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A STUDY ON PRIVATIZATION OF BANKS IN INDIA

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ABSTRACT

The Banking Regulation Act, 1949 defines "Banking "as "the means of accepting, for the purpose of lending or investment of deposits of money from the public repayable on demand or otherwise. It also defines "Banking Company" as any company which transaction business. Banking is entirely different and distinctive from any other business institution. It is made up of common man's deposits. The decision to privatize banks is taken after 51 years of independence. The first time the nationalization of banks happened in 1969. The responsibility to select Public Sector Banks to be privatized in the FY2021-22 was given to NITI Aayog. Central Bank and the Indian Overseas Bank are the foremost choices for privatization. The two departments: Department of Financial Services (DFS) and the Department of Investment and Public Asset Management (DIPAM) will scrutinize and decide which bank will be privatized. Finance Minister Mrs. Nirmala Sitharaman said in her 2021-22 Budget Speech that in 2021-22-year the government will privatize two banks. The paper tries to find the reason for the Privatization of banks, why only few banks are going to be privatized, the effect of post-Privatization, challenges in the way of its implementation.

KEYWORDS: *Privatization, Banks, Government, Impact.*

1. INTRODUCTION

Privatization means divestiture to private entity. It is one of the policy reforms, intended to enhance the performance of state-owned enterprises. Privatization is a political procedure and has crucial economic and social implications that not only affect enterprise performance, but also social welfare and stability. The social outcomes must be taken into consideration in any impact assessment, especially those associated with employment, social safety net measures. Privatization guarantees higher competition and brings in more private involvement in the government activities. It liberalizes different policies to unleash forces of competition and to induce market forces into the economy. It is also known as structural adjustment program for the economy. From the Global Rating Agency perspective, the Privatization plan is seen as a broader agenda to reform the Indian banking sector. The government has disinvestment target of Rs 1.75 lakh crore for FY22. This amount is approximately 3.5 of times the actual realization of year 2020.

OBJECTIVE OF THIS STUDY:

1) To find why only few banks are being Privatized.
2) Scope, and effect of post-Privatization
3) Challenges in the way of its implementation.

2. LITERATURE REVIEW

The term "Privatization "was coined in 1969, in the book "The Age of Discontinuity" by Peter R. Drucker. Privatization is a new term but not a new phenomenon. Megginson (2001) **[1]** wrote that, in ancient Greece, the government possessed forests, mines, land but had an agreement with individuals and firms who harvested the natural resources. Divya Verma Gakhar& Abhijit Phukon (2020) **[2]** discovered that monetary and operational performance of companies has progressed appreciably because of Privatization. Further, firm-specific factors and other parallel reforms adopted by organizations have significantly influenced their overall performance. The established regression model is tremendously significant with F-ratio of 31.825 at 99% significance level. The degree of explanation of the model is strong with adjusted R2 at 0.956 implying that only 4.40% of explanation in the dependent variable cannot be explained by designated independent/explanatory variables. Kousadikar and Singh (2013) **[3]** discovered that Privatization of state-owned enterprises (SOEs) were developed as a crucial tool for economic policies pertaining to development and improvement of developing countries.

3. METHOD AND MATERIALS

The paper uses secondary data from various journals, books, articles, research papers and newspaper.

Consolidation among PSBs since 2008

Year	Consolidation
2008	State Bank of India (SBI) acquires associate bank State Bank of Saurashtra
2010	SBI acquires associate bank State Bank of Indore
2017	SBI acquires five associate banks: ▪ State Bank of Bikaner & Jaipur ▪ State Bank of Hyderabad ▪ State Bank of Mysore ▪ State Bank of Patiala ▪ State Bank of Travancore ▪ SBI also acquired Bharatiya Mahila Bank
2019	Dena Bank and Vijaya Bank merged with Bank of Baroda
2020	▪ Oriental Bank of Commerce and United Bank of India merged with Punjab National Bank ▪ Syndicate Bank merged with Canara Bank ▪ Andhra Bank and Corporation Bank merged with Union Bank of India ▪ Allahabad Bank merged with Indian Bank

