ISSN (Online) : 2348 - 2001

International Refereed Journal of Reviews and Research

Volume 10 Issue 2 March - April 2022

International Manuscript ID : 23482001V10I2032022-02

(Approved and Registered with Govt. of India)

Privatization of Banking Sector and Its Impact in Indian Scenario

Dr. Sudhir Kumar

Principal

Government College for Women

Bhiwani, Haryana

Abstract

A vast sweep of time and space is covered by the history of India's financial sector, from the time of the British to the present day, through nationalisation, privatisation, and the growth of an increasing number of foreign banks in the country. Thus, the banking industry in India has come a long way. As India has developed, so has its banking industry, which has reached a new level of prominence. As a result of technological advancement, banking practises have been disrupted. However, the pillars of banking, such as trust and the confidence of customers in the bank, remain unchanged. In terms of investor and partner confidence, most banks are still thriving. However, the emergence of new types of risks is inevitable given the dynamic nature of the banking industry. This article makes an effort to categorise the general predictions, challenges, and opportunities facing the Indian Banking Industry.

Keywords: *The Indian Banking Industry, the Consequences of Bank Privatization in India, Privatization of Banks in India.*

ISSN (Online) : 2348 - 2001

International Refereed Journal of Reviews and Research

Volume 10 Issue 2 March - April 2022

International Manuscript ID : 23482001V10I2032022-02

(Approved and Registered with Govt. of India)

Introduction

There have been some truly mind-boggling situations in the global economy as of late, including the liquidation of banking and monetary systems, an obligation emergency in major countries throughout the world, and a euro zone emergency. Major economies, including the world's leading economies, have seen a slowdown as a result of the situation's growing uncertainty. This hints to some actual conversation starters regarding the perseverance, development, and maintenance of a decent course of events. In spite of this upheaval, India's banking sector has been one of the few to maintain its strength [1].

The Indian banking sector has been expanding at a breathtaking rate during the past decade. A number of factors have contributed to the vitality and stability of India's banking sector, including a faster rate of credit extension, rising benefit and efficiency like banks in new markets, a reduced rate of non-performing resources, and a focus on budgetary integration. Indian financial institutions are beginning to alter their strategy for economic development and reevaluate alternatives in order to keep the economy moving [2].

Banks in India were nationalised by the government in 1969. The plan's stated objective was to steer the financial sector in order to broaden access to financial services and promote economic growth. This was consistent with the post-independence plan of taking over the economic "commanding heights," but that tactic was already exhibiting indications of malfunction. Since then, results have been inconsistent at best, and economic reform has involved both expanding the role of private sector banks and attempting to improve the public sector through structural changes.

ISSN (Online) : 2348 - 2001

International Refereed Journal of Reviews and Research

Volume 10 Issue 2 March - April 2022

International Manuscript ID : 23482001V10I2032022-02

(Approved and Registered with Govt. of India)

Prominent economists Poonam Gupta and Arvind Panagariya (GP) make a meticulous and compelling argument for a large push to privatise India's public sector banks in an article that has garnered a lot of attention. There are now 12 of them, however the State Bank of India (SBI) is exceptional due to its size, significance, and high standard of operation. In light of this, GP recommends that SBI continue in the public sector while vehemently advocating for the full privatisation of the remaining 11 banks.

Evidence from the performance of public vs private banks over the past few decades supports the privatisation argument. Even though there is a wide range of results within each group, private banks generally fare better than their public sector rivals. Increased efficiency brought about by privatisation can lead to better use of the economy's financial resources, expansion of the financial sector, and sustained growth of the economy as a whole.

GP propose a plan of action that proposes using the success of two exemplary public sector banks as a template for the rest of the system. For privatisation to be successful, the government would have to sell off all of its holdings. It seems to reason that if privatisation is to yield positive results, those results should come from autonomous management and increased productivity. By the same logic, combining government-owned financial institutions would be a bad policy move. GP are neutral on the specifics, therefore it's possible that significant strategic purchases or a decentralised ownership structure may be involved. They propose, in particular, that non-financial corporations should be permitted to acquire banks, with the problem of regulating and enforcing a ban on crony lending addressed accordingly. They point out that non-financial businesses, such as diverse IT companies, now have access to banking and banking-like services thanks to technology advancements.

