

## Privatization of Banks in India: A Feasibility Study

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### Abstract:

The Indian banking sector has played a critical role in the country's economic stability and growth. In recent years, there has been a growing debate regarding the privatization of banks in India, as the Indian government explores ways to enhance efficiency, profitability, and competitiveness in the banking industry. This research paper conducts a comprehensive feasibility study on the privatization of banks in India. - Private sector banks focus more on growth, whereas Public Sector Banks focus on social welfare and providing financial aid and assistance to weaker sections as well as to richer sections of Indian Society. There should be a balance between both of them. The government's main objective should be to ensure that each and every citizen of India is able to use banking services and not profit maximization.

### Keywords:

*Finance; Economics; Banking; Business; Public sector banks; Privatization; India.*

### Introduction:

The total asset size of Indian banks is around \$2.3 trillion at present, which is about 1.2 times the country's GDP, signifying banks' role in the Indian economy. – (According to the article – “Biswajit Patra, Purna Chandra Padhan & Puja Padhi (2023) Efficiency of Indian Banks, Cogent Economics & Finance”). The public sector banks (Public Sector Banks) control the majority share of banking business in India.

### Size of the Indian Banking Sector as a percent of GDP:-

#### 1991-92 to 2020-21

Indicator	1991-92	2000-01	2010-11	2020-21
Assets	51.6	60.5	94.1	99
Bank Deposits	40.1	49.3	73.6	78.7
Bank Credit	24.1	24.6	56.3	54.6
Credit to Private sector*	21.7	21.0	51.6	49.4

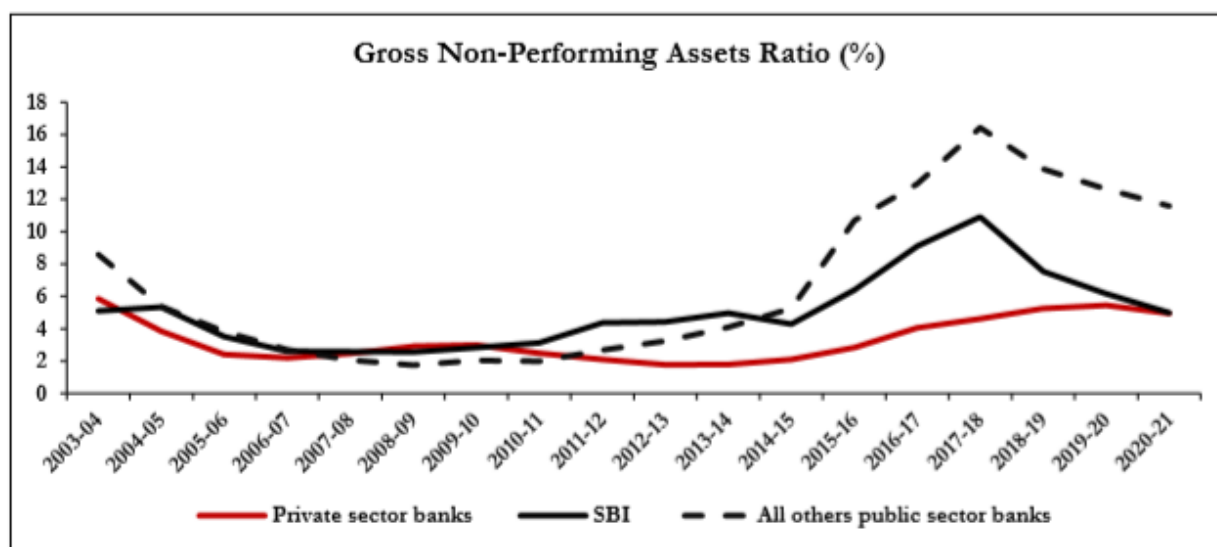
*Source: Reserve Bank of India statistical tables.*

The Public Sector Banks in India are facing a stressful situation as evidenced by high non-performing loans (8.8 percent) and low capital adequacy ratios (14.4 percent) in comparison to

their private counterparts which were 4.6 percent and 18.7 percent, respectively, as noted by the Financial Stability Report, RBI (December 2021).

According to NCAER Working Paper Poonam Gupta and Arvind Panagariya (WP 141) - In India, banks have done a generally poor job of lending, resulting in frequent defaults on repayments, and consequently episodes of large accumulations of non-performing assets (NPAs). the NPA problem is primarily concentrated in these public sector banks (Public Sector Banks). They believe that without transferring the ownership of these banks into private hands, the banking sector in India cannot be placed on a path to sustained growth free of repeated episodes of NPAs.

