Financial Sector Reforms in India with Special Emphasis on Financial Inclusion; an Overview

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Abstract: In the early 90's when India became a part of globalization process then it was urgent need to reform the financial markets of India to go with the globalised world. So Govt. of India introduced a comprehensive structural and financial sector reform process. The objective of the reform process was to initiate gradual deregulation of financial sector and to integrate the different segments of the financial market in order to cop up with the globalization process. The reforms of financial markets have been doing in comprehensive and holistic way. Financial inclusion, that is to bring the large segment of the country within the mainstream organized financial sector, is the most important objective of the reform process. In this paper I have tried to discuss the various aspects of reforms and the impact of it on the economy.

Key words: financial markets, financial inclusion, globalization, non banking institution.reform,

India faced a critical balance of payments crisis in 1991.In that situation, on the recommendation of the Committee on the Financial System, whose chairman was M. Narasimham, Govt. of India introduced a comprehensive structural and financial sector reform process. The objective of the reform process was to initiate gradual deregulation of financial sector and to integrate the different segments of the financial market in order to cop up with the globalization process. So it was necessary to establish a competitive and efficient banking system for the whole development process. Digitalisation and globalization of the operating environment of banks and other financial institutions has increased competitive pressure which in turn has compelled to be innovative and efficient to meet the changing customer demand. In this changing scenario the main task of the authority is to maintain the stability of the financial system as well as provide sufficient flexibility to financial institutions so that they can survive in the changing world.

The financial sector in India is going through a reform process and government is trying to create a conducive and efficient financial market to meet the post liberalization market demand and challenges. Financial sector reforms in is an essential part of economic reforms process and from early 90s the reform process is going on to stabilise the economy. Reforms in the financial markets have been implemented within the overall monetary policy framework and in coordination with reforms in money and foreign exchange markets. Many major reforms have been initiated in different phases, allowing for transition so as not to destabilize market conditions .

Aspects of Financial Sector Reforms:

Reforms in Indian financial sector are comprehensive in nature. Legal, technical, non technical, institutional and many kinds of aspects are related in this reform process.

Opening up of Financial sector: Indian financial market has been opened up for foreign entities and various restrictions has been removed in case of international transactions. Policies have been taken to prepare the Indian financial institution so that they can compete with the global institution. After the introduction of globalization process presence of foreign entities within the domestic banking sector has remarkably increased. Due to this financial openness, the cost of financial intermediation has declined and quality of financial services has improved.

Financial Regulation and supervision: In 1994 The Board for Financial Supervision (BFS) was formed to supervise the banking and non banking financial institutions because in order to get the benefits of globalization process it was necessary to introduce a strong and efficient financial regulation and supervision system. Thus the prudential regulations were fortified by reorientation of on- site inspections and introduction of off-site surveillance. Previously inspection was confined under closed economy and the inspection was to ensure the appropriate credit planning and its allocation. Now the focus has shifted to the assessment of bank's safety and soundness and to find out the areas where correction action is necessary for strengthening the financial institution and for improving its performance. In view of growing liberalization process monitoring of the cross border flow of funds has become important.

Developing and Strengthening Financial Infrastructure: A successful financial liberealisation needs some pre conditions like soundness of bank balance sheets, presence of well established institutions, existence of adequate safety nets ,vigilant supervision etc. As from early 90's foreign banks and new private banks have taken entry in the Indian financial market, competition has increased in financial system. So reform process in India has sought to strengthen the balance sheets of individual banks.

Legal measures: To get an efficient financial system it is necessary to have a regulatory framework with well defined objectives and a clear and adequate legal framework as well as a transparent supervisory procedure. All these needs comprehensive legislations, which would enable the regulatory authorities to exercise their power. The Reserve Bank of India has been trying its best to upgrade and strengthen the legal framework in order to cop up with the new environment.

a) Credit Information Companies (Regulation) Act, 2005: It is aimed at providing for regulation of credit information companies and to facilitate efficient distribution of credit. No company can commence or carry on the business of credit information without obtaining a certificate of registration from RBI. The Act also empowers the RBI to determine policy in relation to functioning of credit information companies and to give directions to such companies credit institutions and specified users.
b) Government Securities Act,2006: This Act was introduced to consolidate and to amend the law related to Government securities and its management by the RBI. The Act applies to Government securities created and issued, whether before or after the commencement of the Act, by the Central or a State Government. This Act would facilitate widening and deepening of the Government securities market and its more effective regulation by the RBI.
c) Payment and Settlement Systems Act, 2007: According to this Act ,no person other than RBI shall commence or operate a payment system except under and in accordance with an authorization issued by RBI under the provisions of the Act.

