ECONOMIC REFORMS IN BANKING SECTORS AND THEIR IMPACT ON THE PROFITABILITY OF BANKS (A STUDY OF COMMERCIAL BANKS OF CHHATTISGARH STATE)

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ABSTRACT

Banking sector reforms in India have a glorious record of being a catalyst in making banking grow and develop in a robust manner. Productivity, profitability, and efficiency of the banks have all been positively impacted by the reforms that started from the year 1991. This review article analyzes the various reforms that have made the Indian banking sector more vibrant and productive. A contextual reference of Chhattisgarh state is a feature of the review. Very briefly the review highlights some major game-changer initiatives in Chhattisgarh state, thanks to the reformed banking sector.

Keywords: *Commercial banks, Chhattisgarh, Reforms*

Introduction

The banking sector reforms in India were introduced by the report of the Committee on the monetary framework, prevalently known as Narasimhan Committee. This committee, which presented its report in 1991, recommended different measures to improve the efficiency and wellbeing of the banking sector by making it more competitive and vibrant (Ahluwalia, 2002). It influenced the productivity, profitability, and efficiency of the banks to a huge degree (Mohan, 2005).

Given below are some of the key features of these reforms:

1. The changes were not driven by any banking crisis nor were they a result of any external support package. They were embraced much before the significance of the financial sector to prevent crisis was perceived by global organizations and different nations in the mid-1990s before the Asian financial crisis.
2. To expand competition in the banking sector new private sector banks were authorized. An essential for the award of the permit was that these banks must be completely automated from day one.
3. The outcomes are undeniable as these banks have become high tech banks. This has had a "demonstration" impact on the whole framework. The Government stake in nationalized and State Bank of India was brought lower permitting them to raise capital from the market.
4. Banks were permitted to diversify into various financial services and are currently offering an entire scope of financial items like universal banks.
5. Active steps were likewise taken to improve the institutional arrangements, including the legal framework and technological system.

Review of literature

There are several articles that deal with the banking sector reforms and their impact on the banks. Below are a few recent examples.

In her book, Mallya (2019), noted that some of the important banking sector reforms are – a change in banking supervision towards prudential regulations, a reduction in CRR and SLR, interest rate deregulation, prudential norms for income recognition, asset classification, and provisioning and adoption of Basel norms for capital adequacy standards.

According to Khadwal (2019), financial sector reforms in India introduced as a part of the structural adjustment and economic reforms customized in the mid-1990s have profoundly affected the working of the financial institutions, especially banks. The essential goal of financial sector reforms was to improve the locative efficiency of resources, guarantee financial stability, and keep up trust in the

financial framework by upgrading its soundness and efficiency. The paper is introducing financial sector reforms in India, recognize the arising issues, and investigate the possibilities for additional change. The efficiency and profitability of the banking sector in India have assumed great significance because of extreme competition, greater client demands, and changing banking sector reforms. This investigation endeavors to measure the relative performance of Indian banks. For this investigation, the researchers have utilized public sector banks, old private sector banks, new private sector banks, and foreign sector banks. We know that in the service sector, it is hard to evaluate the output since it is intangible. Segmentation of the banking sector in India was done along with the accompanying premise: number of banks, offices, number of employees, business per employee, deposits per employee, advances per employee, bank assets size, nonperforming assets, and so forth. It implies that efficiency and profitability are interrelated. The facts confirm that efficiency isn't the sole factor yet it is a significant factor that impacts profitability. The key to expanding profitability is incremental efficiency. For this, the authors have prescribed a few recommendations to tackle the difficulties faced by the banks especially public sector banks.

The examination by Chattopadhyay (2019), analyzes a few features of the banking sector improvement during the post-reform period beginning from a change in the structure of the banking sector to efficiency, productivity, and soundness. This is finished with the assistance of accounting measures. The Indian banking sector has had the option to change itself from a conventional banking set-up to a modern and universal banking system by offering different types of services without affecting the social banking component. The selection of innovation encouraged such change. It is presently following the best global practices as set by the Basel norms. Therefore, different efficiency/productivity and soundness boundaries have moved towards the best worldwide standard. The examination of different accounting measures recommends that there has been a huge improvement in the efficiency and productivity of the commercial banks in the post-reform period, although the level of progress shifts across the bank groups. It has put itself into a worldwide standard in numerous angles, including new products, service quality, and improved payment and settlement system.

