BUSINESS ENVIRONMENT

UNIT-2

PART-V

2. FINANCIAL SECTOR REFORMS:

Financial sector reforms include reforms for the financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market. We know that in India financial institutions are controlled and regulated by the RBI. The main aim of the financial sector reforms was to change the role of RBI from regulator to facilitator of financial sector. It implied that now financial institutions were allowed to take decisions in many areas (like interest rate structure) without consulting the RBI. The main financial sector reforms were as under

i. Movement to market determined interest rate structure,

ii. Capital market development promotion of stock exchanges;

iii. Reduction in the Statutory Liquidity Ratio:

iv. Increase in the foreign investment limit in banks up to 50 per cent.

v. Foreign Institutional Investors (FIls) such as merchant bankers, mutual funds and pension funds to be allowed to invest in Indian financial markets

vi. Establishment of private sector banks, Indian as well as foreign.

Financial sector includes financial institutions like commercial banks, investment banks, stock exchange operations and foreign exchange market. The financial sector in India is controlled by the Central Bank - Reserve Bank of India (RBI). RBI is known as the apex (supreme) body as it occupies the top most position in the monetary and banking system of the country. RBI decides the amount of money (i.e. deposits) that the banks can keep with themselves, fixes interest rates and nature of lending to various sectors. The reforms introduced under financial sector are:

1. Change in Role of RBI: The role of RBI was reduced from regulator to facilitator of financial sector. As a result, financial sector was allowed to take decisions on many matters, without consulting the RBI.

As a regulator (prior to liberalisation), RBI used to fix interest rate structure for the Commercial Banks. After changing the role as a facilitator (post-liberalisation), RBI now facilitates the free-market forces to act accordingly. In the post liberalisation era, greater autonomy has been ensured for financial institutions for their functioning.

2. Origin of Private Banks: The reform policies led to the establishment of private sector banks. Indian as well as foreign. For example, Indian banks like ICICI and foreign banks like HSBC increased the competition and benefitted the consumers through lower interest rates and better services.

3. Increase in limit of Foreign investment: The limit of foreign investment in banks was raised to around 51% Foreign Institutional Investors (FII) such as merchant bankers, mutual funds and pension funds were now allowed to invest in Indian financial markets. Though banks have been given permission to generate resources from India and abroad, certain aspects have been retained with the RBI to safeguard the interests of the account-holders and the nation.

4. Ease in Expansion Process: Banks were given freedom to set up new branches (after fulfilment of certain conditions) without the approval of the RBI.