Reforms in Indian Banking Sector: Retrospect and Prospect

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Introduction

Why Banking sector reforms were introduced? Banking Sector reforms were introduced mainly to remove the ongoing deficiencies in the banking sector. The reformations in the Indian Banking Sector were brought up with the foundation of the Narasimham Committee which was constituted in 1991. Two reports were submitted by the committee one in 1992 and the other in 1998. The reports basically focused on increasing the efficiency and viability of banking sector. Since before 1991 the banking system was both over regulated and under regulated. Over-regulated in the sense that multiple regulated interest rates were prevailing at that time and a larger proportion of bank funds were restrained from providing loans to private sector for investment by government through high SLR and CRR. And under-regulation in the sense that there was lack of transparency in accounting practices of the banks and non-application of international norms.

After nationalization of 14 large banks in 1969, an urgent need of competition aroused in the Indian Money Market which could make the financial system more competitive, productive, and efficient and hence later on Private Banks like HDFC, ICICI banks, UTI banks etc came into existence. Their existence was to bring about “Operational Flexibility” and “Functional Autonomy” in order to improve productivity, efficiency and profitability of banks.

Keyword: Banking sector reforms,Narasimham Committee, Demonetization, Goods and Services Tax (GST),Behavioural Finance,Economic and Financial Stabilization, Emerging Trends in Risks and Financial Reporting,Merger and Acquisition, Banking Crisis

We have witnessed two big reforms recently in Indian Economy one is ‘Demonetization’ in 2016 and the other is ‘GST’ in 2017.Although the instance of Demonetization plunged people into a situation of distress and gave a big jolt to the Indian economy but the major beneficiary of this move was the banking sector.

In 2017 there were rumours of some of the public sector banks being closed which was due to the “**Prompt Corrective Action**(PCA)” initiative of RBI. Some of the listed publicbanks were kept under the watch list of RBI mainly due to three reasons i) large bad loans, ii) weak capital levels and iii) low return on assets. This PCA framework is not a new but a 15 years old concept introduced in December 2002 which was reviewed in April 2017 and will be reviewed again in 2020. The PCA framework tracks three key areas of bank operation i) Gross NPA/Net NPA, ii) Capital Adequacy Ratio, and iii) Return on Assets.Since April 11 banks were put under PCA framework Allahabad bank , Bank of India, Central bank of India, IDBI bank, UCO bank, Dena Bank, Oriental Bank of Commerce, Indian Overseas Bank, Bank of Maharashtra ,Corporation bank, United Bank of India. Now, since the PCA framework was introduced only in April 2017, it will be too early to judge its performance whether it will be effective or not in future.

Coming to the otherprospecting reforms the move towards the cashless economy will encourage the digital mode of transactions. Further the Aadhaaran Unique Idenfication system and Jan Dhan Account for the financially excluded is a good opportunity for the banks as well as government in the near future.

Behavioural Finance

What is rational behaviour? Are you taking rational investment decision? It won’t be surprising to hear that maximum number of people in India make financial decision based on their emotion and biases. Mainly investmentsare driven by various sentiments andemotion like greed, fear and pride etc causing psychological biases.Many people think that they canoutperform the market and make profit simply by replicating the strategies which are used by successful professionals and/or taking the opposite position held by the "losers". But do you think investment decisions are that easy? So, one of the biggest challenges to our own success can be our own instinctive behavioural biases. Basically our mind behaves in two ways:

- **Intuitive mind:** Intuitive mindtend to make quick judgment easily with very less efforts and no conscious input. Such behavior may result into wise decisions sometimes but most of the time it lead to irrational or poor decisions incurring a big issue and losses in case of financial decisions.
- **Reflective mind**: Reflective mind tends to make decision analytically with conscious efforts. Here, the decisions are slow but more thoughtful and rational.

What is rational behaviour? A rational behavior is a decision making process which is based on making choices that result into the most optimal level of benefit. There are certain models like Capital Asset Pricing Model (CAPM) and Efficient Market Hypothesis (EMH) which help in predicting and explaining certain events. With the passage of time certain anomalies were found in the finance and economic theories which said that the human behavior is unpredictable and couldn’t be explained based on theories available. Since the traditional models of economics and finance are based on the assumption that market participants behave rationally and their decision making is free of biases but in reality the investors are subject to behavioural biases. Daniel Kahneman and Amos Tversky are considered the fathers of behavior economics/finance. Later

Richard Thaler went on to collaborate with Kahneman and Tverskywho intermingled economics and finance with psychology to present rational concepts.So, one of the biggest challenges to our own success can be our own instinctive behavioural biases.

