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"A Study of Privatization in Indian Banking System"

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Abstract

Privatization is the transfer of ownership from the public to the private sector. Privatization is being partially or fully in most of the countries of the world. It is essential to develop the banking system to give impetus to the Indian economy. To strengthen the Indian banking system, reforms are made in its structure as required by the government. Banks were nationalized after independence and at present time the government is emphasizing on privatization of banks.

In this research, we will study the advantages and disadvantages of privatization on the Indian banking system. To understand the impact of privatization, we will discuss in detail several important aspects like deposits, loans & advance, Non Performing Assets, assets & operating profits, investment, government schemes, priority sector lending and return on assets & return on equity to study the financial performance and profitability of public and private sector banks.

***Keywords*:** Privatizations, Indian banking system, Financial Performance, Profitability, Nationalization, Economic growth

Introduction

Privatization is a process by which government intervention in economic activities is reduced or eliminated. Through privatization, the government hands over the state and centrally owned public sector units to private individuals and institutions. Privatization leads to increase in market competition, new investment aids, improvement in services, the invention of new financial products, increase in employment opportunities, and increase in profit, which accelerates the economic growth of the country. The government can transfer its ownership, partially or wholly as per requirement. Government can privately undertake public sector units in two ways.

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Government selling public sector units:

I. Government can privatize them by reducing part of their ownership stake in those public sector units.

Privatizations may increase the profitability of those public sector units by improving the efficiency and cost reduction, so that those units can help in the economic development of the country. The government of India adopted Liberalization, Privatization, and Globalization in 1991 to overcome the economic crisis, which led us to move the Indian economy from a close to open economy concept. These changes have seen an unprecedented increase in the economic development of the country.

The Indian Banking Sector: A Brief view

At present, the banking sector has a special contribution to the Indian economy. Indian banking is the largest banking system in southern Asia. Commercial banking facilities in India started from the time of the British. The Reserve bank of India Act was introduced in 1934 under the Recommendation of the Hilton Young Commission (1926) and was established on 1 April 1935 as a central bank. Before independence, the RBI also acted as a central bank in countries such as Pakistan, Bangladesh, and Myanmar. Banking services and facilities expanded after independence. RBI was originally privately owned, but in 1949, RBI was nationalized, so that it was completely owned by the Government of India. The Reserve Bank of India is the central bank in India that controls and regulates the entire banking system. After independence, all commercial banks operating in India were privately owned. Banks were nationalized twice by the erstwhile government for the purpose of developing the banking sector and expanding banking services. The first time 14 banks were nationalized in 1969 and the second time 6 banks were nationalized in 1980. The government has been merging and acquiring weaker public banks for the last two decades and connecting them with a strong banking system to improve their functioning.

The changes that are taking place in the Indian banking sector are promoting privatization. In January 1993, the Reserve Bank of India issued guidelines regarding obtaining licenses for new private banks and RBI made some fundamental change to these guidelines in 2008.

On 21 January 2019, the government privatized IDBI bank by selling its stake in IDBI Bank to LIC. Honorable Finance Minister Smt. Nirmala Sitaraman while presenting the union budget 2020-21 in Parliament said that two other Public sector banks will be privatized.

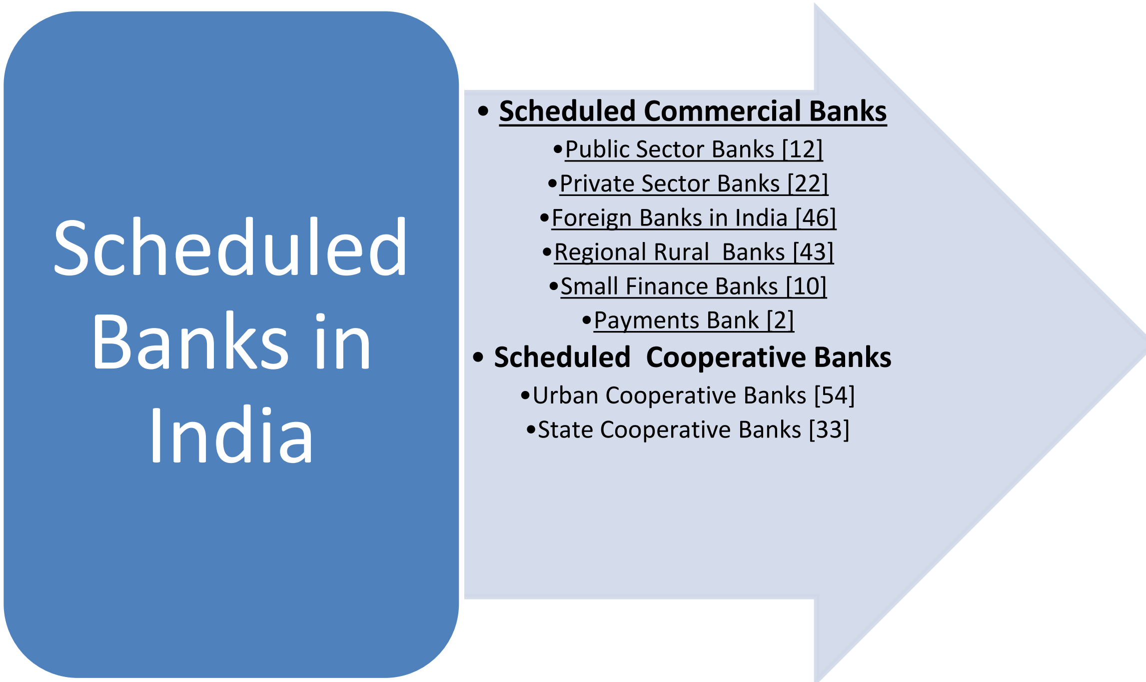

Figure 1. Scheduled banking Structure in India [as on march 31, 2020]

