Privatisation of Public Sector Enterprises: A Study of Banking Sector in India

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Abstract

This paper attempts to study how enhancing efficiency and performance of **public sector** enterprises mainly of **banks** comes through ex-ante and ex-post **privatization** performance of the **enterprises**. We have large number of historical facts to show how the feudal lords and aristocrats for maintaining the façade of their power and aristocracy borrowed money from the traders by pledging their property. But this proved to be illusive and eventually they failed to resurrect their pride and prejudice. The manner in which the Modi government has been putting the maharatna and navratna PSUs on sale reminisces the historical facts. The Modi government is in hurry to sale and disinvest the profit making PSUs. It certainly does not augur well for the country and its economy. The most intriguing is why the prime minister is hell bent to cripple these PSUs. They are all profit making bodies. Some PSUs might have turned irrelevant in the prevailing scenario, but it ought to be not forgotten that these have laid the strong foundation for the modern India. It is worth noting that the maharatnas and navratnas have withstood the rigours of the globalisation and liberalisation and continue to earn profit. People would certainly like to know the reasons for their disinvestment and sale.

There always has to be some rational justification. When a company like Bharat Petroleum Corporation Ltd (BPCL) is also being offered for 'strategic disinvestment' along with Shipping Corporation of India and Container Corporation of India, the nation obviously expects to know the reason behind it. A few more PSUs have been selected by the government where its shareholding will be brought to less than 51 per cent. The Indian banking sector is facing a crisis on an unprecedented scale. The problem becomes peculiar when more facts are brought to light. Indian banking sector can be divided into two categories. There are private sector banks, and there are public sector banks. The private sector banks seem to be performing well. However, public sector banks have become a menace. The non-performing assets in these banks are rising at an alarming rate. As a result, the Indian government has announced a $19 billion recapitalization plan. This plan is meant to give the banks some breathing space while they get their finances in order. However, recapitalizing banks does not seem to be working. The recent fiasco at the Punjab National Bank has revealed that the problems facing Indian banking are structural in nature. They cannot be solved using cosmetic measures. The recapitalization of banks may prove to be a potent fix in the short run. However, it will not be long till these same banks find themselves in the middle of another crisis.

Key words enterprises, Indian banking sector, PSUs, Indian government, privatization

Introduction

Disinvestment of Public Sector Undertakings (PSUs) is an avowed policy of the Union government. This has to be done only under the situation when the PSU has been in red, eating into government revenue and failing to produce profit and revenue. But this is certainly not the case with the maharatnas and navratnas. Is it for augmenting the financial resources of the country or simply to help some private sector players? One can comprehend the logic behind divestment of a loss-making PSU but when a Maharatna or Navratna company is being offered to the private sector, what is the lesson to be learnt? Several of 'maharatna' and 'navratna' companies, including ONGC, IOC, GAIL and NTPC, could soon lose their identity and become part of the empire of the private sector. The Finance Ministry is also planning to approach NITI Aayog to prepare yet another list of PSUs where their holding could be brought down to below 51% and also point out which of these could shed the PSU tag and become independently board-run private companies. Many critics have suggested that privatization of banks is the only way that India's public sector banks can be transformed into entities which are commercially viable. They believe that public sector banks should be run by bankers and not bureaucrats is taking root in the psyche of the average Indian. Centre's much-awaited new policy to determine strategic/non-strategic sectors will likely see as many as 16 sectors being identified as 'strategic', virtually covering all conceivable sectors with supposed strategic nature. The government will continue to have at least one public sector company in these sectors. The policy, likely to be unveiled by the end of this month, could also see entry of private players into atomic energy and space sectors, while allowing the sole state-run entities in these sectors – Nuclear Power (atomic energy) and Antrix (space) – to retain their public sector character.

Along with a clutch of other firms, Bharat Heavy Electricals (BHEL) falls under the 'heavy and medium engineering sector', one of the 16 'strategic sectors' identified by the government, where only one firm needs to retain the PSU tag. That implies the new policy doesn't accord any outright exemption to Bhel from privatisation, but the company could still be preserved in the public sector, given its crucial role under the Make in India campaign and its potential as a domestic equipment manufacturer to rein in the cost of power to consumers. The new policy, while not being dramatic in its redefinition of strategic and non-strategic sectors, still offers significant scope for large-scale privatisation and/or consolidation of central PSUs, including several large companies in sectors such as petroleum refining and marketing, crude exploration, power generation, coal and metals. Most of these sectors have more than one PSU, even more than four in some cases.

Currently, there is no clear definition of strategic sector. According to some regulatory purposes, only space and atomic energy are considered strategic while the railways is categorised as sector involving social good, and so eligible to be in the government sector only.