#### Gross NPAs Ratio (2003 - 04 to 2020 - 21)



Source: Reserve Bank of India statistical tables.

Over the years, the question of whether to privatize banks in India has been a subject of considerable debate. This research compares Public Sector Banks with Private Sector Banks and tries to provide a rational conclusion to this debate.

Objectives of The Study:

- To compare Public Sector Banks with Private Sector Banks.
- To Identify the Importance of Public Sector Banks for India.

Research Methodology:

This research is based on an online-centric methodology, relying exclusively on digital sources for data collection and analysis.

Findings:

Comparison of Public Sector Banks with Private Sector Banks

*Growth Rates*

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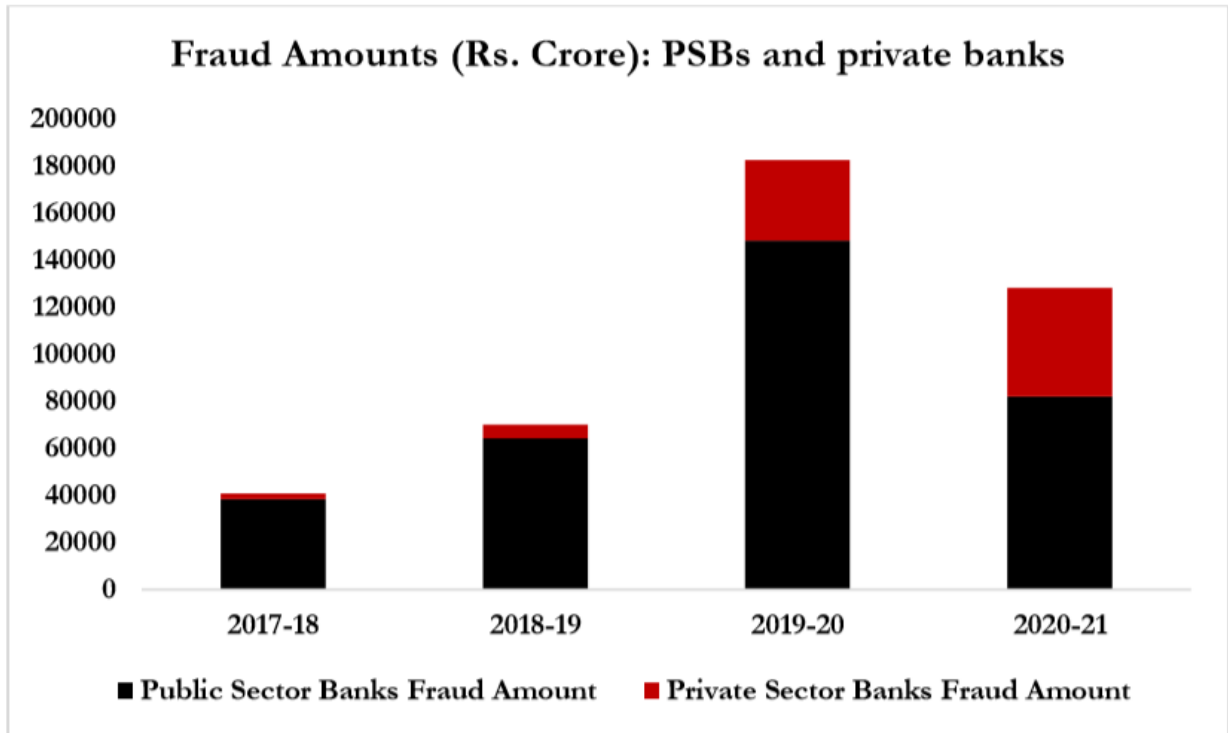
Average Annual Growth Rates

<b>Bank Group</b>	<b>1990-2000</b>	<b>2000-2010</b>	<b>2010-2020</b>
<b>Assets</b>			
SBI	13.3	15.6	10.9
Other PSBs	13.1	18.6	8.7
Private banks	<b>31.7</b>	<b>24.6</b>	<b>17.7</b>
Scheduled Commercial Banks	14.6	18.5	11.6
<b>Advances</b>			
SBI	11.7	21.1	10.6
Other PSBs	11.9	23.7	8
Private Banks	<b>31.4</b>	<b>28.5</b>	<b>19.2</b>
Scheduled Commercial Banks	13.6	23.1	11.6
<b>Deposits</b>			
SBI	16.4	16	11.4
Other PSBs	14.3	18.4	8.7
Private Banks	<b>32</b>	<b>22.1</b>	<b>17.7</b>
Scheduled Commercial Banks	16.3	18.1	11.5

*Source: RBI, Statistical Tables Relating to Banks in India (Tables based on Annual Accounts).*

The growth rates of assets, advances and deposits, of banks are represented in the above table. The annual growth rates of private banks are higher than those of SBI as well as Public Sector Banks. The table clearly represents the superior performance of private banks.

