HS 210 INDIAN ECONOMY

TERM PAPER

TOPIC: **EFFECT OF PRIVATISATION OF BANKS ON INDIAN ECONOMY**

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Privatisation of banks

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Introduction

We start with the fundamental question of the privatisation of banks and whether it includes all the PSU banks. The answer is quite simple; it is a process through which the government is trying to sell the various loss-making public-sector bank that suffers from huge NPA problem which is basically due to low efficiency and how this public sector banks have been working in terms of the norm and procedure these banks follow in giving loans as you will find that most of the recent scams have been in the public sector bank in the recent decades whether it be Vijay Mallya or Neeraj Modi.

The government has already reduced the number of public sector bank by a series of measure from 28 to 12 and is now thinking to privatise another four

The idea of privatisation is not a new one, and over the past many years, many committees have been proposing the idea of bringing down the stake in these public sector banks.

Let's look at some of them.

Narasimham committee proposed to bring the stake to 33%

Pj Nayak committee suggested to get it to about 50%

Important questions

So, the nationalisation process of the 14 largest banks in 1969 is now going the opposite way. There comes a massive question for us that what went wrong with this public sector is that they are at this stage and is loss-making a huge why govt is privatising them, or there can be other reason we will find out as we proceed in our discussion don't worry.

Reasons for privatisation

The primary reason which most of you will tell is the loss-making scenario

So let us start our discussion by analysing the performance of these four banks that are initially shortlisted to be privatised based on

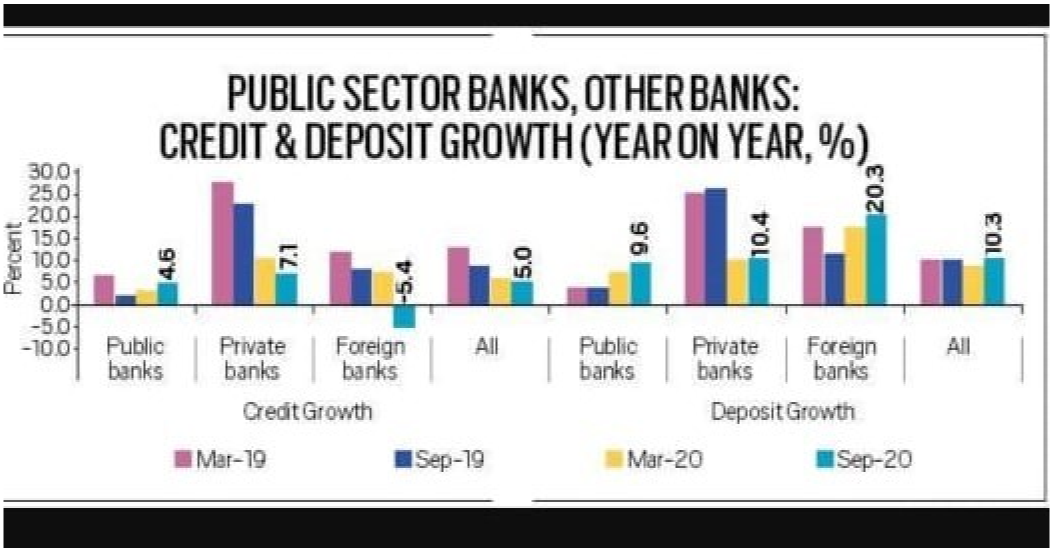
· Bank of India

· Bank of Maharashtra

· Indian overseas bank

- Central bank of India

If we analyse them based on performance, you will find that people are right indeed.


PUBLIC SECTOR BANKS, OTHER BANKS:
CREDIT & DEPOSIT GROWTH (YEAR ON YEAR, %)
Percent
30.0
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
4.6
7.1
-5.4
5.0
9.6
10.4
20.3
10.3
Public banks
Private banks
Foreign banks
All
Public banks
Private banks
Foreign banks
All
Credit Growth
Deposit Growth
Mar-19
Sep-19
Mar-20
Sep-20

These banks have been posting heavy losses year on year basis, but most of them have posting losses after 2015-2016(I am talking about these four banks in general)

So, another question happened just after 2015-2016 that these four banks started posting heavy losses.?

