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IMPACT OF PRIVATIZATION ON INDIAN BANKING SECTOR IN THE GLOBALIZATION ERA

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ABSTRACT
Privatization has become a popular measure for solving the organizational problems of governments by reducing the role of the state and encouraging the growth of the private sector enterprises. However, privatization takes a number of forms and has been approached in various ways during the move away from government control to other forms of owner¬ship in developing countries. Privatization has leaded the corporate world into the new world of dynamic competition with the search of new resources, global markets, expanded global networking. The consequences of privatization have focused onto the fields of economics, international relations, management and sociology. The scope of the privatization aspect is different for different fields of business and different sectors. Specially the financial sector and banking sector. The economy of the nation is focused on the financial and banking sector. In this paper an attempt has been made to identify the general sentiments, a revolutionary approach towards privatization and future challenges for the Indian banking industry. This article is divided in three parts. First part includes the introduction and literature review. The second part discusses the Indian banking scenario and challenges face by Indian banking industry. Third part concludes that urgent emphasis is required on the Indian banking product and marketing strategies in order to get sustainable competitive edge over the intense competition from national and global banks.

KEYWORDS
Privatization, Banking Industry, Performance, India.

INTRODUCTION
Privatization is the process of transferring ownership of a business, enterprise, agency, public service or public property from the public sector (a government) to the private sector, either to a business that operates for a profit or to a non-profit organization. Privatization is both a challenge and an opportunity for Indian banks to gain strength in the domestic market and increase presence in the global market. On the basis of various parameters, paper finds that there is a fast penetration of foreign banks in India and public sector banks, particularly SBI is intensively entering in foreign countries, same is the case of ICICI Bank as this bank is capturing foreign markets at a fast pace. At the end, the present paper finds some challenges and also explores the future opportunities. On the basis of the experience of already global went banks, paper suggests some strategies that how Indian banks can make their presence effective in the global market. Globalization refers to widening and deeping of international flow of trade, capital, labour, technology, information and services. Privatization has led to an overall economic, political and technological integration of the world. In our country, first economic reforms (1991) gave birth to globalization and second phase of banking sector reforms strengthened the globalization. Various reform measures introduced in India have indeed strengthened the Indian banking system in preparation for the global challenges ahead. The banking sector in India has remained regulated since nationalization in 1969. Private bank entry was restricted after nationalization to prevent unfair competition, urban concentration and lending to rich and well known firms. This resulted in elimination of competition among public sector banks, public-private sector banks. India is the largest country in South Asia with a huge financial system characterized by many and varied financial institutions and instruments. The Indian financial sector was well-developed even prior to the political independence of the country in 1947. Privatization has become a popular measure for solving the organizational problems of governments by reducing the role of the state and encouraging the growth of the private sector enterprises. However, privatization takes a number of forms and has been approached in various ways during the move away from government control to other forms of owner¬ship in developing countries.

LITERATURE REVIEW
The role of public sector banks and other financial institutions in economic development has been examined in many studies. There are two broad views about government involvement in financial systems around the world, i.e., the ‘development’ view and the ‘political’ view. The development view as advocated by **Gerschenkron (1962)** states that governments can intervene through their financial institutions to direct savings of the people towards developmental sectors in countries where financial institutions are not adequately developed to channel resources into productive sectors. Gerschenkron’s view was part of a broader consensus in development economics that favored government ownership of enterprises in strategic economic sectors. Realizing this importance of financial sector in economic development, governments in developing countries sought to increase their ownership of banks and other financial institutions in the 1960s and 1970s, in order to direct credit towards priority sectors. Contrary to this view, in recent years a new ‘political’ view of government ownership has evolved which asserts that state control of finance through banks and other institutions politicizes resource allocation for the sake of getting votes or bribes for office holders and thereby results in lower economic efficiency. **Barth et al. (2001)** using cross country data on commercial bank regulation and ownership from over 60 countries find that state ownership of banks is negatively associated with bank performance and overall financial sector development and does not reduce the likelihood of financial crises. Another study **[La Porta et al. (2002)],** 406 Opinions based on data of government owned banks from 92 countries around the world, finds that government ownership of banks is high in countries which are characterized by “low levels of per capita income, underdeveloped financial systems, interventionist and inefficient governments and poor protection of property rights”. The study further finds evidence that government ownership of banks is associated with slower subsequent financial development, lower economic growth and especially lower growth of productivity. Now we come to the