Behavioural Finance helps us to have peace of mind, make us understand our risk appetite, allows us to feel more confident about our investment plan, make us understand the purpose of each investment in our portfolio, help us to predict trading behavior, saves us from making common behavioural mistakes, used as a basis for creating more efficient trading strategies.

The chart below is a great example of this emotional rollercoaster and how it impacts our investment decisions.

Source: https://www.investopedia.com/advisor-network

Managing and Resolving Systemic Banking Crisis

Since the great depression of 1930s the world economy faced its most dangerous crisis in 2008. These episodes of financial crisis have generated huge costs to both national and international financial system. Banking crisis is that which affects banking activity. In systemic banking crisis a country experiences a large number of defaults and financial institutions and corporations face great difficulties. Whereas managing a systemic banking crisis is a costly, complex and a multiyear process. An efficient coordination of the banking strategy and the overall appropriate policy framework is required to minimize the cost of banking crisis and to manage the banking crisis successfully. A delay in addressing the emerging crisis always tends to increase the costs and prolongs the crisis. An area of research known as Early Warning System (EWS) has been developed to predict the crisis and avert the cost arising from such crisis**.**

According to IMF India's financial sector is facing considerable challenges with high non-performing assets. Financial Sector Assessment Programme is conducted jointly by a team of IMF and World Bank. The aim of the programme is to have a very comprehensive and in depth view of the financial system in countries with big systemic financial systems.

Indian Banks' Association(IBA) revealed that increasing NPA in banking sector i.e default payment in education loans is causing crisis in the Indian banks. Rising NPA in education loan is propelling banks' stress. The default in repayment has risen to 7.67% of the outstanding amount at March-end, 2017 from 5.7% 2 yrs ago. Further, the total outstanding education loan at end of the fiscal 2016-17 was Rs 67,678.5 crore, of which Rs 5,191.72 crore could be categorised as NPA.

Although the Reserve Bank of India (RBI) has announced various restructuring schemes, the bad loans have risen up from Rs 261,843cr by 135 per cent in last two years. They now constitute 11 per cent of of the gross advances of Public Sector Unit (PSU) banks. In all, the total NPAs including both the public and private sector banks were Rs 697,409cr in December 2016. These figures were compiled by Care Ratings.

RBI's Financial Stability Report (FSR) said, "Under baseline scenario, the PSBs' GNPA ratio may increase to 12.5 per cent in March 2017 and then to 12.9 per cent in March 2018 from 11.8 per cent in September 2016, which could increase further under a severe stress scenario."

Economic and Financial Stabilization

"The (global economic growth) curve is moving up slowly, it is obvious that this upward movement is going to help several economies including India." The major objectives of economic stability are full employment and the achievement of a degree of price stability**. I**nstruments used to attain economic stabilization are: Monetary Policy, Fiscal Policy and Direct Controls.

Recently, the government (Finance Minister ArunJaitley) tabled a Financial Resolution and Deposit Insurance (FRDI) bill 2017 in August in the Lok Sabha. The main provision of this bill is to set up a resolution corporation replacing the existing Deposit Insurance and Credit Guarantee Corporation.**The motive of the bill is to protect customers of banking system in times of financial distress. But the bill is in controversy due to its "bail in" clause.** While 'bail out' clause refers to the use of public funds to permeate capital into a sick company and 'bail in' clause involves the use of depositors' funds for such purpose. This 'bail in' clause has caused a lot of concern among depositors who are worried they may lose their hard earned money deposit with the banks. The bill is being reviewed by the committee due to the controversy.Financial System Stability Assessment (FSSA) is taking a close look at the Financial Resolution and Deposit Insurance Bill.

Emerging Trends in Risks and Financial Reporting

An industry consist of multiple functioning departments some are interdependent and some are not but at the end of the day all these departments are interlinked together in a common thread by Accounting and Finance Department. Every department records and reports its accounting and financial aspects for presentation before its stakeholders. Financial Reporting provides vital information about the financial health and activities of the company. Also accounting disclosures are as important as the actual numbers. Hence standards and rules should be kept up to the mark with the evolution of different nature of companies. Investors, Board of Directors, Senior Managers and other stakeholders are seeking more finance department now. Proper Financial Reporting helps the management to make efficient decision regarding the company's objectives and its overall strategies.

New Trends in Financial Reporting

A demand for concise financial reporting is increasing day by day. The anomaly regarding longer and detailed financial reporting is unwillingness to read and understand it by the shareholders due to its length. The willingness to read an annual report decreases when the report length reaches 100 pages or more most of the accountants and shareholders drop reading it at amidst.Concise financial reporting meaning "cutting the clutter", this movement seeks to bring to life the statement "less is more". In Present Scenario the success of any organization is not just bound to its traditional measures of financial and manufacturing capital but a series of issues are increasing in its context such as environmental impact, broader concept of sustainability and information and technology. Hence the organizations are more progressively required to consider a huge range of externalities such as social, intellectual, environmental etc. The need for more value based reporting led to the establishment of the International Integrated Reporting Council (IIRC) in 2010. This was an international movement how to provide a more integrated form of reporting for companies.