Let's just analyse the situation.

- If you talk about bank India, you will find that though the revenue had enhanced from 46.40 thousand crores in 2017 to 49.28 crores in 2020. The losses had also piled up from 1.47 thousand crores in 2017 to 3.05 thousand crores in 2020
- Bank Maharashtra has a similar situation where the revenue is continuously increasing or remaining stable, but still, it is posting huge losses
- Similar situation in figures can be seen for the central bank of India as well as Indian overseas bank

You will find contrast and be keen on knowing that if the revenue has grown, then why does the bank is, again and again, posting such huge losses every year?

The answer is the NPA that is the non-performing assets that the banks have been suffering from, so you understand that banks are regularly giving loans, but the profit they earn by getting back the loan with interest is not working with these banks.

So, another important question what can be done to remove the NPA problem?

And if privatisation is the only way, then is NPA a problem only in public sector bank?

WE all know what happened with yes bank, which was on the stage of closing if the RBI did not save it.

So we will look at these various points as we proceed further in our discussion.

Other reason includes

It is strengthening the healthy banks that often come under pressure due to many loss-making banks by reducing their burden.

Advantages and disadvantages

ADVANTAGES

Bank privatisation is likely to provide a lot of benefits, they include, 1)GREATER PROFITS:-Most private banks like Citibank, Kotak Mahindra bank, HDFCetc… are profitable, to a significant extent. Many PSUs are not making profits, and the government is thinking that the privatisation of PSU banks may convert them from loss to profitable self-sustainable businesses.

2)IMPROVED EFFICIENCY:-It is found that Private sector banks are more advanced than Public sector Banks. Banks in the private sector are known for their operational efficiency. Private banks achieve more profit than any other business. This makes them more competitive with superior service to gain customers. A private firm has pressure from shareholders to perform efficiently.

3)LESS FRAUDS:-Privatization will also help to reduce the burden of the Government of India. This is because private banks are stricter towards loans and frauds. We came across a news story where PNB was defrauded of $1.8 billion by a few junior level bank officials. Frauds of such scale do not occur in private banks like Citibank etc.

4)SHAREHOLDERS:-

It is argued that a private firm has pressure from shareholders to perform efficiently. If the firm is inefficient, then the firm could be subject to a takeover. A state-owned firm doesn't have this pressure, so it is easier for them to be counterproductive.

5)FOREIGN INVESTMENT:-The foreign investors prefer to invest in private sector banks rather than public sector banks.

6)LACK OF POLITICAL INTERFERENCE:-When faced with problems in the public sector, the government takes decisions based on what would be best for the next election. This is because they are motivated by political pressures rather than economic and business sense. For example, a private company may employ limited workers and even fire if there are many workers. But in the government's case, the government may be reluctant to fire workers because of the negative publicity involved in job losses. Therefore, state-owned enterprises often employ too many workers increasing inefficiency. Public banks are also constantly bullied for political motives. Privatisation will allow these banks to focus on their long term goals with reduced government interference.

7)Short term view:-

The government may think only in terms of the next election. Therefore, they are reluctant to invest in infrastructure improvements that will benefit the firm in a long time because they are more concerned about projects that benefit before the election.

** Loans are sanctioned at a faster rate.

DISADVANTAGES

1)SCHEMES BY GOVERNMENT:-Central or State Governments require Nationalized banks to implement their schemes like Jan Dhan Yojana, Atal Pension Yojana, Farm Loan waivers are lesser in Private Banks as the Govt can only request but cannot order or pressurise the Private banks to fulfil their schemes.

**Privatisation will adversely affect lower sections of society.

2)RURAL AREAS:-Private Banks are opening more branches in the Urban, Industrial areas and focusing less on Rural Areas, which is a big drawback. As a result, the load on SBI will increase, and it can't manage the giant bag, so banks' privatisation is a big drawback for rural people.

3)UNFAMILIARITY WITH LOANS OF AGRICULTURAL SECTOR:-Even if private banks open the branches in the rural areas, the private banks may not be familiar with the sanction of loans related to the agricultural sector. They may charge a higher rate of interest as a loan, which kills the motive of govt to discourage the prospects of going to the moneylender, more prominent farmers for the loan by small farmers or other rural people.

