Literature review: the indian banking system

Finance, Banks

Literature reviews that Indian banking system consist of a larger structure on of financial institutions, Commercial banks, foreign financial institutions. These structural transformations of Indian finance system can be divided into three parts. First, the post independence period (1947-1968). The Reserve bank of India, performed role as a supervisor and controller of finance system. RBI, dominated over all the forms of finance controls in India. In this time RBI, worked on financial stability, credit control, and regulation of interest rates and formation banking structure. The second financial repression, period <1969 to 1990> the movement commenced with the nationalization of banks. This nationalization of commercial banks derives the base for changes in finance and banking system. The result into interest rate regulation and credit programmers deposit and banking working methods etc. The third period known as financial reform and liberalization period. Started in early 90's. In that period government of India was more likely to more liberalized. The three committee in 1985, vagual in 1987 and the Narasimham committee 1991. The most influential recommendations made by the committee of Narasimham regarding liberalization, consolidation and privatization in banking system. And the government of India started a financial reform era with the financial sector liberalization program. The main aims of financial liberalization program is to regulate the rates of interest, cash reserves and performance financial system consist of financial institute stocks exchanges and banks. It makes liberalization program enhance the importance of banking sector and make it more efficient and competitive.

The globalization, deregularisation and privatization system emphasized on Washington consensus. These leads country to simplistic way of transforming system by functioning of market and state owned institution’s restructuring. The liberalization program made changes internal economy. It restated more competitive and productive in shorter period. The liberal interest rates and reserve limits of banks resulted into stable and sound borrowing and lending market and monetary policy of government. The bank requires to keep certain amount of reserves to avoid too uncertainty an future due to competitive market another element of banking reforms is stabilization, non performing loan, which burdensome for banks are recapitalized and require standard working environment one of the most effective part is alteration of state owned banks into private sector banks. Under the government controls state owned banks recommends to sell out its public portion to private sector and consume the public property in other economic project which needs more funds and these funds are taken from the privatization of state owned banks.

Under the Nationalization act 1969, the largest banks were nationalized with the aim of increase in public deposits. The reason behind the nationalization of banks to grow the economy and bank network expansion. The government of India requires enhancing the economy and serving to prior areas. In 1980, more six banks were nationalized added into public share in banks to keep landing to priories’ areas. It was material to control on banking system and resulted into increase in priority area landing and five year plans of Indian Government. Moreover, these turned into inefficiency in banking system instead of providing equal distribution of funds. Addition banking system faced problems in 1980s these are the period of unprofitability and inefficiency and in mid 80s creates more limitations on returns and capital and reserves. These leads banks to the unrealistic performance standards. As mention above the 1991 Narasimham committee caters a influencing idea on banking sector reforms which idealized on interest rate deregulation, credit services and entry of new banks on Indian market private as well as foreign banks.

Before the committee, interest rates were medium of subsidiary between different sectors of economy. Deregulation of interest rates was major part of making reforms that gave growth to financial savings and improve organizational finance system. On the other hands committee recommended total liberalization on deposits rates. In 2004 RBI set only rates for the savings and NRI deposits rates rest of the other deposits banks are free to levy their rates. The last major recommendation of committee was on entry of new banks in Indian market. Before it was a limited authority to the banks to do with interest rates and deposits, there were totally restrictions for new banks entry. Due to liberal view of new banks entry in Indian market seven private and twenty foreign banks started their operations in India after 1990. As per RBI (2004), the liberal aspect of new banks entry improved the quality of operation, risk management, technological changes and competition.

In addition, before 1990 public sector bank distorted market system by its non profitability and inefficient management. To recover the stability in market Government inject more funds in 1993 and 1999 to liquidate the government and depositors bear loses through public sector banks. In 1995

SBI act framed partial privatization of public sector banks and SBI was the first bank to get funds in form of equity and become private sector bank. Despite of partial privatization Government decide to increase the private holding up to 49 percentage and to control banking system appointment was made for a public agent to control administrative strategies after all the changes have been made the Indian banking sector covers several changes and explore the improvement effect.

In case of privatization of Indian banks there are only interest rates, credit control and deposits rates to know the changes in economy are increase in savings. It predicts the removal of deposit policy in baking will lead to increase in capital availability these can make changes in private sector capital formation. The interest rates make vary forms the fixed deposit rates, lending rates are increased and steadily decline in 1990 which effect on today’s market. The Repressioninst policy reduction improves the risk management of banks it is an indication of liquidity. The liberalization treated as an instrument of financial policy reformation of credit rates and statutory lending rates the division of two rates in minimum and maximum can gradually effect the repressive of monetary policy. As the liberalization program aimed to make banks more efficient and productive to compose the efficiency of banking sector based on technical efficiency, scale and scope efficiency called parametric and non parametric efficiency. The parametric methods considered banking returns and input like production and profit, cost, revenue to know how effective bank is performing.