Objective:

This paper intends to explore and analyze nature and implication of **privatising** PSBs especially of banks resulting in more efficient **banking sector**. Based on number of institutional **studies** have made comparisons for the post-liberalisation period of investment in these **sectors**. Which are **private** in character in the **financial sector**

Imposing Morality on Finance

At present there are more than two dozen CPSEs with government stake of less than or close to 60%. .Considering the mammoth infrastructure of PSEs in India, there is a scope for developing start-ups using their unspent resources, a useful starting point for many start-ups. It would be better for India to learn lessons from the experiences of China and Singapore in using PSUs strategically than simply selling them off. It is worth mentioning that even the Bharatiya Mazdoor Sangh (BMS), the trade union arm of the RSS has opposed the government's plan to privatise public sector undertakings (PSUs) which was anti-worker 'unjust decisions'. It also described advisors who have suggested to the government to sell PSUs as 'predatory'. It said the government had "no moral right or authority to sell national assets created by its predecessors". In simple words, this means that poor projects with questionable rates of return are funded by these banks because the system is run by political connections and corruption.

During the 2014-2019 period, the government raised Rs. 2,79,622 crore from the disinvestment of public sector enterprises (PSEs), compared to Rs 1,07,833 crore collected during 2004-14. Recently, five companies were up for 100 per cent disinvestment, including three large profit making companies BPCL, the Container Corporation of India and the Shipping Corporation. The planned disinvestment of these big three is in addition to the proposed 100 per cent sale of Air India, and Industrial Development Bank of India (IDBI). The move towards divesting ownership in strategic sectors will have long term consequences.

Putting on sale the LIC, the largest company in terms of assets, has really come as a shock. It caters to the needs of millions of policyholders. These steps of the government points to some ulterior motives of the policy makers. It would be wrong to view this merely as a part of Nehru bashing mission of Modi and his colleagues. We are consistently fed with the information that PSUs have failed India. But it is not true. A large number of PSUs have been earning huge profit and a simple government push would galvanise them. But ironically the governments are not at all interested to streamline and augment their functioning. An impression is being created by the corporate sector, having blessings of the political establishment that they are burden on the economy of the country. No doubt times have changed and the economy now has other engines of growth, but the PSUs are most dependable for taking care of the strategic sectors of economy.

It is not that the government is simply involved in selling the PSUs, it is already on the mission to withdrawing from health and education sectors, leaving the citizen with almost no choice but to seek costly education and unaffordable healthcare offered by the private sector. The way the government was moving ahead, simply implies that Modi government intends huge amount of cash money in its hands. Centre seems to be more concerned for liquidity than structural adjustment and long-term macroeconomic change.

Privatisation:

- It means migration from the Public to Private Sector through the transfer of ownership, management and control.
- In India, privatisation is aimed at improving the inflow of Foreign Direct Investment (FDI) or investment in sectors that require technological advancements, thereby directly providing a boost to Economy.
- Govt has now announced that all PSUs in non-strategic sectors will be privatized, while in the strategic sector, there will be only one to maximum 4 PSUs fully owned by Govt.
- Rest every PSU in India will be privatized.
- Objective behind PSU Privatisation
- Minimise the administrative cost of the Central Government
- Boost the CPSE Disinvestment programme of the central government

Disinvestment:

Disinvestment, or divestment, refers to the act of a business or government selling or liquidating an asset or subsidiary or the process of dilution of a government's stake in a PSU (Public Sector Undertaking).

Disinvestment indicates only a partial dilution of control by the Govt and still retaining overall ownership of a particular enterprise, whereas privatisation for all purposes signify relinquishing the entire ownership in favour of private parties.

Privatization's experience:

India's attempt at dismantling the PSUs over the years has seen little success, with the last big-ticket privatization taking place between 1999 and 2004.

Since then, most governments have tried to disinvest and privatize. But this has led only to incremental progress, with no big-ticket privatization taking place since then. A good example is Air India, the national carrier that the Centre has repeatedly tried to privatize. However, it has met with limited success.

Stiff opposition from unions, concerns of allegations of graft and criticism of the sale of “family silver” act as major hurdles to the drive for privatization.

A good example of privatization and its effect on the enterprise is Hindustan Zinc. The Atal Bihari Vajpayee-led BJP government sold 45% of Hindustan Zinc for ₹769 crore in 2002. The 30% stake the government retained was valued at over ₹20,000 crore. The company became the world’s second-largest zinc-lead miner and one of the top 10 silver producers. Management change and privatization can thus raise shareholder wealth through improved efficiency. Companies in which Central Government or a CPSE holds 51% stake or direct holding are known as Central public sector enterprises (CPSEs) or Public Sector Units (PSUs).

In India, CPSEs hold key position in sectors like Petroleum, Banks, Coal, Power, Steel and Mining such as SBI in Banking sector; LIC in life insurance; Coal India Limited in coal sector and others. Most PSUs are making losses and are funded by the largesse of taxpayers. The public resources spent on them could be better utilized elsewhere, especially for development.

