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PRIVATIZATION OF INDIAN BANKING SECTOR-A BOON OR A BANE

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ABSTRACT

Privatization in a narrow sense, implies the induction of private ownership in publicly owned enterprises, but in a broader sense, it connotes besides private ownership the induction of private management and control in the public sector enterprises. It can also be referred as the general process of involving the private sector in the ownership or operation of a state owned enterprise. Thus the term refers to private purchase of all or part of a company.

Keywords: *Privatization, Public Sector Enterprises, Private Purchase, Market Force.*

Introduction

It involves greater market force, ensures higher competition, reduces the role of the state in the economic sphere and thus brings in greater private involvement into government activities. It liberalizes different regulations to unleash forces of competition and to induce market forces into the economy. It is also referred to as structural adjustment programmes for the economy as a whole and as an element of broader economic policy. However, in its strict sense, privatization refers to divestiture to private entity. It is one of the policy reforms, meant to improve the efficiency of state owned enterprises. Privatisation is a political process and has important economic and social implications that not only affect enterprise performance, but also social welfare and stability. The social effects have to be considered in any impact assessment, particularly those related to employment, social safety net measures.

Statement of the Problem

In the process of privatization, causality is often public interest.

Objectives of the Study

- To study the objectives of privatisation.
- To study the causes of inefficiency of public sectors.
- To study the importance of private sector banks in India.
- To study the RBI guidelines for the new private sector banks.
- To study the constitutional obligation that the banks have to adhere to.
- To study the recommendations of first and second Narasimham committees and Verma committee.
- To study the effect of the reforms.

Objectives of Privatisation

- To strengthen the private sectors.
- Government to concentrate on areas like education and infrastructure.
- In the event of globalization the government felt that increasing inefficiency on the part of public sectors would not help in achieving global standards.

  Hence a decision was taken to privatise the Public Sectors.

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Causes of Inefficiency of Public Sectors

- Bureaucratic administration
- Out dated Technology
- Corruption
- Lack of accountability.
- Domination of trade unions
- Political interference.
- Lack of proper marketing activities.

Importance of Private Sector Banks in India

The private sector banks play a vital role in the Indian economy. They indirectly motivate the public sector banks by offering a healthy competition. The following are their importance:

- **Offering High Degree of Professional Management**

The private sector banks help in introducing a high degree of professional management and marketing concept into banking. It helps the public sector banks as well to develop similar skill and technology.

- **Creates Healthy Competition**

The private sector banks provide a healthy competition on general efficiency levels in the banking system.

- **Encourages Foreign Investment**

The private sector banks especially the foreign banks have much influence on the foreign investment in the country.

- **Helps to Access Foreign Capital Markets**

The foreign banks in the private sector help the Indian companies and the government agencies to meet out their financial requirements from international capital markets. This service becomes easier for them because of the presence of their head offices/other branches in important foreign centres. In this way they help a large extent in the promotion of trade and industry in the country.

- **Helps to Develop Innovation and Achieve Expertise**

The private sector banks are always trying to innovate new products avenues (new schemes, services, etc.) and make the industries to achieve expertise in their respective fields by offering quality service and guidance.

They introduce new technology in the banking service. Thus, they lead the other banks in various new fields. For example, introduction of computerised operations, credit card business, ATM service, etc.

R.B.I. Guidelines for the New Private Sector Banks

As part of reforms process in the financial services sector, the R.B.I. issued in January 1993 guidelines for licensing of new banks in the private sector. After 8 years it has revised its guidelines in January 2001.

Some of the important conditions of revised guidance issued by the RBI for the entry of new banks in the private sector are as follows:

Paid –up- Capital

The initial minimum paid up capital for a new bank would be Rs.100 crores. The initial capital should be raised to Rs.300 crores within 3 years of commencement of business. The overall capital structure of the proposed bank would have to be approved by the RBI.

Promoters Contribution

The promoters’ contribution will be a maximum of 40% of paid up capital of the bank at any point of time. The initial capital, other than the promoters’ contribution can be raised through public issue (or) private placement. The Promoters contribution of 40% will be locked in for 5 years from the date of licensing of the bank. Similar conditions would apply within 3 years of commencement of business.

Foreign Investment

Non-resident Indian participation in the primary equity of a new bank will be to a maximum extent of 40%. In case of foreign banking (or) finance acting as a technical collaborator (or) Co-promoter, equity participation will be restricted to 20% within the above ceiling of 40%. In case of shortfall of foreign equity contribution of NRI's then multilateral institutions would be allowed to contribute foreign equity to the extent of shortfall in NRI contribution of the equity. The necessary approval of FIPB should also be obtained.

