



EFFECT OF PRIVATIZATION AND NATIONALIZATION ON INDIAN BANKING SECTOR

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ABSTRACT

Banks play a crucial role in the growth of the economy as they deal with money. Banks provide guarantee to keep our money safe and in return it gives interest. The study aims to evaluate the effects of nationalization and privatization on Indian banks. Various factors have been considered to examine the effects of privatization and nationalization, including sources of public sector inefficiency, measures of firm performance, economic issues and mode of privatization. The data was collected for the period of 1998 to 2021 from Indian banks. Data envelopment Analysis (DEA) was used to evaluate the financial reports of the banks selected to evaluate the financial reports of the banks selected to evaluate the efficiency of input and output variables. 20 private banks were nationalized in 1980's and same banks now government want to privatize. Privatization of banks must be increased and maintained to sustain the efficiency of banks and implement strategies to maintain the assets. Performance of private banks has been observed effective and efficient as compared to public sector banks.

Keywords: Privatization, Nationalization, Indian banking, Performance

INTRODUCTION

A bank is a financial institution licensed to receive deposits and make loans. Banks may also provide financial services such as wealth management, currency exchange and safe deposit boxes. There are several different kinds of banks and investment banks. In most countries, banks are regulated by the government or central bank of the country.

Brief history of Banks in India

Modern banking in India originated in the mid of 18th century. Among the first bank was the bank of Hindustan, which was established in 1770 and liquidated in 1829-32. The largest and oldest bank which is still in existence is the state bank of India(SBI). It originated and started working as the bank of Calcutta in mid-June 1806. In 1809, it was renamed as bank of Bengal. This was one of the three founded by a presidency government, the other two were the bank of Bombay in 1840 and the bank of Madras in 1843. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State bank of India in 1955. For many years, the presidency banks had acted as quasi-central banks, as did their successors, until the reserve bank of India was established in 1935, under the reserve bank of India act, 1934. The Reserve bank of India, India's central banking authority, was established in 1st April 1935, but was nationalized on 1st January 1949 under the terms of the Reserve Bank of India (Transfer to public Ownership) Act, 1948.

On July 19, 1969, Indira Gandhi who was both Prime Minister and Finance Minister at that time decided to nationalize 14 largest private banks of the country. With Imperial Bank already nationalized and renamed as State Bank of India in 1955, this decision pushed 80 percent of banking assets under the control of the state.

The performance of financial system is an essential aspect in the development of economy for any country. The existence of established financial system can be used to promote the financial stability of a country, On the contrary, distortion can be experienced by an unstable banking system among interest rates, economic activity and inflation. Therefore, privatization and nationalization of banks are undertaken to sustain the financial performance of banks. Privatization of banks owned by government and other measures introduced were the main financial reforms, commenced in the early years to invigorate the country's financial system. Due to efficiency of privatization, there is an influence on balancing the budgets in the capital markets of developing countries. The effect of nationalization and privatization of banks has been focused to determine the financial efficiency of Indian banking system.

The effect of privatization and nationalization is empirically evidenced on banking sector performance. Various factors have been considered to examine the effect of privatization and nationalization includes sources of public sector inefficiency, measures of firm performance, economic issues and the mode of privatization. On the contrary, mixed evidence has shown the doubt of privatization and nationalization effect on the performance of banking industry. According to Hussar, performance enhancement of Indian banking sector is reported to be 28% after privatization. The effect of nationalization and privatization has not been empirically evidenced, considering the case of Indian banks for the period of 90s till present. There is a need to consider and focus on the impact of privatization of national banks on their financial performance in India. Thereby, the focus of this study has been to examine the nationalization and privatization effect on Indian banking industry.

The relevance of this study consists in the emphasis towards the impact of privatization with the consideration of the accounting indicators.

1. LITERATURE REVIEW

1.1. Performance of banks after privatization

Brown and Earle (2015) have estimated the effects of domestic and foreign privatization on the banks productivity via long panel data of state-owned manufacturing firms Ukraine. The study has used the longitudinal dimension of data for measuring and controlling pre-privatization for selection bias and for estimating long-run impacts. The findings have shown that increasing multi factor productivity in eventually emerged in domestic privatization, indicating a 25% relative response to state-owned firms after six years. By considering the performance of Indian Banks, pooled ordinary least square method is integrated to

observe the profitability and growth after privatization. It has been determined that market capitalization, assets, equity and inflation significantly affected the performance of Indian banking industry after nationalization. The significance of privatization has been emerged among nationalized banks in Indian economy. The anticipation of ore-privatization selection bias is observed for the long-run impact. Patel and Patel (2015) have examined that there is a strong and positive impact of possession structure on the financial performance of banks. The study has examined the performance of banks and their stocks after officially privatized from the State Bank of India.