Selling them can also yield non-tax revenue, which could be used to augment public infrastructure. Moreover, their turnaround by the private sector can generate tax revenue for the government. The Centre has had some success with disinvestment over the years. Of late, most of the disinvestments are funded by the Life Insurance Corporation of India.

The problem in disinvestment is that it does not ensure a change in management of the enterprise. To make PSUs efficient, there is a need to bring in private management that runs it with the aim of maximizing profit.

Thus, privatization is important and disinvestment a second-best alternative that yields revenues for the Centre, but does not improve the condition of the enterprise.

Benefits of Privatization

Bank privatization is likely to provide a lot of different benefits. Some of the most obvious ones are listed below:

Increased Efficiency:

The private sector banks in India are already much more advanced than the public sector banks. Even though the nationalized banks have a large depositor base, they are always playing a game of catch up. This situation is likely to worsen over the years. This is because foreign investments are now being allowed in private sector banks as well. Hence, foreign banks are likely to acquire stakes in some of these banks. They will also introduce some of the operational efficiency that foreign banks are known for, in Indian banks. On the other hand, private sector banks are reeling with loan frauds and so on. The fact of the matter is that these banks are simply not competitive.

Compliance and Risk Mitigation:

Experts in the banking sector are bewildered at the inefficiency displayed at Punjab National Bank. How is it that with the connivance of a few junior level bank officials, a businessman was able to defraud the bank of $1.8 billion? This sort of incident is never reported at banks like Citibank and J.P. Morgan even though they operate in several nations and have more complex operations. Privatization of banks will ensure that they benefit from compliance norms and risk mitigation processes followed at these banks.

Problems Associated With Privatization

At the current moment, it does seem like privatization is the only viable solution. However, that is not the case. There are several problems associated with privatization.

No Buyers:

The Indian banking sector has received some very bad PR in the recent past. The entire world knows that the loan book of these banks is less than optimum. It is also an open secret that had these banks not been backed by the government, most of them would have been bankrupt by now. The balance sheets of these banks show positive equity only because they are in possession of some of the priciest real estate that the government owns. It is obvious that the government would not like to sell its real estate. Hence, the only thing that they would be selling is a banking license with a dysfunctional portfolio. Most analysts in the banking sector are of the opinion that the government would be lucky to find even a single buyer given the state of affairs at these banks.

Worker Unions:

Also, these government banks have a huge payroll. Their employees are considered government employees and cannot be easily sacked. The moment they hear about privatization, it is likely that they will panic. This is likely to start protests and political fights all over the nation. Managing the workforce will be one of the biggest challenges that the Indian government will face if they decide to privatize these ailing banks.

The Narendra Modi government at the Center has accelerated the privatisation process of at least 4 major state-run banks in the country. The government holds a large stake in Punjab and Sindh Bank, Bank of Maharashtra, UCO Bank and IDBI Bank and now wants to sell it. The central government's plan is to privatise many state-owned banks and fund a big budget by selling stakes in some banks. According to a Reuters report, the PMO has asked officials to speed up the process of selling the stake of these banks.The government holds a large stake in Punjab and Sindh Bank, Bank of Maharashtra, UCO Bank and IDBI Bank and now wants to sell it. According to sources, the central government's plan is to privatize many state-owned banks and fund a big budget by selling stakes in some banks.

The reason for this is that the government banks are facing financial crisis due to the decrease in tax collection. A letter was written to the Finance Ministry from the PM office earlier this month, in which these 4 banks in this financial year are said to complete the process of privatization.

The source said that the process of privatization of banks has started and it is being discussed by the government. Although no official information has been given by the government in this regard so far, but in another report recently it was claimed that the government is working on a plan to privatize about half a dozen banks in the country. According to economists, the government wants only 4 to 5 government banks in the country. Currently, there are 12 state-owned banks in India, of which the central government holds more than 51 percent. Apart from this, 47.11% stake is in IDBI Bank. Government insurance company LIC holds a 51 per cent stake in this bank. The government wants to start this process of privatization of banks at a time when the country's major state-run banks are struggling with the NPA crisis. However, the situation regarding privatization process is still not completely clear and the government is constantly discussing in this regard.

Apart from this, some officials have suggested to the government that these banks should be restructured before privatization so that their losses can be reduced. Its privatization government can also offer VRS to additional staff. Under this, such branches in the country and abroad can be closed, which are running in deficit.Apart from banks, Modi government has been planning to privatize larger public entities like railways, Airlines and LIC.The government has been questioned by Congress and labour organizations against the large scale privatization in the country

Privatization in Banking Loan

Commercial banking has traditionally been the backbone of banking. Banking was created to funnel idle resources in households to productive purposes in business. Over the long period of time that banking has been in existence, the nature of products provided to commercial customers has undergone a huge change. Several new types of products have been introduced in response to the changing demand in the marketplace and certain old products have become obsolete. In this article we have listed down the products that are currently offered by banks to their commercial customers.

