

A Conceptual Critical Analysis on The Indian Banking Sector's Privatization: Is it A Major Boost or A Downfall?

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Abstract: In a strict sense, privatization denotes the introduction of private ownership in publicly traded companies, but in a broader sense, it also denotes the introduction of private management and control in public sector companies. Involving the private sector in the ownership or management of a state-owned firm is another name for it. Thus, the phrase describes a private acquisition of all or a portion of a business. This paper focuses on critical analysis on the Indian Banking sectors and find an answer whether privatization is a major boost or a downfall. The data has been secondarily collected by the researcher in an attempt to conceptually through a light in this regard

Keywords: Market forces, public sector enterprises, and privatization.

I. Introduction

India's government nationalized the nation's banking sector in 1969. The objective was to direct the financial industry in order to promote economic growth and make financial services more accessible to all. This was consistent with the post-independence goal of controlling the "commanding heights" of the economy, but by that point, the plan had already begun to exhibit problems. The results have been, at best, inconsistent, and economic reform has involved allowing private sector banks to gradually expand while working to strengthen public sector banks through structural changes.

Prominent economists Poonam Gupta and Arvind Panagariya (GP) make a careful and compelling case for a major effort to privatize India's public sector banks in an analysis that has already attracted a lot of attention. There are 12 of these at the moment, but the State Bank of India (SBI) stands out for its size, significance, and operational excellence. Therefore, GP proposes that SBI stay in the public sector while vehemently advocating for the complete privatization of the other 11 banks.

The relative performance of public and private sector banks over the past few decades forms the basis of the privatization argument. Although there has been a wide range in each category's performance quality, on the whole, private sector banks outperform their public sector counterparts. Greater efficiency through privatization can enable higher overall economic growth, encourage financial sector expansion, and enhance the allocation of financial resources throughout the economy.

GP propose a strategy that calls for the establishment of two robust public sector banks as a model, with the remainder to follow (a suggestion made by NITI Aayog). To prevent any lingering suspicion of arbitrary meddling after privatization, comprehensive government divestment would accompany privatization. If the advantages of privatization are going to come from independent management and operational effectiveness, then this makes sense. Due to this justification, combining public sector banks is not a wise course of action. Regarding the precise procedure, particularly the likelihood of distributed ownership and significant strategic buyers, GP are largely ambivalent. They specifically contend that banks should be available for purchase by non-financial corporates, with the problem of preventing crony lending being handled by adequate regulation and enforcement. They point out that technical advancements are already allowing a variety of non-financial enterprises, including different tech corporations, access to banking and services that are similar to banks.

Although bank privatization won't be simple, the time appears to be perfect. If India's economy is to grow at rates that will provide enough excellent jobs for its population, it will undoubtedly require a more efficient financial sector. Because there are so many individuals working in public sector banks, there are significant political barriers. The administration has already delayed parliamentary consideration of the legal reforms that would be required to start the privatization process in response to bank unions' expressed objections. By granting new licenses to private sector banks, it could appear to be simpler to expand the banking industry. However, doing so would make the suffering and expenses associated with having an ineffective banking system worse.

There is obviously a need for a strategic vision and study of what India's financial sector might look like in ten years while the political concerns related to privatization are being processed. This entails considering the effects of technology, the function of non-bank financing companies, the industry's competitive structure, scale and other factors for efficiency, and—most importantly—a new regulatory architecture. Regulations can be crafted to reduce risk while also advancing effectiveness and inclusivity. On paper, the regulatory structure may be sufficient in some circumstances, but monitoring and enforcement tools may be far from appropriate.

India requires a banking industry of considerably higher caliber. New opportunities for efficiency and inclusion are created by technological innovation. But there are particular hazards and difficulties in the world of finance. Problems in the financial sector have the potential to spread like wildfire and collapse the entire economy. However, the GP ideas are grounded in a conviction that India has the skills, background, and capability to fundamentally reform its banking industry. There is a strong technical argument

in favor of moving forward with privatization, but the public sector needs to do more to manage the political economy of the transformation and to fulfill its regulatory obligations following the restructuring.

In the end, the case for privatizing India's public sector banks comes down to economic growth. Without a more efficient banking industry, the government will never be able to achieve its goals of growing the industrial sector of the economy. If manufacturing—along with the rest of the economy—is to prosper, privatizing public sector banks can only be one element of a plan of financial sector reform and growth. The political difficulty of this reform will include articulating that connection.

