"FINANCIAL SECTOR REFORMS & THEIR IMPACT ON BANKING SECTOR"

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ABSTRACT:

Indian economy has been recording impressive growth rates since 1991. The main thrust of the financial sector reforms has been the creation of efficient and stable financial institutions and development of the markets, especially the money and government securities market. In addition, fiscal correction was undertaken and reforms in the banking and external sector were also initiated. The year 1991-92 is the year of remarkable initiatives taken by the Government of India affecting the various facets of the Indian economy. Considering the scenario in which banking sector was in the year 1990-91, a number of initiatives were taken by the Reserve Bank of India for improving the efficiency of the banking sector and for opening up the banking sector. Taking this as a base, the author intends to examine the impact of the reforms on Credit Deposit ratio, Credit to GDP ratio, Investment in Government securities to deposits, share of business of public sector banks, the proportion of various types of advances etc. Further, it goes on to examine the difference in various aspects of the working results of the Public sector banks and private banks when compared with foreign banks.

[Keywords: Indian economy, Capital market, Foreign exchange reserves, Economic growth, and Banking Sector Reforms].

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1.0 Introduction:

Financial sector reforms introduced in the early 1990s as a part of the structural reforms have touched upon almost all aspects of banking operation. For a few decades preceding the onset of banking and financial sector reforms in India, banks operated in an environment that was heavily regulated and characterized by sufficient barriers to entry which protected them against too much competition. The banking reform package was based on the recommendation proposed by Narsimhan Committee report (1992) that advocated a move to a more market oriented banking system, which could operate in an environment of prudential regulation and transparent accounting.

One of the primary motives behind this drive was to introduce an element of market discipline into the regulatory process that would reinforce the supervisory effort of the reserve bank of India (RBI). Market discipline, especially in the financial liberalization phase, reinforces regulatory and supervisory efforts and provides a strong incentive to banks to conduct their business in a prudent and efficient manner and to maintain adequate capital as a cushion against risk exposures. The administered interest rate structure, both on the liability and the assets side, allowed banks to earn reasonable spread without much efforts.

Although banks operated under regulatory constraints in the form of statutory holding of government securities and the cash reserve ratio (CRR) and lacked functional autonomy and operational efficiency, the fact was that most banks did not efficiently. The functioning of the market's disciplining mechanism and also the effectiveness of the supervisory process, however, is hindered by weak accounting and legal system, and inadequate transparency of accounting disclosures. From a central bank's perspective, such high-quality disclosures help the early detection of problem banks by the market and reduce the severity of market disruptions. Consequently, the RBI as part and parcel of the financial sector deregulation, attempted to enhance the transparency of the annual reports of Indian banks by, among other things, introducing stricter income recognition and assets classification rules, enhancing the capital adequacy norms, and by requiring a number of additional disclosures sought by investors to make better cash flow and risk assessment.

2.0 Main Objectives of the Study:

The main objectives of the present study are as follows:

1. To find out the Impact of financial sector reform on banking sector throughfollowing correlation.

- Profitability per employee and expenses per employee.
- Profitability per branch and expenses per branch
- Profitability per employee and business per employee.
- Profitability per branch and business per branch.

3.0 Hypotheses

1. Profitability per employee is significantly correlated with the expenses per employee and business per employee.
2. Profitability per branch is significantly correlated with the expenses per branch, business per branch.
3. Profitability per employee and per branch is significantly correlated with the Net NPAs to Net Advances. Database Performance Highlights of Public, Private and Foreign Banks (various issues, 2004-2005 to2009-10), IBA, Mumbai

4.0 Review of the Literature:

Joshi (1986) in his study of all scheduled commercial banks operating in India analyses the profitability and profit planning relating to the period 1970-1982. The study discusses and trends in profits and profitability of commercial banks nationalization. The factors leading to the deterioration of profitability are highlighted.

Minakshi and Kaur (1990) attempted to measure quantitatively the impact of the various instruments of monetary policy on the profitability of commercial banks. The study empirically proves that pre-liberalization banking being highly regulated and controlled industry, has suffered a lot so far as profitability concerned. The bank rates and reserve requirements ratio has played a significant role in having a negative impact on the bank's profitability.

Ojha (1992) in his study attempts to measure the productivity of public sector commercial banks in India. After identifying various measures of productivity like total assets per employee, total credit per employee, total deposits per employee, pre-tax profits per employee, net profit per employee, working funds per employee, ratio of establishment expenses to working funds and net interest per employee, comparison is made with the banks at the international level. The study concludes the Indian banks have very less productivity ratio compared with western countries. Since in his study a comparison has been made of Indian public sector banks, which have to perform other social functions unlike western commercial banks.