Industrial Loans

The primary business of commercial banks is to make loans to large industrial corporations. Corporations in any nation are interested in obtaining debt at favorable terms. The bank is in a position to fulfill this demand through the services that they offer.

Although with the evolution of the debt market, the idea of banks as the principal source of debt has become outdated as far as mega corporations are concerned. Mega corporations are in a position to raise funds directly from the markets. This proves cheaper since they do not have to pay an intermediary i.e. the banks. Therefore in the past century or so, banks have seen their primary business declining. To combat this decline, they have created special teams which provide capital market services and assist clients in issuing their debt securities. Banks have centuries of experience regarding dealing in debt markets and hence are in a position to provide their expertise for a fee. Therefore debt market advisory has become one of the major products that banks sell to mega corporations.

Project Finance

Project finance is one type of loan for which mega corporations largely rely on banks till date. In case of project finance, the banker finances the project as an individual entity. The parent company that is sponsoring the project has a limited liability in case the loan goes bad. For instance, if bank funds DEF project that was initiated by ABC Corporation and the project goes bankrupt over time.

In this case, banks only have access to the assets owned by DEF project. ABC Corporation does not have to assume any liability for the losses the bank incurred while financing the project. The project is treated as a separate entity in its own right.

Syndicated Loans

Banks often times combine to make huge syndicated loans to corporations. This is because the debt requirements of a particular corporation, let's say, General Electric may be so huge that any single bank may not be in a position to fulfill them without creating a significant risk on their books. Hence, in such cases, several banks have to form a syndicate to fulfill the loan requirement. One bank may play a lead role in coordinating with other banks and making the funds available to the corporation. Hence, this bank would be called the "lead financier" and would be entitled to a special fee over and above the regular interest that is earned on the loan. Also, the corporation will service the loan i.e. pay the payments to this bank only. It is the lead arranger that will have to create a mechanism to redistribute the monthly payments to the other banks proportionately.

Leasing

With the advent of off balance sheet financing, a lot of companies have started using leasing as a financing method. This is because it provides control of the said asset without leveraging the balance sheet of the given corporation. Banks have become heavily involved in the business of such financial leases. Financial leases are being signed by companies for acquiring real estate, automobiles, factory equipment or such other major fixed assets. It needs to be noted that banks usually only fund financial leases and not pure play operational leases.

Foreign Trade Financing

A lot of the corporations in the world today are multi-nationals. Thus their business interests cross national borders. This means that foreign trade in rampant and has become the norm. Now, foreign trade has some special financing needs. Banks have traditionally specialized in such financing. In the modern world too, banks provide letters of credit, export financing, bank guarantees and other such services to corporations which help them conduct foreign trade in an efficient manner.

Bills of Exchange

Companies often use bills of exchange for accounts receivables and accounts payables purposes. For instance if company A agrees to pay company B at a later date, they could sign a bill of exchange for the same. Company A can then take this bill of exchange to the bank at get the bill discounted. This means that the bank will take over the right to collect receivables from B. They will do so by purchasing the bill at a discount. This means that they will pay company A, a discounted amount for the bill. The difference between the face value of the bill and the discounted price for which the bank bought it is considered to be the interest earned by the bank.

Bills discounting is an important service provided by banks to many commercial corporations. This service helps them streamline their accounts receivable processes. The list provided above is not exhaustive. Banks provide many more services to their commercial customers. For customers that offer a sizeable chunk of business banks may even customize or create new products to meet their requirements.

Conclusion

Indian banking sector was earlier in private hands. However, during the 1970's, the Indian government was of the opinion that banks favor the rich and that the poor must also be given access to cheap credit. With this view, several banks were nationalized. It is a huge irony that the banks which were nationalized based on pro-poor agenda are today facing mounting losses because they have loaned out huge sums of money to the rich without proper diligence.

The present-day Prime Minister of India, Mr. Narendra Modi firmly believes that the job of the government is to govern. He also believes that the government has no business meddling in any other business. That does not seem to have prompted him to privatize the twenty-one public sector banks which are under the control of the government today. These banks account for over 70% of all credit creation in India. Also, since these banks do not ration their credit as per the market mechanism, the government meddling leads to gross malinvestments. The success of privatisation depends on the transparency of the process and the effectiveness of the regulators. A private investor is always too willing to purchase a cheap institution. But at the same time it is scared of the future development. The management is sceptical that a future government which will replace Modi government may create complications for it. While welcoming the private sector, the government should ensure a level playing-field with well-defined rules of the game. Elected governments have an inalienable obligation to reconcile growth with equity. If the growth narrative is going to be overwhelmingly decided by the private sector, governments should necessarily script their own equity narrative.

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