question: how privatization can improve the performance of a state owned enterprise? Generally, the case for privatization of state owned enterprises can be grouped around three main themes, i.e., competition, political intervention and corporate governance. The competition argument states that privatization will improve the operation of the firm and the allocation of resources in the economy, if it results in greater competition. Privatization can improve efficiency even without changing market structure if it hinders interventions by politicians and bureaucrats who would like to use the SOEs to further their political or personal gains. It is also argued that corporate governance is weaker in state owned enterprises than in private firms because of agency problems. "SOEs have multiple objectives and many principals who have no clear responsibility of monitoring" **[Clark et al. (2003)].** Another reason for SOEs to have poorer corporate governance is the weak incentive structure for managers to perform efficiently. They do not face a market for their skills or the threat of losing their jobs for non-performance. Thus, "less competition, greater political intervention and weaker corporate governance are strong theoretical arguments against state ownership" [Clark et al. (2003)]. Clarke et al. (2003) using a combination of country case studies and cross country analyses conclude that privatization of banks improves performance as compared to continued state ownership. However, continued state ownership even in minority shares of privatized banks is found to have negative effects on their performance. Privatization of state owned banks through public share offerings produces lower gains than direct sales to strategic investors in countries where the institutional environment is weak. Lastly, they find that the benefits accruing are reduced if foreign banks are not allowed to participate in the privatization process. **Otchere (2003)** presents a comprehensive analysis of the pre and post privatization performance of privatized banks and their rival banks in low and middle-income countries. The author does not find any significant evidence of improvements in the privatized banks' post privatization performance. In fact, the privatized banks have a higher proportion of bad loans and appear to be overstaffed relative to their rivals, in the post privatization period. The continued government ownership of Opinions 407 privatized banks is found to be responsible for their underperformance, as it hinders managers' ability to restructure them effectively. Using a comprehensive dataset of bank privatizations in 101 countries during the Period 1982-2000, **Boehmer et al. (2003)** examine the economic and political factors that are likely to affect government's decision to privatize a state owned bank, in both developing and developed countries. Their findings indicate that in developing countries, a bank privatization is more likely the lower the quality of the country's banking sector, the more right wing the country's government is, and the more accountable the government is to its people. **Milind Sathye (2005)** examines the impact of privatization on bank performance and efficiency using data of banks in India for the five-year period — 1998-2002. Statistical analysis was performed using the difference of means test for three groups of banks — partially privatized, fully state-owned, and those already in the private sector. Partially privatized banks have performed better as compared to the fully public sector banks in respect of certain financial performance and efficiency parameters. Partially privatized banks also seem to be catching up with the banks already in the private sector. No significant performance or efficiency difference was seen in these two cohorts of banks. Overall, going by the results of this study, partially privatized banks have continued to show improved performance and efficiency in the years after privatization. In several countries, post-privatization outcomes were far from satisfactory.

INDIAN BANKING SCENARIO: NEED FOR A REVOLUTIONARY APPROACH TOWARDS PRIVATIZATION

Nationalized banks such as State Bank of India (SBI), though pygmies in the international banking market, are banking behemoths of India. They have branches spread over the entire length and breadth of the country. With the government offering an assured business, nationalized banks and State Bank of India in particular should not take a complacent view. They should evolve service-intensive products and make their employees customer-friendly. With competition from private and foreign banks knocking at the door, the banks should realize, size is no more an insurance against the onslaught of competition from sleek private and foreign banks. A revolutionary approach to privatize ownership is the need of the hour.

