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Indian Banks' Nationalization and Credit Growth: A Study of Few Indian Banks to Identify the Impact Factors

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Abstract

India has completed 50 years of Indian Banks' Nationalization. This study examines the role of Banking Nationalization in India's Credit growth and also analyzes whether it has met its purpose. It assesses the impact of Banking Nationalization on credit growth over the years in rural and small scale sectors. It also covers various troubles which have arisen because of Nationalization like increased NPA and Frauds. Further, primary data is collected to found significant hurdles in achieving the goals of Banking Nationalization. The data for the study is collected through an online survey conducted across four Banks with the sample size of 250 respondents, working in Managerial Positions (Scale I and above). The data is then analyzed using Exploratory Factor Analysis with SPSS to segregate the crucial factors that have impacted the current Indian Banking Structure. It is found that Structural Issues, Poor Corporate Governance, Political Interference, Multiple Regulators, and Anticompetitive Nature are the primary impact factors. These factors along with a mixed review by the respondents on the future of nationalization, clearly suggest that there is an underlying problem with the current banking system which cannot be solved with Banks' Mergers only. There is no denying that Gradual privatization is the way forward but along the way banking structure needs a major transformation for survival, and have to show innovative approach in recruitment process, regulation, government schemes implementation, service delivery, and even use of technology. The current study also suggests some solutions based on the primary data collected.

Keywords: Bank Nationalization, Institutional Credit, Rural Credit, MSME Credit.

Introduction

Banking is a backbone of any economy as the credit provided by the banks is the main factor for continuous growth. The credit supplied by the bank is the need of the individuals, small & medium enterprises and even large scale enterprises. The growth of an economy is directly dependent on the smooth functioning of its banking and related industries. The ease of credit availability is seen as an important parameter for understanding the development stage of a country. Therefore, the banking structure plays an important role when it comes to how far and how easily the credit is available in the country. A number of initiatives like formation of developmental Institutions like IDBI, ICICI, SIDBI, NABARD, etc., along with Nationalization of Indian Banks and Setting up of Regional Rural Banks were the major policies that helped in supporting the developing Indian Economy which was majorly agricultural based. Nationalization of banks was not easy and was taken to support the rural and agricultural population, medium and small enterprises through ease of credit and Financial Inclusion. There is no doubt that the nationalization has helped Indian Economy, but every policy or initiative needs periodic review. Government ownership is found to have a negative impact on risk management. State owned banks are found to be taking more risk because of government protection (Iannotta, Nocera, & Sironi, 2013). Indian Nationalized Banks are not in a good shape now as most of them have reported huge Non-Performing Assets in last few years.

They are also facing problems like banking frauds, competition from private banks, etc. It’s time to relook if Nationalization of Banks has met its laid objectives effectively. Going by the problems faced by the Indian Banking space, questions are being raised about the current banking structure also.

How have nationalized banks performed in the important agricultural and msme’ credit growth?

What are the main issues with the current nationalized banking structure?