A study by Sethi and Krishnakumar (2020) states that, in India, the NPAs increased numerous folds and reached alarming levels in 2013. The available mechanisms, for example, the Corporate Debt Restructuring Scheme, were not satisfactory to address this issue. The Central Reserve Bank of India with the Government of India presented different guidelines, schemes, and regulations like system for revitalizing distressed assets to tackle NPAs during the period 2013-2017. Taking the instance of India, the motivation behind this paper is to inspect strategy activities and investigate the effect of regulatory shocks on the equity market returns and the systematic risk of individual banking stocks utilizing an all-encompassing version of the market model. The examination finds that banking stocks didn't generate significant abnormal returns on the declaration of these measures. Notwithstanding, the systematic risk of the banking sector reduced significantly on the introduction of regulatory measures, and this risk reduction has been fundamentally in the stocks of private sector banks.

Review of reforms

The banking sector reforms were introduced based on the recommendations of various committees especially the two Narasimhan committees in 1991 and 1998 (Narasimhan et al., 1991; "Economics Discussion", 2020; Varghese, 2020).

1. The first phase of reforms: The first phase of reforms included the following –

- Change in Policy Framework: The improvement in policy framework has been accomplished by reducing the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), deregulation of interest rates, widening the extent of lending to priority sectors and linking the lending rates to the amount of advances.

- Improving Financial Health: Attempts to improve the financial strength of the banking sector has been made by prescribing prudential norms. Also, steps have been taken to diminish the extent of Non-Performing Assets (NPAs).
- Enhancements of Institutional Framework: Recapitalization, creating a competitive environment, and strengthening the supervisory system.

2. The second phase of reforms: Based on suggestions of the Committee on Banking Sector Reforms, April 1998 (the second Narasimhan Committee) the RBI issued prudential norms. The significant goal of setting such norms was to ensure soundness, financial safety, and solvency of banks. These norms are coordinated toward ensuring that banks carry on their activities as prudent entities, are free from undue risk-taking, and don't violate banking regulations in pursuit of profit. The major focus of the reforms was the following –

- NPAs: The public sector banks faced a key challenge in the 1990s in terms of NPAs. The RBI offered three options to banks to restructure bad debts: Debt Recovery Tribunals (DRTs); Settlement Advisory committees (SACs); and Recapitalization from the Government. The most recent development for the resolution of NPAs is the Insolvency and Bankruptcy Code 2016. The Insolvency and Bankruptcy Code, 2016 (IBC) is the bankruptcy law of India which looks to merge the current structure by making a single law for insolvency and bankruptcy. The bankruptcy code is a one-stop answer for settling bankruptcies which recently was a long cycle that didn't offer a financially feasible game plan. The code intends to secure the interests of little financial specialists and make the way toward working together less cumbersome.
- Capital Adequacy Ratio: Banking sector changes were initiated by implementing norms consisting of Capital Adequacy Ratio (CAR). The center of such changes has been the broadening of prudential norms to be compatible with the internationally accepted standards. In 1988 the Basel Committee for international banking supervision made an endeavor worldwide to decrease the number of bank failures by tying a bank's CAR to the riskiness of the advances it makes. For instance, there is less possibility of credit to a government going bad rather than an advance to an internet business. Thus, the bank won't need to hold as much capital in reserve against the first credit as against the second. Globally, commercial banks are under the regulatory obligation to maintain minimum capital funds for security. The explanation is that a bank's capital base is fundamentally significant for its long-term viability. It likewise goes about as a safeguard in the medium term since it enables to absorb shocks and hence evade the risk of bankruptcy. A bank's capital funds should be identical to the prescribed ratio on the total of the risk-weighted assets and other presentations. CAR is a proportion of the measure of a bank's capital expressed as a level of its risk-weighted credit introductions. It is identified with risk weight assigned to assets obtained by banks in the typical cycle of conducting business. It is additionally identified with the extent of capital to be maintained on such total risk-weighted assets. CAR is determined based on risk weightage on assets in the books of accounts of banks. Any kind of business exchange did by a bank involves a certain particular sort of risk. Along these lines, for wellbeing, a bit of capital must be put aside to make arrangements for this risk. This segment goes about as a hedge against uncertainty, i.e., a 'secret reserve' to absorb any conceivable future misfortune.
- Diversification of Banking Operations: During the time of economic liberalization PSBs have expanded their activities considerably. They have moved in new areas such as mutual funds, venture capital funding, merchant banking, and other para-banking activities such as factoring, leasing (lease financing), hire-purchase, and so on. The principal objective has been to make profits by deriving the greatest economies of scale and scope, amplifying the client