The relationship between privatization of national banks and their performance has been examined by numerous studies. These studies have deployed DEA system to measure the effect of privatization on the financial performance of banking industry. The findings indicated that there was a positive and significant influence of privatization on the financial performance of banking industry. The contribution of liquidity and liability ratios is moderately implicated on the expansion of financial efficiency and banking industry profitability. Thereby, privatization incurs an effective approach in sustaining and enhancing the performance of banking industry.

1.2. Performance of banks after nationalization

It has been determined that the performance of banks after nationalization enabled to direct the credits to priority fields of small scale, exports and agriculture, which cannot be expanded in rural areas. By integrating such processes, public confidence can be improved on banks and ultimately the performance of banks can be increased. The performance of the banking industry is specifically evaluated based on the financial management tool, mainly including ratio analysis technique is to explore financial statements using distinct ratios and then compare them with the pre-defined benchmark. The profitability of banks is highly determined by the consequences of nationalization. Panel data estimation has been used to significantly measure the performance of Indian banking industry over the period of six years. Profitability factor is considered to be the most important factor that influences the performance of Indian banking industry. Bank size and ownership are other significant variables that have moderate impact on the nationalization of banks. The results have indicated that efficiency attributes of bank branches were significant under profitability and productivity aspects as they both possess comparative tendencies. On the contrary, the size of the branch decreases if branch efficiency and productive scale increase. Thereby, nationalization of banking industry significantly reflects the financial performance in terms of profitability and productivity.

1.3 Arguments in Favour of Nationalisation of Banks

- Promote economic development
- Curb economic concentration of powers
- Attain Full employment
- Full utilization of natural resources
- Efficiency
- Social and Economic justice

1.4 Arguments in Favour of Privatisation of Banks

- Commercial banks would now get more freedom in making credit decisions and attract more deposits
- It will create a healthy competitive environment in the banking sector which in turn would improve the quality of service to the public
- It would reduce unnecessary political intervention and this will increase the efficiency of banks
- Privatisation of banking would help to improve the profitability

2. SCOPE OF THE STUDY

This study aims to examine the privatization and nationalization effect on Indian banking industry.

2.1. Key points under discussion

- The impact of privatization on the performance of Indian banks
- The impact of nationalization on the performance of Indian banks
- The impact of privatization and nationalization on the performance of Indian banks in terms of efficiency.

3. OBJECTIVE OF THE STUDY

- To generate public confidence in the banking system of the country.
- To prevent economic power in the few hands.
- To prevent the use of bank frauds for anti-social activities.

4. DISCUSSION

Improving the performance and efficiency of public sector banks is a main goal of economic reforms in several countries, including India. It has been believed that performance and efficiency of banks can be improved by private ownership. It has been observed that partially privatized banks performed better than public sector banks in terms of efficiency parameters and financial performance. Partially privatized banks were observed catching up with the private sector banks. There was no significant difference found regarding performance and efficiency in two cohorts of banks. Indian partial privatization appeared to have resulted with positive outcomes. Indian government is already considering a step to take its stake down to 33%. The performance of public sector banks is at par with private sector banks as evaluated by Kumar et al (2012) in terms of efficiency. Public sector banks have seen gradual reduction in the government control with the liberalization of the banking sector. The influence of privatization between public and private banks has been studied by Sankar and Maran (2015). The profitability and efficiency of the banks have been revealed, which indicated that public banks were lower in terms of efficiency than private banks. Profitable factors can be driven towards the improvement of banking sectors through the appealing impact of privatization and nationalization. Several factors have been studied through privatization and nationalization enduring influence on the efficiency and imperative impact on the banking industry of India.

CONCLUSION

The study intends to examine the consequences of privatization and nationalization for Indian banking industry. The efficiency of Indian Banking industry after privatization and nationalization process is emerged from loans and investments. Capital structure can be further improved after spending massive revenue in the domestic and international capital markets. Greater number of banks will provide more precise results, using data envelopment analysis. Camel approach can also be employed on greater sample size to evaluate the privatization and nationalization effects.

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