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Impact of Privatization on Indian Banking Sector

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Abstract:
Privatization is transfer of ownership from the public to the private sector as well as the control over assets. In broader terms, it involves greater influence on demand and supply force, make sure that there is higher competition, it brings greater involvement in government activities. It brings liberalization in different regulations to release forces of competition and to implement demand and supply forces into the economy.
Privatization is contemplate to bring up competition, making sure greater capital investment, competitiveness and modernization, resulting in development of employment and providing improved quality of products and services to the consumers and reduction in the tax burden. As part of improvement process in the financial services sector, in January 1993 RBI issued certain guidelines for getting license of new banks in the private sector. It has been revised after 8 years in January 2001. Some of the important conditions in the private sector as per revised guidelines by the RBI are Paid Up Capital, Promoters Contribution, Foreign Investment etc. The study involves the benefits how the number of branches increased after privatization, increase of credit facilities for agriculture and increase of job opportunities, and adverse impacts of privatization on Indian Banking like high interest rates, less 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 uses wrong means to recover loans from people.
Keywords*:* *Privatization, Interest Rate, Job Opportunities & NPVs*

Introduction

In 1998, a committee headed by former Reserve Bank of India (RBI) governor M Narasimham had recommended that the government reduce its stake in public sector banks to 33 percent. The recommendation was part of a wider set of reforms suggested – which included consolidation – to ensure a healthy Indian banking sector that can meet the needs of a newly liberalized economy.

In the 2000-01 government decided to accept the recommendations of the Narasimham Committee on Banking Sector Reforms for reducing the requirement of minimum shareholding by Government in nationalized banks to 33 percent. This had been done without changing the public sector character of banks and while ensuring that fresh issue of shares is widely held by the public. The government's share in individual banks is not being reduced but the share of government banks in Indian banking is being pushed down. Call it privatization of Indian banking by stealth.

The shift links back to the government's *Mission* Indradhanush program announced in 2015. As part of that plan, the government set aside Rs 70,000 crore for capital infusion into banks over four financial years. The amount was nowhere near what these banks actually needed. Rating agencies, analysts, and bankers all called for a greater allotment of capital to sustain the country's public sector banks.

A few banks have reported earnings for the March 2017 quarter so far, but when all numbers are in and tallied, the end of financial year market share for nationalized banks would certainly be lower than the previous year. To be sure, nationalized banks could wrest back market share if they have the capital to clean up and grow but it doesn't look like the authorities are in a hurry to do that.

Objectives of the Study

To study about the privatization how it brings advantages to the Banking Sectors.

To know the development factor of Private Sector Banks.

To gather information how privatization leads to a success of the banks.

To know whether privatization leads to benefit or harmful to the Customers.

Research Methodology

Research paper is descriptive in nature and information used is collected from different articles, magazines and internet.

RBI Guidelines for New Private Sector Banks

As a part of reforming sector in financial services, in January 1993, the RBI issued certain guidelines for providing license for new banks in the private sector. It has revised his guidelines after 8years in January 2001. Some of the important guidelines by the RBI to new Private Sector Banks are:

Paid-Up Capital: The new banks should maintain initial minimum paid up capital Rs.100crores. Within 3years of commencement of business banks should raise initial capital to 300crores. The overall capital structure of the banks would have to be approved by the Reserve Bank of India.

Promoters Contribution: The maximum contribution of promoters will be 40% of paid up capital at any point of time. The initial capital can be raised through public issue other than promoters' contribution. The contribution of 40%will be locked for 5years from the date of licensing of the bank.

Foreign Investment: The participation of non-resident Indian in the equity of new bank will be a maximum extension up to 40%. In case of foreign banking, co-promoter equity participation will be restricted to 20% within the upper limit of 40%. In case of shortage of equity participation by foreign contributors then multilateral institutions would be allowed to contribute foreign equity to cover the shortfalls of the equity. The necessary approval by the Foreign Investment Promotion Board (FIPB) should be obtained.

Banks Promoted by Large Industrial Houses: Individual companies are allowed to participate in the equity of bank up to 10% limit because they are directly or indirectly connected with new banks and this applies to all large business house who are interconnected companies.

Capital Adequacy Requirements: The minimum requirement of the bank to maintain capital of 10% on a commencement of its operation.

Constitutional Obligation: The constitutional method in India helps to remove the unequal opportunities and rewards for different social positions or statuses within a group of society. The main intention of framers of Indian Constitution is citizens should be safe and secure.