Banks Promoted by Large Industrial Houses

A large industrial house will not be allowed to promote new banks. However individual companies, directly (or) in directly connected with new banks can be permitted to participate in the equity of bank up to 10% limit and this is applied to all interconnected companies of large business house.

Capital Adequacy Requirements

The bank will be required to maintain a minimum capital adequacy ratio of 10% on a continuous basis from the commencement of its operation.

Constitutional Obligation

The constitutional method in India facilitates eradication of social inequalities and exploitation. The framers of Indian Constitution in its Preamble declared that the citizens should be secured. Further the following articles in the constitution and the judgements in the Supreme Court support the economic welfare of the weaker sections of society.

Supreme Court in *Chandra Bhavan Boarding v. The State of Mysoredeclared* the constitutional philosophy in the following words:

"The mandate of the Constitution is to build a welfare society in which justice, *Social, economic and political*, shall confirm all institutions of national life. The hopes and aspirations aroused by the Constitution will be belied if the minimum needs of the lowest of our citizens are not met".

A reading of Article 38 and Article 39 of the Constitution of India gives the idea that for greater equality among people, all monopolizing tendencies should be discouraged.

Supreme Court in *Tara Chand Vyas v. Chairman & disciplinary Authorityheld* that distribution of material resources as laid down in Art. 39 (b) of the Indian Constitution is the means for the development of the weaker sections.

Court in the case of*Dalmia Cement (Bharat) Ltd. and another v. Union of India and others.*Court held that the right to socio-economic justice in the trinity, the preamble, fundamental rights and directives is to make the quality of life of the disadvantaged people meaningful.

In Muir Mills Ltd V. Suti Mill Mazdoor Union, the Supreme Court regarded social justice as the living concept of revolutionary import. According to the Court, it gives sustenance to the rule of law and meaning and significance to the ideal of a welfare state. One of the functions of a welfare state is nationalization of industries.

Recommendations of First and Second Narasimham committees and Verma Committee

The first Narasimham Committee on Financial System made the recommendations to liberalise the policies towards foreign banks to open offices in India but however, they have to adhere to the statutory requirements of Reserve Bank. The reason behind such a step was thebelief that it would have a beneficial impact on improving competitiveefficiency of Indian banking system and also upgrading work technology among banks in India. Thus, the committee recommended for bank privatization, it suggested everything that would be appropriated for a market driven and profit seeking private bank.

The Committee on Banking Sector Reforms (BSR) recommended the second dose of banking reforms in April 1998. Narasimham was the chairman of this Committee also. The main theme of the Second Narasimham Committee report is that strengthening the banking system is critical to the growth of the economy and this would require tightening capital adequacy, income generation and provisioning norms over the next four years. The Committee recommends further that the minimum shareholding by Government/Reserve Bank of India in the equity of nationalized banks and SBI be brought down from 51% to 33%. Unlike the other one, this Committee openly comes out in favour of bank privatization.

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 all these committees consider that banking sector should be restructured to bring efficiency to it. The Government has taken many measures to implement the recommendations of the committee.

Effects of Reforms

The effect of the reforms was that the new set of banks were towards profiteering, fully exploiting opportunities offered by capital market related activities neglecting the priority sectors and the weaker sections. The reforms had following changes:

- **Priority Sector Lending**

The increase in the NPAs became a major concern for the government, various committees were formed which came with the recommendations for deteriorating the priority sector lending. As a result of these recommendations the share of priority sectors in total net bank credit declined consistently from 40.9 per cent in June 1991 to 39.3 per cent in June 1992 and further 35.9 per cent in June 1993. The interesting thing is that, target for priority sectors remained unchanged at 40 per cent even after this. The Reserve Bank of India appears to have chosen to wink at the default. Thus, there is a conscious neglect of priority sectors.

- **No More Subsidized interest**

The committees also recommended for abolishing the subsidised interest rates for the priority sector. As a result, even a small borrower today has to pay an interest rate of 12.5 per cent as against 10 per cent earlier. In the estimation of the National Credit Council, the various institutional credit agencies like cooperative, commercial and RRB's met only 38% of the estimated credit requirements of agriculture in 1976-78. There have been only marginal improvements in this position.According to the Khusro Committee Report, total term credit requirement for 1999 – 2000 is Rs. 7595 crores. This shows that, institutional credit supply is inadequate. This coupled with absence of subsidy in interest rates will affect the agricultural sector, create food scarcity, and effect the human rights.