Source -: Report on trend and Progress of banking in India 2020, RBI, Mumbai.
* As included in only the Second Scheduled banks of the Reserve Banks of India Act, 1934
(Note - : figures in brackets indicate number of banks in each group)

Era of nationalization

Nationalization is the process of change of ownership in which a private institution or business entity is managed and regulated by the government. Any private institution or business entity is considered to be owned by the government when a minimum of 51% of its capital is with the government. The nationalization of banks in 1969 and 1980 changed the picture of the Indian Banking System. After Nationalization, the public began to have more confidence in banks, which led to more use of banking services. The government started directly influencing banking activities, due to which many effects can be seen on the Indian banking sector. On the one hand, banks expanded banking services by opening branches in urban areas as well as rural areas. Banks provided financial assistance to small farmers, traders and other individuals at affordable rates for the development of rural areas. On the other hand, public sector banks start to suffer from many problems. Such as increased government intervention in decision making and appointment of higher management officers, increase in cases of internal corruption and scams, continuous increase in the value of NPA's and banks continue to suffer losses.

The government has to invest huge amounts of capital every year to meet the losses of public sector banks. The government has to spend a large part of its income on recapitalization. In order to reduce the increase in the financial burden of the government due to recapitalizations in banks, from time to time, recommendations were made by the committees regarding the government's shareholding in PBSs. The Narasimham Committee (1991 and 1998) suggested that government shareholding in public sector banks should be limited to 33 %. The P. J. Nayak committee (2014) Committee suggested that the government' shareholding in Public sector banks should be less than 50%. If the government reduces its shareholding from Public sector banks, then the Banks will work more freely, which can increase their efficiency.

Objective of Study

1. To carry out an analytical review on the increasing need for privatization in the Indian banking sector at present.
2. This research aims to examine the effect of the privatizations of the Indian banking System.
3. To conduct a comparative study of financial performance and profitability of Public sector banks and Private sector banks

Research Methodology

This study will be analytical and exploratory research. We will use secondary data to reach the objective of this research. In secondary sources, we will include books, magazines, journals, published reports, articles, newspapers, and official websites. In our research, we will study statistical data with the help of bar graphs, column charts, tables, and graphical, etc. so that they can be easily understood.

In this research, we will critically analyze the merits and demerits of the privatization of banks. And we will conduct a comparative study of the financial performance and profitability of Public sector banks and Private sector banks so that we can know whether privatization is beneficial or not for The Indian banking sector. We will analyze the weak aspects of public sector banks to find solutions to the problems arising from them.

The impact of Covid19 on the Indian banking system will not be considered in this study. That will be the limitation of our study.

Review of Literature

Before starting this research, we have studied and reviewed many types of literature related to our research, which are as follows:

Milind Sathye 2005 according to Him studied and analyzed the financial data of nationalized banks and private banks from 1998 to 2002, and concluded that privatizing the banks had seen a considerable improvement in the financial position of those banks, thereby increasing the efficiency of those banks. Along with that, the profits of those banks increased.

The Economic time: According to Raghuram Rajan (formal RBI governor) suspecting that the process of privatization of week Public sector banks has been completed, he said that selling state-run banks to big industrial houses would prove to be a big mistake and it would not be politically viable to sell large Public sector banks to foreign banks.

The economic time: According to Honorable Prime Minister Shree Narendra Modi advocating the government on privatization, it said that the government wants to privatize the public units which are not in good financial condition and which are continuously in deficit. He said that the government has to invest capital every year to meet the deficit of these public units, which is a large part of the government's income spent to make up for the deficit, due to which the government is not able to spend much money on other developmental schemes.

ADBI working paper: According to Kim and Panchanatham 2019, Reform is essential, especially in developing countries of Asia. Privatization may prove to be a way to improve the state-owned enterprise. A developing nation like India, which has a mixed economy, has both advantages and disadvantages to privatization. If SOE's act like private sector institutions, they can fulfill social responsibility while making a profit as well. The utmost need to improve SOE is being felt, so the process of complete or partial privatization should be continued.

According to K.B. Mathur 2002, about privatization of public sector banks in India, based on assumptions rather than factual analysis, minimum knowledge, an international experience whose evidence is unclear, etc, due to which we are not able to have a strong stand on privatization of public sector banks. Public sector banks are facing many problems. But, it is not necessary that where the bank is dominated by the private sector, there cannot be a banking crisis. The government needs stricter laws and a strong regulatory framework that can increase efficiency and benefits from the privatization of the banking sector.

According to Viral Acharya and Krishnamurthy V. Subramanian, He has done a comparative analysis of public sector banks with new private sector banks. They, in this analysis, have assessed the health of Indian public sector banks and their effectiveness in the Indian banking system. He said that some public sector banks can be privatized and capital can be re-allocated. Those public sector banks which have poor asset quality can be closed down. More and more new banks may be introduced to improve the level of competition.