International Security Standards: At present, there are a number of security standards available for different financial applications and most of them are internationally accepted . The objectives of these standards are providing management direction, managing information security within organization, maintaining appropriate protection of corporate assets, reducing risks of human error, controlling access to information and preventing unauthorized access, counteracting interruptions to business activities and critical business processes from the effects of major failures or disasters, ete.

Migration to Basel II Norms: The world banking systems are migrating to the Basel II regime. The Basel II framework is expected to promote adoption of stronger risk management practices by banks to address major risks. The RBI has adopted a participative and consultative approach for both designing and implementing the transition process. Many public sector banks and old private sector banks have already prepared a roadmap for migrating to Basel II.

Technological Solutions for Financial Services: In modern era, technology plays a crucial and important role in banking sector. The Central Vigilance Commission (CVC) has directed to achieve hundred percent computerization of branches and already the public sector banks have crossed the 70 percent level of computerization of their business. Computerisation and adoption of new advanced technologies have enabled the banks to provide better and more efficient customer services by offering multiple options to the customer. The growth in multiple delivery channels to customers such as internet based banking, mobile banking and anywhere banking has benefited the customers as well as bankers. Now customers have a wide variety of options to choose from and banks have been able to reduce costs which have a positive impact on their profitability.

Financial Inclusion:

Another important vision of financial sector reforms in India is the inclusion of poor people into the financial sector and this is popularly termed as financial inclusion. In most developing countries, a large section of poor people has very little access to financial services. So they depend on private moneylenders for their productive and non productive purposes. In India, banking sector has spread rapidly throughout the country but in spite of that a large section of people, particularly in rural areas are excluded from formal financial system Not only rural areas, there is huge number of financial exclusion in urban areas also. The cost of financial exclusion is enormous for the society as well as individuals. This may create instability and obstacle to achieve full potential due to financial constraints. The introduction of Automated Teller Machine (ATM), internet banking, credit cards, debit cards etc are restricted to certain segments of society. A large section of people whose income is low do not have access of basic banking services. They do not have bank accounts and other services like financial advisory services, insurance facilities, payment services etc. All these are termed as financial exclusion.

Financial inclusion does mean only having a bank account. Actually the people who want access financial services but are denied is called financial exclusion.

Recommendations of the Committee on Financial Reforms: Government of India formed a committee on financial inclusion headed by C. Rangarajan in 2006. The committee prepared a strategy report on financial inclusion and submitted it to the government in 2008. The committee explained the financial inclusion as a comprehensive and holistic process for ensuring access to financial services and timely and adequate credit to poor people at an affordable cost. According to committee, financial inclusion should include access to mainstream financial products such as bank accounts, credit, remittances and payment services, financial advisory services and insurance facilities.

According to the report in India 51.4 percent of farmer households are excluded from financial service both formal and informal sources and 73 percent of farmer households do not access formal sources of credit. Exclusion is most acute in central, eastern and north-eastern regions with 64 percent of all financially excluded farmer households. The Committee prescribed various major recommendations to the commercial banks, regional rural banks and also to the co-operative banks in order to promote financial inclusion and bring the large section of people of the country within the organized financial coverage.

According to the Committee on Financial Inclusion (Chairman: C. Rangarajan), 2008, “Financial Inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.” Financial inclusion should ensure some financial services to every individual like no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive purposes, life and non life insurance etc.

Financial inclusion is necessary condition for high growth and for the reduction in income inequalities. If poor people get the benefit of basic banking services, they can contribute to the development process and can fight against poverty. Financial inclusion increases growth inducing productive activities.

Now describe the strategies for having an inclusive financial sector. If financial inclusion becomes true in reality it will bring a large number of populations within the organized financial system. Government is trying to give financial services to each individual. RBI has taken various measures for the expansion of financial inclusion in India and that is considered as essential for economic growth of the country. A developing economy needs sustainable and diversifying growth. If a large section of people remains out of financial services, they would not be able to use their full productive capacities which in turn would reduce their income as well as consumption.

So overall strategy for expansion of financial inclusion should try to improve the existing formal credit delivery mechanism, should take measures to improve credit absorption capacity among poor individual, should introduce effective outreach and technology based solutions.Indian socio- economic environment is very complex in nature and taking into consideration this thing RBI has been adopting multi dimensional approach to bring the large section of people within the financial coverage. RBI has taken different realistic measures in this regard. Here we can have a look to some kind of measures.