Objectives of The Study

- To research the privatization's goals.
- To research the reasons behind public sector inefficiencies.
- To research the significance of private banks in India.
- To research the RBI's regulations regarding establishing private sector banks.
- To research the legal requirements that banks must follow.
- To review the Verma committee's and the first and second Narasimham committee's recommendations.
- To research how the reforms are working.

Significance of The Study

Privatization, refers to the divestiture to a private entity in its precise definition. It is one of the policy changes intended to increase the effectiveness of state-owned businesses. The political process of privatization has significant economic and social ramifications that have an impact not just on business performance but also on social welfare and stability. Any impact analysis must take into account the social implications, especially those pertaining to employment and social safety net programs. Thus, the researcher felt the need to do critical analysis in this regard .

Objectives of Privatisation

- To make the private sectors stronger.
- The government should prioritize sectors like infrastructure and education.

The government believed that rising public sector inefficiencies would hinder the achievement of global standards in the event of globalization.

Therefore, the decision to privatize the public sectors was made.

Causes of Inefficiency of Public Sectors

- >Inefficient bureaucracy,
- >outdated technology,
- >corruption, and a lack of accountability.
- >Political meddling;
- >Trade union dominance.
- >A lack of effective marketing initiatives.

Significance of private banks in India

In India's economy, the private sector banks are extremely important. They provide good competition, which serves as an indirect incentive for the public sector banks.

- Providing Highly Professional Management

A high level of professional management and marketing concepts are introduced into banking with the aid of the private sector banks. It supports the development of comparable expertise and technology in public sector institutions as well.

- Fosters Positive Competition

The private sector banks provide the banking system's overall efficiency levels some good competition.

- Promotes International Investment

The private sector banks, particularly foreign banks, have a significant impact on foreign investment in the nation.

• Aids in Opening Up Foreign Capital Markets

Private sector foreign banks assist Indian businesses and government organizations in obtaining the funding they need from global capital markets. Because they have their head offices and other branches in significant overseas cities, providing this service is made simpler for them. They significantly contribute in this way to the development of trade and industry in the nation.

• Promotes the growth of innovation and expertise

Private sector banks always seek to develop new product outlets (new plans, services, etc.) and encourage industries to become experts in their particular domains by providing high-quality support and advice.

They modernize the banking industry's technologies.

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

The R.B.I. released rules for licensing new banks in the private sector in January 1993 as part of a reform initiative in the financial services industry. In January 2001, it updated its policies after 8 years.

Following are a few of the key requirements of the RBI's updated guidance for new banks entering the private sector:

Paid-up Capital

For a new bank, the first minimum paid up capital would be Rs. 100 crores. Within three years of the start of the firm, the initial capital should be increased to Rs. 300 crores. The RBI would need to approve the proposed bank's total capital structure.

Promoters' Support

A maximum of 40% of the bank's current paid-up capital may be contributed by the promoters at any given moment. In addition to the promoters' contribution, the initial capital may be raised through a public offering or a private placement. For five years following the bank's licensing date, the 40% promoter contribution will be locked in. Similar terms would apply three years after the start of the business.

Overseas investment

A new bank may only have a maximum of 40% of its primary stock held by non-resident Indians. Foreign banking or finance working as a technical collaborator or co-promoter will be limited to a maximum equity involvement of 20% under the previously mentioned 40% cap. Multilateral institutions would be permitted to contribute foreign equity to the extent that NRI contribution of the equity fell short in the event of a shortfall in the foreign equity contribution from NRIs. Additionally, FIPB permission that is required must be obtained.

Promoted by Big Industrial Houses to Banks

It is prohibited for a sizable industrial building to advertise for new banks. However, individual businesses that are directly (or indirectly) related to new banks may be allowed to participate in bank equity up to a 10% cap. This rule is applicable to all interconnected businesses that are part of large business houses.

Adequacy Requirements for Capital

The bank must continuously maintain a minimum capital adequacy ratio of 10% starting when it first begins operating.

