**FINANCIAL SECTOR REFORMS AND THE PERFORMANCE OF BANKING SECTOR IN INDIA**

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**ABSTRACT**

Banking sector reforms should learn to follow the advice of Prof. Yunus. While providing small loans to poor is an economic intervention, it begins a process of transformation in the life of an individual member. A women who believes she has no worth starts to believe in her ability to improve her own life. Conventional banking rejected poor as non-credit worthy. Its mission is to help poor people to help themselves to over come poverty. Poverty is not created by the poor but institutions and policies which surround them. So appropriate changes may be made in the institutions to contain poverty. The poor do not get any opportunity to explore their potential and so their ability remains unutilized. Financial sector reforms have failed to check farmers suicide in India which were 1,56,562 during 1995-2004. Srijit Mishra observes that the returns from agricultures inadequate (Rs. 1,000 per month) and the farmer is unable to face risks like whether market credit and technology. In the ensuing years, the credit limit to agriculture may be raised to 40 per cent loans may be provided without collateral employment generating schemes may be created in lean season and loan weaver to the extent of Rs. 2,80,000 Crore in the current year along with crop loan insurance schemes and supervision over end.

**INTRODUCTION**

The economic reforms were initiated in the 1980's and took up with greater vigour in the 1990's helped push the growth rate of the economy close to 9 per cent a year. There has been air increase in our gross investment and saving rate, particularly in the last three years. In a democracy like ours, the Government is due bound to focus on equity. At the same time, in an open economy we cannot ignore the efficient dimension. We have to ensure that resources are used efficiently. We have been looking for ways to combine our concern for equitable outcomes with our concern of efficient utilisation of resources. Ever since we have demolished the licence Raj, firms are operating in far more competitive markets and external liberalisation has created more competitive markets and limited the scope for oligopolistic environment.

The economic reforms of 1991 unleashed a new era of entrepreneurial growth in India. As pointed out by our Honourable Prime Minister or Monmohan Singh in an article entitled "we are off to a good start", published in Times of India (25.10.2007). The successful implementation of our social and human development initiatives requires greatest public-private partnership (ppp). Both in infrastructure development and in social and human development we have encouraged such partnership. A synergy between public support and private initiative can help multiply the productivity of resource utilisations. Prof. Muhammad Yunus said credit is a kind of key a passport to explore the potential of a person credit was the real missing link between people and their creative potential. He wanted to make credit available to more and more poor people to give them the chance of better future. India's rural credit is unique in its reach and diversity. In recent years, rural areas have witnessed varying rates of development progress and growth. There is a large body of consensous that India's credit is unique in its reach and diversity. It seems that, Rural Financial Institutions (RFS) have touched the lives of millions of people and supported through efficient resource mobilization and credit deployment banks as well government programmes directed to accelerate the process of integrated rural development, step up farm output, create self-employment opportunities, minimize the incidence of poverty and regional in balance.

Viewed against this back drop, in the present paper an effort is made to analyse and assess the role and effectiveness of banks in their effort to disburse credit for the development of agriculture and complementary sectors, small scale industries business sector and poverty alleviation programmes. The study is based on secondary data and covers a span of five and half decades from 1950-51 to 2005-06. Broadly, credit delivery channels in India can be classified as non-institutional and institutional money-lenders, traders land­lords, friends and relatives come under non-institutional sources and Government, Co-operative Banks Commercial Banks and Regional Rural Banks come under institutional sources. Lending by Private Sources is exploitative, bears high interest rate and does not cover the long term development needs of formers. Institutional credit is non-exploitative directed to serve the marginal and small farmers backward regions, touch areas covered by special pulses production programme and reduce the role of shylok-like money senders in rural areas.

**Rural Financial Institutions**

Institutional rural credit in India was in ascendency during the 1970's when the government began with the practice of extending loans to farmers; in drought years called "Taccavi" loans. At the welcome suggestion of F. Nicholson, co-operative credit societies were started in the country in 1904, in line with Raiffeisen model in Germany. For a long period Co-operatives and land Development banks catered to the short term and long term credit needs of farming community in the country. After a critical scrutiny of the credit delivery system in rural areas, the All India Rural Credit Committee observed succinctly that, the lion's share of the credit requisites of rural households, particularly the poor flowed from the traditional sources such as land lords, traders, money lenders and relatives, (Dr. Amrit Fatal, 2007).

**The Advent of Multi-Agency Approach**

By the mid-Sixties, the credit requirements of the agricultural sector grew main-fold and it was realized that co-operatives in isolation may not be able to cater to the mounting demand of rural credit. So, the concept of a Multi-Agency Approach to rural credit was evolved involving nationalization of the hither to privately run fourteen commercial banks. The two folds tasks entrusted to commercial banks were to earmark 40 per cent of total credit to the priority sector on a priority basis and expand the net work of their branches in rural areas to reach the poor. Today, the Indian economy is served by 92,000 primary co-operatives, 28 public sector commercial banks and 32 private sector Banks operating in villages through their 32,000 branches in rural and Semi-Urban areas and 196 Regional Rural banks which Provide their Services to rural population through 14,311 branches.