5.0 Data analysis and Discussion:

This paper contributes to the impact of banking sector reforms on the efficiency of banks in five different bank ownership groups in India during the post-third banking sector reforms period i.e. from 2005 to 2010. The analysis is based on ratio analysis. We used the following parameters to assess the efficiency of Indian bank groups vis-à-vis their counter parts. Profitability per Employee: The profit per employee is in the range of Rs.0.41 to 2.32 lakhs during the study period in G-I, similarly, it was between Rs.0.77 to 2.04 lakhs in G-II, Rs.1.08 to 6.15 lakhs in G-III and Rs.8.07 to 15.17 lakhs in G-V.

Table-I: Profitability per Employee - X1

(Rs. Lakhs)

Years	G-I	G-II	G-III	G-IV	G-V
2004-05	0.44	0.85	1.08	7.75	8.07
2005-06	0.41	0.77	1.09	5.14	8.35
2006-07	0.65	1.21	1.89	4.56	12.12
2007-08	1.65	1.59	2.62	9.20	15.17
2008-09	2.32	2.00	5.09	5.20	14.89
2009-10	2.03	2.04	6.15	0.77	11.52
Average	1.26	1.42	2.98	5.44	11.68
S. D.	0.85	0.55	2.15	2.91	3.06
C.V. (%)	67.46	38.73	72.15	53.49	26.20

5.1 **Profitability per Branch:** For Indian public sector banks, the profits per branch were in the range of Rs.6.39 to 41.08 cr. during the study period. Among the Indian banks, new private sector banks displayed the highest profits per branch that lie between Rs.19.09 to 174.34 cr. But overall, foreign banks show excellent results in this parameter. The profitability per branch was in the range of Rs.623.56 to 1405.67 cr. On an inter-temporal basis, per branch profits have been increasing gradually in the Indian banking sector.

The growth in branch profits for Indian banks is attributable to the overall increase in profitability in the banking industry. In the case of the foreign peer group, profitability per branch shows a small increase over the period covered by this study. Hence, on an average, branch profitability of foreign banks is higher than that of G-I, II, III & IV. But, we can also say that G-IV is quite active and competing with foreign banks.

Table-II: Profitability Per Branch - X2

Years	G-I	G-II	G-III	G-IV	G-V
2004-05	7.43	19.87	14.30	123.70	623.56
2005-06	6.39	16.39	14.24	76.44	637.06
2006-07	14.80	25.37	24.17	83.91	897.33
2007-08	23.50	33.12	35.32	174.34	1032.39
2008-09	32.70	41.08	61.12	123.96	1029.27
2009-10	27.98	41.06	71.87	19.09	1405.67
Average	18.80	29.48	36.84	100.24	937.55
S. D.	10.92	10.61	24.49	52.96	292.25
C.V. (%)	58.19	35.99	66.48	52.83	31.17

5.2 **Expenses per Employee:** On average, Indian banks pays less as compared to foreign banks. Among Indian banks, new private sector banks pay on an average Rs.59.83 lakhs as compared to G-I, II & III who pay Rs.14.00, 14.43 & 18.07 lakhs respectively. The highest expenses per employee incurred by G-V (foreign banks) having Rs.79.84 lakhs per employee. G-IV & G-V pays higher and attractive salary to the efficient employees; they also provide better facilities and incentives to their employees. Due to this reason, per employee expenses are higher even return per employee is much higher as compared to their counterparts.

Table-III: Expenses Per Employee - Y1

(Rs. Lakhs)

Years	G-I	G-II	G-III	G-IV	G-V
2004-05	9.76	9.93	13.80	44.76	76.33
2005-06	12.22	12.83	15.35	55.26	85.26
2006-07	14.30	14.55	18.34	50.76	92.99
2007-08	15.20	15.62	21.33	100.51	26.17
2008-09	15.85	16.48	19.88	60.91	74.21
2009-10	16.68	17.19	19.73	46.79	64.10
Average	14.00	14.43	18.07	59.83	79.84
S. D.	2.58	2.69	10.34	20.77	2.91
C.V. (%)	18.43	18.64	16.10	34.72	12.95

5.3 **Expenses per Branch:** Among the Indian banks, average per branch expenses incurred by new private sector banks (G-IV) is at the tune of Rs.1169.06 lakhs as compared to G-I, II % III with branch expenses of Rs.205.34, 303.38 & 228.74 lakhs respectively. But branch expenses are the highest in G-V having amount of Rs.6364.72 lakhs for each branch.