In Indian traditional economy needed to lift the banking sector through technological changes, global market, economic pressure and bank crisis forced to change in way of doing business in traditional way. It helps in increase in competition at local market by removal of interest rates on current account, deposit rates. More competition enhanced the service of banks in free services, capital formation and mergers. The Indian economy faces various challenges due to privatization. First, the government unable to consider the running of nationalized banks during 1997-1998 crises. In this period government cannot pressure the security holders to disclose their holding and these creates problems in negotiation of foreign bank partners and for debt forgiveness issues. Though state owned banks serves qualitative and respectable task in banking sector. In India, state owned banks only work on remote areas like rural and urban banking. Alternatively some credit unions and financial institution also seems, in remote areas state owned banks encourage small and medium enterprises by lending programmers, in crisis time state owned banks has quick time to deal. The cycle time is quicker than private banks some time lack of local infrastructure for finance, government organization only is the way to get hands. These are the way state owned serves public and make quality service against less return against service.

Privatization Experience and Issues

The privatization in recent years, the way to sell out some states to some financial institutions foreign organization. Other way government directly sell its parts to public in form of equity in stock market. These method might be useful to countries state owned banks because lack of supervision of bank management, another thing is to transparent operations before it privatized, because of they need to know the what they are buying. The bad factor during privatization was bank commercialization and collection of loans. Globalization suggest the more effective completion partially nationalize banks therefore moved to fully privatized in short period for operational efficiency later on the issue arise on reserving some share for state. The share of state in private banks derives the powers to influence the decision making and strategies of banks. The way accepting a state ownership becomes a better option.

Mergers and consolidation and efficiency

The banking system consists of various institutions in size, ownership, competitive profitability, structure and technology. The relationship between profitability and size of bank is relative, smaller number in having loss making institution and lager organization has very advantage over small organization like return on capital. But smaller banks have good efficiency in work while large organization. Above state bank consolidation is new phenomenon for competition due to entry of foreign banks, privatization and deregulisation.

Crises deregulisation and globalization causes increase in the foreign banks in economy, there is no doubt that the region has become more open for foreign has become more open for foreign banks. The foreign bank entries enhance the quality of banking services foreign participation load to foreign international trade and membership of the European union and these will turn domestic banks into foreign banks and assist home country to provide service abroad. As foreign banks came in India, they serving large corporate customers and no service for ruler and small sized organization they are unattended. The risk of pricing is in foreign banking is more likely. If risk was proper than organization have advantage because the foreign banks entry is dangerous because of distribution and a market imperfection reasons.

There is a plenty of literature on the bank efficiency but in the developing country it concerns to banking performance on maintenance acquisition and regulation and mergers. There are various hypothesis to measure the efficiency of banks but due to mix results if enable to derive the proper result. Deregulation in various country will goes very well in developing country. The mergers and acquisitions are improves the efficiency. The improvement efficiency is mainly generating higher output than input, revenue than costs.

Micro economy theory provides the framework for effective banking, in the developing country due to lack of completion. They started reforming economy with deregulation. Deregulisation give more freedom to banks and thus if increase in bank cost and technical progress of liberalization. The state ownership banks aims to fulfill public aims and government plans. The non economic goals such as provide low rate leading, loans and interest rates stability. It called public owned bank but there is no access for common people to participate in management actions. The collective decision making process lead management to inefficient last the state bank is the support from government and gets benefit to inefficient management. Over the last two decades. Many countries are availing to go with private state owned banks. Privatization is the way of improvement in efficiency. Privatization brought drastic changes in ownership of Indian banking sector from government to private, private and local control to foreign control.

Privatization deals in change in corporate field and looking for improvement. Ownership push the organization toward divestment mechanism to improved management structure. Berger argues that the examination of bank efficiency is varied in form of static, dynamic and selective on performance. Even though, bank efficiency is improves any in different structured banks. By Appling a vital concept of bank efficiency gives more detail literature for privatization liberalization affect and foreign institution participation with respect of developing economy and Indian finance system. The financial reforms provide so many improvements in Indian economy. First, improvement In financial structure of banking industry there is more sophisticated and define process carried between intermediate banks and financial institutions. The lowering the statutory-emption had lowered and that turn to provide more finance for commerce in India. The structure of intrest rates become more gradual and independent so many banks can provide better loans and landing system makes easy and vast so financial exchange become fast and reliable. To enhance the performance of public sector banks are recapitalized and put some restrictions on management and allow public agents in area of operation so that it become more trustworthy. The micro prudential measure improves the bank working conditions to cope up with international standard practice the result banks improves their working conditions in just 90 days and gave more competitive and safety. The liberalization process gives many good results but it has many drawbacks too. According to world development report , the liberalizations in order to count the risk as a market reforms whereas the financial conditions are differ from the expected. The crisis of 1992 many banks were affected and these resilience filled by the government in sense of pouring money in deficits. The reforms brought technological changes in banking sector many new foreign banks had fast network of working and technology, network payments, electronic transfers these turns into best banking practice developed.