Previous Studies

(Micco, Panizza, & Yañez, 2007) in their study found state owned bank are comparatively less profitable than their private counterparts in developing countries and a regression analysis based on a large sample consisting of both state owned banks and privately owned bank in both developing and industrial countries confirmed larger share of state owned banks in developing countries and these state-owned banks increase their lending during the election years. The study plugs the political use of state owned banks in developing countries, but also cannot ignore the developmental role played by them. Further, (Tonnineli, 2008) has analyzed the rise and fall of State Owned Enterprises in western Countries. The phases of Nationalization and then privatization are discussed in detail to highlight the fact that the success of any structure does not only depends on ownership but changes in the socio economic structure. Increased regulation has proved beneficial in creating competitive markets for many Nordic countries like France and Swedan. (Fungáčová, Herrala, & Weill, 2013) in their study found Nationalized banks helping the economy through credit supply in comparison to foreign banks during the times of financial crises. However, the financial performance of Nationalized banks deteriorates if they are politically interfered (Shen & Lin, 2012). Partial Privatization of Chinese banks have proved to increase efficiency and revenue gains both in short term and long term (Jiang, Yao, & Feng, 2013). There is no convincing evidence to go with Privatization or Nationalization alone, it depends on a number of factors like developmental stage of the country, demographics, etc. In India, (Sathye, 2005) has studied the efficiency of partially privatized Indian Banks against Nationalized banks for the period 1998-2002. The researcher has used return on assets parameter for evaluating the financial performance and deposit per employee for efficiency performance, and found that in both the parameters partially privatized banks are doing much better as compared to Nationalized banks. (Kumar, 2014) in his report have highlighted that as per one of the report published on Economic Freedom of the World, India's score is always on the lower side mainly because of its predominantly 'public' character of banking in India. The work also emphasize on the fact that Indian PSBs have failed the objectives of Nationalization and it concludes with demand for immediate denationalization of nationalized banks. (Mitra, Samaddar, & Sen, 2016) in their study have highlighted the political motives behind the Nationalization of Indian Banks. It also confers the series of events that took place before nationalization. Further, it shows that nationalization of Banks could not achieve its stated objectives in the initial period. It concludes that during the early period, big peasants and government were the real beneficiaries of bank Nationalization and the Banks were stuck with other objectives like fulfilling the credit needs of the public utilities like electricity board, transport corporations, etc. In the long Run, Bank Nationalization has supported the Indian economy and has been pivotal in providing loans to the needy, but big Industrial houses have controlled the government policies and misused the Bank Nationalization by getting all type of exemptions and loans at lower interest rates. (Babu & Ashok Kumar, 2018) in their work have tried to evaluate the effects of Nationalization and Privatization on Indian Banks using DEA approach. The data for the same was collected for the period from 1998 to 2016. It was found that private banks are more efficient as compared to nationalized banks, and it is recommended to increase privatization in Indian Banking Space

Research Gap

Many of the previous studies found private organization doing comparatively better than their public counterparts in Indian Banking. However, developing economy like India cannot quickly take the road to privatization because of the developmental role played by the nationalized banks. This research will try to fill the gap on how these nationalized banks have performed on their nationalization objectives. There were many objectives but we will study the institutional credit growth for important priority sector i.e. agriculture and MSME. This study will also try to identify the factors which could be the reasons for nationalized banks not achieving their stated nationalization objectives, and solutions that could save nationalized banks.

Objectives of the Study

1- To analyze the current Institutional Lending Scenario in Rural and MSME Sectors.

2- To identify the factors which have affected the Indian PSBs for not achieving its nationalization objectives.

3- To identify the solutions that can save nationalized banks.

Sample Size

The data for the study is collected through online survey. The sample consists of 250 respondents from four banks. The banks selected for the research includes Canara Bank and PNB Bank which are Nationalized Bank, third Bank is SBI which is a Public Sector Bank and fourth one is IDBI where government has recently disinvested. The respondents are working in these banks in Scale 2 and above.

Statistical Tools

The data collected is analyzed using Exploratory Factor Analysis with SPSS 20 to identify the impact factors. Further primary data is also tabulated for the factors that can save the nationalized banks.

The paper is divided in two Sections. Institutional Rural Credit Scenario, performance analysis of Nationalized Banks in rural and msme credit growth. Data Analysis, Results, and Conclusion will be covered in Section II.

Section I

Institutional Rural Credit Scenario in India

The rural Credit market in India, since long has been dominated by the unorganized sector of lending. Post-Independence, there was an urgent need for ease of credit in rural areas, and also to save the farmers and bonded labors from the glitches of the Sahukars. Subsequently, several steps were taken by the RBI so that the reach of institutional credit can be increased. The steps involved the creation of Agricultural Refinance Corporation in 1963, followed by the opening of Regional Rural Banks in 1975. Another critical step was the Nationalization of Major Commercial Banks, 14 banks in 1969 and followed by six more in 1980. Further, the formation of the National bank for Agriculture and Rural Development (NABARD) in 1982, has helped in the evolution of Micro Credit in rural areas with the help of Micro Financial Institutions and Self Help Groups. All these efforts were put in to institutionalize the Credit channel for the weaker section and have resulted in increased presence among the rural population post-independence.