PSBs that were not part of the mega consolidation in 2020

▪ Bank of India	▪ Bank of Maharashtra	▪ Punjab & Sind Bank
▪ Central Bank of India	▪ Indian Overseas Bank	▪ UCO Bank

The decision to choose the banks for privatization may be based on the following criteria:

a) **Price to book value:** As these banks' shares are quoted in the market, the market rate of the share gives a demonstration on how the bank is rated in the market. As the government's intention must be to get maximum realization for its assets, a higher Price to Book Value ratio, may fetch better realization.

b) **Price-earnings ratio-** The PE ratio also gives a demonstration of the way the market values these banks. When the banks are offered for privatization, the bidder may offer a greater price than price under the existing PE ratio.

c) **Market capitalization** – One of the reasons for the authorities to privatize the banks is to achieve the aim of stake sale and to manage the financial position. So, the banks which can provide maximum funds via method of privatization can be a vital standard to determine the candidate.

d) **Capital adequacy ratio**: One of the motives for privatizing banks is to escape from the duty of supplying further capital to these banks to satisfy CAR norms. That manner the CAR of banks may be another crucial criterion to determine the candidates for privatization.

Thus, Indian Overseas Bank has the best market cap, maximum PB ratio, Lowest CAR, and 2nd maximum PE Ratio.

Bank scorecard

Bank	PE Ratio	Market cap (₹ cr)	PB Ratio	CAR
Bank of Maharashtra	30.1	13,710	1.4	13.65
Indian Overseas Bank	42.2	26,381	1.6	11.49
Central Bank of India	-7.7	9,577	0.4	12.39
Bank of India	-14.3	22,845	0.6	12.80
Punjab & Sind Bank	-0.4	1,132	0.2	13.40
UCO Bank	104.6	10,860	0.6	11.80

CAR as on Sep 2020 or Dec 2020 as reported by banks

Method of privatization: The process to convert PSB into private banks relies on different factors like figuring out the buyer, valuation of the assets, quantity of employees and their future, the pressure of the trade unions and political repercussion. The 1st possibility is to sell the banks to industrialist. But according to former RBI governor Raghuram it would be a deplorable and grave mistake to sell it to an industrialist.

The second method is that the government may sell the banks to a current non-public bank like HDFC Bank, ICICI Bank, AXIS Bank via bids. For this, the offer may be better for banks with branches which can be rationalized after merger. This may also offer greater business to the acquirer bank with fewer branches. The staff strength also can be a standard which can determine the bidding price as the new entity has to take over the group of workers also with all the present service conditions.

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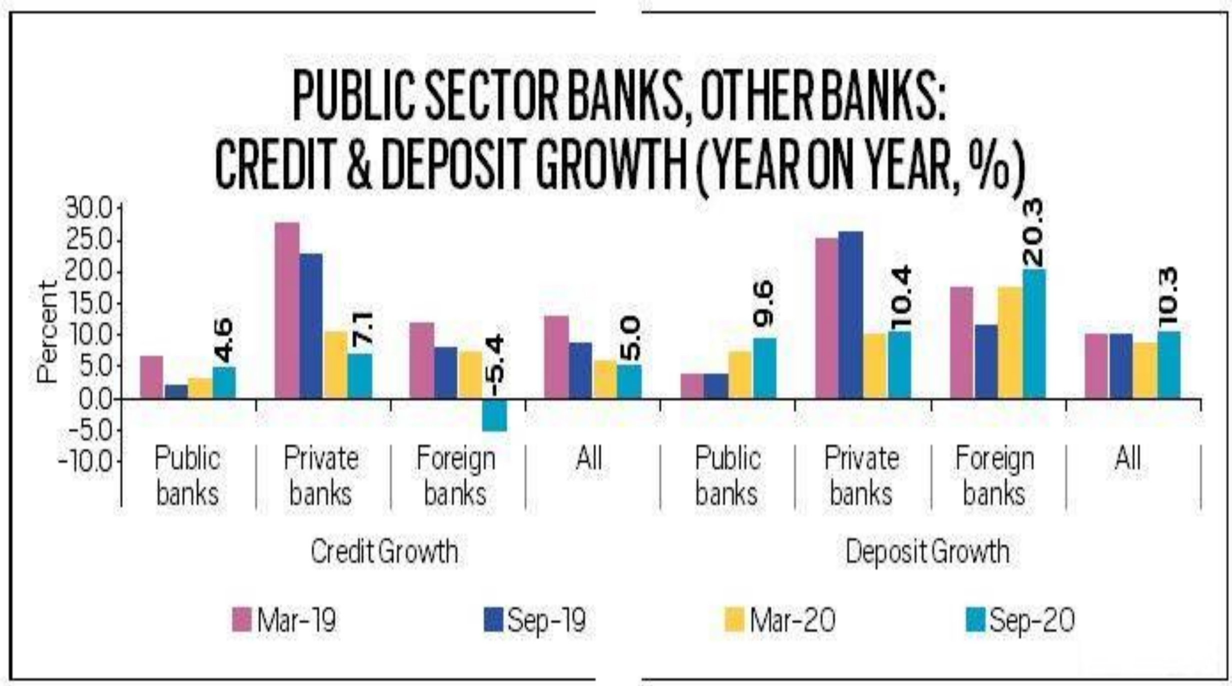
The third possibility is a foreign bank. But selling one of our big banks directly to a foreign purchaser could be politically difficult.