*Fraud Amounts**Fraud Amounts in Public Sector Banks and Private Banks (2017 - 18 to 2020 - 21)*

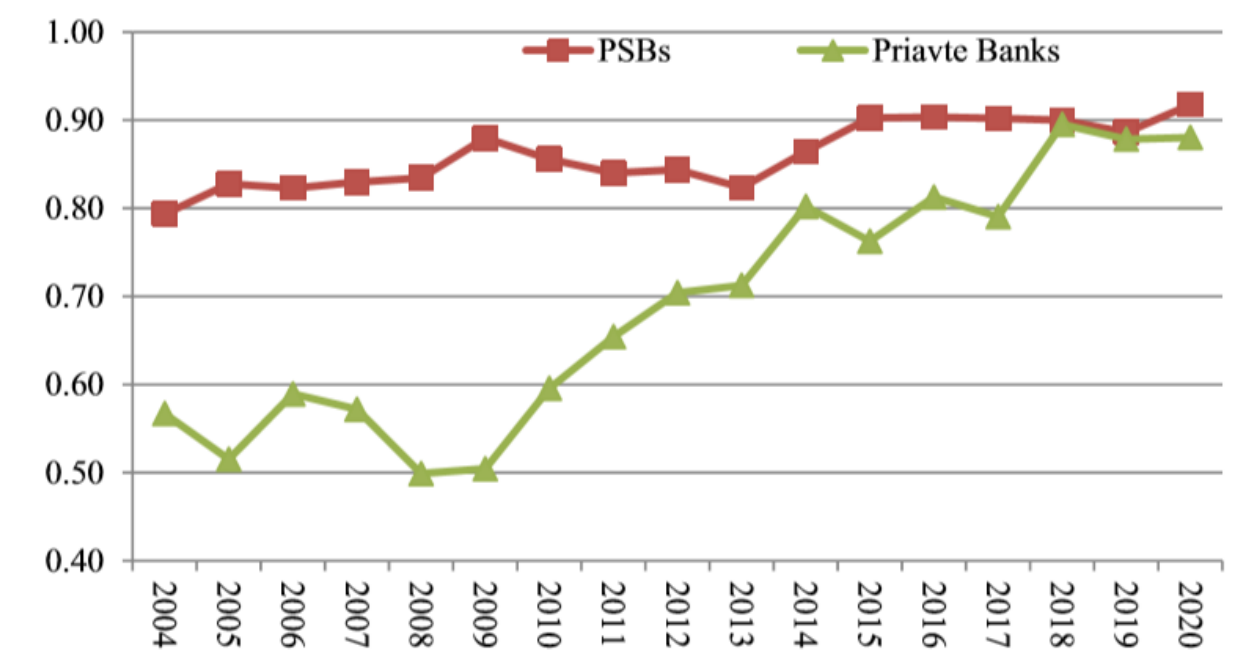


Source: RBI Annual Reports

Over the years bank related frauds have increased. Large number of frauds are associated with Public Sector Banks, whereas private sector banks have done an impressive job as compared to Public Sector Banks - regarding frauds. Lower fraud amount in private sector banks represents the sincerity, efficiency, security and trustworthy nature of private sector banks.

*Business Efficiency*

Business Efficiency (2004 - 2020)