Obligation of Constitution

Social injustice and exploitation are made easier to eradicate in India because to the constitutional system. The Preamble of the Indian Constitution made the statement that the citizens should be safe. Additionally, the Supreme Court's rulings and the following constitutional articles enhance the economic welfare of society's poorer groups.

The Supreme Court stated the constitutional theory in *Chandra Bhavan Boarding v. The State of Mysore* as follows: "The purpose of the Constitution is to create a just society where social, economic, and political justice uphold all governmental institutions. If the most basic requirements of our citizens are not satisfied, the hopes and aspirations sparked by the Constitution would be dashed".

According to a reading of Articles 38 and 39 of the Indian Constitution, all monopolizing tendencies should be avoided in order to promote more equality among people.

The distribution of material resources as outlined in Art. 39(b) of the Indian Constitution is the means for the development of the weaker sections, according to the Supreme Court's ruling in *Tara Chand Vyas v. Chairman & disciplinary Authority*.

Dalmia Cement (Bharat) Ltd. & others v. Union of India & others: before the court.

According to the court, the purpose of the right to socioeconomic justice in the preamble, the trinity, and the fundamental rights and directives is to improve the quality of life for those who are less fortunate.

The Supreme Court recognized social justice as a revolutionary notion in *Muir Mills Ltd v. Suti Mill Mazdoor Union*. The Court claims that it supports the rule of law and provides the idea of a welfare state substance and significance. Nationalization of industries is one of a welfare state's functions.

First and Second Narasimham Committee and Verma Committee recommendations

The first Narasimham Committee on Financial System recommended liberalizing procedures for international banks opening operations in India, although they must still follow Reserve Bank statutory restrictions. The rationale for this action was the expectation that it would enhance the competitive efficiency of the Indian banking sector and advance work technology among Indian banks. Therefore, the committee proposed everything that would be proper for a market-driven and profit-seeking private bank when it came to bank privatization.

In April 1998, the BSR (Committee on Banking Sector Reforms) recommended the second round of banking reforms. This Committee's chairman was also Narasimham. According to the Second Narasimham Committee report, tightening capital adequacy, income generation, and provisioning rules over the next four years will be necessary to strengthen the banking system, which is essential to the expansion of the economy. The Committee also suggests lowering the minimum government/Reserve Bank of India equity holdings in nationalized banks and SBI from 51% to 33%. This Committee, in contrast to the other, publicly supports the privatization of banks.

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.

Reforms' effects

The result of the reforms was a new generation of banks that were more focused on making a profit, fully utilizing chances provided by capital market-related operations while ignoring the priority industries and the weaker portions. The following modifications resulted from the reforms:

***Lending to Priority Sectors**

As a result of the government's growing concern over the rise in NPAs, many committees were established, and they produced proposals for weakening lending to the priority sectors. Due to these suggestions, the proportion of priority sectors in total net bank credit steadily decreased from 40.9% in June 1991 to 39.3% in June 1992, and then to 35.9% in June 1993. It's interesting to note that even after this, the target for priority sectors remained at 40%. It appears that the Reserve Bank of India decided to ignore the default. Thus, priority sectors are purposefully ignored.

***Elimination of Subsidized Interest**

The panels also proposed doing rid of the priority sector's subsidized interest rates. As a result, a modest borrower must now pay an interest rate of 12.5% instead of the previous 10%. According to the National Credit Council, just 38% of the expected credit needs for agriculture in 1976–1978 were provided by the various institutional credit agencies such cooperative, commercial, and RRBs. Only slight advancements have been made in this position. The entire amount of term credit required for 1999–2000 is Rs. 7595 crores, according to the Khusro Committee Report. This demonstrates the lack of institutional credit supply.

This, along with the absence of interest rate subsidies, will have an impact on the agricultural sector, lead to a shortage of food, and undermine human rights.

***Affects on Agriculture**

In terms of India, 59.4% of the working population is involved in agriculture, which serves as the foundation of our nation's economy. However, the productivity per hectare and person in this industry is lower. Inadequate non-farm services like financing and marketing are one of the key causes of this agriculture backwardness. Regarding finances, the farm industry has such a high demand for credit that Indian banking will have to work very hard to even partially supply this demand. Similar to large-scale businesses, small-scale industries are crucial for the national economy because of their contribution to growth, job creation, and widening the base of income distribution.