Recommendations of First & Second Narasimham

Committee and Verma Committee

Narasimham Committee has not directly supported to banks in privatization, it suggested certain recommendations for market strategy and profit seeking banks. Narasimham Committee said that there is consistency in foreign investment policy with other aspects of government policy. We believe that the entry of foreign banks to the domestic country brings more beneficial to the country from the point of view of competitive efficiency improvement of Indian banking system and also up gradation of work technology.

In April 1998, The Committee on Banking Sector Reforms (BSR) recommended the second stage of banking reforms. The chairman of this committee is Narasimham. The main theme is making strong of the banking system to the growth of the economy and this will bring efficiency in capital adequacy, generation of income and providing related norms over the period of next four years. On the other hand, The

Verma Committee report of 1998 recommended to closing down weak banks. According to the committee, weak banks means the banks which have high non-performing assets. As per the view of Verma committee rural branches have high non-performing assets and considering those banks are weak banks. If weak banks are allowed to perform in the society it affects the efficiency of other banks as well. The Verma Committee report of 1998 on the other hand recommends closing down weak banks. According to the Verma Committee, weak banks are those banks, which have high non-performing assets. The Committee found that many of the rural branches have high non-performing assets and considered those banks as weak banks. If the weak banks are allowed to function in the economy it will affect the efficiency of other banks also. Thus it is clear that as per the recommendations of all these committees banking sector should restructure to bring efficiency in it. The government has taken many measures to implement the recommendations of the committee.

Effect of Norms : The new banking culture protected by reforms, is reflected in ignoring the priority sectors, fully unfair treatment of opportunities offered by capital market related activities. As the chairman of Sate Bank of India correctly pointed out, "this approach Breaks faith of an innocence of realities of Indian economy" These brings following changes in activities:

Priority Sector Lending: The general perception of the priority sectors is that prescription of 40% of net bank credit, which have lead to the higher level of Non Performing Assets (NPAs). The accepted facts that increase in Non Performing Assets will definitely 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 backbone of Indian economy. 59.4% of the population is engaged in agriculture, but this suffers from lower productivity compared to per hectare and per worker. One of the main reason for lack of productivity is inadequate service like finance and marketing. Credit requirement for agriculture sector is so large to meet their requirements. 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. Licensing policy, liberalization also one of the reason for regional imbalances. As per the section 22 of the Banking Regulation Act, 1949, before commencing business in India every company should obtain license from the RBI.

Arguments for Privatization

The following may be the arguments for privatization of banks in India: Public sector ownership has an inherent handicap due to it being extremely diffused. This makes it less amenable to effective control by shareholders, compared to private ownership.

Bank nationalization had given monopoly to the government in the banking industry. As in case of any monopoly situation, the quality of service went down and the people suffered. State ownership of banks reduces competition and breeds inefficiency.

There is no evidence to suggest that State ownership lowers the probability of banking crises. The sale of public equity of banks may be particularly lucrative now. Twelve of the 27 PSBs and 19 private sector banks are listed on stock exchanges, and the market has appreciated their recent performance. During the years 2001-03, all PSBs declared high profits, with some banks reporting 200 to 300 per cent growth in their bottom line! The bullish bond market enabled many banks to book record trading profits in trading in Govt. securities. Additional good cheer was the passage of the new Act, which enables banks to seize the assets of defaulting borrowers.

A sixth rationale for privatization is that it enhances efficiency and productivity through proper management and control.

The competition, not merely ownership, is the key. And foreign competitors might bring additional benefits take fresh capital as shown in other emerging markets. A foreign owned bank, with large capitalization, can withstand local disturbances better.

The private sector and foreign banks can resist local government pressure to lend to favoured sectors.

Frequent recapitalization of State-owned banks is a huge burden on Government budget. The relative insensitivity of the public sector banking system to its cost structure, inability to respond quickly to the changing market trends and the greater rigidities in the management decision-making processes because of what may be described as 'non-commercial' considerations.

Dr. Jalan, Governor of RBI has given the following arguments in support of privatization of the banking sector.

Indian legal system provides full protection to the private interests of the public servant including in the banks and further public sector banks have been afflicted with management by 'non-commercial' considerations. He believes that accountability to the shareholders will make sure that the officers stay on course.

Poor internal control and risk-management systems of the banks; and greater accountability on the part of corporate.