The IIRC's CEO Paul Druckman Stated "Integrated reporting is an attempt at getting businesses to tell their story (or strategy) by addressing six different capitals or stores of value they use to produce goods or services.These are financial, manufactured, intellectual, human, social and relationship and natural capital.Information about financial and manufactured capital is currently provided by the financial report while information about natural and social capital is conveyed by a sustainability report. However, information about intellectual and human capital is not yet well reported" (Fisher, 2015).

It is important to understand that integrated reporting is not just merging financial and sustainability reports but combine and link the disconnected financial and sustainability data in a meaningful way. It is the interlinking between the sustainability strategy and business strategy to provide the relevant information which is useful and helps stakeholders to identify the priority areas for decision making.

According to Times of India article update of February 2017 in order to improve the disclosure standards and help shareholders in their decision making, SEBI had asked top 500 listed companies to voluntarily adopt integrated reporting in next financial year 2017-18. The companies are required to prepare BRR (Business Responsibility Reports) additionally with the annual reports.

New trends in Audit reports

After Global financial Crisis a loud call in the change in the pattern of audit reports has been observed. The call is to present more detailed and descriptive audit reports rather than just a pass/ fail type of audit opinion. Now with the new standards set up a more detailed audit report including the Key Audit Matters (KAM) is required to be presented by the auditors. The key matter would be the risk area and the detailed outline of the tests they performed to satisfy themselves regarding the financial performance and position of the company.

Financial Intermediary and Capital Market

Financial intermediaries are playing a key role in the world economy today. They are behaving as the lubricants that keep the economy going.A **financial intermediary** is an institution or individual that serves as a middleman among diverse parties in order to facilitate financial transactions. Some of them are commercial banks, investment banks, stockbrokers, pooled investment funds, building societies, credit union, financial advisers or brokers, insurance companies, collective investment scheme, pension funds cooperative societies and stock exchanges.Financial intermediary directly and indirectly connects the surplus and deficit agents.

Financial intermediaries in recent trends are playing pivotal role in elimination of poverty and other debt reduction programs.Some other initiatives of financial intermediaries like micro credit have reached out to the neglected masses increasing the economic well being of them. Further “financial hyper marts” are being developed to cater the complete needs of the investors and borrowers.

With the increased complexity of the financial system, banks and other financial intermediaries have to come up with new and innovative products and services to meet the diverse needs of the borrowers and lenders.New and innovative roles of Financial Intermediaries are evolving in the Economy nowadays. Some of the programmes are:

- Entrepreneurial Development programmes(EDPs)
- Self-employment programmme
- Housing finance
- Backward area Development
- Priority sector
- Integrated Rural development scheme
- Introduction of Electronic System

There existed very few individual investors in the pre-independence period henceIndian capital market was hardly in existence at that time.Indian Capital market showed a widespread growth after independence. Capital Market supplies industry with fixed and working capital and finances medium term and long term borrowing of the central state and local government.

The Indian capital market is divided into two. First the gilt-edged market referring to the market which trade government and semi-government securities backed by the RBI. Second the Industrial securities market referring to the market that trade for shares and debentures of old and new companies.This market is further divided into the new issues market and old capital market meaning the stock exchange.

New financial intermediaries introduced in Indian capital market are:

- Merchant Banking
- Leasing and Hire- Purchase Companies
- Mutual Funds
- Global Depository Receipts (GDR)
- Venture Capital Companies (VCC)
- Other New financial Intermediaries
- Technology Development and Information Company of India (TDICI)
- Risk Capital and technology Finance Corporation (RCTFC) Ltd.
- Infrastructure Leasing and Financial Services (IL &FS) Ltd.
- Credit Rating Information Services of India (CRISIS) Ltd.
- Investment and Credit Rating Agency (ICRA)
- Credit Analysis and Research (CARE) Ltd.
- Stock Holding Corporation of India (SHCIL) Ltd.

One more market is growing worldwide erratically these days that is the cryptocurrency market with when Bitcoins came into existence in 2008 published under the name of Satoshi Nakamot. Bitcoin was set into the blockchain for the first time in 2009. Cryptocurrency is digital money traded online without any intermediary. The trading of cryptocurrency is based on block technology. There is no any legal framework regarding the trading of cryptocurrency in India still people are trading with bitcoins and other cryptocurrency. According to CNBC India Report a committee of finance ministry officials, IT ministry officials, NITI Aayog, and Reserve Bank officials, may be inching closer to legalizing virtual currencies in India.