Despite the challenges, now appears to be the time to privatise banks. If the Indian economy is to develop at rates that would produce enough excellent employment for its population, then the banking sector must be improved. Given the vast number of individuals who have their livelihoods dependent on public sector banks, there are formidable political hurdles. As a result of opposition from bank unions, the administration has delayed bringing the necessary legal reforms to parliament for privatisation to proceed. Issuing additional licences for private sector banks may seem like a simple way to increase the size of the banking sector. However, this would just make the problems with the financial system worse for a longer period of time.

While the politics of privatisation are being worked out, a long-term perspective and study of the state of India's financial system in 2020 is plainly needed. As part of this process, it is important to analyse the effects of technology, the function of non-bank financing businesses, the structure of competition within the sector, size and other efficiency factors, and, most importantly, a new regulatory framework. Risk may be mitigated, efficiencies increased, and more people included in society through well-crafted regulations. There are situations where the written regulations are sufficient, but monitoring and enforcement mechanisms are inadequate. Despite the fact that it has immediate difficulties in combating inflation and managing the currency rate, the Reserve Bank of India (RBI) should focus its resources on strengthening its ability to perform all of the other components of its mandate as a financial regulator.

The quality of India's financial system must dramatically improve. The expansion of opportunities for both effectiveness and broadening participation brought about by technological progress is encouraging. However, the world of money has its own set of difficulties. Issues in the financial sector have the potential to spread like wildfire, bringing the entire economy down with it. However, the GP recommendations are

founded on a belief that India has the expertise to completely overhaul its banking system. There is a strong technical argument in favour of privatisation, but the public sector must take the lead in handling the political economics of the transition and in fulfilling its regulatory duties following the reorganisation.

Privatizing India's public sector banks will be beneficial to the country's economy. Without a more robust financial system, the government's plans to grow the industrial sector can never be realised. As such, privatising public sector banks can only be one part of a plan of financial sector reform and growth if manufacturing and the rest of the economy are to prosper. Part of the political difficulty of any change will be explaining this relationship.

Historical Dimensions

The Bank of Hindustan, India's most reliable financial institution, opened its doors in 1870. After that, the foundation for modern banking in India [3] was built by the establishment of three administration banks under the Presidency Bank's supervision in 1876, namely the Bank of Calcutta, Bank of Bombay, and Bank of Madras. The Imperial Bank of India was established in 1921 as a result of the merger of all of India's administrative banks. Before the creation of RBI [4], the central bank conducted a certain number of essential financial functions.

Outside of managing in international commerce, it deals with a wide variety of financial services for businesses. In 1949, Congress approved the Banking Regulation Act. This rule effectively placed RBI under federal supervision. The demonstration resulted in a significant increase in RBI's operational forces for managing and controlling banks. Moreover, the Act gave RBI the authority to issue licences and the responsibility to head up evaluations. It was in 1955 when RBI took over the Imperial Bank of India, rebranding it as the State Bank of India. SBI

ISSN (Online) : 2348 - 2001
International Refereed Journal of Reviews and Research
Volume 10 Issue 2 March - April 2022
International Manuscript ID : 23482001V10I2032022-02
(Approved and Registered with Govt. of India)

acquired eight private banks scattered throughout the states of the prior august in 1959, turning them into wholly owned subsidiaries. In 1960, RBI was hired to force a merger between financially weaker institutions [5].

It resulted in a drop from 566 banks in 1951 to only 85 in 1969, each with more than Rs.200 crores in reserves. The original intention behind nationalising banks was for them to function as catalyst experts in the field of economic growth. In 1992, the Narasimha Committee report advocated for extensive changes to the financial sector in order to showcase financially acceptable practises throughout the world. In 1993, once the Banking Regulation Act was revised, new private sector banks were authorised. The banking business serves as the backbone upon which the growth of any economy is built [6].