Arguments in favor of privatizations of banks

1. Privatization will improve the quality of services offered by banks and provide new up-to-date facilities to customers.
2. In operational, organizational, and financial-related functions, the private sector banks perform better than the public sector banks.
3. The privatization of banks will increase foreign investment as foreign investors prefer to invest in Private sector banks.
4. In private banks, a very tough attitude is taken against debt and fraud, due to which the problem of NPA is less seen in Private sector banks.
5. The public sector bank lacks the competitive spirit as compared to the Private sector banks.
6. The concept of minimum risk in Private sector banks is strictly followed.
7. Introducing new financial products in the market by private banks leads to innovations in the banking sector.

Arguments against privatization of banks

1. Through Public sector banks, the government can implement its financial schemes, such as Jan Dhan Yojana, Mudra Yojana, and many schemes, etc. But the government cannot put any kind of pressure on private banks to implement these schemes. The government can only request private banks to implement these schemes.
2. Private sector banks will open more branches in industrial and urban areas but show less enthusiasm for branches in rural areas.
3. Private Banks will give less priority to loans related to the agriculture sector and even if they give loans, they will have to be paid at a higher interest rate in return.
4. Private Banks will charge higher service charges to maximize their profits, which will adversely affect the medium and poor people of the country.
5. If the banks are privatized, then the employees working in the banks will always be afraid of losing their jobs.

Impact of privatizations on the Indian banking sector

To study the impact of privatization on the Indian banking sector, we will analyze the data of the last few years. For this, we will do a comparative study of financial performance and profitability of public and Private sector banks through the following points.

1. **Deposits -:** Banks have two meager functions, which are to accept deposits and provide credit service. We will use the deposit data to conduct a comparative study between public and private sector banks. These deposits mainly include demand deposits, saving bank deposits, and term deposits. The deposits of all commercial banks have been steadily

increasing over the years. Private sector banks have attracted customers by adopting competitive interest rates, which have increased their deposits.

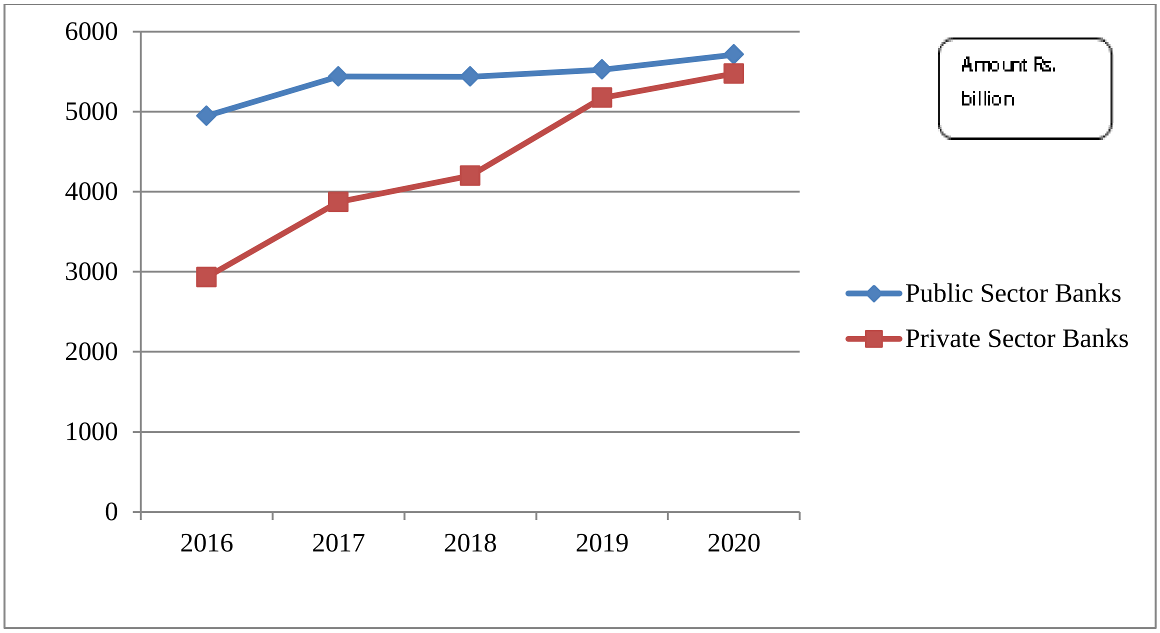

Figure 2. Demand Deposits of Public and Private Sector banks

Source -: report on trend and progress of banking India 2019-20, 2018-19,2017-18,2016-17

Figure 2 shows demand deposits in public and private sector banks. In the year, the demand deposits in private sector banks were Rs. 2932 billion, and in the year 2020, this amount increased to Rs. 5475 billion. Demand deposits in public sector banks were Rs 4948 billion in the year2016, which increased to Rs. 5713 billion in the year 2020.

Studying the data for the last 5 years, we find that there was a 53% increase in saving bank deposits in private sector banks, and a 35.85% increase in savings bank deposits in public sector banks (see fig. 3). On the comparative study of saving and demand deposits, private sector banks are performing better than public sector banks.