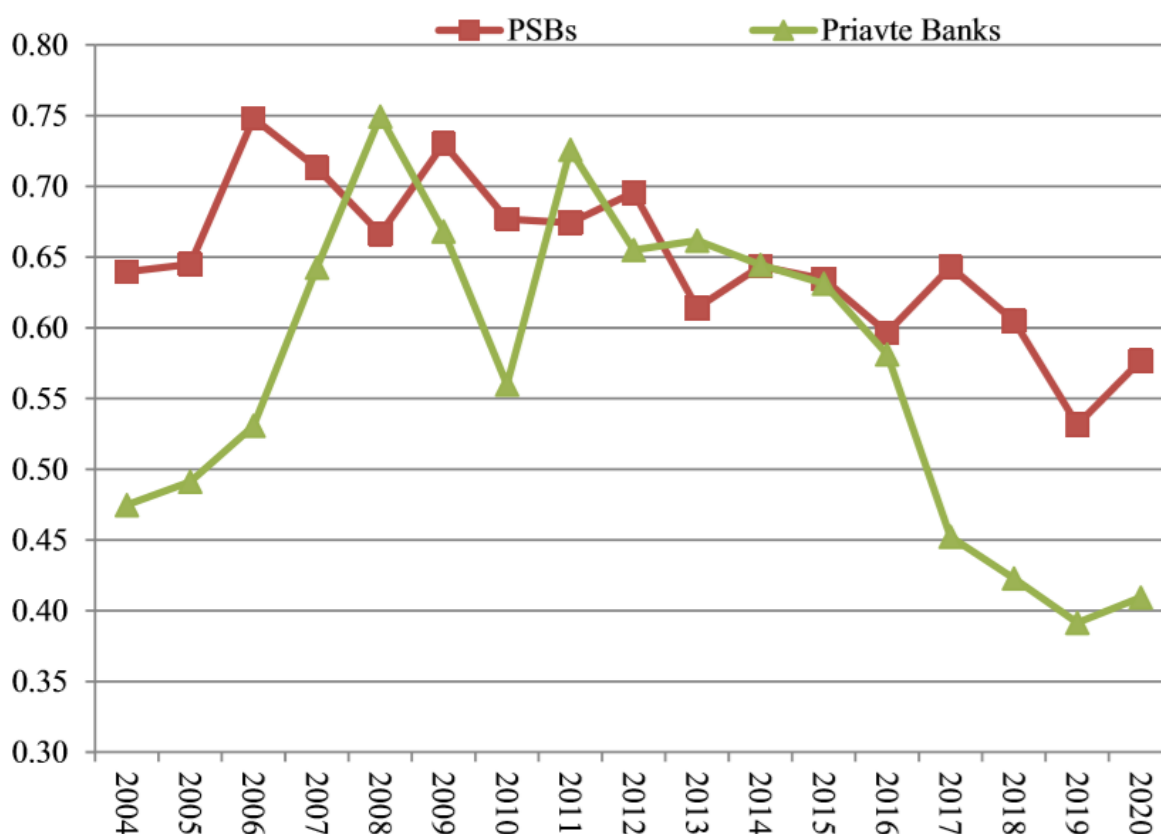


Source - Biswajit Patra, Purna Chandra Padhan & Puja Padhi (2023) *Efficiency of Indian Banks – private versus public sector banks: A two-stage analysis*, *Cogent Economics & Finance*

Above diagram shows that, Public Sector Banks have played a major role as compared to private sector banks, in business efficiency. However the private sector banks are improving their business efficiency, and were able to reach on par with Public Sector Banks. According to “Biswajit Patra, Purna Chandra Padhan & Puja Padhi (2023) *Efficiency of Indian Banks – private versus public sector banks: A two-stage analysis*, *Cogent Economics & Finance*” article - In 2017, the RBI brought maximum Public Sector Banks under prompt corrective action (PCA) framework wherein the weak banks in terms of lower capital, banks reporting continuous losses are restricted for doing additional loans business. These banks are advised to concentrate on profit. It restricted more than half of the Public Sector Banks in India; 11 out of 21 banks are kept under this framework. This reduced the business growth of Public Sector Banks. To some extent, the post-demonetization of 2016 and GST implementation have some effect on these Public Sector Banks.

### *Profit Efficiency*

#### *Profit Efficiency (2004 - 2020)*



Source - Biswajit Patra, Purna Chandra Padhan & Puja Padhi (2023) *Efficiency of Indian Banks – private versus public sector banks: A two-stage analysis*, *Cogent Economics & Finance*

Existing studies show that private banks are more profit efficient as compared to Public Sector Banks (According to - Piyush Kumar Singh & Keyur Thaker | (2020) Profit efficiency and determinants of Indian banks; A truncated bootstrap and data envelopment analysis, Cogent Economics & Finance, 8:1, 1724242, DOI: 10.1080/23322039.2020.1724242), but according to table - 6 the profit efficiency scores of Public Sector Banks is higher as compared to private sector banks, the profit efficiency scores of the Public Sector Banks increased from 0.60 in 2016 to 0.64 in 2017 for the short time period, which may be due to the PCA framework in 2017, as their main target was to increase profit. Otherwise, the profit efficiency scores reduced for both the bank groups from 0.63 as of 2015 to a low of 0.58 and 0.41 in 2020 for Public Sector Banks and private banks, respectively. (According to “Biswajit Patra, Purna Chandra Padhan & Puja Padhi (2023) Efficiency of Indian Banks – private versus public sector banks: A two-stage analysis, Cogent Economics & Finance” article).

From the above data its clear that private sector banks are superior to public sector banks, but according to the above reports Public Sector Banks are also doing a great job as compared to private sector banks, in profit efficiency and business efficiency. According to the Hindustan Times Aug 2022 – report – (which was representing an article by experts on RBI) public sector banks have performed better in terms of promoting financial inclusion and had also mentioned that Big Bang privatization of public sector banks can do more harm than good.