The Indian banking sector has been hit by a number of financial tsunamis during its expansion. Both the 2008-2009 financial crisis in the United States and the current crisis in Europe are recent developments. The global economic condition as a whole is quite fundamental. India was spared the effects of the global financial crisis because to the country's stringent financial regulations and rules. First and foremost, we must understand the state and structure of the Indian banking industry as a whole [7] in order to appreciate its challenges and opportunities.

There can be no healthy economy with weak banks. But, would excellent banking arrive with privatisation? When private banks were nationalised in 1969 and liberalised in 1991, why did this happen? he may wonder a number of things, including those listed above.

The government of the union was obligated to own 51% of the stock under the Banking Act of 1970. There was nothing political about Mrs, all of which had differing

capital standards). When banks first emerged as a public service, they were out of reach for millions of people, especially the poorest people living in rural regions.

Nationalized banks were considered to have met expectations when the first round of reforms began in 1991, launching barefoot banking and tremendously expanding their reach via the Improved asset-liability management, prudential oversight, and accountable client care are only some of the outcomes of the changes that have been implemented in the banking industry. In just fourteen years, they had become emblems of inefficiency due to a growing pile of non-performing assets (NPAs).

As part of an effort to broaden access to banking services, small finance banks and small payment banks emerged after 2005 as a result of this "inclusive banking" strategy. Excluding regional rural banks and urban cooperative banks, there are presently 93 scheduled commercial banks, up from 76 in 1991.

In 1991, there were 60,220 bank branches across the country, with 35,206 located in rural areas, 11,334 in semi-urban areas, 8,046 in urban areas, and 5,624 in major metropolitan areas. By 2022, this number had increased. As a result, the average number of customers served by a branch has decreased to 9,500 from 14,000 in 1991.

The banks' combined deposit and loan balances amounted to Rs3.8 lakh cr and Rs1.32 lakh cr, respectively. After 30 years, The percentage ratio between credit and deposits increased from 34.2 to 69.88, more than doubling. In 1991, commercial banks kept 15% of their deposits at the central bank as cash reserves, up from 3% in 2007. The Reserve Bank of India made sure banks had enough money so they could lend responsibly and meet people's needs.

ISSN (Online) : 2348 - 2001
International Refereed Journal of Reviews and Research
Volume 10 Issue 2 March - April 2022
International Manuscript ID : 23482001V10I2032022-02
(Approved and Registered with Govt. of India)

The government has allowed banks to set interest rates for certain groups of borrowers based on how much of a danger they see them as representing. The financial institutions' fundamental substance shifted. In spite of technological advancements, banking fees have steadily increased over time. More than 43 crore people have joined the financial system thanks to Jan Dhan accounts during the past eight years.

The decade of data between 2000 and 2020 reveals rising advances in both the commercial and state banking sectors, as well as NPAs. The expectation of NPA-free lending from banks, however, amounts to a demand that they forego risk. In addition, the creation of megabanks and a Bad Bank would neither rid them of toxic assets or lessen their losses. When the government consolidated key PSBs into a single SBI and reduced the number of PSBs from 28 in 1991 to only 10 today, they disregarded the lessons of the 2008 crisis.

Concerning the priority sector requirements, the regulator does not see private banks, foreign banks, and PSBs on a same footing. After being nationalised, the focus shifted to sectors such as agriculture, small industries and businesses, affordable housing, affordable education, and transportation (including boats and catamarans). However, the composition and content of these sectors have undergone significant shifts over the past thirty years. The Indian Banks Association, the banking industry's lobbying group, successfully won periodic reordering of priorities. The fundamental goal of prioritisation is undermined by the fact that 40% of total loan is designated for this reason.