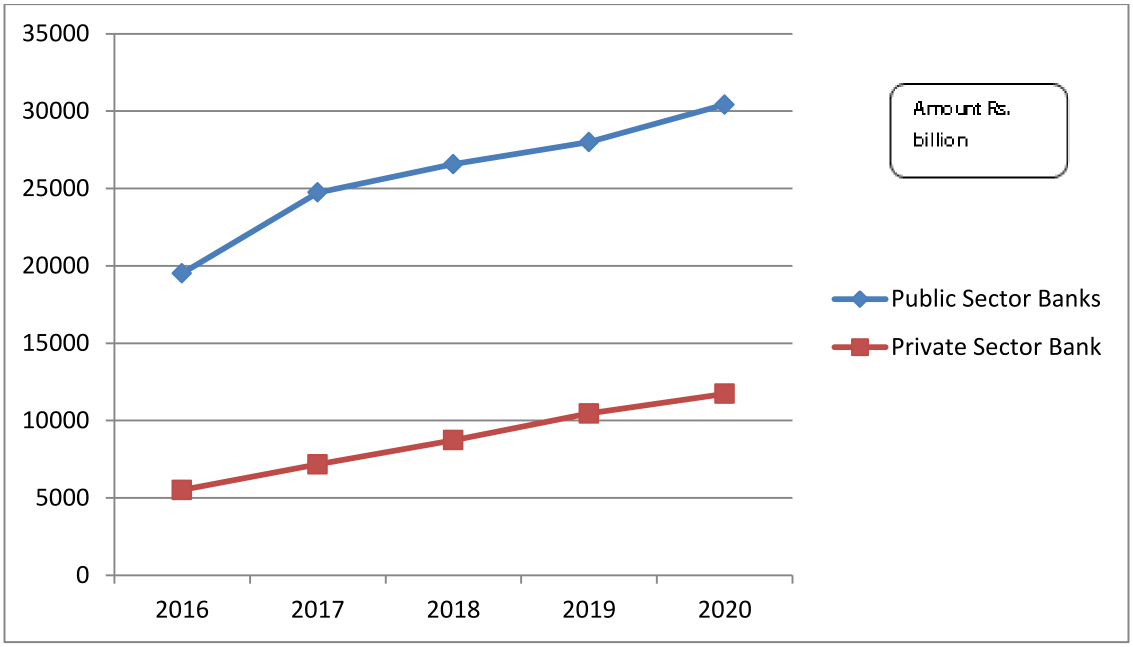

Figure 3. Saving Banks Deposits of Public and Private Sector Banks

Source -: report on trend and progress of banking India 2019-20, 2018-19,2017-18,2016-17**.**

On the other hand, figure 4 shows the term deposit amount of public and private sector banks. in the period 2016 to 2020, the amount of term deposits in private sector banks increased 46.55%. term deposits by public sector banks increased by 7.26% in the year 2016 to 2020.

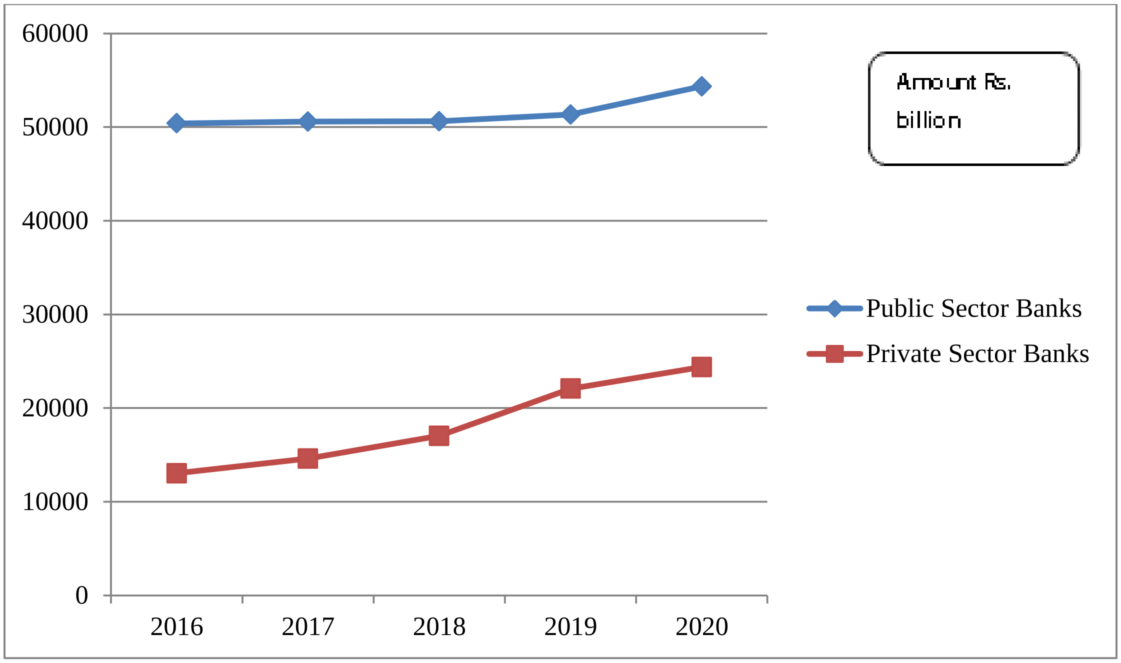

Figure 4. Term Deposits of Public and Private Sector Banks

Source -: report on trend and progress of banking India 2019-20, 2018-19,2017-18,2016-17**.**

2. **Loan and Advance -:** lending is one of the main functions of banks. Loans and advances also include purchased and discounted bills, cash credits, overdrafts, and term loans. banks provide loans to individuals, firms, companies, industrial units, institutions to the best of their ability. In Figure 3, the amount of lending by banks has been steadily increasing between the period 2016 to 2020. Public sector banks increased their loans and advances by about 9.16 percent from 2016 to 2020. At the same time, loans and advances in Private sector banks increased by about 46%. A comparative study between public and private banks shows that the increase in loans and advances by private banks is much greater than that of public banks.