#### Identifying the Importance of Public Sector Banks in India

##### *Jan Dhan Yojana*

Pradhan Mantri Jan Dhan Yojana (PMJDY), was announced by the Hon'ble Prime Minister Shri Narendra Modi on 15th August 2014 and launched by him on 28<sup>th</sup> August 2014 across the country, as the biggest financial inclusion initiative in the world. The Public Sector Banks have played a major role in the successful implementation of PMJDY. According to The Economic Times (ET-BFSI) Sep 2022, report – The share of private banks in credit is more than 40%, they account for only 3% of Jan Dhan Yojana.- “ The government had pulled up private banks for having a disproportionately low share in schemes like Jan Dhan Yojana.”

##### *Rural lending*

According to a Mint article (livemint.com – private banks reluctant about rural lending) Mar 2013 – The private banks have stayed away from directly lending to small farmers and weaker sections in India’s far-flung areas. This clearly explains the reason for the superior performance of private sector banks over the years (by avoiding risks). Thus, Public Sector Banks play a vital role in rural lending and lending to weaker sections in India.

##### *Funding Large Projects (Reason for massive asset-liability mismatch in Public Sector Banks)*

Due to the backing of the government, public sector banks can take risks that private banks cannot afford to take. The long-term loans of the private banks are very small so they keep their assets-liability position in some sort of a balance. For large investment projects, most of them (loans) are carried by public sector banks. This is the main reason for massive asset-liability mismatch in Public Sector Banks – “According to MoneyControl interview with former chief statistician Pronab Sen on August 25, 2022”.

The above cases indicate that private sector banks focus more on growth, whereas Public Sector Banks focus on social welfare and providing financial aid and assistance to weaker sections as well as to richer sections of Indian Society.

#### Discussion :

Several studies, research papers, news articles, and so on suggest and support the privatization of Public Sector Banks in India. NCAER July 2022 report – suggests privatizing all public sector banks except SBI. RBI suggested that a gradual approach should be followed regarding privatization of banks. “According to MoneyControl interview with former chief statistician Pronab Sen on August 25, 2022”. – Privatization will run the risk of having insufficient funds for massive capital investments. Instead of privatization, the government should implement a European model in India that will allow banks to raise money in the capital markets for lending purposes, says Pronab Sen. Both the Public Sector Banks and Private Sector Banks are equally important for India. Complete privatization can lead to financial instability and may result in the demolition of social objectives. Thus there should be a balance between both of them. A lot of articles say that - Public Sector Banks' main problem is NPAs. According to “Brahmaiah, B. (2019) Why Non-Performing Assets Are More in Public Sector Banks in India? Theoretical Economics Letters, 9, 75-85.” Credit risk is a major source of NPA. Inefficient and defective credit risk management policies and practices lead to the crystallization of more NPAs in banks. Thus, the NPA problem is a management issue or a governance issue. Public Sector Banks' performance can be improved with proper and effective management. Banks are not just profit-making entities but also important institutions that can contribute to economic stability and equity. Privatization can result in more efficient allocation of resources and innovation in banking services but may lack in providing help, assistance, loans, and so on to poor people. Both Public Sector Banks and Private Sector Banks have their advantages and disadvantages. Several articles tell that Private Sector Banks have earned more profits as compared to Public Sector Banks. According to The Economic Times – Banking Mergers in India have been beneficial to the banking sector as the financial performance and efficiency improved. Even though Banks have earned more profits, the government’s main objective should be to ensure that each and every citizen of India is able to use banking services and not profit maximization. Public Sector Banks' contribution in rural areas is appreciable, whereas Private Sector Banks have shown very little interest in rural areas of India. Thus, there should be a neutral approach – i.e. both Private Sector Banks as well as Public Sector Banks are important for India.

#### Conclusion:

Banks play a major role in India’s economy. Private sector banks are superior to public sector banks, but Public Sector Banks are also doing a great job as compared to private sector banks, in profit efficiency and business efficiency. Public sector banks have performed better in terms of promoting financial inclusion. Private sector banks focus more on growth, whereas Public Sector Banks focus on social welfare and providing financial aid and assistance to weaker sections as well as to richer sections of the Indian Society. Both the Public Sector Banks and Private Sector Banks are equally important for India. Complete privatization can lead to financial instability and may result in demolishing social objectives. Thus there should be a

balance between both of them. The government's main objective should be to ensure that each and every citizen of India is able to use banking services and not profit maximization.

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