Liberalization: It’s Impact on Indian Banking Sector

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ABSTRACT

Indian financial sector has undergone an important role in inspiring and stabilizing the growth of an economy. Economics essentially involves the efficient transfer of funds in exchange for goods, services or promises of future return, it brought momentous changes in the financial sector in general and banking in particular. While there have been striking changes in the financial structure, India remains a bank conquered financial system. One of the major purposes of financial liberalization was to make the financial institutions more efficient and competent. A number of developing countries have undertaken financial sector reforms in order to pursue the goals of economic growth and improved living standards. This paper examines aspects of the development of India’s financial sector particularly after 1990 when financial liberalization began. The usual confidence is that liberalization process allows for the development of a competitive financial system, which aids the efficient allocation of resources by mobilizing savings through the growth of financial intermediation and asset diversification.

Keywords: Liberalization, banking, Development, India

INTRODUCTION

India introduced important financial sector reforms in the mid-1990s through entering the new private and foreign banks, liberalizing interest rate controls, enhancing the role of market forces, and reducing state prevention of bank credit through reductions in reserve and statutory liquidity requirements, which together stood at about 50 percent of assets in 1992.

Numerous authors have argued that development in financial intermediation has a constructive relationship with economic growth. Empirical evidence shows that a more developed financial system is associated with higher rates of economic growth, although the nature of any causal relationship is disputed (Lawrence, 2003). The Indian financial system comprises a large network of financial institutions, commercial banks, stock exchanges and an extensive range of financial instruments. It has undergone a significant operational transformation since the initiation of financial liberalization in 1990s. Before financial liberalization, since mid-1960 till the early 1990’, the Indian financial system was considered as an instrument of public finance (Agarwal, 2003). The growth of Indian financial sector in the post independent period can be divided three distinct periods. During the first period (1947-68), the Reserve Bank of India (RBI) consolidated its role as the agency in charge of supervision and banking control (Sen & Vaidya, 1997). Till 1960’s the neo-Keynesian perspective dominated, claimed interest rates should be kept low in order to remote capital accumulation (Sen & Vaidya, 1997). During this period Indian financial sector was characterized by nationalization of banks, directed credit and administered interest rates (Lawrence & Longjam, 2003) the second period (1969- mid1980) known as the period of financial repression. The financial suppression started with the nationalization of 14 commercial banks in 1969. As a result interest rate controls, directed credit programs, etc. increased in greatness during this period (Sen & Vaidya, 1997). The third period, mid 1980’s onwards, is
characterized by consolidation, diversification and liberalization. However a more comprehensive liberalization program was introduced by the government of India during early 1990’s.

Source RBI

The recommendations of the Narasimham Committee provided the plan of the reforms, especially with regard to banks and other financial institutions. In 1991, India launched comprehensive financial sector liberalization program. This programme includes de-controlled interest rates, reduced reserve ratios and slowly reduced government control of banking operations while establishing a market regulatory framework. The important objectives of the financial liberalization were to advance the overall performance of the financial sector in the country, to make the financial institutions more efficient and knowledgeable. It remains the main source of resource for many households, small and medium and also caters the large industries enterprises. And also provides many other financial services. Underlining the importance of the banking sector, several major banking sector precise reform as a part of financial reforms were introduced to improve the performance of the Indian banking and to make them much more competent and efficient.

Why Liberalization

The Government of India enclosed liberalization polices in the year 1991-92, keeping in view the benefits of liberalization. The major pushes of the liberalization of 1991 related to measures to address balance of payments crisis through fiscal consolidation and limited tax reforms, removal of controls on industrial investment and on imports.
reduction in import tariffs, creation of a less unfavorable environment for attracting foreign capital, prudent management of movements in the exchange rate while allowing market forces to play a greater role in its determination, convertible of rupee for current account transactions and finally, telecommunication sectors and opening energy for private investment (domestic and foreign). It was expected that in the process liberalization, increased competition could turn the banks more efficient, bring about improvement and ultimately benefits the clienteles.

Some main causes that were behind the dull performance of the banks prompted the initiation of the banking sector reforms. Some of these causes were:

- Great emphasis on directed credit programmers.
- Skilled interest rate structure.
- Excessive regulations on administration's structure and managerial resources.
- Deficiency of focus on profitability.
- Monopoly on banking.
- Negligence of suitable Accounting and Risk Management System.
- Lack of operational transparency.
- Great support from government.

The reforms were introduced with an aim to bring about a paradigm shift in the banking industry. Hence, banking reforms were made an essential part of the liberalization process. In 1991 starting of financial reform provided the necessary platform for the banking sector to operate on the basis of working flexibility and functional autonomy; enhancing efficiency, productivity and profitability.

OBJECTIVE

- To know about impact on Indian financial system since liberalization.