During a 2019 speech at Ahmedabad University, RBI Governor Shaktikant Das reflected on the banking industry before its nationalisation. Bank deposits and outstanding bank credit were both heavily concentrated in only five cities in 1969:

Ahmedabad, Mumbai, Delhi, Kolkata, and Chennai. In turn, this contributed to the political consensus that "private sector banks, when left to their own devices, are not adequately mindful of their greater obligations towards society." In reference to the fact that just 617 of the country's 2,700 towns had access to commercial banking services before nationalisation, he cited the RBI's History of Banking, Volume III. And out of the estimated 6,000,00 hamlets, only roughly 5,000 had access to financial institutions. The distribution was also skewed.

Demand for nationalisation, with the aim of protecting depositors and bondholders' interests, arose in the United Kingdom, Australia, and the United States during the 2008 recession. The unbanked and under-banked have yet to be reached, which is the whole point of nationalisation. Complete privatisation is not a choice that can be made while still pursuing the goal of financial inclusion. If concerns about public-sector bank governance are resolved, then private- and public-sector banks can coexist while still fostering healthy competition.

After the RBI establishes its objectives, behest lending should cease. When it comes to regulation, owner and regulator cannot work together. A supervisor is the finest option for making sure they are healthy and productive. The government seems to have come to terms with the fact that its ability to monitor is quite limited, and that it would be preferable to relinquish such duty. It also likely understood that it could do no more to enhance governance in PSBs.

There is, however, less evidence suggesting that private banks are flourishing and more able than PSBs to meet the public's banking needs. Growth seems to be coming from the wealthy, and the wealthy don't seem to be complaining about inflation under the current administration. By altering the existing institutional structure, governments can reduce or eliminate spending on programmes that

directly benefit the poor, so freeing up resources to pursue non-inclusive economic agendas. Politically and financially, this is a bad thing. While privatisation in and of itself is not inherently negative, the current timing and motivation for doing so raise serious red flags, especially in light of the recent consolidation of PSBs.

- *In 1969, the government made the decision to take over the 14 major commercial banks. The plan was to bring the banking industry in line with the socialist policies of the time.*
- *the insurance industry was nationalised in 1956, while State Bank of India (SBI) was nationalised in 1955.*
- *In the previous 20 years, administrations have alternated between supporting and opposing the privatisation of PSU banks. The government first proposed privatisation in 2015, but the governor of India's central bank was against it.*
- *Current privatisation measures, together with the establishment of an Asset Reconstruction Company (Bad Bank) owned only by banks, highlight a strategy of seeking market-led solutions to difficulties in the financial system.*
- *The government has yet to alter the applicable banking regulations to permit the sale of its controlling share in two public sector banks despite announcing their privatisation in the Budget for 2021-22.*
- *Why is Privatization Being Done, Exactly?*

Degrading Financial Position of Public Sector Banks:

- Public sector banks' financial positions have not improved considerably despite years of capital infusions and governance changes.
- Several of them have more stressed assets and lower profitability, market capitalization, and dividend payment records than private banks.

ISSN (Online) : 2348 - 2001
International Refereed Journal of Reviews and Research
Volume 10 Issue 2 March - April 2022
International Manuscript ID : 23482001V10I2032022-02
(Approved and Registered with Govt. of India)

Part of a Long-Term Project:

- To kick off a long-term plan calling for only a small number of state-owned banks and the consolidation or privatisation of the others, two public sector banks will be privatised.
- To begin with, the government intended to privatise four. Whether or if the government decides to divest from a further two banks in the following fiscal year will depend on the results of the first two.
- Since the government is the biggest shareholder, it will no longer be required to give annual equity support to the banks.
- As a result of several decisions made over the past few years, the government today only owns 12 of the once-numerous 28 state-owned banks.

Strengthening Banks:

- In an effort to lower the cost of its bailouts, the government is privatising the more successful financial institutions while still bolstering the remaining ones.

- **Recommendations of Different Committees:**
  - The Narasimham Committee recommended a 33% reduction in the government's holding in public banks, and many other committees had made similar recommendations.
  - The P J Nayak Committee recommended a lower target percentage than 50%.
  - A group commissioned by the Reserve Bank of India has recently proposed that established corporations be allowed to start their own banks.