Merger and Acquisition

Merger and Acquisition are strategic moves usually taken by companies foreseeing scope for business expansion. Merger leads to formation of a new company, acquisition leads to purchase of a company by other and no new company is formed.A great potential has been seen in case of Merger and Acquisition (M&A) deals in India. Indian Companies are heading towards new markets and many foreign companies are trending towards Indian Companies for their growth and expansion. The volume of M&A deals has been trending upwards particularly in the fields of pharmaceuticals, FMCG, finance, telecom, automotive and metals.Liberalization, economic reforms, need for investment in Indian Corporation, favorable government policies are some of the factors which lead to the growth of mergers and acquisition in India

India is likely to see M&A worth $50 billion in 2018 according to a report. According to different data compilations, there were a total of 944 transactions (664 domestic and 280 cross-border) in 2017 worth $46.5 billion ($13.1 billion domestic and $33.4 billion cross-border), said the chamber(ASSOCHAM).This was against a total of 553 transactions (358 domestic and 195 cross-borders) worth $17.5 billion ($7.2 billion domestic and $10.3 billion cross border) in 2016.Further to encourage merger and acquisition in India the chamber recommended easing of guidelines and legislative support in the Income Tax Act and the Competition Act. "Amendments in the Stamp Act, 1899 to bring uniformity of Stamp Duty in all Indian states particularly to M&A transactions can prove to be a catapult for the future M&A's in India," Assocham said.

- In April 2017 Indian e-commerce giant Flipkart acquired the Indian wing of eBay, which infused $500 million into Flipkart as well as sold its Indian operations unit for an exchange of equity stake in Flipkart. As Flipkart doesn’t have the global presence, the acquisition will bolster the cross border trade and help Flipkart to combat Amazon’s onslaught.
- Axis Bank acquired Accelyst Solutions Private Limited and Freecharge Payment Technologies Private Limited for $60 million.
- Vodafone-Idea merger
- Airtel-Telenor merger
- Google’s acquisition of Halli Labs
- Based in Bangalore, Halli Labs develops solutions to traditional problems using Artificial Intelligence (AI), Machine Learning (ML), and deep learning technologies. Google acquired this 4-month old startup for an undisclosed amount in June 2017.
- ONGC to complete Hindustan petroleum acquisition by March

Strategic Policy and Entrepreneurship

The fastest emerging megatrend of 21st century is Entrepreneurship. Entrepreneurship is inclining towards reshapingof economies and industries throughout the world. Entrepreneurs are the life blood of any expanding economy, generating jobs, introducing new products and services and promoting greater upstream and downstream value chain activities.

The ideal entrepreneurial environment involves five pillars:
1. Access to funding;
2. Entrepreneurial culture;
3. Supportive regulatory and tax regimes;
4. Educational systems that support entrepreneurial mindsets; and
5. A coordinated approach that links the public, private and voluntary sectors.

India has ranked 68th position in the Global Entrepreneurship Index (GEI) of 2018 which is topped by US the list was prepared for 137 countries in the world. The GEI score is based on overall entrepreneurship attitude and potential. India was at 76th position in 2014 69th position in according to the GEI of 2017. For the first time a Ministry of Entrepreneurship (with Skill development) was introduced by the present government. The reasonbehind it was the poor record of nurturing entrepreneurs and creating an entrepreneurial ecosystem. The business culture in India is dominated by males and there is little for women entrepreneurs. In a report of World Bank it said that India can grow in double digits if more women participate in the product line of the Indian Economy. The country needs more women entrepreneurs who can drive the economy ahead. For Instance Pradhan MantriRozgarYojana preference is given to women beneficiaries and several relaxations are given to women to facilitate their participation.

Conclusion

It has to be understood that although there are similarities and common parlance among countries but still in the end, all countries have to act differently to deal with their special social, economic, legal and political issues. It is very important to keep in mind that no model prove one size fits all model for dealing with the different issues of different countries. Management of crisis and implementation of reforms often requires adjustments in most aspects of economic policy implementation.Commerce and Industry Minister Nirmala Sitharaman in one of her interview indicated that “systemic reforms being pushed by the government may have some short term pain but will make India an easier place to do business.” The government’s major priority in this pre-election period is to accelerate the growth momentum. The recent Government of India is committed towards making systemic reforms which will eventually bring rapid growth in near future. In current scenario implementing necessary structural reforms in order to restore a healthy banking sector is of paramount importance further the focus of the government is shifting towards specified policy initiative aimed at improving job opportunities and growth numbers.Thus with so many new and effective schemes and initiativeadopted by the government of India, things are looking quite positive for the banking sector.

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