All these initiatives have paid off to an extent, but a report submitted in 2013 on the farmers' credit-related issues highlights the negligence of small and marginal farmers as they are still facing the problem of limited access to institutional credit. The fragmented landholdings have increased the number of small and marginal farmers in the last few decades, and thereby they constitute about 80% of the current land holdings. The report also mentions that untimely and inadequate credit, along with procedural hassles, are the reasons because of which small and marginal farmers are continuing the old way of credit at higher interest rates through non-institutional lenders (Pradhan, 2013).

Table1: Break-up of Institutional and Non-Institutional Credit

	1951	1961	1971	1981	1991	2002
Institutional Agencies	**7.2**	**14.8**	**29.2**	**61.2**	**64.0**	**57.1**
Government	3.3	5.3	6.7	4.0	5.7	2.3
Co-op. Society/bank	3.1	9.1	20.1	28.6	18.6	27.3
Commercial bank incl. RRBs	0.8	0.4	2.2	28.0	29.0	24.5
Insurance	--	--	0.1	0.3	0.5	0.3
Provident Fund	--	--	0.1	0.3	0.9	0.3
Others institutional agencies*	--	--	--	--	9.3	2.4
Non-Institutional Agencies	**92.8**	**85.2**	**70.8**	**38.8**	**36.0**	**42.9**
Landlord	1.5	0.9	8.6	4.0	4.0	1.0
Agricultural Moneylender	24.9	45.9	23.1	8.6	6.3	10.0
Professional Moneylender	44.8	14.9	13.8	8.3	9.4	19.6
Traders and Commission Agents	5.5	7.7	8.7	3.4	7.1	2.6
Relatives and Friends	14.2	6.8	13.8	9.0	6.7	7.1
Others	1.9	8.9	2.8	4.9	2.5	2.6
Total	***100***	***100***	***100***	***100***	***100***	***100***

Source: RBI WORKING PAPER SERIES Persistence of Informal Credit in Rural India: Evidence from 'All-India Debt and Investment Survey'

There are surveys conducted from time to time by RBI and the National Sample Survey Organization (NSSO) of the Government of India to find out the rural credit scenario of India. Various other committees have also worked on Farmers Issues and Micro Financial Institutions. The above chart data is based on these reports submitted from time to time. The chart clearly shows the growth of Institutional credit, which was just 7.2 percent in 1951. A sudden jump was observed in 1971 with 29.1 percent and 1981, with 61.2 percent, only a few years after nationalization. No doubt nationalized banks, along with cooperative banks, have helped the rural economy. But as seen in the chart in 2002 the institutional credit is found to be losing to non-institutional lenders. The same is confirmed by a recent report of NABARD in 2017 which confirms that a significant proportion (approx. 30 percent) of agricultural households still bank on non-institutional sources of credit (NABARD, 2017). Even after 50 years of Nationalization of Indian Banks, along with so many other initiatives, the number of people who are still left out from the formal channel of credit is a matter of concern. There is a direct link between the formal credit and economic wellbeing of the rural household. The formal lenders are explicitly biased towards farmers with large landholdings, and therefore, medium and small farmers are left out (Anjani Kumar, Mishra, Saroj, & Joshi, 2017). The reasons that they are not getting credit from formal institutions are because they cannot offer any collateral security, and sometimes they are not deemed creditworthy. So, these small and marginal farmers find it much easier to get credit from other non-institutional sources, and they end up paying more interest, sometimes even losing their leftovers (assets like Gold, Silver, etc.) (Ibrahim, 2016).

A further analysis of commercial banking lending to agriculture sector indicates that only 40.90 percent of the small and marginal farmers have been covered as per the agriculture census 15-16. One of the other problems which have emerged is the Regional Disparity in Agricultural Credit. Some states are getting double of the agriculture GDP, whereas some of them are at just around 30%. It is worrying and indicates that the inclusion agenda is far from achieved (Report of the

Internal Working Group to Review Agricultural Credit, 2019). In comparison to commercial banks, Small Finance Banks which have specified priority sector targets have done reasonably well in a short period.