- **Creation of Big Banks:**

The establishment of large banks is another aim of privatisation. There is no

way for privatised PSBs to become large enough to generate a greater propensity for risk and lending capacity unless they join with existing major private banks. Therefore, privatisation is a complex endeavour that necessitates looking at issues from many perspectives and trying out new approaches, but it has the potential to usher in a more stable and secure financial system for the sake of all parties involved.

Rewarding Crony Capitalism:

The privatisation of the PSBs is similar to selling the banks to private corporates, many of which have defaulted on loans from the PSBs, and would only reward crony capitalism.

Job Losses:

- Jobs will be lost, stores will close, and people will be shut out of the economy as a direct result of privatisation.
- Since the private sector does not adhere to quota regulations for the weaker groups, the privatisation would decrease job prospects for Scheduled Castes, Scheduled Tribes, and Other Backward Classes (OBC).

Financial Exclusion of Weaker Sections:

Public sector banks were expanding into rural regions and providing financial inclusion, whereas private sector banks tended to serve only the wealthiest customers and concentrated in large cities.

Bailout operation:

Bank employee groups have referred to the privatisation initiative as a "bailout operation" for defaulting corporations.

A large portion of the problematic loans may be traced back to the private sector. They should be held accountable for their actions. On the other side, the government is rewarding them by selling off the banks. The Way Forward Public Service Bodies (PSBs) require enhanced governance and administration. The PJ Nayak committee provided guidance in this regard by suggesting that the government not be involved in the selection of top public sector officials (everything the Banks Board Bureau was supposed to do but could not). PSBs can be transformed into a public company, similar to the Life Insurance Corporation, instead of being privatised at random (LIC). However, while keeping the government in place

Key Perspectives

These days, India's economic climate is unlike any other in the world. Before the era of liberalisation, the Indian banking sector was seen very differently. This was because the government of India had begun taking active steps to play a role in the sector after receiving the Industrial Policy Resolution in 1948 [8].

Under the Reserve Bank of India (Transfer to Public Ownership) Act, 1948, the Reserve Bank of India was nationalised on January 1, 1949. The Reserve Bank of India (RBI) was given the responsibility "to administer, control, and assess the banks in India" with the passage of the Banking Regulation Act in 1949. There can be no new banks or branches of existing banks without first receiving permission from the Reserve Bank of India (RBI), and no two banks can share the same chief executive officer. In the 1960s, the Indian financial sector had developed into a crucial tool for accelerating the country's economic development [9].

Competitive Environment

Competition among banks is become more intense. While the Indian banking sector is resilient, the current global financial scenario does pose real risks. Some unknown

ISSN (Online) : 2348 - 2001
International Refereed Journal of Reviews and Research
Volume 10 Issue 2 March - April 2022
International Manuscript ID : 23482001V10I2032022-02
(Approved and Registered with Govt. of India)

banks have recently been liquidated. Shrieves (1992) claims that as risk increases, so does the need for more financial resources. Researchers looked at the banking industry as a large case study, and their findings show that the guidelines they developed were only partially effective even in the era they claimed to be protecting. Moreover, it was assumed that any changes in bank capital for the foreseeable future would be entirely random. Mergers and acquisitions in the realm of fiscal enterprises were pondered by Wolgast (2001). The author focused on bank CEOs and how they might improve the success of mergers, the board's handling of risks, the stability of the financial system, and the fluidity of the market. The findings suggested that large corporations are able to maintain an unprecedented level of risk across the board. When it comes to handling various types of risk, Al-Tamimi and Al-Mazrooei (2007) looked at the procedures and policies of the board. Moreover, they considered the potential for risk in the CEO role plays that both banks use [10].

Banks' exposure to unknown trade risk, credit risk, and occupational risk were identified as the top three sources of uncertainty. Sensarma and Jayadev (2009) tried to assess the capability of banks to deal with general hazard by using selected accounting ratios as risk-management executive variables [11].