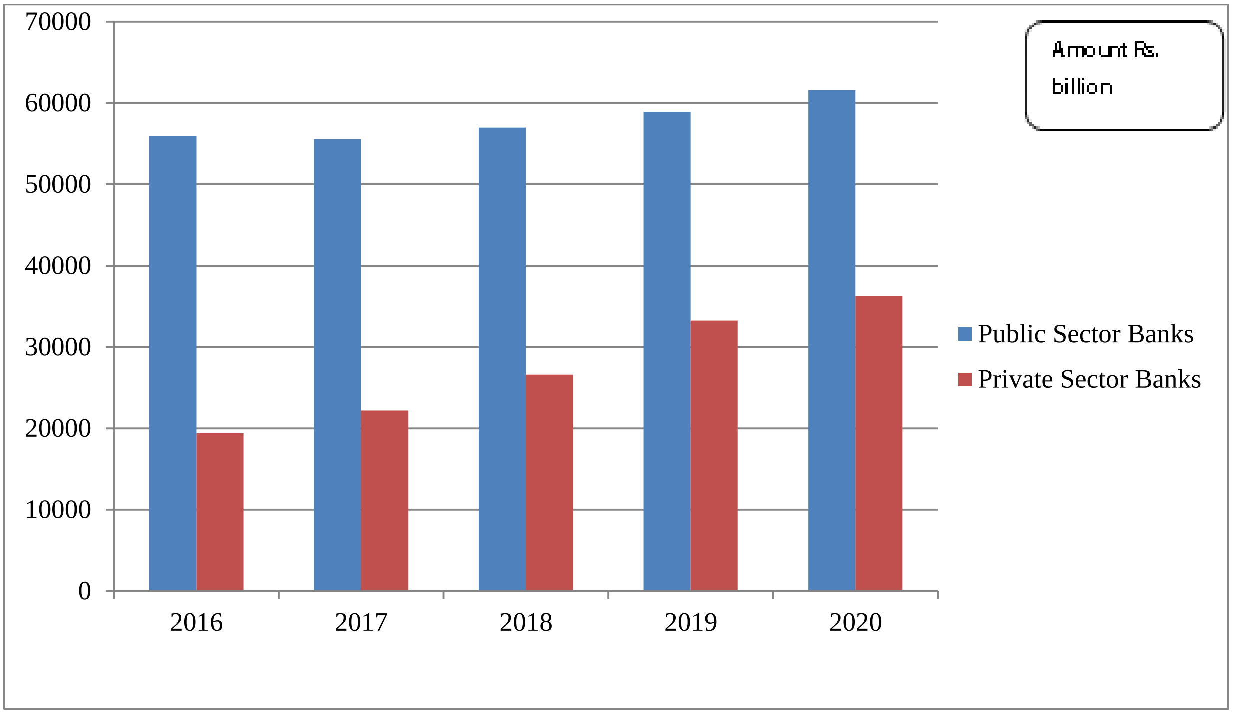

Figure 5. Loan and Advance

Source -: report on trend and progress of banking India 2019-20,2018-19,2017-18,2016-17.

3. **Non Performing Assets (NPA)-:** NPA are emerging as the biggest problem in the Indian banking sector at present. Public sector banks and private sector banks are suffering from the problem of NPA's. Public sector banks are continuously incurring losses due to NPA's, due to which the government has to invest huge amounts of capital every year. Despite the government's recapitalization, there is no significant difference in the financial performance of Public sector banks. The Verma committee 1998 in its reports suggested that those weak banks which have high NPA's should be closed down. If weak banks are allowed to function then they will affect the efficiency of other banks which will hurt the economy of the country.