1. **Virtual Banking:** SBI has yet to computerize its operations and network all its branches. The computers currently available serve only to relieve the burden of the clerical staff of maintaining manual ledgers and not to penetrate into areas of customer service. ATMs, Anytime-Anywhere, round the clock and telephone banking is still a far cry. These computers at the best remain only as desk ornaments. With the New Telecom Policy (NTP) almost in place, telecom sector will soon be revolutionized. E-commerce, telephone banking, consumer banking, Internet banking, insurance et al are waiting just around the corner. At least in major metros, virtual banking will soon take-over from the brick-mortar banks.
2. **Manpower Retraining and not Retrenchment:** As a hangover of the past socialistic mindset, all the nationalized banks have excess workforce. This is indeed a hot potato for the management of many enterprises and is therefore being handled with kid gloves. In India, it is everyone's worry to look at business as a source of employment, while making money is secondary. In this ocean of manpower, every institution does have its share of highly skilled and talented manpower, which contribute to asset building. It is the semi skilled manpower having outdated skills, which form the excess baggage. All banks must invest in re-training the manpower so that they can migrate from the areas that will be vacated by computerization. The level of Non-Performing-Assets (NPAs) is still at very high levels and to start with, some of this excess manpower can cover areas of debt recovery.
3. **New Products and New technologies:** The new product areas that require greater penetration are personal banking, housing finance, consumer durable finance, auto-finance, internet banking, insurance, telephone banking et al. Development of these new areas call for heavy investments and this cash - flow can only generated by privatization. In addition, surplus manpower once retrained can be absorbed in the new ventures.
4. **Banking simplicity**: Private Banker is the one person who will serve as your point of access to the wide spectrum of premier products and services we offer throughout the TD Bank north financial services network.
5. **Time savings**: Private Banker will come to you. Whether your signature is required, or you request an analysis of products and services, they will do whatever it takes to ensure your convenience. In short, they'll make the bank operate on your schedule.
6. **A powerful partnership**: They'll work closely with you and your staff. They'll also work with your attorney, accountant, insurance specialist and investment advisor to coordinate services. They have an extensive array of in-house business partners at your disposal to provide their expertise in these areas as necessary.

STRUCTURE OF INDIAN BANKING INDUSTRY

Banking Industry in India functions under the sunshade of Reserve Bank of India - the regulatory, central bank. Banking Industry mainly consists of:

- Commercial Banks
- Co-operative Banks

The commercial banking structure in India consists of: Scheduled Commercial Banks Unscheduled Bank. Scheduled commercial Banks constitute those banks which have been included in the Second Schedule of Reserve Bank of India (RBI) Act, 1934. RBI in turn includes only those banks in this schedule which satisfy the criteria laid down vide section 42 (60) of the Act. Some co-operative banks are scheduled commercial banks although not all co-operative banks are. Being a part of the second schedule confers some benefits to the bank in terms of access to accommodation by RBI during the times of liquidity constraints. At the same time, however, this status also subjects the bank certain conditions and obligation towards the reserve regulations of RBI. For the purpose of assessment of performance of banks, the Reserve Bank of India categories them as public sector banks, old private sector banks, new private sector banks and foreign banks.