4)NO JOB SECURITY:-Coming to the working staff, the workload will be much more, as there is no scheme for the safety of employees, so there will not be any job security like public sector banks.

5)This is also unjust and will create added problems for employees who have specifically strived to secure government jobs. Privatisation may also introduce variable income. This decision will most likely result in panic and protests across the country.

The private banks are stricter when it comes to the recovery of loans. That is why you observe lesser NPA's in the financial books when compared to the public sector banks.

As the advantages outweigh the disadvantages and the fact that public banks have been a menace in the recent past, privatisation would mark the start of turning the banking sector around. This does not mean that the government must sell its share and wash its hands off the industry. It is essential to consider that Privatization alone would not solve all of the sector's problems.

Looking back at past failures, it is also essential that the government introduces adequate governance among other measures to ensure that banks do not once again enter their prior state.

In conclusion, privatisation is good for the urban economy but can be a disadvantage to the rural economy.

Impact of Privatisation

Privatisation is contemplated bringing up the competition, making a sure more significant capital investment, competitiveness, and modernisation, resulting in employee development and providing improved quality of services to the consumers and reducing the tax burden. During the pre-privatization period, the government used to pay fewer amounts dividends to its shareholders due to its complex cost structure. Privatisation leads to cutting short the capital and revenue expenditure, which leads to an increase in share value in the market.

The new banking culture, protected by reforms, is reflected in ignoring the priority sectors, entirely unfair treatment of opportunities offered by capital market-related activities. The study involves the benefits of how the number of branches increased after privatisation, increase of credit facilities for agriculture and increase of job opportunities, and adverse impacts of privatisation on Indian Banking like high-interest rates, fewer job securities, interference of politician and Industrialist, less control of government over private banks, private sector use private recovering agents to recover bad loans these agencies use wrong means to recover loans from people. As the chairman of the State Bank of India correctly pointed out, “this approach Breaks faith of an innocence of realities of the Indian economy” This brings the following changes in activities:

- **Priority Sector Lending**: The general perception of the priority sectors is that 40% of net bank credit’s prescription leads to a higher level of Non-Performing Assets (NPAs). The accepted fact that an increase in Non Performing Assets will affect the Indian Banking System.

- **No More Subsidized Interest**: The main aim of Narasimham committee is that the real interest rate always should be positive; it should not create any concession in the aspect of interest rate.

- **Impact on Agriculture**: As far as India is concerned, agriculture is the backbone of the Indian economy. 59.4% of the population is engaged in agriculture, but this suffers from lower productivity than per hectare and per worker. One of the main reason for the lack of productivity is inadequate services like finance and marketing. The credit requirement for the agriculture sector is so large to meet their needs. RBI improved the policies of agricultural advances from 54.1% in 1992 to 59.6% in 1995.

- **Regional Imbalances**: As per the Verma committee, such banks should be closed who involve in lack of non-fund business, augmentation of non-interest income, establishment cost is high, and non-capability to improve the sustainability of business levels. They are licensing policy liberalisation also one of the reasons for regional imbalances. As per section 22 of the Banking Regulation Act, 1949, every company should obtain an RBI license before commencing business in India.

Alternatives

Reform proposals have mainly focused on ownership and have issued strident calls for privatisation. Even if there was political support for this idea, there are a few important challenges.

The total current account and savings account(CASA) ratio of SBI and public sector banks is nearly 43% in 2020. This reflects the confidence of customers in the government implicit in these entities. The banking customers in India expect their deposits not to face any uncertainty, even when they fail. In such an environment, and where alternatives in other well-managed banks with significant branch networks are not yet entirely in place, privatisation could cause a flight of savings from banking to physical assets.

The alternative to the privatisation of PSBs is:

The core strength of PSBs is the deposit franchise. Their branch network in far-flung areas, combined with the government's trust, means that they are the preferred choice of the mass-market customer, rural customers, and, often, retired individuals.