Institutional Credit to Micro, Small and Medium Enterprises (MSME)

The MSME sector is the pillar stone of the Indian Economy. MSME share in Gross Domestic Product has significantly increased over the last few years. The sector should be given needed attention in a country like India, where the MSME sector is helping in fighting the grass-root problems of inequality, unemployment, and poverty (Bhuyan, 2016). Research work done in the field highlights the current challenges faced by MSMEs in India like inadequate and untimely credit, undeveloped equity capital market, infrastructural issues, and limited government support (Patnaik, Satpathy, & Rachayeeta, 2016). MSME sector in India comprised of mostly first time entrepreneurs with limited owner's funding or sometimes even without the capital to start the business. They are more technology friendly and well informed (Gupta & Kumar, 2017). They bring with them innovative ideas, technical and managerial skills, but they require funding at many stages mostly seed capital to start the business and additional capital at a later stage for technology up-gradation, venturing in new markets, and sometimes for further expansion in domestic markets (Munda & Swain, 2014). As per the report of (International Finance Corporation, 2018) on estimation of debt demand of MSME in India, it is found that around only 16 percent is financed through formal sources. Out of all the formal sources, commercial banks accounts for nearly 81 percent. There is no deny that commercial banks have played an important role in supporting the MSMEs, but addressable credit gap is huge. The government has tried to support these MSMEs through various schemes and initiatives, but it requires support from multiple channels and innovative methods of financing to close this gap. In the last few years, Fintech Companies have evolved and found to be doing outstanding in the Indian MSME Lending. We will try to analyze the performance of various financial institutions with a special focus on nationalized banks.

Table2: Credit to MSME Sector

Year ended	Public Sector Banks	Private Sector Banks	Foreign Banks	Scheduled Commercial Banks	Non-Banking Finance Company
	Amt. O/s	Amt. O/s	Amt. O/s	Amt. O/s	Amt. O/s
March 2014	7583.78	2471.22	344.30	10399.30	85.76
March 2015	8526.89 (12.44%)	2815.48. (13.93%)	367.87 (6.85%)	11710.26 (12.61%)	286.48 (234.05%)
March 2016	8205.48 (-3.77%)	3590.85 (27.54%)	363.73 (-1.13%)	12160.07 (3.84%)	880.13 (207.22%)
March 2017	8289.33 (1.02%)	4309.62 (20.02%)	365.02 (0.35%)	12963.98 (6.61%)	1113.10 (26.47%)
March 2018	8645.98 (4.30%)	4107.60 (-4.69%)	488.81 (33.91%)	13242.39 (2.15%)	1441.40 (29.49%)
March 2019*	9367.24 (8.34%)	5717.04 (39.18%)	691.37 (41.44%)	15775.66 (19.13%)	1622.17 (12.54%)

Source: As reported by Scheduled Commercial Banks to RBI

Table 2 indicates that Scheduled commercial banks and Non-banking Finance Companies have been doing equitably well in total commercial lending. However, nationalized banks' growth in the last five years is not encouraging. In comparison to nationalized banks, private sector banks have done remarkably well and acquired a substantial market share in MSME Sector. Private sector Banks lending to MSME have grown with an average rate of 26.5% in comparison to miserable 5.4% of nationalized banks in the last 5 years. Even after 50 years of Banks' Nationalization, PSBs have done restricted lending to MSMEs because of their creditworthiness and limited available information. Another major issue which has hindered the credit growth is ever rising Non Performing Assets of PSBs. It is scary to see that most of the MSME lending is majorly focused on urban centers, and therefore, most of the rural centers are still deprived of access to formal credit. As per the current norms under priority sector lending, there is no defined sub-target of MSME lending (Report of the Expert Committee on Small Enterprises, 2019). The government is taking initiatives through various policies, but lacks proper execution and coordination (Lahiri, 2012). Hence, it won't be easy to narrow the huge credit gap under the existing banking structure where none of the nationalized banks are primarily MSME focused.