No frills account: In 2005,banks were instructed to make available a basic no frills bank account either with zero or very low minimum balance with the errand of achieving greater financial inclusion in order to bring maximum number of population within the organized financial coverage. All the banks including private banks as well as foreign banks are reported to have introduced the basic banking no frills account.

General Credit Card: To provide hassle free easy credit the banks has introduced General Credit Card . A card holder may have upto a certain limit based on the assessment of income of the household without insistence on security or purpose or end use credit and the interest rate should be reasonable.

Business Facilitator and Business Correspondent (BC) Models: In 2006, banks were permitted to utilize the services of non government organizations and self help groups, micro finance institutions and other civil society organizations as intermediaries in providing financial and banking services through the use of Business Facilitator and Business Correspondent (BC) models and this model allows banks to do cash in cash out transactions at the location of the BC and allows branchless banking.

Passbook facility: Banks are not interested to issue passbook to the small customers and non issuance of passbooks increases financial exclusion indirectly. In 2006, RBI instructed the banks to offer the passbook facility to all its savings bank account holders and not to charge on the customers for that account.

Pradhan Mantri Jan Dhan Yojana (PMJDY): It is a major financial inclusion programme which was launched by the prime minister Narendra Modi on 15 August, 2014. He scheme is applicable to 20 to 65 years age group and it aims at to expand and make affordable access to financial services such as bank accounts, remittances, credit, insurance and pensions. By June 2018 , over 31 crore bank accounts were opened and over Rs 792 billion were deposited under the scheme.

As part of financial inclusion principle RBI also instructed the banks to simplify the process of opening up bank accounts by the common man through a simplified Know Your Customer (KYC) procedure in the financial year 2006-07. Along with that RBI also advised the banks to promote credit counseling and financial education for the customers and also instructed to make it available all printed material used by retail customers in the concerned language.

Impact of Financial Sector Reforms: Now we discuss the impact of financial sector reform process in India. Since early 90s Indian financial sector has been going through a reform process. It has become more vibrant, competitive and efficient and it has adopted diversified systems. Now it is more market oriented. Many financial institutions have diversified and engaged themselves into various activities like investment banking, infrastructure financing, providing guarantees for domestic and offshore lending for infrastructure projects. Non banking financial companies have expanded rapidly and that are giving opportunity the depositors to hold assets and the borrowers are getting the opportunity of enhancing the scale of funding of their activities. Non banking financial companies have provide different type of services such as loans, investments, equipment leasing, hire purchase, mutual benefit and chit fund activities and housing finance. Due to the reform process, the mutual funds market is growing rapidly. The mutual funds have been mobilizing the financial surpluses of households for investment in capital markets and capital markets are the important source of financing corporate investments. Financial market in India includes money market, credit market, foreign exchange market, debt market, capital market. Nowadays, derivatives market also growing and banks also are doing the insurance business. Before 90’s the financial market used to control the pricing of financial assets and restrict the transactions and entry and financial institutions were characterized by low liquidity and high transaction costs. All these things were not conducive for development and efficiency of the markets.

The financial sector reforms have changed the structure and have increased the efficiency and stability of the financial markets and integrated the markets. But despite of improvement in banking sector due to reform process, the banking sector is still facing the problem of non- performing assets (NPA). Reform process has failed to improve the situation. Apart from that co-operative banks have failed to realize the momentum of financial reforms. Reforms have not increased its stability and efficiency rather the quality and profitability of co-operative banks have deteriorated in the reform period. This is unfortunate because only co-operative banks have extensive branch network and reach out to people in remote areas and deterioration of it means it hampers the rural credit delivery system.

Conclusion: The studies show that to go with the globalization process, Indian government has reformed the financial sector. A comprehensive and holistic approach has been adopted to continue the process of reform and the process is going on. The rules and regulations have been implemented steps by steps in different phases. It is evident that the whole financial sector has become dynamic, competitive, and efficient. Computer and other kind of new technologies have in adopted in financial sectors which have brought a significant change in financial services of financial institutions. Customers have benefited immensely from the new technologies and banks also have been able to reduce operating costs. It is also true that government’s objective to bring the large section of population within the mainstream organized banking sector is partially successful but till now huge number of people do not have any bank account. So miles to go before we sleep.

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