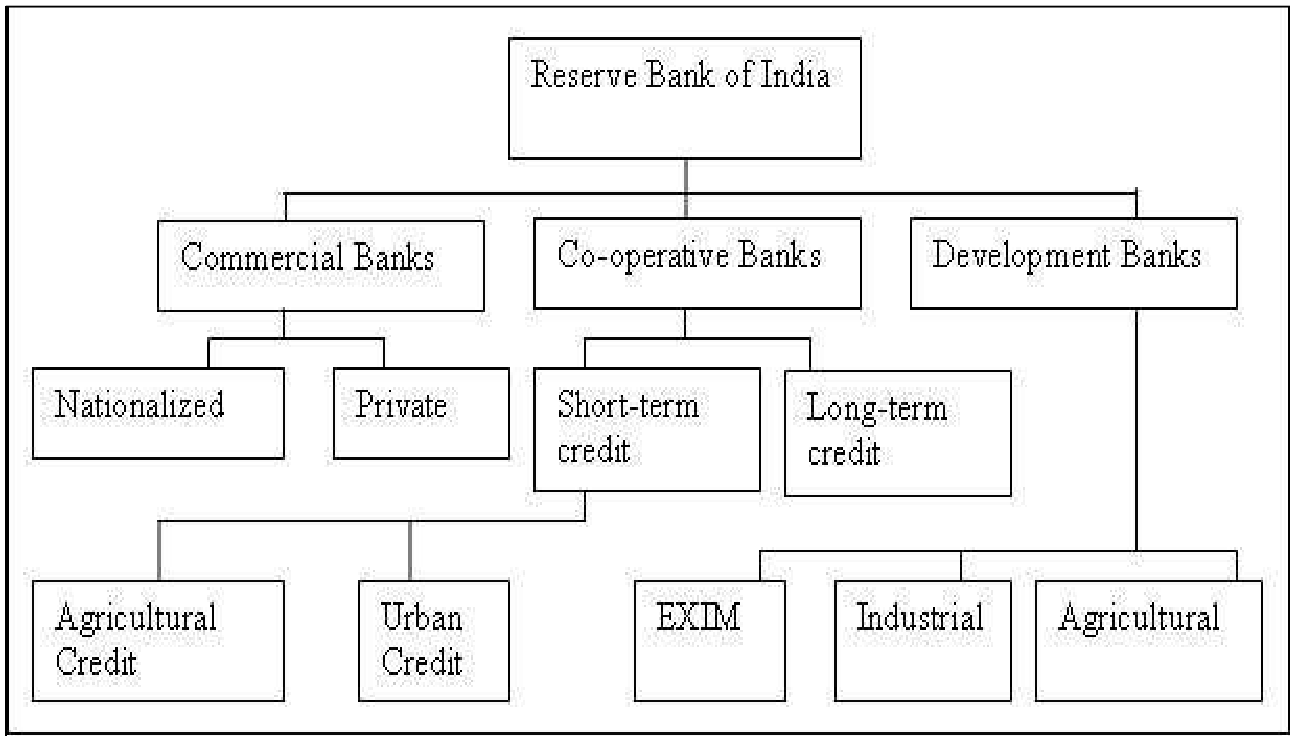

TABLE 1: COST OF FUNDS AND RETURN ON FUNDS - BANK GROUP-WISE (Per cent)

Sr. No.	Bank group/year	Cost of Deposits	Cost of Funds	Return on Advances	Return on Funds
1	**Public sector banks**				
	2009-10	**5.68**	**5.35**	**9.10**	**8.34**
	2010-11	**5.12**	**4.89**	**9.09**	**8.41**
1.1	Nationalised banks				
	2009-10	5.64	5.37	9.18	8.46
	2010-11	5.13	4.93	9.20	8.50
1.2	SBI Group				
	2009-10	5.75	5.32	8.93	8.10
	2010-11	5.09	4.80	8.84	8.21
2	**Private sector banks**				
	2009-10	**5.36**	**4.83**	**9.89**	**8.60**
	2010-11	**4.97**	**4.56**	**9.67**	**8.56**
2.1	Old private sector banks				
	2009-10	6.28	6.13	10.95	9.22
	2010-11	5.63	5.50	10.42	8.98
2.2	New private sector banks				
	2009-10	5.01	4.42	9.56	8.40
	2010-11	4.73	4.27	9.43	8.44

Source: *Report on Trend and Progress of Banking in India 2010-11, RBI, Mumbai.*

COST OF FUNDS DECLINED

As shown in above table cost of funds is declined in public sector from 5.35 to 4.89. In private sector also cost of funds is declined. The cost of funds is 4.83 in 2009-10 and declined to 4.56 in 2010-11.

RETURN ON FUNDS IMPROVED

Table 1. shows that return on funds improved of private sector and public sector both. But the return of private sector (8.56) is more than public sector (8.41). This indicates the better position of public sector.

TABLE 2: RETURN ON ASSETS OF BANKS FOR SELECT ECONOMIES

Country	2007	2008	2009	2010	2011*
Advanced economies					
France	0.4	0.0	0.4	0.6	...
Germany	0.3	-0.1	0.2	...	...
Greece	1.0	0.2	-0.1	-0.6	-0.3
Italy	0.7	0.3	0.2	...	...
Japan	0.3	-0.3	0.2	0.4	...
Portugal	1.2	0.4	0.4	0.5	0.5
Spain	1.1	0.8	0.6	0.5	...
United Kingdom	0.4	-0.4	0.1	0.2	...
United States	1.2	-0.1	-0.1	0.9	1.2
Emerging and developing economies					
Russia	3.0	1.8	0.7	1.9	2.3
China	0.9	1.0	0.9	1.0	...
India	0.9	1.0	1.1	1.1	...
Malaysia	1.5	1.5	1.2	1.5	1.8
Brazil	3.4	1.5	2.4	3.2	3.3

Source: *Report on Trend and Progress of Banking in India 2010-11, RBI, Mumbai.*

** Up to the period ending March*

France in 2010 (Table 2). The RoA of US banks turned positive by 2010 after staying in the negative zone in 2008 and 2009; it showed a further increase in 2011 (March). In Russia, China and Malaysia, RoA of the banking system, which had dipped between 2008 and 2009, recovered between 2009 and 2010. In Russia and Malaysia, the trend of increase in RoA continued even in 2011 (March). The RoA of Indian banks too showed a modest rise between 2008 and 2010.