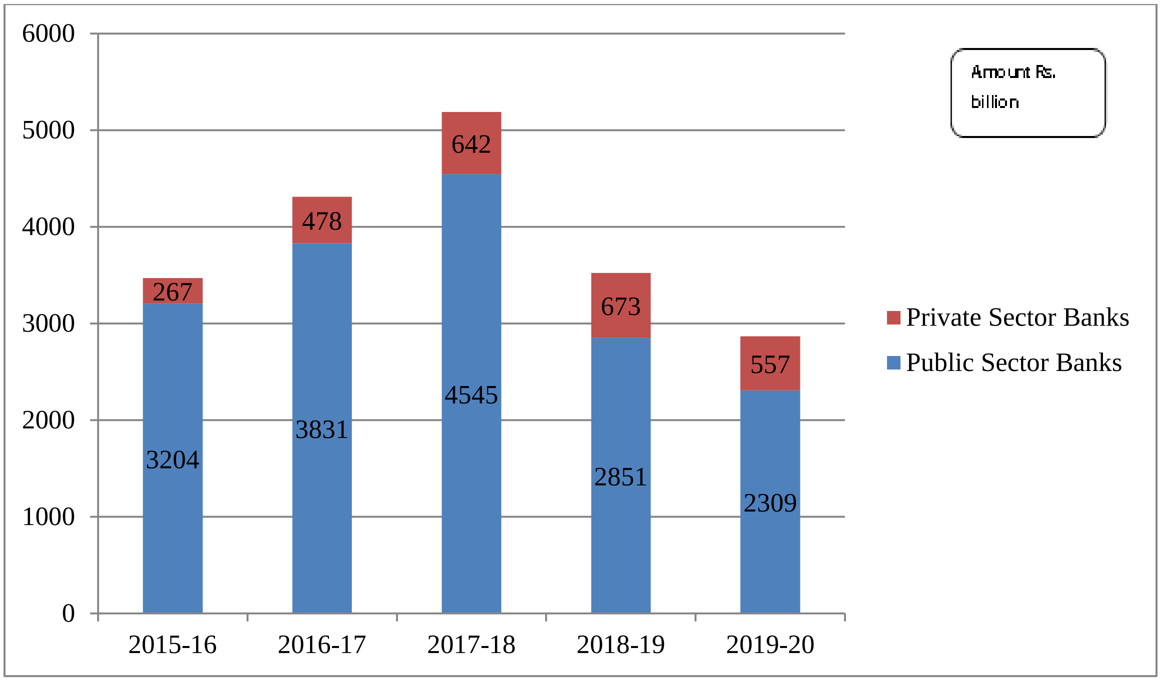

Figure 6. Net Non-Performing Assets (Closing Balance per year)

Source -: report on trend and progress of banking India 2019-20,2018-19,2017-18,2016-17.

Figure 6 shows the closing balance of Net NPAs for the years 2015-16 to 2019-20. Analyzing the data of the last few years, it is known that in the year 2015-16 the closing balance of Net NPAs in Public sector banks was Rs. 3203 billion, and the closing balance of Net NPAs in Private sector banks was Rs. 267 billion. In the year 2019-20, the closing balance of Net NPAs in public sector banks is Rs. 2309 billion, and the closing balance of Net NPAs in private sector banks is Rs. 557 billion. Looking at the data from the outside, it appears that the value of Net NPAs in public sector banks is much higher than that of private sector banks. On the other hand, on a comparative study of the data of the previous years, I found that the value of net NPAs in the public sector banks is continuously decreasing while the value of net NPA in Private sector banks is increasing continuously.

4. **Assets and Operating Profit-:** The assets and operating profit of any organization are indicative of their financial performance and profitability. The chart shows the share of Public sector banks, private banks, and foreign banks in total assets and operating profit during the period 2012-13 to 2019-19. After studying the chart, it was found that the share of Public sector banks in total assets was 70%, while in the year 2019-20; this share fell to around 60%. The share of Public sector banks in total operating profit was more than 60 in the year 2012-13, while in the year 2019-20, the share of Public sector banks in total operating profit was less than 50%. The share of Public sector banks in total assets and total

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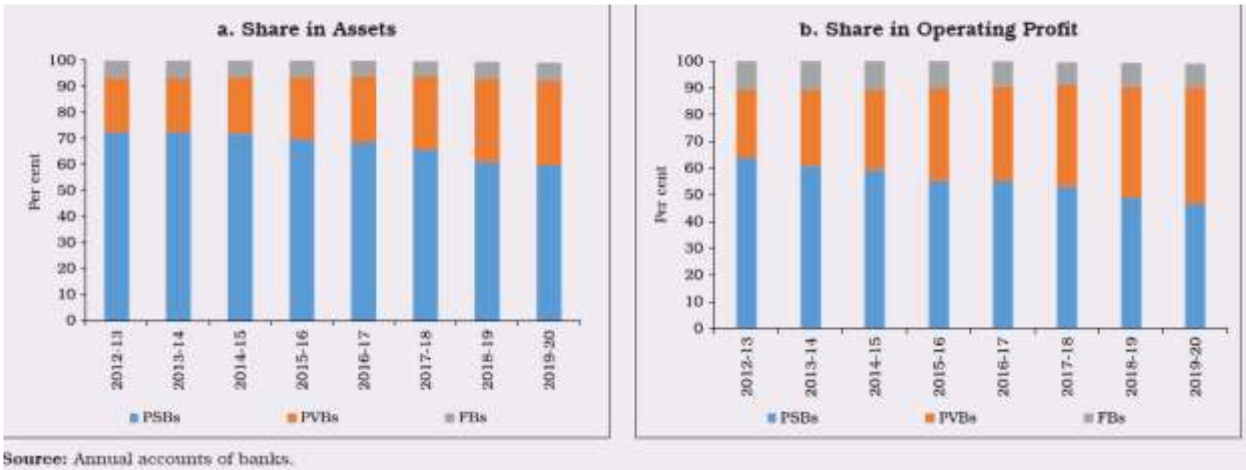
operating profit has been steadily falling year after year. The increase in the share of private banks in total assets and total operating profit indicates that the financial performance and profit of private banks are continuously increasing.



Bank group wise share in assets and operating profits

Source -: report on trend and progress of banking India 2019-20

5. **Investment-:** The bank uses its deposits and reserve and surplus capital to invest so that banks can get other sources of income. Banks normally invest in government securities (Inside India or Outside India) and other approved securities and non-approved securities. 22481 billion rupees were invested by Public sector banks, whereas in the year 2020, 29406 billion rupees have been invested. The amount of investment by Public sector banks in the year from 2016 to 2020 increased by 23.54 percent. On the other hand, Private sector banks invested 7985billion rupees in 2016 and in 2020 the investment amounted to 12930 billion rupees. When compared to the growth in investment, the investment rate of private sector banks is much higher than the investment rate of Public sector banks.

