PRIVATIZATION OF PUBLIC SECTOR BANKS: A NECESSARY EVIL OR AN UN-NECESSARY DEBATE

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Abstract: **The present era in banking sector is marked by the consolidation of players to gain the market share. The compliance of Basel-3 norms has also acted as catalyst for the consolidation process. The rising level of NPA has led to the dilution of the capital possessed by the banks. It is well established fact now that the PSB's NPA level contributes to a great extent to this menace. There have been many articles by various experts on Privatization of PSBs as a solution to this problem. However, there are many well known economists who have opposed this measure. This paper looks into various pros and cons of the same and analyzes the issue through the solution oriented approach.**

Keywords: **Banking, NPA, Privatization, Public Sector Banks, Loans, Capital, Basel**

Introduction:

Recently RBI suggested privatization of Government Banks. The Government said that it can recapitalize the Public Sector Banks (PSBs) to a limited extent.The challenge of recapitalizing the chronic banks led to the Deputy Governer of RBI to suggest a change. This has a backdrop of rising Non Performing Assets (NPAs), dilution of capital, degrading credit risk policy and appraisals, increased instances of banking frauds etc.

However, the intelligentsia is divided on this issue. The Nobel Peace Prize-winning economist Muhammad Yunus suggests that he does not recommend privatization of PSBs, as even the private banks have not shown any 'exceptional performance' in many countries. On the other hand, several experts, including Chief Economic Advisor Arvind Subramanian and former Niti Aayog Vice Chairman Arvind Panagariya, had pitched for privatization of PSBs after spate of frauds were unearthed in state-owned banks, including over Rs 13,000 crore scam in the Punjab National Bank (PNB). The Bangladesh-based champion of micro-finance Yunus also said that ways have to be found to stop frauds in the banking sector.

Why Privatization of PSB's?

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

(i) " 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.

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

(iii) 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 12 per cent.

India has failed to accumulate capital despite having secured such an increase in domestic savings 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, over time, a consumer of community's savings".

The analysis of the statement (i), proves that the bureaucratization of the public sector banks is one of the major hurdles. This statement throws light on the conflict between the dual roles played by the Government in India. The inherent conflict between the business and social goals to be attained by the Government is evident. It showcases the ineffectiveness created in the system due to excessive protection given to public servants and their indifference towards the shareholders. The business in today's world is full of cut throat competition, multiplicity of players and product innovation where the PSB's have the public servants who are least interested in EPS maximization for shareholders which will automatically lead to betterment of customer service and thus fulfillment of the other socio-economic goals.

Now if we analyze statement (ii), it points towards the poor internal management system which is very much evident from the one after other banking frauds popping up in the news every day. If we look into the Risk Management policies of government banks and compare the same with their counterparts in private sector, the risk management of private sector banks have proved to be much prudent and tested. Let us look into the lending norms and the credit assessment techniques, in private sector banks where the concept of "Turn Around Time" has become part of its commitment, the CAMS (Credit Assessment and Management System) made by private sector banks have been simplified to serve the borrower in a better and timely manner, still word format based traditional forms of CAMS are used. Needless to say that the credit decisions taken are influenced by Political lobby and they are mainly driven by the ulterior motives.

The internal control systems have proved to be ineffective in case of the Government run banks as they have failed miserably in case of fraud control, prevention, detection and disaster management.

The point no. (iii) talks about the capital formation to emerge as business leaders. India, traditionally being a country with a excellent track record of savings have been able to face worst of the crises only due to the habit of savings which has kept the health of the economy resilient and immune from the global financial difficulties. Now, if we look into these frauds, where is this money which is loss for banks coming from. If we look into this, this is coming from the savings of the masses. Also it is a big hurdle in case of capital formation for our country as that part of money is written off. It is important to safeguard the capital and savings of the people of our country, which is evident from the functioning of the private sector banks.

Why Privatization May not be an Answer?

If we look into our Indian society, here none of the issues can be isolated from other issues prevailing. Here the social issues not separate from the economic issues, economic issues are not separate from political issues etc. Hence, the argument that economic motives of the banking can be separated from its social motives in a country like ours is vague.

Also, the total current account and savings account (CASA) base of PSBs in India was Rs30.2 trillion (including State Bank of India, or SBI) and Rs 18.9 trillion (excluding SBI) in 2017. By and large, this reflects the confidence of customers in the implicit government support to these entities.

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

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

Banking crises, he said, erupt in countries where banks are largely private also. It had happened in the US, the UK and Europe. SocGen, JP Morgan and UBS were some that had faced major problems.

Conclusion:

From the various examples as stated above the following conclusions can be drawn:

- NPA issue or dilution of capital is not related to government sector or private sector, it is mainly governance issue. Hence, the governance of our banks should be strengthened.
- The social policies as enforced by various governments should not be blindly enforced for short political gains rather the economy should also be observed.
- Banks mainly have capitalist role to play, hence its social roles should be backed by the government commitment and be backed by the government funds.
- 3E's – Economy, Efficiency and Effectiveness should be promoted.
- In no case, the investment in the assets having return less than cost of the funds for the Banks. They should not be used by the politicians for furthering their short political gains.
- Financial sector regulators like RBI, SEBI, IRDAI should be strengthened.
- The banking sector in India should make a quick move towards the Basel-III norms as that will improve the risk management of the banks.
- Consolidation of Indian Financial and Banking sector should be on priority and should be quickened.
- Privatization may be done to a limited extent but that is definitely not the only solution. Rather strengething of regulations, governance, norms and procedures should be focussed.
- HR Management of the public sector banks should be improved.

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