base, and giving different kinds of banking services under one umbrella (both directly as also through subsidiaries). Numerous banks such as the State Bank of India have become a one-stop financial services center.

Impact on performance

The various banking reforms noted above have had a profound impact on banks' efficiency and in turn on their profitability. Below are key summary aspects that will drive banks' profitability going forward.

1) SLR and CRR: The recommendations regarding the decrease of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) has been vigorously implemented. The effective SLR has been cut down considerably. The CRR also has been cut down multiple times. Both have now been utilized all the more frequently as a tool of monetary policy. One reason for the low profitability of the banks was the high pre-emption of funds through SLR and CRR and that too at extremely low return. India utilized these funds as financing of its own operations with low cost. The return to the banks was lower than the expense of raising these funds.
2) New Banks and Branch Licensing: The reforms have seen new private sector banks. These new banks are efficient and have set standards for use of technology. These competing banks force the incumbent public sector banks to adopt new technologies. Moreover, banks with adequate capital are free to set up new branches.
3) Merger of banks: The reforms have led to the consolidation of the Public Sector banks. Given the high number of banks, with little differentiation of services made a lot of sense to merge and create a few large banks. These large banks can derive synergy benefits and be ready to take on the leading private sector banks.
4) NPAs: The reduction of NPAs is the key to improve profitability. To address the high NPAs, special Debt Recovery Tribunals have been set up. Moreover, Settlement Advisory Committees are to be set up to deal with chronic cases of NPAs. Further, securitization and sale to asset reconstruction companies will help banks to recover the maximum from the NPAs.

Chhattisgarh State Development: Result of banking reforms

A combination of right policies, natural strengths, and a vibrant banking sector has led to superior growth in Chhattisgarh state. Below are certain facets of development that highlight the strength of its banking sector.

Chhattisgarh, located in the central part of India, is among the richest Indian states in terms of mineral wealth. At current prices, the Gross State Domestic Product (GSDP) of Chhattisgarh -is estimated at Rs. 3.62 trillion in 2020–21. GSDP (in Rs.) of the state at current prices will grow at a CAGR of 9.97% between 2015–16 and 2020–21 ("Ibef.org", 2020). This clearly shows the outperformance as compared to Indian GDP growth as a whole country.

Chhattisgarh is poised for significant investment in various industrial infrastructure. Chhattisgarh State Industrial Development Corporation (CSIDC) has set up industrial growth centers, seven industrial parks, and three integrated infrastructure development centers (IIDC). The state has notified another special economic zone (SEZ) in Rajnandgaon District. As of February 2020, the state had two formally approved SEZs.

The state has allocated Rs. 4,688 crore for construction of roads and bridges under State Budget 2020–21. Moreover, the state has allocated Rs. 396 crore for the development of three smart cities—Raipur, Naya Raipur, and Bilaspur.

During 2019, 61 Industrial Entrepreneur Memorandums (IEM) were filed in Chhattisgarh with an investment of Rs. 5,132 crore. In December 2019, the Airports Authority of India (AAI) recommended privatizing Raipur airport.

Conclusion

The various banking reforms have a significant bearing on the profitability of the banks. The lowering of SLR and CRR will mean higher availability of funds for lending and hence

higher profitability. The new state-of-the-art private banks have exerted pressure on their peer public sector banks to increase their efficiency. The merger of public sector banks will bring about much-needed consolidation and will create few but large public sector banks. The various recovery processes pertaining to the NPAs will help quicker resolution and hence improvement in the banks' profitability.

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