"Financial Liberalization and Banking Sector Effectiveness in India"

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Abstract – India has over the last decades experienced different degrees of repressive policies in the banking sector. This paper attempts to examine the changes in the productive efficiency of Indian commercial banks after financial sector reforms.

Keywords: Financial Liberalization, Banking Sector, Efficiency

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INTRODUCTION

It has been around one and half decade since financial sector reforms were initiated in India. As banks are the major segment of the financial sector in India, reform measures are primarily aimed at improving the performance of the banking sector. The importance of banking system in India is noted by the fact that aggregate deposits stood at 55 percent of GDP in 2004-05 and bank credit to government and commercial sector stood at 26 percent and 33 percent of GDP respectively in 2004. An efficient banking system has significant positive externalities, which increases the efficiency of economic transaction in general. Therefore, one of the important objectives of financial sector reforms was to improve the efficiency of banking system (RBI, 2002). Thus it is essential to study the efficiency levels of Indian commercial banks to understand the impact of financial sector reforms on its performance.

REVIEW OF LITERATURE:

Most of the studies which look at the efficiency of Indian commercial banks concentrate on cost, profit, income or revenue efficiencies [Das Abhiman, Ashok Nag and Subhash Ray, 2005; Shanmugam and Lakshmanasamy, 2001; Kumar and Verma, 2003; Mohan and Ray, 2004; Das et al, 2005; Kumbhakar and Sarkar, 2003; and Sensarma, 2005]. Among them few studies use data related to either only pre-reform period or only post-reform period. Furthermore many of them use data for a single time period which makes it difficult to compare the efficiency in a dynamic setup. While few studies concentrate on the efficiency of only public sector banks, others look at the relationship between ownership and efficiency. Most of the studies use Data Envelopment Analysis (DEA) method as a technique of analysis. While these studies are no doubt relevant, it is important to note that there are only a limited number of studies that examine productive efficiency of the commercial banks in India.

FINANCIAL LIBERALIZATION AND BANKING SECTOR EFFECTIVENESS:

The credit deposit ratio reflects the management performance of the banks. It can be seen after financial liberalization, most of the banks reported higher C-D ratio. The C-D ratio is the highest in case of the foreign banks and lowest in case of the public sector banks. The overall commercial banking sector witnessed an increase in the credit-deposit ratio. In 1980, the C-D ratio for all commercial banks was 63.32 percent, and increased to 73.46 percent in 2007. The investment deposit ratio has also increased, but marginally. The asset quality reflects the structural soundness of the banking sector. The ratio of contingent liability shows, the foreign banks are more exposed to default, which implies the foreign banks provide most sophisticated services. It is because most of the foreign banks are concentrated in urban areas and mostly carter to large clients. The contingent liability to asset ratio of the total commercial banks shows, it has declined from 25 percent in 1980 to 16 percent in 2007. The foreign banks and the private banks are exposed to more losses in case of default and the public sector banks are less exposed to default..

CONCLUSION:

In this paper we found that banking sector plays a significant role in the financial growth of a country. The banking segment reforms in India were started as a summarize measure of financial liberalization and financial sector reforms in the country. The banking sector being the life line of the financial system was treated with utmost significance in the financial sector reforms. The reforms were intended at to make the Indian banking industry more spirited, adaptable, well-organized, and productive, to follow international accounting standards and to free from the government's control.

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