In order to tally these accounting percentages, they employed multivariate quantifiable techniques. The impact of the CEOs' hazard scores on stock returns was also dissected, with the use of relapse analysis, in the research. According to experts, the risk management skills of Indian bank CEOs have been steadily rising over the past several years. Stock price gains for banks were vulnerable to the firms' capacity to manage risk. According to the findings, if financial institutions want to increase investor wealth, they need to prioritise properly managing various risks. In the mid-1990s, the Narasimha Rao administration authorised a small number of private banks as part of a progressive policy. The proposed loosening of rules for

ISSN (Online) : 2348 - 2001
International Refereed Journal of Reviews and Research
Volume 10 Issue 2 March - April 2022
International Manuscript ID : 23482001V10I2032022-02
(Approved and Registered with Govt. of India)

Foreign Direct Investment has laid the way for the next phase of Indian banking by allowing every Foreign Investor in banks to be granted democratic rights that might exceed the existing high of 10%, which has now gone up to 74% with certain constraints. The banking industry in India was rocked by the new setup. Up until this point, the standard practise among brokers was known as the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4). The new generation brought with it innovative ideas and sophisticated approaches to working with traditional financial institutions. And that's what sparked India's retail explosion. People asked their banks for more money, and they gave it to them.

Conclusion

At 12 p.m. on July 19, 1969, the government of India passed a bill that nationalised the 14 largest businesses in the country. In 1980, the government took over 6 additional commercial banks. The government's desire to have more control over the flow of credit was a driving factor in the decision to nationalise the sector. As a result of the second phase of nationalisation, Over ninety-one percent of India's banking industry is currently owned or controlled by the government. It wasn't until 1993 that the government formally combined New Bank of India and Punjab National Bank. A total of 20 state-owned banks were reduced to 19 as a result of this massive consolidation. After this point until the 1990s, nationalised banks grew at a pace of approximately 4%, almost in line with the average rate of growth of the Indian economy.

References

[1] Sathye, M. (2005). Privatization, performance, and efficiency: A study of Indian banks. Vikalpa, 30(1), 7-16.

[2] Megginson, W. L. (2005). The economics of bank privatization. Journal of Banking & Finance, 29(8-9), 1931-1980.

ISSN (Online) : 2348 - 2001
International Refereed Journal of Reviews and Research
Volume 10 Issue 2 March - April 2022
International Manuscript ID : 23482001V10I2032022-02
(Approved and Registered with Govt. of India)

[3] Swamy, V. (2012). Impact of macroeconomic and endogenous factors on non performing bank assets. Available at SSRN 2060753.

[4] Goyal, K. A., & Joshi, V. (2012). Indian banking industry: Challenges and opportunities. International Journal of Business Research and Management, 3(1), 18-28.

[5] Kikeri, S., & Kolo, A. (2005). Privatization: trends and recent developments. The World Bank.

[6] Davis, J. M., Richardson, T. J., Ossowski, R., & Barnett, S. A. (2000). Fiscal and macroeconomic impact of privatization (No. 194). International Monetary Fund.

[7] Sarkar, S. (2010). The parallel economy in India: causes, impacts and governement initiatives. Economic Journal of Development Issues, 124-134.

[8] Ataullah*, A., Cockerill, T., & Le, H. (2004). Financial liberalization and bank efficiency: a comparative analysis of India and Pakistan. Applied Economics, 36(17), 1915-1924.

[9] Kumar, M. A., Harsha, G. S., Anand, S., & Dhruva, N. R. (2012). Analyzing soundness in Indian banking: A CAMEL approach. Research Journal of Management Sciences ISSN, 2319, 1171.

[10] Selvakumar, J. J. (2015). Impact of service quality on customer satisfaction in public sector and private sector banks. PURUSHARTHA-A journal of Management, Ethics and Spirituality, 8(1), 1-12.

[11] Banerjee, A., Cole, S., & Duflo, E. (2005). Bank financing in India. In India's and China's recent experience with reform and growth (pp. 138-157). Palgrave Macmillan, London.