**Progress in Institutional Credit**

Commercial banks provide direct loans and term loans to farmers for purchase of pumps, tractors and agricultural machineries for construction of tube wells for development of fruits and vegetables. They also lend indirect finance to agriculture by financing co­operatives and subscribing to share capital of land development banks. They finance state government and F.C.I, for procurement, storage and distribution of food grains. The Banks have performed a notable job in financing poverty eradication schemes, like, I.R.D.P. and P.M.R.Y. Similarly, the Banks are guiding and financing small Farmers Development Agency by, supervision, so that the small farmers can convert dry holding into wet holding. It is discernible from Table-20.1 that, the performance of commercial banks was commendable between 1970-71 and 1980-81 but it has not improved in 1991. There has been rosy improvement in the relative share of co­operatives in total lending to farmers from 3.5 per cent in 1951 to 10.4 per cent in 1961 and then to 20.1 per cent in 1971 and 28.6 percent in 1981 but the relative share has a step decline to 6.1 percent in 1991. Over the years, there has been a phenomenal increase in the credit disbursement by public sector and nationalized banks from Rs. 7,438 million in 1970-71 to Rs. 3005,182 million in 1999-2000. Annual disbursement on average was Rs. 49,688.2 million by co­operatives (51.25%) followed by commercial banks at Rs 42,911.6 million (42.84%) and R.R.Bs at Rs. 6826.8 million (5.91%).

**Narasimhan Committee Report**

 According to the All India Rural Credit Survey Non-institutional sources supplied 91.27 per cent of the total rural credit in 1951-52. This share has steeply declined to 71 per cent in 1971-72 and further to 36 per cent in 1990-91. The financial sector reforms revolve round three premises. (1) The spirit of competitive efficiency should cover the financial sector for the reforms to be meaningful and successful. (2) To be able to perform the task effectively in an environment of competitive efficiency, the financial system itself should be healthy and profitable (3) The financial sector can operate on an efficient basic provided it has a measure of autonomy in decision making and that credit and investment decisions should be based on professionalism and free from any type of extraneous pressure. A highly regulated and over administered financial and banking sector would be ill-suited to the emerging needs of the real sector. Financial systems should have choice with regard to whom they finance. Competitive efficiency is central to the operations of the financial sector to give the saver and investor a wide range of choice with regard to both the institutions and instruments of credit. An aspect of health of the financial system is in building up depositor and investor confidence. A healthy system suggests a profitable operation so that capital funds can be built up. Any erosion of profitability could weaken its strength to withstand adverse turns in the financial and economic conjecture. To build up its internal strength and profitability the system needs a measure of flexibility and autonomy in decision making on the basis of a professional approach to credit.

 Over the years the productivity, efficiency and profitability of the system have suffered. There has been erosion of profitability which has weakened the inherent strength of the system. Excessive degree of regulation of various aspects of operations of the institutions resulted in the loss of a'operational flexibility. There can be no gain-saying in the tremendous quantitative progress made by the Indian financial sector.

The objective of developmental credit policy was to extend the reach of bank credit both geographically and functionally-geographically in sense of covering the under-banked regions of the country in the rural hinterlands and functionally to extend credit to agriculture small industries and the self-employed sectors which were deemed important in terms of their contribution to national income, growth, expansion of employment opportunities and widening the base of economic power. Functional expansion needs a physical presence and this was the logic behind branch expansion in the number of bank branches and the density coverage is reflected in the sharp decline in the population served by a bank office from 65000 in 1969 to less than 12000 now. Nearly, 3 out of 4 bank offices today are in rural and semi-urban areas a matter of spatial distribution of banks. The banking services cover 300 million deposit accounts. Bank deposits which in 1969 were 13 per cent of GPP have risen smartly 38 per cent in 1990.

**Reforms of the Banking Sector**

Reforms in the Banking Sector are underway since 1992. Statutory liquidity Ratio on Demand and Time liabilities have been reduced from 38.5 to 25 per cent. The cash reserve ratios has been reduced by R.B.I, from 15 to 5.5 per cent in 2001 to enable R.B.I, to lend money to industries and other sectors which were starved of credit. There has been reduction in Prime pending rate of S.B.I, and other banks on advances over Rs. 2 Lakhs decontrol of interest rate on terms deposits decontrol of rate of interest on Bank loans above Rs. 2 Lakhs, and interest rates slabs were reduced gradually from 20 to 21,1994-95.

**Prudential Norms**

The purpose of prudential norms involve recognition of income classification of assets and provisioning of bad debts was to ensure that the books of commercial banks reflect their financial position more accurately and in keeping with internationally accepted accounting practices. Banks are required to make 100 per cent provision of (NPAS) Non-performing assets and 30 per cent provision against doubtful debts during 1992-94 capital adequly norms were fixed at 8 per cent by R.B.I, in April 1992.