- **Impact on Agriculture**

As far as India is concerned, agriculture forms the backbone of our economy to such an extent that 59.4 per cent of the working population is engaged in agriculture. However, this sector suffers from lower productivity per hectare and per worker. One of the main factors responsible for this backwardness in agriculture is inadequate non-farm service like finance and marketing. As regards finance, the credit requirement of agriculture sector is so large that to meet even a part of this requirement, Indian banking will have to strive hard. Likewise, small-scale industries are also important for national economy in terms of their contribution to growth, employment generation and broadening the base of income distribution. These sections are elevated to the status of priority sectors because they are financially and socially backward. But, still their financial requirements are not met.

- **Regional Imbalances**

The committees recommended for the abolishment of branch licensing and for the closure of banks where there was an increase in NPAs.The effect will be that new banks entering the field will not open branches in rural areas. High fixed costs of establishing financial intermediaries coupled with relatively low demand for banking services in rural area make it unprofitable for private agents to open branches in these areas. Even if one set up rural branch, interest rate will be high. Now the condition will be that there will be private banks with exorbitant rates of interest. There will not be any more lending to socially desired goals. Rural credit will not be available. Thus a small borrower will be in the pre-nationalization period.

- **Reduction in SLR- CRR ratio**

It is with a view to augment the lendable resources of banks to enable them to meet the genuine production requirements for credit, without generating excessive monetary expansion, that decision to reduce CRR has been taken. Accordingly it was reduced by one percentage point from 14% to 13% .The reduction in CRR would augment the lendable resources of banks by about Rs. 3,80,000 crores and also significantly improve the profitability of banks. But the banks, to engage freely in speculative transactions, with the sole purpose of maximizing their profits will use the reduction in SLR – CRR.

- **Incompatible with Small Borrowers**

Profitability has emerged as the single most important criterion for judging the operational efficiency of individual banks. This is another feature of new banking culture. A result of these banks is finding increasingly convenient to lend in bulk to non-banking financial companies (NBFC), than to small-scale industries and micro business. The latter in fact are being pushed into the arms of NBFC, which charge lending rates of 25 per cent or even more.

- **Back to Nationalization Era**

The committee recommended for reducing the shareholding by government/Reserve Bank in the equity of the nationalized banks and the State Bank should be brought down to 33 per cent. Dilution of government state in nationalized banks will eventually result in the control of these banks by private enterprise, as was the case in the pre-nationalization era.

- **Unemployment**

Subsequent to nationalization employment in the banking industry has grown very significantly. This is partly due to branch expansion and partly because of diversification of banking services. But, after privatisation, the enormous increase in business and the inadequacy of traditional banking procedures have strengthened the case for computerization of banks. Naturally, the proposal to close down unviable public sector units has come in for strong opposition.

- **Money Laundering**

In the demonetisation process very recently major responsibility along with RBI was on the banks but, majority of the private banks in the drive for profiteering were found involved in money laundering cases which were detrimental in the public interest.

Conclusion

Banks play an important part in the economic progress of the country. Public funds are involved in the banking and insurance sectors. Both these collect the surplus money from the society and channelize it in the socially desired directions. Any malfunctioning in these sectors may be detrimental to society as well as to the individual. Moreover, with the Indian constitutional mandate, Indian economic activity has to satisfy the demands of distributive justice and public interest. But in the process of privatization, causality is often public interest. This is because privatization has created some improper behaviour in human beings. Illegal aptitude for money is the main cause of corruption, which is possible in the fully free and market oriented economy.

Public sector banks have achieved major goals of nationalization. These banks have grown significantly. There are certain shortcomings in the nationalized sector, like deterioration in the quality of credit portfolio of banks, substantial amount of non-performing assets and inadequate recovery of claims. But this should not lead to a doubt the success of nationalization of banking structure in implementing the human rights values. It is true that only a portion of weaker section was able to reap the benefit of bank nationalization. Is there a remedy for the protection of weaker section with in nationalized sector?

One solution will be to retain nationalized sector and to make the working of the Debt Recovery Tribunal effective and powerful. The Supreme Court in a recent case held that the Tribunal can go beyond the Civil Procedure Code and the only check on its power is to observe the principles of natural justice. Another solution will be to take adequate security before granting loan. Gujarat High Court in *State Financial Corporation v. Lotus Hotel Pvt., Ltd.,* held that repaying capacity of the borrowers and security of the money are the only factors to be considered by banks on giving loans. Banks have full discretion to decide on the matters of loan.The Government and Reserve bank of India regulations are guidelines only.

In the case of privatization, banking industry will be dominated by a handful of big industrialists. Such ownership pattern in a critical industry such as banking would not be consistent with the nation’s social and development objectives. Altogether the direction which the government wants to give to banking policy, is not just disturbing but clearly adverse to development and equity. Thus it can be seen that the new banking culture is alienating not only the small borrower but also the small saver. This is against the objective of nationalization and also against constitutional obligation of equitable distribution of wealth.

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