Table-IV: Expenses Per Branch - Y2

(Rs. Lakhs)

Years	G-I	G-II	G-III	G-IV	G-V
2004-05	166	232	182	747	5985
2005-06	189	274	200	820	6502
2006-07	206	304	234	934	6883
2007-08	217	326	288	1905	5866
2008-09	224	338	239	1450	5129

2009-10	230	346	230	1159	7824
Average	205.34	303.38	228.74	1169.06	6364.72
S. D.	23.99	43.43	36.52	441.82	931.51
C.V. (%)	11.68	14.32	15.97	37.80	14.64

Overall, we may conclude that among the Indian bank groups, new private sector banks had shown excellent growth in their efficiency and this group is competing with foreign banks in terms of many parameters of efficiency. Number of factors are contributing in their excellent efficiency performance like work culture, dedication, loyalty, technology, better facilities, new products/services, management, transparency etc. Business per Employee: Since different employees in a bank contribute in different ways to the revenues and profits of a bank, it is difficult to come up with one universal metric that captures the business per employee accurately.

5.4 **Business Per Employee** The business per employee is quite low in G-I, II & III as compared to G-IV & V. the average per employee business is the highest in G-IV i.e. Rs.905.83 lakhs and G-V has an average of Rs.901.50 lakhs during the study period. Thus, deposits mobilization and advances per employee are higher in G-IV & V. These bank groups are providing a better interest on deposits and lower interest on advances; their market policies are quite effective as compared to Indian public sector banks.

Table-V: Business Per Employee - Y3

Years	G-I	G-II	G-III	G-IV	G-V
2004-05	126	122	171	938	699
2005-06	160	160	202	749	817
2006-07	197	182	227	906	958
2007-08	222	205	299	1094	1014
2008-09	256	302	317	873	981
2009-10	308	379	355	875	940

Average	211.50	223.50	261.83	905.83	901.50
S. D.	65.69	93.83	72.32	112.31	119.83
C.V. (%)	31.06	41.98	27.62	12.40	13.29

5.5 **Business per Branch:** On an average, the per branch business is lower in G-I, II & III as compared to that of G-IV & V. it was only Rs.2704.17 lakhs in G-I whereas it was Rs.17659.17 lakhs in G-IV and Rs.73263.17 lakhs in G-V. In this parameter foreign banks have lion's share among all the Indian bank groups. Hence, the new private sector banks in India have led the way in this regard, because of the better use of technology and other infrastructure.

Table-VI: Business Per Branch - Y4

(Rs. Lakhs)

Years	G-I	G-II	G-III	G-IV	G-V
2004-05	2152	2860	2255	14989	54800
2005-06	2478	3411	2633	11131	62272
2006-07	2446	3793	2904	16673	70929
2007-08	1295	4260	4035	20733	69025
2008-09	3612 67787	6196	3891	20776	67787
2009-10	4242	4242	4149	21656	114768
Average	2704.17	4662.17	3311.00	17659.17	73263.17
S. D.	1058.07	1782.03	812.63	4144.05	21155.42
C.V. (%)	39.13	38.22	24.54	23.47	28.88

The problem of NPAs is a matter of serious concern. It is a very serious problem for our public sector banks. The report of the RBI on NPAs says that reducing NPAs should be treated as a "national priority". The average rate of NPAs is very high i.e. 6.03 pc in old private sector banks where public sector banks are in succession with 5.29 pc and 4.62 pc in G-I & II respectively, and for this internal and external factors are responsible.

Table-VII: Co-efficient of Correlation

Variables/ Years	G-I	G-II	G-III	G-IV	G-V
X1 & Y1	0.85*	0.90*	0.67	0.62	0.04
X2 & Y2	0.89*	0.89*	0.42	0.55	0.42
X1 & Y3	0.54	0.92**	0.84*	0.19	0.19
X2 & Y4	0.89*	0.93**	0.93**	0.61	0.92**

6.0 Conclusions:

From the above discussion, it is vivid that to have a cohesive and strong financial system capable and responding to the changed economy, it becomes important to have a dynamic, autonomous and profitable financial system. At present, Indian banking system needs a fresh outlook and keeping in mind the various distortions, government should introduce third banking sector reforms. In the end the key to banking reform may lie in the internal bureaucratic reform of banks, both private and public. In part this is already happening as many of the newer private banks (like HDFC, ICICI) try to reach beyond their traditional clients in the housing, consumer finance. The major factors, which are critical for the success in the complex scenario, are:

- Commitment to develop strong long lasting relationship with customers and to provide quality services;
- Professional, motivated and innovative staff;
- Commitment to earn the highest possible profits with consistent produce and management of risk;
- Obsess for growth.

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