Given the low deposit rates offered by banks in India relative to the risk-free rate, these deposits represent a tremendous value in profitability cushion. The erosion of value happens on the lending side. This occurs due to a few reasons: firstly, mandated lending through various schemes, in addition to priority sector lending targets; secondly, the poor risk management competencies of banks, particularly vis-à-vis managing the concentration risks of specific sectors and business groups; and third, lack of specialised underwriting skills, given that customers tend to range from large firms and farmers to small businesses and mortgages. The math here is straightforward—the risk-adjusted return from the bank's lending activity erodes all the value created by the deposit-taking activity.

Narrow banking proposals that suggest PSBs only invest in government securities (akin to the payments bank design) run the risk of starving the real sector of much-needed bank credit. What we propose is to find a balance between completely discretionary lending and zero lendings by PSBs. We call this the “risk aggregator" model. Here, the deposit-taking activity would continue as the present. On the lending side, rather than PSBs directly originating credits through branches or consortia and hoping for the best, they would assemble a portfolio of credits originating by specialist institutions (non-bank finance companies and small finance banks) with credit appraisal and underwriting capabilities in chosen sectors and geographies.

Assembling this portfolio of loans can be done in various ways, such as direct purchases of their loans and investing in securitised assets representing underlying loans originated by these specialist institutions. This also implies a clearer role for these specialist institutions and their contributions to efficiently extending credit. With such an assembled portfolio of loans, the “risk aggregator" focuses on managing aggregate risk on the balance sheet.

A full transition into the creation of banking aggregators would ensure a more efficient approach to capital while, importantly, preserving the deposit franchise of PSBs. This is because, under the risk aggregator model, the PSB asset book would be highly rated owing to the high levels of diversification and granularity in underlying loans.

Portfolio-level guidelines would need to be specified, including concentration limits concerning their capital, sectoral or regional concentration, and extensive and connected exposures to single borrowers or closely related groups of borrowers. The risk aggregator model would be subjected to high-quality risk reporting requirements made possible by the availability of accurate and complete data along business lines, legal entity type, asset type, industry, region and other groupings that permit identifying and reporting risk exposures, concentrations and emerging risks.

The Reserve Bank of India has innovated on the banking design in recent years by introducing the differentiated banking regime. PSB as a risk aggregator fits into this thinking, especially in the context of transforming existing institutions to safer controls, particularly in light of new requirements, such as the implementation of new reporting norms, around the corner.

Personal outlook towards privatisation

When it comes to bank privatisation, we could argue that the privatisation of PSBs is not a pro-poor initiative because the poor receive small loans at lower interest rates than private banks, which would never be favourable to issuing and waiving bad farm loans.

It's a well-known fact that private banks are less likely to grant farm loans as quickly as their public-sector counterparts.

One of the reasons why public sector banks have worse loan quality is because of this.

NPAs in the banking sector have several negative consequences that must be addressed.

Bankruptcy is covered by the provisions of the FRDI bill 2017.

The bailout procedure is the most contentious clause. Assets and liabilities of stressed public sector banks can be transferred to private companies or bridge service providers, depositors can lose their deposits under bail-in provisions, and PSBs can be consolidated or privatised through mergers, amalgamations, and acquisitions.

Our findings suggest that privatised banks have lower economic efficiency and solvency than banks that the government still owns. Also, profitability rises after privatisation, but efficiency, risk exposure, and capitalisation may worsen or improve depending on the type of owner. However, privatisation leads to significant improvements in economic efficiency and credit risk exposure over time. We also discovered that newly privatised banks controlled by local industrial groups are more vulnerable to credit risk and interest rate risk following privatisation.

Conclusion

Finally, today's public sector banks are completely in debt. The banks are blind to the realities on the ground. The Globalization Delusion of Developing Economies with Social Media: Economic liberalisation benefits are never used to benefit the general public. We have seen the destruction of our public sector industries due to economic liberalisation, and we have recently seen how FDI and GST affect the economy. We've seen how these failures have manifested themselves in the form of black money. The privatisation of banks would benefit the wealthy class at the expense of bank employees. The privatisation of banks signifies a commitment to economic development in the face of business.