Section II

Problems faced by Nationalized Banking Structure

The current Nationalized Banks are facing a number of problems ranging from poor organizational structure, operational and execution issues, and rising NPA & Frauds. The performance of nationalized banks have been hit hard by the rising NPA and big ticket size frauds, which has raised questions about its structure and operations. In the last three years, few nationalized banks were not allowed to lend, and they were under prompt corrective action because their NPA has crossed the threshold limit. These failing small banks are proposed to merge with large banks and it is seen in the past that these types of mergers results in failure of the strong bank as well. Further, nationalized banks are evaluated on Frauds and NPA.

Frauds

In the past few years, big ticket size frauds have surfaced and around 92% of the reported fraudulent loan cases are given by Nationalized Banks. The data reveals that maximum cases, which are found to be fraudulent, are sanctioned at least five years ago. And it is quite shocking that on an average it takes around 55 months to detect fraud of Rs 100 crore or more. The number of reported frauds in nationalized banks and especially the likes of the case of Nirav Modi of PNB, highlights the incoordination, poor monitoring, and inefficient nationalized banking structure.

Non-Performing Assets

NPA has increased considerably in the Last 5 Years. Noticeably, Industry and especially large corporate houses have been the major contributor to the current NPA figures which clearly reflect political intervention. Another sector that has largely contributed in NPA after Industry, is the agriculture sector. Various schemes introduced from time to time like KCC have proved to be beneficial for the farmers; however, NPA in agriculture has seen a sudden increase in the last few years because of the frequent announcement of loan waivers. Farmers do not pay the loans even if they have the ability to pay in anticipation of loan waivers. Instead of tackling the underlying problems in agriculture, the loan waiver schemes are being used by the politicians for their political advantage. Sometimes, loan waivers are detrimental for the small farmers as they could not get further loans from banks even if they have availed the loan waiver scheme only once earlier. Another important scheme MUDRA, for small and medium enterprises, has also started showing signs of distress with huge NPA figures. Other factors that have contributed to increase NPA are recovery management and limited appraisal skills among staff in nationalized banks (Sharma, Rathore, & Prasad, 2019).

It is quite evident that nationalized banks are facing issues on performance, operational, execution and recovery front. Further, the study will identify the impact factors using Primary Data.

Data Analysis

Data is collected for 28 questions out of which 24 questions were analyzed to find the factors which have affected the Bank Nationalization. Three questions were directed towards their opinion on whether bank Nationalization has achieved its objectives. The last question is a multiple options based question directed to understand the factors that can save PSBs.

The tables below are retrieved from SPSS 20 after analysis.

KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.700
Bartlett's Test of Sphericity	Approx. Chi-Square	668.489
	df	276
	Sig.	.000

Figure 2: KMO and Bartlett's Test

- Bartlett's test of sphericity value of 0 is less than 0.05 of the significance level as shown in Figure 2 indicates that a factor analysis may be useful with our data.

- The Kaiser-Meyer-Olkin Measure of Sampling Adequacy was applied and as shown in Figure 2, the value obtained is .700 which indicates the proportion of variance in variables that might be caused by underlying factors. Since Value is higher than .500, factor analysis can be applied.

Rotated Component Matrix[a]

	Component				
	1	2	3	4	5
Too many circulars but limited execution				.571	
Staff is given proper training at frequent intervals	.667				
Flaw in current loan recovery policies and laws	.577				
Bank's infrastructure and software are outdated	.700				
Most of the RBI's policies are politically Influenced			.630		
Banks' Board and top management appointments are partly political.		.689			
Need for overhauling the current PSB's Structure	.589				
Govt. overused banks for public interest policies				.694	
Multiple regulators have a negative impact		.881			
Third-party product selling has hampered core banking				.690	
PSB's political use for big Industrial houses.			.789		
Single simplified banking software for all departments	.535				
Clerical staff with limited accountability impacted the bank's efficiency					.772
Many overlapping laws make regulation difficult		.522			
Separate staff & recovery office in every district	.617				
Too much Govt. Interference in RBI's working			.864		
Loan default in rural areas is due to the anticipation of loan waivers					
Mergers of PSBs can solve the current banking problems	.536				
Need for innovative Credit monitoring	.557				
My salary justifies the hard work I put in					.674
Banking Boards are powerless and non-functionary.				.763	
Fear of government agencies while sanction loans		.556			
Staff involvement in non-core activities increased NPA				.783	
Too many regulatory acts are baffling		.881			