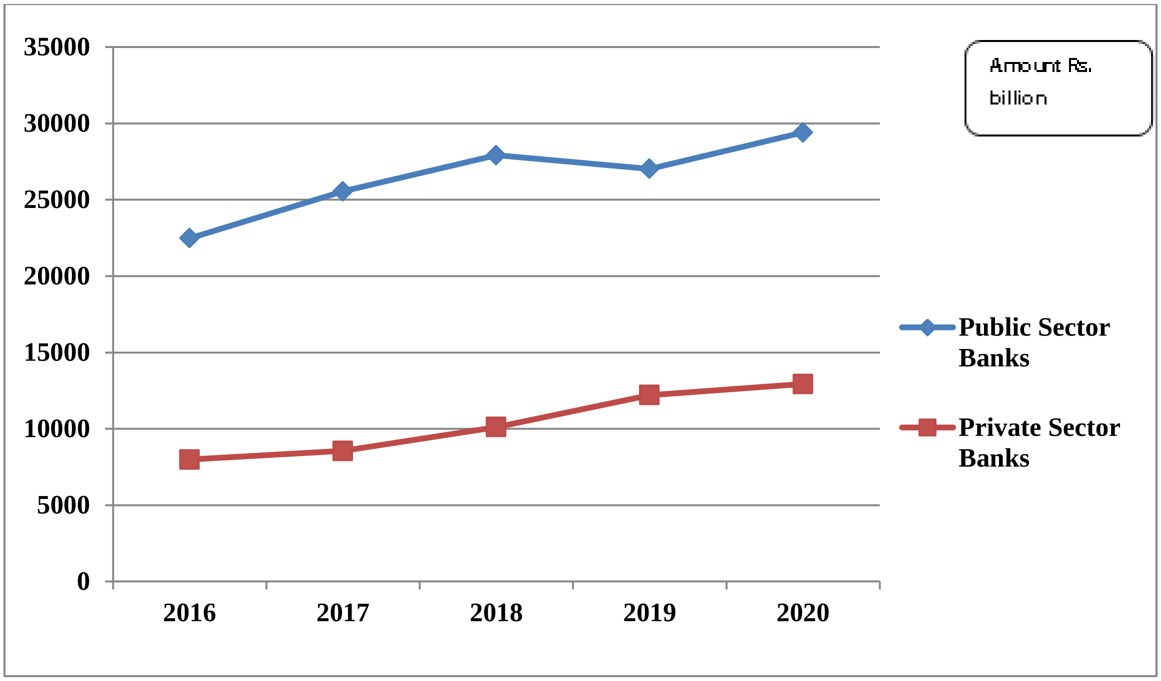


Figure 7. Investment

Source -: report on trend and progress of banking India 2019-20,2018-19,2017-18,2016-17.

6. **Government financial scheme: -** Many financial schemes are introduced by the government, whose aim is to connect the people of the country to the banking system and improve the financial facilities available to them. To fulfill these objectives, the government implements these schemes with the help of banks. The government will need public sector banks to implement such welfare financial schemes on a large scale. Pradhan Mantri Jan Dhan Yojana (PMJDY) is a financial inclusion scheme run by the central government. Bank accounts are opened under this scheme to ensure financial services, which do not require customers to keep any minimum balance in the bank account. After studying the data given in table no. 01, it shows that while a total of 42.38 crore accounts were opened under PMJDY, only 1.25 crore accounts were opened by private sector banks. Taking about the deposit amount, only 3.09 percent of the total deposit was deposited by private sector banks. These data conclude that private sector banks do not show much eagerness about these government schemes.

Bank Name /type	Number of Total Beneficiaries	Deposits in Account (in Crore)
Public Sector Banks	33.53	112185.85
Regional Rural Banks	7.60	27525.61
Private Sector Bank	1.25	4458.12
Grand Total	**42.38**	**144169.58**

Table -: 01 Pradhan Mantri Jan Dhan Yojana (PMJDY)

Source – www.https://pmjdy.gov.in/account **Note -** Beneficiaries as on 12/05/2020

7. **Priority Sector Lending-:** Priority Sector means those areas which are essential for the basic needs and development of the country. To ensure that adequate credit facilities are available in priority sectors, RBI has issued guidelines mandating that all scheduled banks (which do not include RRBs and small savings banks) should have 40% of their total borrowings. These have to be distributed in priority areas; this is called priority sector lending. The priority sectors include agriculture, micro small and medium enterprises, export credit, education, housing, social infrastructure, renewable energy, and others.