Challenges in converting PSB into private banks: The record of privatization in India is instead dismal. In the 2019-20 budget, disinvestment revenue was pegged at Rs 1.05 lakh crore which reduced drastically to Rs 65,000 crore in the revised estimates. Even this collection goal was not achieved with the actual disinvestment amounting to Rs 50,298.64 crore. Budget 2020-21 plans the disinvestment proceeds at Rs 2.10 lakh crore, Rs 1.20 lakh crore from CPSE share sale and Rs 90,000 crore from a share sale in PSBs and financial institutions, along with the listing of insurance behemoth LIC, however the government garnered much less than Rs 20,000 crore in disinvestment receipts from different routes.

For instance, despite the government offering to sell its complete 100% stake, the strategic divestment of Air India to a non-public company has again and again failed, prompting it to extend the closing date for submitting preliminary bids by 5 times. The government has also reduced the eligibility standards for prospective bidders, from a requisite net worth of Rs 5,000 crore to Rs 3,500 crore. Even attempts by officers from the civil aviation ministry to lure foreign shoppers did not garner expected interest. The president of the All-India Backward Classes Federation, Dabbiru Srinivasa Rao says that privatization would result in social injustice and denial of the reservation to BCs and other sections. Bank unions have termed the privatization method a "bailout operation" for corporate defaulters. " Private sector is liable for the big bad loans" says The All-India Bank Employees Association . In fact, they must be punished for this crime. But the government is rewarding them via way of means of handing over the banks to the private sector."

Reason for Privatization:



Recommendations of Different Committees: Many committees had proposed bringing down the government stake in public banks under 51%: The Narasimham Committee proposed 33%. The P J Nayak Committee recommended under 50%. An RBI Working Group recently advised the entry of business houses into the banking sector.

Degrading Financial Position of Public Sector Banks: After so many years of nationalization and government reforms, the financial position of PSBs have not improved significantly. Many of them have better levels of stressed assets than private banks, and additionally lag the latter on profitability, market capitalization and dividend payment record.