Extraction Method: Principal Component Analysis.
Rotation Method: Varimax with Kaiser Normalization. (a. Rotation converged in 9 iterations.)

Figure 3: Factor Analysis

Result & Major Findings

1. 65% of the respondents strongly agree or agree to the fact that Banking nationalization has met its purpose of increased rural and agriculture credit.

2. 62% of the respondents strongly agree or agree to the fact that Banking Nationalization has met its purpose of Financial Inclusion and Economic Growth.

3. 52% of the respondents strongly disagree or disagree to the statement that Banks' Nationalization has failed because of lack of trained staff and unstructured procedures in nationalized banks.

4. On analyzing the questions under principal component analysis as per the figure 3, the factors have been formulated and are named as Structural Issues, Multiple Regulators, Political Interference, Poor Corporate Governance and Anticompetitive Nature. These factors based on the analysis have impacted the nationalized banks and proved to be hurdles in achieving the objectives of nationalization

5. On the question of Survival of Nationalized banks, respondents have given their options in the following order

Table3: Responses ranked for the question on survival of PSBs

Rank	Factors that can save Nationalized banks	
1	Limited Government Interference	76%
2	Specialized Branches for Retail, Loan Recovery, Agriculture Loans, Third Party Product	68%
3	Single Strong Bank Regulator	66%
4	Simplified & Strong Loan Recovery Laws	62%
5	Competitive Salary for staff	58%
6	Latest Technology & Infrastructure for Credit Monitoring	55%
7	De-Nationalize	44%

Conclusion

The Nationalization of banks was an important step, but looking at the current, it is quite evident that nationalized banks have supported the economy over the years. But, it is alarming to see 30 % of the rural population still depend on non-institutional sources of credit. Also, Nationalized Banks are losing to Private players in MSME as well. The data collected and analyzed in this research clearly reflects that there is a structural problem with nationalized banks points to the fact that mergers of nationalized banks, on the lines of Narsimhan recommendations, alone cannot solve the underlying problems of nationalized banks.

Nationalized Banks have been used by the governments for their political gains, and now it's time to have limited government interference along with a single strong regulator. There is no denying to the fact that India still needs the developmental role played by the nationalized banks, and the responses received also clearly goes against denationalization as the solution. But answers to the question of survival of nationalized banks points towards a major transformation in some key areas like the recruitment process in nationalized banks, Government schemes implementation, stricter recovery laws, better technology and even service delivery. Nationalized Banks can survive only if some significant steps are taken, keeping aside political benefits.

Suggestions

1. In 3 years, total of 10 Small Finance Banks, which are operational, have achieved approximately 82 percent under overall priority sector lending. They have also overachieved the sub-target lending targets. They long with Fintech Companies are doing a remarkable job in catering to msme sector, it is suggested to have specialized MSME bank post mergers where improved technology along with specialized staff will efficiently cater to MSME Sector. There are examples like Equity Bank in Kenya, which is primarily SME Focused, and has done outstandingly with its innovative product and policies which are framed from time to time like Priority Sector Lending

2. Lending and loan recovery can be improved if innovative technology and digitization can be used to link appraisal process, KYC, checking of land records and credit history.

Limitations

The study is based on the data collected online of only four banks out of which two were nationalized. The data is collected from the bank employees. To get a more comprehensive view, the same study can be done by collecting data from top Management of Banks, CAs, Financial Professionals, and even customers.

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