FUTURE CHALLENGES OF BANKS IN INDIA

Deregulation: This continuous deregulation has made the Banking market extremely competitive with greater autonomy, operational flexibility and decontrolled interest rate and liberalized norms for foreign exchange. The deregulation of the industry coupled with decontrol in interest rates has led to entry of a number of players in the banking industry. At the same time reduced corporate credit off take thanks to sluggish economy has resulted in large number of competitors batting for the same pie.

New rules: As a result, the market place has been redefined with new rules of the game. Banks are transforming to universal banking, adding new channels with lucrative pricing and freebees to offer. Natural fall out of this has led to a series of innovative product offerings catering to various customer segments, specifically retail credit.

Efficiency: This in turn has made it necessary to look for efficiencies in the business. Banks need to access low cost funds and simultaneously improve the efficiency. The banks are facing pricing pressure, squeeze on spread and have to give thrust on retail assets.

Diffused Customer loyalty: This will definitely impact Customer preferences, as they are bound to react to the value added offerings. Customers have become demanding and the loyalties are diffused. There are multiple choices, the wallet share is reduced per bank with demand on flexibility and customization. Given the relatively low switching costs; customer retention calls for customized service and hassle free, flawless service delivery.

Misaligned mindset: These changes are creating challenges, as employees are made to adapt to changing conditions. There is resistance to change from employees and the Seller market mindset is yet to be changed coupled with Fear of uncertainty and Control orientation. Acceptance of technology is slowly creeping in but the utilization is not maximized.

Competency Gap: Placing the right skill at the right place will determine success. The competency gap needs to be addressed simultaneously otherwise there will be missed opportunities. The focus of people will be on doing work but not providing solutions, on escalating problems rather than solving them and on disposing customers instead of using the opportunity to cross sell.

PROBLEMS OF PRIVATIZATION

1. **Surplus employees:** The defect of the system is that some of the workers are declared surplus. There is an increase in the rate of unemployment.
2. **Unbalanced growth**: The management of privatized banks provides credit in specific areas and people. As a result, there is unbalanced growth in the country; especially rural areas may remains under developed where credit facilities do not exist.
3. **Loans for few persons**: The management of privatized bank can extend loans of their favored persons. In this way only few persons are benefited.
4. **Owners association**: The aim of privatized banks is to earn profit. For these purpose owners associations are made which enter into agreement of earning high profit. The bank can increase the rate of service charges. Such associations may not care for customer's welfare.
5. **No of branches in rural areas**: The private bank owners do not like to setup there branches in rural areas. The banking facilities remain confined to cities where sufficient deposits are available. A large part of population will be deprived of banking facilities.
6. **Jobs for relatives**: The management of privatized banks may provide jobs to their friends and relatives. The deserving persons are ignored.

CONCLUSION

Today the pace of economic change is far rapid than at any point in the history of mankind .With each passing moment, the economies of the world are getting further integrated and interlinked. The term 'global village' is no longer a myth, but a reality which we need to live with. The world over, there are the shifts towards the lesser government involvement in the field of business. The famous quote "The business of government is not to be in business" by John Moore seems to hold relevance these days, because of the privatization wave across the countries. The main purpose is to understand the issue and critically examine if increased private enterprises leads to any desired improvements. The result can be seen in the performances of the banks and the whole financial and non financial industries in India.

Privatization has changed the whole facet of Banking with new infrastructure, people, technology, high performances, quality services along with the giving a base to the concept of customer satisfaction.

SUGGESTIONS

As per the above discussion, we can say that the biggest challenge for banking industry is to serve the mass market of India. Companies have shifted their focus from product to customer. The better we understand our customers, the more successful we will be in meeting their needs. In order to mitigate above mentioned challenges Indian banks must cut their cost of their services. Another aspect to encounter the challenges is product differentiation. Apart from traditional banking services, Indian banks must adopt some product innovation so that they can

Compete in gamut of competition. Technology up gradation is an inevitable aspect to face challenges. The level of consumer awareness is significantly higher as compared to previous years. Now-days they need internet banking, mobile banking and ATM services. Expansion of branch size in order to increase market share

is another tool to combat competitors. Therefore, Indian nationalized and private sector banks must spread their wings towards global markets as some of them have already done it. Indian banks are trustworthy brands in Indian market; therefore, these banks must utilize their brand equity as it is an valuable asset for them.

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