India should increase its domestic savings and invest them in the services sector to emerge a leader in the world economy. He also quotes W. Arthur Lewis to the effect that the central fact of economic development is that of capital accumulation and that would require an increase in the rate of domestic savings from 4 per cent to 12per cent. India has failed to accumulate capital despite having secured such an increase in domestic saving because till the 1980s, the state-controlled financial system acted as deposit-taking agencies and providers of credit and finance for designated and centrally determined purposes 'the public sector' instead of being a generator of savings for the community's good-became, overtime, a consumer of community's savings'.

Arguments against Privatization

One of the Directive Principles is that the Government would strive at redistributive justice in the country. Bank privatization is a step away from this direction.

Public sector banks in India have already been exposed to increasing competition. The forces of competition have already been pushed Public sector banks to optimize its resources an order to reach technical efficiency. It is felt that conclusions are being drawn on the basis of incomparable units - all of this to favour privatization and even foreign ownership.

Privatization opens the way for the domination of the economy by foreign capital. Since it is extremely difficult to distinguish in practice between domestic and foreign capital within the private sector when they are operating together in joint ventures, or when a domestic firm can be a front foreign capital, any expansion in the scope for the private sector necessarily enlarges the sphere of operation of foreign capital as well.

Privatization would remove a large chunk of the economy from the purview of public scrutiny and hence from the realm of social accountability. A basic distinction between public and private property consists in the fact that the formers, in principle, is socially accountable, and this is enforced through Parliament and its committees. How well this job is done is a separate issue? If it is badly done then that requires reforms in a different sphere. But privatization puts an ends to this form of social accountability and hence constitutes in a fundamental sense an abridgement of democracy.

Social accountability is not merely intrinsically desirable. It becomes absolutely necessary when enterprises have to fulfill certain social functions going beyond mere profit making. Privatization, and even making public enterprises concentrate exclusively on profit making, effectively does away with these social functions.

All privatization involves the selling of state property at 'throwaway' prices. This is true the world over. And it has been true in India too as the Comptroller and Auditor-General's report pointed out some time ago. In other words, in privatizing enterprises the state is not merely changing the form of its property from enterprises to schools or hospitals or reduced public debt but is transferring gratis some state property to private monopolists. Since state property has been built up through the through the sacrifices of the common people through tax payments or inflation-induced restraints on consumption, privatization amounts to an tax payments or inflation-induced restraints on consumption, privatization amount to an implicit act of plunder, or what Marx called "primitive accumulation of capital": a few are being allowed to filch from many through the courtesy of the state.

India has been a planned economy for the last about five decades. But in absence of any effective control over the commercial banks, the economic planning was incomplete and monetary policy targets were difficult to achieve and pursue. With the nationalization of banks, the government could actually plan and pursue the monetary policy targets and it would be wrong to say that the decision of bank nationalization was a mistake.

Findings

In the process of privatization banks should maintain a minimum paid up capital of Rs.100 crores within 3 years of commencement should raise to 300 crores. Here there should be a involvement of promoters and foreign investments as well. All the capital structure format should be approved by Reserve Bank of India.

As per the RBI rules individual companies were allowed to participate in a equity of the banks up to 10% limit.

Narasimham Committee decided to bring efficiency in capital of Private sector banks and in up gradation of technology.

Verma committee recommended that those banks have non-performing assets are weak banks. If these banks were allowed to function it will affect the efficiency of other banks as well.

As for as agriculture is concerned 59.4% of population is engaged in agriculture, their main problem is less productivity due to insufficient credit finance.

By privatization private ownership will come into existence and they lead to all the decisions with regards to business concerned.

Privatization lead to a monopoly system, this will reduce the quality of efficiency and public will suffer.

Public sector banks already foster their technological advancement due to competition. It is favour to privatization and foreign ownership.

Conclusion

Bank plays an important role in economic progression of the country. Public fund are involved in insurance and banking sectors. It collects surplus money from the society and uses it in desired directions. As per the Indian Constitution, main economic activity is to satisfy the public interest, but in the process of privatization, it harms the public interest. This was the reason created improper behavior in human beings. India as whole are affected by privatization in Banking and insurance sectors. Because argument says that, government will not protect the public money and win the public confidence. Another point is that profit will not be revealed by such companies. It is doubtful obligation to the society. But this cannot be considered as failure of banking sectors. Only a part of the weaker section will affect the success of the sectors. There is one possible solution to retain their success is that make a working of Debt Recovery Concept effective and powerful. In the case of Privatization, Banking Industry will be dominated by other big industries. Such industry to the society ownership pattern of big industries are not consistent in banking industries. Finally what government suggests is not just disturbing but clearly developing and beneficial to the society. This will bring new culture in banking not only for small borrower but also for small saver.

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