seven key strategies to reform PSBs, which include appointing personnel, building framework for accountability, Board of Directors, de-stressing, empowering the banking system, optimum capitalization and reforms related to governance. Mission Indradhanush aimed at addressing issues like the overhang of stressed assets, weak corporate governance, and lack of capital, among others, and making the PSBs more efficient and competitive.
- To redress complaints of clients that are not resolved to their satisfaction, an internal Ombudsman is appointed by the banks. The internal Ombudsman is a senior official appointed by the bank to redress customer complaints that are not resolved to the satisfaction of the customer. The Ombudsman is expected to independently examine the grievances and make an impartial decision based on the facts and circumstances of the case. This move by RBI is indeed a step towards enhancing customer satisfaction and ensuring that banks prioritize customer service.

- The proposed Insolvency and Bankruptcy Bill is aimed at streamlining the insolvency and bankruptcy process in India and providing a more effective framework for resolving debt disputes. The BLRC has made some important recommendations to ensure that the process is fair, transparent, and efficient, and we look forward to seeing how these recommendations are incorporated into the final legislation.
- The RBI has implemented several initiatives to improve the banking system in India. The early detection of non-performing assets and the implementation of corrective action plans are crucial steps towards promoting a healthy banking environment. The initiative taken by RBI to clean bank’s books up to 2017 are no doubt admirable and will undoubtedly help to restore public confidence in the banking system.
- The government's announcement of new banking reforms is an effort to boost the Indian economy and improve the banking system. To speed up the development and funding of long-term infrastructure projects that are critical to the country’s growth DFI-Development Finance Institution was established. A Bad Bank is created to resolve the issue of Non-Performing Assets. The creation of a Bad Bank to address the problem of chronic non-performing assets (NPAs) will help to free up capital for banks, enabling them to lend more to productive sectors of the economy. The initiative of privatization of Public Sector Banks will reduce the pressure on government in terms of mobilizing additional capital and ultimately make the banking system more efficient.
- The Supreme Court's ruling is a significant step in the fight against corruption in the banking sector. Under the Prevention of Corruption Act 1988, the employees working in private sector banks will be treated as public servants. They will now be held accountable for any corrupt activities they engage in while performing their duties. This ruling sends a strong message that corruption will not be tolerated in the banking sector, regardless of whether it is a public or private institution.
- The progress being made in the banking sector through the adoption of innovative approaches like JAM and the issuance of licenses to Payments Banks and SFBs is very effective. These initiatives are certainly making a significant impact on last-mile connectivity and financial inclusion, which is an important issue to address. It's great to see that SFBs are mobilizing deposits and extending credit to small and marginal farmers, as well as MSMEs, which is helping to support these segments of the economy.

## Impact of Banking Sector Reforms

Banking sector reforms have a significant impact as these reforms infused improvements in the Banking system of India. Them a in focus of the reforms was improving the effectiveness, transparency and accountability of Indian banking system and promoting financial inclusion and stability.

Some of the key impacts of banking sector reforms on the Indian banking system include:

- **Increased Competition:** Banking sector reforms have led to the entry of new players in the market, including private and foreign banks. This has increased competition and provided customers with more choices and better services.
- **Improved Asset Quality:** Banking sector reforms have led to the adoption of better risk management practices and stricter regulatory oversight, resulting in improved asset quality for banks.
- **Increased Financial Inclusion:** Banking sector reforms have focused on promoting financial inclusion by expanding the availability of banking services to underserved and remote regions and populations.
- **Adoption of Technology:** Banking sector reforms have encouraged the adoption of technology and innovation, leading to the development of new products and services and improved customer experience.

Overall, banking sector reforms have a positive impact leading to increased efficiency, transparency, and stability in Indian banking system.

## Conclusion and Recommendations

India has undergone several major economic reforms since the early 1990s, with the intention of boosting economic growth, promoting foreign investment, and opening up the economy to free-market principles. These reforms have included liberalization of industries, privatization of state-owned enterprises, and integration of the Indian economy with the global economy through increased trade and investment. The Indian economy has undergone significant changes over the years, and the financial sector is no exception. With the economic reforms, the financial sector has been steadily evolving to meet the needs of the market.

Moreover, Digital transformation in the banking sector that involves the integration of digital technologies has gone a long way to streamline banking operations, enhance customer experiences and increase efficiency. This includes the adoption of mobile banking, online banking, and other digital applications to improve the delivery of banking services. Digital transformation enables banks to offer a more personalized and tailored customer experience while also providing them with the flexibility to conduct banking transactions from anywhere, at any time.

Some suggestions for banking sector reforms to increase efficiency of banking sector are:

- Strengthening of bank regulatory mechanisms to ensure regulatory compliance and better governance.
- Implementation of robust risk management practices to ensure stability and financial soundness of banks.
- Adoption of technology to enhance efficiency, speed, and security of banking operations.
- Promoting financial inclusion by expanding the reach of banking services to the unbanked and underbanked population.
- Encouraging competition in the banking sector to foster innovation and customer-focused services.
- Increasing transparency and accountability in banks' operations to restore public trust.
- Strengthening the legal framework to address issues related to insolvency, resolution, and recovery of banks.
- Enhancing the role of credit rating agencies to promote greater investor confidence and reduce systemic risks.
- Development of a framework for cross-border banking operations to support international trade and commerce.
- Promoting sustainable finance practices to promote social and environmental responsibility in the banking sector.

The banking sector reforms are critical for the stability and growth of the economy. The reforms aim to promote transparency, accountability, and efficiency in the banking sector. The reforms also seek to enhance the role of the banking sector in promoting economic growth and development.

Some of the key measures that have been implemented as part of banking sector reforms include strengthening of prudential regulations, improving corporate governance, promoting financial inclusion, and enhancing the capacity of the banking sector to manage risks. All these measures are necessary to improve the efficiency of services provided by banks in the current scenario.

Overall, it is important to continue to monitor and evaluate the effectiveness of these reforms to ensure that they are achieving their intended objectives.

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