Because they are economically and socially underdeveloped, these divisions are given the designation of priority sectors. However, their financial needs are still unmet.

***Regional Inequities**

The committees suggested doing away with branch licenses and closing banks where NPAs were on the rise.

The result will be that newly established banks won't set up shop in rural areas. Private agents cannot afford to open branches in

rural areas due to the high fixed costs of establishing financial intermediaries and the low demand for banking services there. Even if a rural branch is established, interest rates will be high. There will be private banks with excessive interest rates as the new requirement. There won't be any more lending for politically correct causes. There won't be any rural credit available.

A modest borrower will therefore be in the time before nationalization.

* A decrease in the SLR-CRR ratio

The decision to cut CRR has been made with the goal of increasing banks' lendable resources so they can satisfy real credit production needs without leading to excessive monetary growth. As a result, it was decreased from 14% to 13% by one percentage point. Banks' lendable resources would increase by around Rs. 3,80,000 crores as a result of the CRR reduction, which would also greatly increase bank profitability.

However, the banks will use the decrease in SLR-CRR to freely participate in speculative trades with the aim of maximizing their profits.

*Not suitable for small borrowers

The most critical factor for assessing the operational effectiveness of certain institutions is profitability. Another aspect of the new banking culture is this. These banks are finding it more easy to lend money in large quantities to non-banking financial institutions (NBFC) than to small- and medium-sized businesses. In actuality, the latter group is being driven into the arms of NBFC, which charge lending rates of up to 25%.

*Return to the Nationalization Era

The committee proposed that the State Bank be reduced to 33% ownership and that the government/Reserve Bank's equity holdings in nationalized institutions be decreased. Nationalized banks will eventually come under the grip of private business, just as it did before the banks were nationalized, as a result of the government state's dilution.

*Unemployment

The number of people employed in the banking sector has dramatically increased after nationalization. This is partly a result of the diversification of banking services and partially a result of branch expansion. However, following privatization, the massive expansion in business and the inadequacy of conventional banking practices have made the demand for bank computerization stronger than ever. Naturally, there has been fierce opposition to the proposal to shut down unprofitable public sector units.

• Money Transfer

Most private banks were found to be implicated in money laundering cases that were damaging to the public interest during the demonetisation process, which was just completed with the help of the RBI.

Conclusion

In the nation's economic development, banks are crucial. The banking and insurance industries involve public cash. Both of them gather the excess cash from the population and direct it in the intended social directions. Any dysfunction in these areas could be harmful to both society and the person. Additionally, due to the constitutional requirements, Indian economic activity must meet the needs of distributive justice and the public good. However, public interest frequently plays a causal role in the privatization process. This is due to the fact that privatization has led to some undesirable human behavior. Corruption is mostly brought on by an illicit desire for money, which is achievable in an economy that is completely free and market-oriented.

Banks in the public sector have largely accomplished their nationalization aims. These banks have expanded considerably. The nationalized sector has some drawbacks, including declining bank credit portfolio quality, a sizable volume of non-performing assets, and insufficient claim recovery. However, this should not cause one to question whether the nationalization of the banking industry was successful in upholding the principles of human rights. It is true that the benefits of bank nationalization were only felt by a small part of the weaker class. Exists a solution to defend the weaker sections of the nationalized sector?

Retaining the nationalized sector and strengthening the Debt Recovery Tribunal's operations are two potential solutions. In a recent decision, the Supreme Court ruled that the Tribunal can go beyond the Civil Procedure Code and that the only way to limit its authority is to uphold the fundamentals of natural justice. Taking appropriate collateral before giving a loan is another option. In *State Financial Corporation v. Lotus Hotel Pvt., Ltd.*, the Gujarat High Court ruled that banks should only take into account the borrowers' ability to repay loans and the security of the money when making loans. Banks are completely free to make decisions on loan-related issues. Government and Reserve Bank of India laws are simply intended as general guides.

In the event of privatization, a small group of powerful industrialists will control the banking sector. Such an ownership structure would be inconsistent with the country's social and development goals in a sector as important as banking. Overall, the path that the administration wishes to take banking policy is not only troubling but also unmistakably harmful to equity and growth. Thus, it is clear that the new banking culture is alienating small savers as well as small borrowers. This runs counter to both the nationalization goal and the constitutional requirement for a fair distribution of wealth.



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