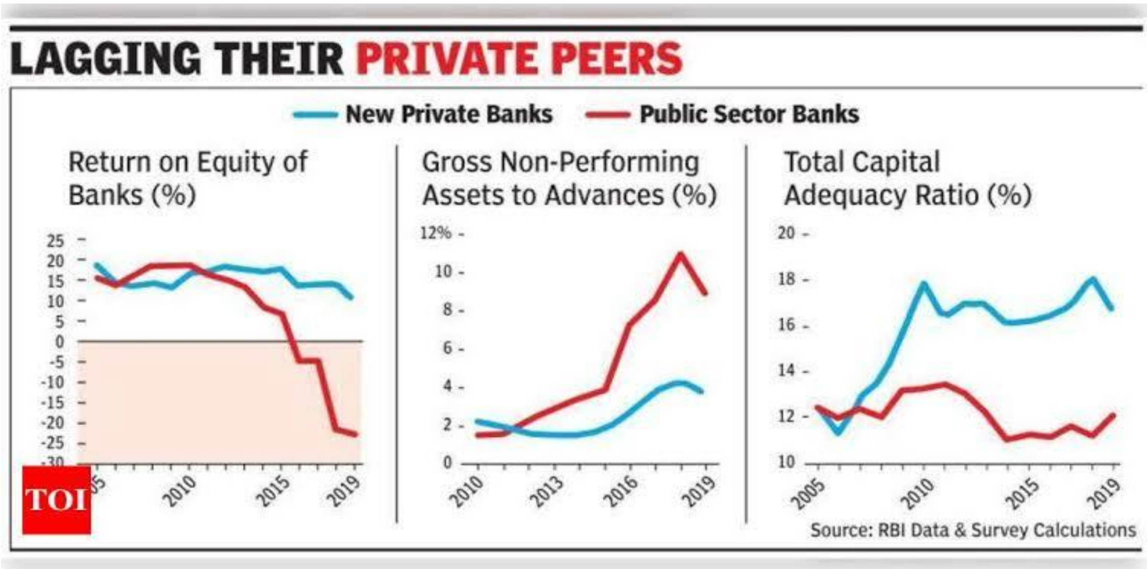
Strengthening Banks: The authorities are trying to enhance the strong banks and minimize their numbers via privatization to lessen its burden of support.

Part of a Long-Term Project: Privatization of two public sector banks will set the ball rolling for a long-term venture that envisages only a handful of state-owned banks, and the rest banks will be either consolidated with strong banks or privatized. The preliminary plan of the government was to privatize four banks. Depending on the achievement with the first two, the government will probably go for divestment in another two or three banks in the next financial year. This will free up the government, the majority owner, from continuing to provide equity aid to the banks year after year. Through a series of movements over the previous few years, the government is now left with 12 state-owned banks, from 28 earlier.

Maximize disinvestment flows: Fitch sees the privatization drive to maximize disinvestment inflows. But this is challenging because banks going for Privatization have generally compromised financials, with impaired-loan ratios ranging between 9.8%-16.3% and common equity Tier I ratios between 8.8%-10.3% in 9MFY21.

Issues with PSU Banks: High Non-Performing Assets (NPAs): After a series of mergers and equity injections by the authorities, the overall performance of public sector banks has shown development over the past couple of years. However, compared with private banks, they continue to have high NPAs and stressed assets even though this has started declining.

Impact of Covid: Due to Coronavirus pandemic, regulatory relaxations are lifted therefore, banks are expected to report higher NPAs and loan losses. According to the RBI's recent Financial Stability Report, gross NPA ratio of all commercial banks may increase from 7.5% in September 2020 to 13.5% by September 2021. This could imply the government might again need to inject



equity into weak public sector banks.

Positive Impact of Post-Privatization: Mitigation of the NPA problem: The most debated problem of the privatization drive and its effect on the economy is the ever-growing and never-ending burden of the Non-Performing Asset (NPA) problem. The banking sector is overburdened with NPA and most of it is contributed by the PSBs that is majorly because of spending on welfare schemes and write-offs but is still a main problem to be dealt with for effective and fast growth of the economy. The financial health of the economy is badly stricken by the growing NPA issue. The privatization drive will surely assist in effectively decreasing the NPA issue and enhance the economy through recapitalizing PSBs with the help of elevating fresh equities thereby empowering the banks to resume lending, enhance their performance and simultaneously privatize their ownership structure. The dilution of the government's stake in the PSBs via way of means of bringing fresh equity and foreign investment may provide the debt-ridden PSBs a push in the direction of recovery and growth.