METHODOLOGY

This paper is mainly based on secondary sources. The researcher made the study based on secondary data collected from various sources like reports and publications of International journal of research in finance sector, RBI reports, books, magazines and internet.
all gone hand in hand. Since liberalization it was noted that there had been improvement in several of measureable indices but there were many areas in which weaknesses still persisted. These included technological-up gradation, customer services, improvement in housekeeping in terms of settlement of entries and balancing of books. It was further noted that the Method to handle the problem of non-performing assets differed from the recommendations.

In the wake of liberalization one cannot hope to continue in isolation. Indian banking system is quite matured today.

Indian banking system is classified into the following categories:

1. Public Sector Banks
2. Private Sector Banks
3. Regional Rural Banks
4. Co-operative Sector Banks
5. Development Banks
6. Foreign Banks

CURRENT STATUS OF INDIAN BANKING

The new policy trembled the banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (borrow at 4%, lend at 6%, go home at 4) of functioning. The new wave ushered in a current outlook and tech-savvy methods of working for traditional banks. All this lend to the retail boom in India.

In recent years criticizes have charged that the non-government owned banks are too violent in their loan recovery efforts in linking with housing, vehicle and personal loans. There are press reports that the bank loan recovery efforts have determined defaulting borrower to suicide. By 2016 the Indian banking industry employed 1,175,149 employees and had a total of 109,811 branches in India and 171 branches overseas and manages and aggregate deposit of Rs. 67504.54 billion and bank credit of rupees 52604.59 billion. The net profit of the banks operating in India was Rs. 1027.51 billion against a turn-over of Rs. 9148.59 billion for the financial year 2012-13.

“PRADHAN MANTRI JAN DHAN YOJNA” (Prime Ministers People Money Scheme) is a scheme for inclusive financial inclusion launched by the Prime Minister of India, Narendra Modi. Run by department of financial services, ministry of finance, on the inauguration day, 1.5Cr (15 million) bank accounts were opened under this scheme. By January 2015, 11.5Cr accounts were opened, with around Rs. 8698Cr ($ 1.4 billion) were deposited under the arrangement, which also have an option for opening new bank accounts with zero balance.

POSITIVE IMPACTS OF LIBERALIZATION

Liberalization have play a very great role in development of Indian economy and also measured an investment in the future financial wellbeing of a
nation. It helps the financial industry as a whole by providing. Liberalization play very important role in development of financial flexibilities of firms and reduce business costs. It develop efficient, strong and more competitive banking institutions, especially meaning full struggle in banking sectors by allowing the private and foreign banks which lead a technological up-gradation of banking sector through wide use of computers and recent communication systems. With the entry of new banks removed major regulatory impediments to profitable working of banks. Globalization leads limit free in covering of foreign investment and foreign exchange. With the entry of private and foreign banks results the up-gradation of banking sector through modern communication and computer system like:

### Changing Role of Banks in India, Since 1991

1. Better Customer Service  
2. Mobile Banking  
3. Bank on Wheels  
4. Portfolio Management  
5. Issue of Electro-Magnetic Cards  
6. Universal Banking  
7. Automated teller machine (ATM)  
8. Internet Banking  
9. Encouragement to Bank Amalgamation  
10. Encouragement to Personal Loans  
11. Marketing of Mutual Funds  
12. Social Banking

### NEGATIVE IMPACTS OF LIBERALIZATION

It would be wrong to expect that liberalization will solve all problems just by the beginning of these comfortable policies, it is not so. The major problems worried with liberalization can be summarized as under:

1) In so far as fiscal deficits are financed by money formation and growing, financial liberalization
helps to accelerate inflation which joined with high exchange rate, promotes capital flight.
2) Rivalry is not routinely enhanced. It leads power to big institution that has market controlling powers.
3) A number of institutions can incorporate their own finance corporations to make finance available on easy terms for purchase of their products; this wonder can also be used against the interest of the society.
4) Change in praise allocation by banks can produce effectiveness gains.
5) Sometimes there can be problems of moral threat.
6) Weight on profitability can lead to speculation and create problems of systemic failures.

Conclusion

Indian experience with the liberalization to increase both the operational efficiency of banks at the institution level and to improve the efficacy of resource allocation economy-wide. The initiation of liberalization in 1990 the financial sector comprises of large network of commercial banks, stock exchanges, financial institution and wide range of financial instruments which has undergone a structural transformation. The entry of private banks has increased rivalry and has meaningfully improved the efficiency and profitability of public banks to the point where they are now comparable to private banks. The Indian banking sector has observed a remarkable shift in its operational environment during the last decade and also results several drawbacks due to liberalization. The reform process undertaken by the government has been applied in a phased manner to allow the banks to have a level playing field and to tune themselves with the changes. Liberalization of the sector has resulted in the arrival of new generation banks in the private sector which have redefined the service spectrum of the banks.

References

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