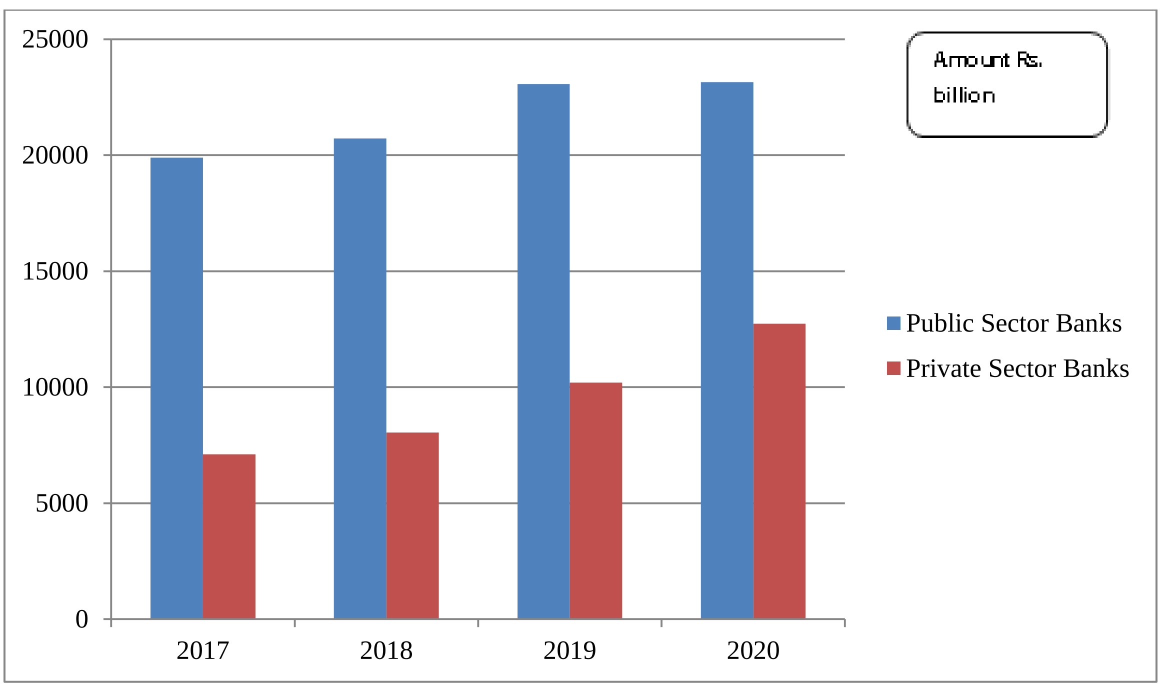


Figure 8. Priority Sector Lending

Source -: report on trend and progress of banking India 2019-20,2018-19,2017-18,2016-17.

Figure 8 shows the lending by public and private sector banks to priority sectors. In the year 2017, the priority sector lending by public sector banks was Rs 19889 billion and by private sector banks Rs 7110 billion. Similarly, in the year 2020, Rs 23142 billion was given by public sector banks in priority sectors, Rs. 12727 billion by private sector banks. In the period from 2017 to 2020, the priority sector lending by public sector banks saw a growth of 14%. On the other hand, the priority sector lending by private sector banks showed an increase of 44.13%

8. **Return on Assets and Return on equity: -** to determine the financial position and profitability of any organization, we can measure that organization's return on assets and return on equity. Here we have studied return on assets and return on equity separately to analyze the financial performance and profitability of public and private sector banks.

Year/ Banks	Public sector Banks	Private sector Banks
2019-20	-0.23	0.51
2018-19	-0.65	0.63
2017-18	-0.84	1.14
2016-17	-0.10	1.30
2015-16	-0.07	1.50

Table -: 02 Return on Assets of Public and Private sector bank

Source -: report on trend and progress of banking India 2019-20,2018-19,2017-18,2016-17

Table no. 2 shows the return on assets of public and private sector banks. A study of the data for the last five years shows that the return on assets in public sector banks is getting negative. And, the rate of return on assets in private sector banks is increasing positively.

Year/ Banks	Public sector Banks	Private sector Banks
2019-20	-4.16	3.30
2018-19	-11.44	5.45
2017-18	-14.6	10.1
2016-17	-2.05	11.87
2015-16	-.3.47	13.81

Table -: 03 Return on Equity of Public and Private sector bank

Source -: report on trend and progress of banking India 2019-20,2018-19,2017-18,2016-17

On the other hand, when it comes to the rate of return on equity, the public sector banks are performing very poorly as compared to the private sector banks. While the private sector banks have good return rates every year, the public sector banks are continuously running in losses. (See table No. 03)

Conclusion

The place of the Indian banking sector in the Indian economy is paramount because it is an incomparable contribution to accelerating economic development. To know the impact of privatization on the Indian banking sector, we analyzed the efficiency of public and private sector banks by studying those common banking functions like deposits and loans & advances. To analyze the financial performance and profitability of public and private sector banks, we studied important aspects such as investment, assets & operating profits, priority sector lending, return on assets, return on equity, and NPAs. Along with this, to know the tendency of public and private sector banks towards government schemes and programs, we did an analytical study based on the popular scheme Pradhan Mantri Jan Dhan Yojana.

In this research, we used the data of the last few years and the suggestions of economic experts to study the increasing participation of private sector banks in the Indian banking sector and the problems of public sector banks. At present, the private sector banks are performing better than the public sector banks. On the other hand, many problems are arising in public sector banks that cannot be solved by full privatization of banks, because privatization is not a long-term solution. If banks are fully privatized, then in the future, many ill effects can be seen. The government should reduce its stake in public sector banks, which will give more autonomy to these banks and improve their efficiency and financial performance. Along with this, the government will get a solution to problems like recapitalization of public sector banks.

Suggestion

After studying the impact of privatization on the Indian Banking sector, we are presenting some suggestions so that the financial performance and profitability of the Indian Banking sector can improve, and the banking sector, as well as the Indian Economy, can progress.

1. The government should reduce its stake in Public sector banks so that the government will have at least a fiscal deficit in the form of recapitalization every year.
2. The dual legal system over public sector banks should be abolished and only central bank control over public sector banks so that the working system can be improved.
3. The government should minimize interference in the appointment of managing officers and managerial decision-making processes of public sector banks.
4. Private sector banks should participate actively in the expansion of banking services, especially in rural areas.

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