Macroeconomic stability post-COVID The privatization drive can have a tremendous effect on the economy during the pandemic by bringing stability at the macroeconomic level. Privatization of some loss-making PSBs will ensure that other PSB rectify their strategy and improve its efficiency and performance. The pandemic has caused the extreme decline in the economic curve of the country and has made a negative impact on banks, which makes it more important to restore the banking sector. The recapitalization of banks via systematic disinvestment of the government holdings and raising equity via private players which includes foreign investments will assist the economy in accomplishing buoyancy post-pandemic.

Administrative performance and quality of customer service – The aspect of administrative efficiency plays a key function in the smooth functioning and governance of a bank. The administrative performance of a private bank in comparison to PSBs is better. The overall customer service is better in a private bank. Therefore, privatization of PSBs will result in an improved customer service experience. The growth in tech-driven products and ease of banking services will also help in enhancing the overall administrative efficiency and customer service. These tech-driven products will also enable the private banks to increase their reach in the rural banking sector and provide quality services to their customers.

Competition – Another pet of privatization is the competition in the market. The privatization drive will offer the private players a level playing field with increased competition in the market which will ultimately drive the private banks to perform better and increase their efficiency. The private banks, because of growth in the competition, will introduce revolutionary products that focus on specific customer preferences keeping in view the risk assessment, risk improvement, product pricing, and decrease service costs

Capital infusion and overseas investment: India has an outstanding capacity of an influx of overseas investment wherein infusing more capital into the banking sector will provide a fillip to the already struggling economy. The PSBs in comparison to the private banks has been less competitive in lending, attracting deposits, and in setting up branches. The banks in the public sector are often reluctant to make credit decisions due to the fear of agencies and regulators. The influx of foreign investment will permit the private banks to take more risks to bring in better products, aggressive lending, improvement in the rural areas, and offering low-price services and lower interest on loans. The infusion of capital together with the growing technology will assist the private banks to provide simpler and fast services via internet banking and mobile banking especially in rural areas, thereby growing the rural banking landscape.

Job creation: The privatization of PSBs will enable the private banks to create more job opportunities for people with specialized expertise in banking, finance, and technology to satisfy their target-oriented requirements with advanced infrastructure and effective manpower.

Negative impact of post-Privatization: Outside the purview of RTI, CVC, etc. – According to the plan/scheme of Privatization, the private sector banks will not be subject to a dual-channel of scrutiny by the Ministry of Finance and the RBI as in the case of PSBs. The private banks will have restricted applicability of Right to Information (RTI) and could bring the private banks

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outside the scope of external vigilance enforcement through Central Vigilance Commission (CVC) and Central Bureau of Investigation (CBI), which tends to have a negative impact from the depositor’s perspective. There are external bodies like CVC, CBI that keep careful watch for possible difficulties, mechanism of RTI and RBI as a watch dog have increased the level of accountability and make sure safety from any foul play. But still, PSBs got involved in several scams, unprofitable lending and increasing NPA problem. This ultimately affects the interest of public at large. On the other hand, the private banks are not answerable to these bodies except RBI.

Issue of accessibility: PSBs have dominance over the accessibility to rural regions, hence, Rural banking is a major challenge for the Privatization drive. Private banks are usually available at the more developed or populous regions of the Nation’s in contrast to PSBs which are present across our country. Reaching this level of presence is quite difficult for private banks. Even if private banks take over all the existing branches of PSB it will still face challenges in building trust among rural people, governance, and maintenance of branches.

Inclination in the direction of profit-making: The primary consideration that drives the private sector banks is profitability. Private banks are willing to make profits and, in a few cases, serve the interest of the promoters as was recently evident from the case of YES Bank. Since the motive of private banks is to make profits, the idea of a welfare state as adhered to by the PSBs may suffer.

SOURCE: SURVEY CALCULATIONS BASED ON DATA FROM CMIE PROWESS

The PSBs performing in the interest of the welfare state extend low-price services, offer the depositors with subsidized accounts and numerous other governmental schemes connected to it. The PSBs offer the option of loan waivers and write-offs to the marginalized population. The private banks on the other hand, because of their profit-centric method may impose high service fees on banking transactions to fulfil their operational charges and expenditure and create a disparity among the wealthy and the poor in terms of loan sanctions and a higher rate of interests on loans resulting in a different section of the society.