**Access to Capital Market**

The companies Act was amended to enable to nationalized banks to enter into market for capital funds through public issues (Holding of Central Government will not be less than 51 per cent of paid up capital).

**Freedom of Operation**

 Scheduled Commercial banks have been given freedom to open new branches, close non-viable branches other than those operating in rural areas and upgrade extension counters.

**New Private Banks**

 New Private banks are allowed to raise capital contribution from foreign institutional investors up to 20 per cent and from non­residential Indians up to 40 per cent.

**Recovery of Debts**

 The Government of India has promulgated Recovery of Debts due to banks and Financial Institutions Act 1993 to accelerate debt redemption process. Six special Recovery Tribunals were set up at Calcutta, New Delhi, Jaipur, Ahmedabad, Banglore and Chennai.

**Local Area Banks**

The setting up of new private local area banks with jurisdiction over three contiguous districts was mooted in 1996-97 budget. These banks are expected to mobilize rural savings and channelise them into investment in local areas. R.B.I, had granted licences to LABS located in Andhra Pradesh, Karnataka, Punjab, Rajasthan and Gujrat.

**Supervision of Commercial Banks**

In the wake of the security scam of 1992 the R.B.I, has taken steps, like setting up of board of financial supervision to strengthen surveillance system of Banks and Financial institutions. The Department of Supervision too was established for the same purpose.

**Suggestions and Application**

**Direct Investment**

 The government should not rely on using statutory liquidity requirement as an instrument of mobilizing funds for the government. The committee has recommended reduction in the SLR from the current 38.5 per cent; of the net demand and time liabilities of banks to 25 per cent ever the next five years. This would leave more funds with banks for allocation to agriculture, industry and trade. A reduction on Cash Reserve Ratio (CRR) from the present level of 15 per cent to 3 to 5 per cent by R.B.I, recommended by the committee.

**Directed Credit Programmes**

While recognizing the role played by directed credit programmes in building up credit to agriculture and small industry the committee believed that redistribute policies should be more in the domain of fiscal rather than credit programmes. The committee suggested a gradual phasing out of directed credit programme and proposed the short term redefinition of priority sector and suggested limiting it to only small and marginal farmers, the tiny sector of industry and otHerweaker sections and indicated that priority sector lending by banks should be limited 10 per cent The rationale behind the reduction in lending to priority sector under director credit system was that after two decades of such assistances the economy seems to have reached a level of maturity, where people can stand on their own feet. The system of Directed Credit should be a temporary and not a permanent one. Banks in particular have been subject to so many regulations and controls through not only statutory requirements but also operational directives and guidelines which have stifled innovation and initiative designed to widen the options available both to the borrower and depositor which is the hall»mark of dynamic and competitive banking. Loan meals represented a virtual-repudiation of the professional credit operations. Loan waivers have added another political dimension. On the structure of interest rates the Narasimhan committee recommended that the level and structure of interest rates in the country should be broadly determined by market forces.

**On Structural Reorganisation of Banks**

For the sake of efficiency in operations, the committee has recommended a reduction in the number of public sector banks through mergers and acquisitions. 3 or 4 larger banks would become international in character, 8 or ten national banks with a network of branches throughout the country be engaged in general baking. The operations of local banks would be confined to a specific region setting up of Asset Reconstruction Fund(ARF). The committee has recommended the establishment of ARF, to take over from the nationalized banks and financial institutions a part of their bad and doubtful debts at a discount The step may help the banks to take off band debts from their balance sheets and recycle the funds so realized into more productive uses. The committee has pleaded for autonomous public sector banks which has to strive for radical change in work technology and culture to become competitive internally and cope with the recent innovations. The committee has advocated the regulation of banking system by R.B.I, and the abolition of dual control over the banking system between R.B.I, and banking division of ministry of Finance.

**Conclusion**

Banking sector reforms should learn to follow the advice of Prof. Yunus. While providing small loans to poor is an economic intervention, it begins a process of transformation in the life of an individual member. A women who believes she has no worth starts to believe in her ability to improve her own life. Conventional banking rejected poor as non-credit worthy. Its mission is to help poor people to help themselves to over come poverty. Poverty is not created by the poor but institutions and policies which surround them. So appropriate changes may be made in the institutions to contain poverty. The poor do not get any opportunity to explore their potential and so their ability remains unutilized. Financial sector reforms have failed to check farmers suicide in India which were 1,56,562 during 1995-2004. Srijit Mishra observes that the returns from agricultures inadequate (Rs. 1,000 per month) and the farmer is unable to face risks like whether market credit and technology. In the ensuing years, the credit limit to agriculture may be raised to 40 per cent loans may be provided without collateral employment generating schemes may be created in lean season and loan weaver to the extent of Rs. 2,80,000 Crore in the current year along with crop loan insurance schemes and supervision over end use of credit may transform static credit into dynamic credit.

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