Private players are prone to failure: The biggest benefit that the PSBs have over the non-public banks is that the PSBs are backed by the sovereign. They aren’t prone to complete failure or turning into extinct as there is always a chance of recovery because of the assist of the government. The most recent instance is the restructuring of the Punjab National Bank (PNB) wherein, the government intervention by way of debt recovery and restructuring of the assets of the bank is sought, after the failure of the PNB because of frauds, scams, and its failure to generate sufficient cash flows to keep it afloat. The private players on the other hand have the choice of exiting the market in the event of its failure which may leave the customers of such banks without any remedy. The profits of the private banks are earned by the shareholders. However, in the event of losses leading to failure, the government is left to make good the deposits either via insurance or via taxpayer bailout. In the case of Citibank, the bank because of its business techniques recorded more than $one hundred thirty billion of write-downs on its loans and investments. The US government, to prevent the failure of the bank, injected $45 billion of new capital into the bank and supplied it with $500 billion of additional help in the form of asset guarantees, debt guarantees, and liquidity assistance, which is a perfect example of the bank's bailout with public money. Therefore, it might not be correct to say that a bigger bank (be it public or private) will have the ability to absorb massive losses and will not fail as a result.

Delay in implementation: Fitch Ratings believes that due to renewed challenges arising in the sector, there will be delay in Privatization plan of the two state-owned banks in FY22. The various reasons are impact of Covid, unsupportive attitude from opposition, finding investors to buy the banks and resistance from trade unions.

Findings:

a) The responsibility to select Public Sector Banks to be privatized in the FY2021-22 was given to NITI Aayog.

b) The Finance Minister Nirmala Sitharaman said in her 2021-22 Budget Speech that in 2021-22-year government will privatize two banks.

c) The two departments: Department of Financial Services (DFS) and the Department of Investment and Public Asset Management (DIPAM) will scrutinize and decide which bank will be privatized.

d) Central Bank and the Indian Overseas Bank are the foremost choices for privatization.

e) From the Global Rating Agency perspective, the Privatization plan is seen as a broader agenda to reform the Indian banking sector.

f) The government has disinvestment target of Rs 1.75 lakh crore for FY22. This amount is approximately 3.5 of times the actual realization of year 2020.

g) The decision to choose the banks for privatization may be based on the price to book value, price earnings ratio, market capitalization and capital adequacy ratio.

h) Government can do privatization by selling the banks to industrialists or private banks, or it can merge it with private banks.

i) There are various challenges in this way i.e., impact of covid, unsupportive attitude from opposition and finding investors to buy the banks and resistance from trade unions.

j) Recommendations of Different Committees, degrading Financial Position of Public Sector Bank, strengthening Banks, part of a long-term projects and maximize disinvestment flows are the reasons for privatization.

k) Mitigation of the NPA problem, job creation, macroeconomic stability post-COVID, capital infusion and overseas investment, administrative performance and quality of customer service and increases competition are some of the positive impacts of Privatization of banks.

l) Inclination in the direction of profit-making, issue of accessibility, private players are prone to failure, outside the purview of RTI, CVC, etc. are some negative impacts of Privatization of banks.

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Limitations of study and Future scope: This paper is wholly dependent on secondary data. Since the privatization has not taken place yet a further study can be done after implementation of this plan, its effect, advantages, disadvantages, and challenges.

4. CONCLUSION

The banking sector in India is certainly considered one among the largest contributors to the growth of the economy and is evolving at a steady pace. However, the banking sector, the PSBs has had a massive effect on a decline in the economy because of the ongoing pandemic. To increase the growth of the economy and the sector, the decision of the government to privatize the PSBs will prove to be a structural change in the banking sector by opening it to private players, growing capital inflow and overseas investment which may turn out to be a boon to the emergence of the new age for banking sector ultimately resulting in economic resilience of the country. Privatizing the PSBs will increase competition in the market and the banks will be prompted to perform better and it will, and it will result in debt-ridden PSBs to go towards a consistent path of growth.

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