

Chapter 9

Challenges of Disinvestment in Public Sector Banks in India

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ABSTRACT

Both Disinvestment and Privatization process in Public Sector Banks initiated by the then NDA Government came to an end soon after UPA Government took over. The Atal Bihari Vajpayee government had proposed to reduce government holding in state-run banks to 33% but the amendment could not be passed in Parliament as Congress, which was the main Opposition party, blocked the move. Later on Congress party with other partners came to power and even The Ministry of Disinvestment was closed. The recommendations of Disinvestment Commission could not be implemented. For last one decade disinvestment process came to a grinding halt, however, now again there are possibilities that Public Sector Banks may initiate the process again. Privatization process may seem to be a remote possibility at present, however, Disinvestment is on agenda of present government. The Government is now set to reduce shareholding to less than 52% while maintaining ownership but selling additional shares which will infuse more capital to fulfil capital adequacy norms as per Basel III. There are a number of challenges to this process and it is necessary to expedite the process. It is assumed that disinvestment process will make public sector banks more accountable and also efficiency may improve, ultimately pave way for privatization in near future.

INTRODUCTION: WHY DISINVESTMENT?

Disinvestment helps in mobilization of resources for rapid economic growth and makes banks more accountable to public which indirectly improves efficiency. More than 51% shares with public sector banks are said to be a potential source of capital formation in India. With an aim to help public sector banks raise capital, government is considering to reduce its stake up to 52% in a phased manner in these banks, Finance Minister Arun Jaitley in the Rajya Sabha, said that “A proposal for allowing public sector banks (PSBs) to raise capital from public market by diluting Government of India holding up to 52 per cent in phased manner is under consideration.” (PTI, 2014)

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World organizations have time and again warned inefficiency of state controlled banking in India and suggested to reduce shareholding. “The World Bank feels that Indian Banking system remains a massively inefficient state controlled system and not competitive. It has desired that public ownership in public sector banks be gradually reduced.” (G., 2001)

The highest monetary authority in India, Reserve Bank Of India and its Dy. Governor opined that, “Unless the public sector banks are privatized, the Indian banking system will remain a public sector banking system. At the present time, public sector banking system operates like a Monolith, if the Indian system is to become modern efficient system, which is internationally competitive, it is essential that the Monolith should crack.” (Tarapore. S.S, 1998). Accordingly, “The then Government had decided to accept the recommendations of the Narasimham Committee on Banking Sector Reforms for reducing the requirement of Minimum Shareholding by the nationalized banks to 33 per cent” (Rajeev, 2005)

Many Governments, particularly Congress led coalition had different opinion on issue of privatization or disinvestment of nationalized banks in India. The then Finance Minister (P.Chidambaram),rightly remarked in a statement that, while the government was willing to reduce its shareholding in public sector banks to 33 per cent, the basic public sector character of these banks would not be compromised. No single entity would be able to corner a major chunk of the shares. What we are saying is that earlier the then government thought of capitalization of the banks and we pumped in over Rs.200 billion to recapitalize these banks in 1993.But we also amended the Banking Nationalization Act to bring the equity so far as the State Bank of India is concerned. Now there are many banks that are coming to us for recapitalization. I have no hesitation in admitting that I am not in a position to give them any money today because I do not have the money to give. Then how do the banks recapitalize? They go to the market and recapitalize; they raise money from the market.” (Nagraj, 1999)

The reduction of government share in equity capital of PSBs to 52 per cent will enable mobilisation of Rs 89,120 Crore approx. on the basis of current market price on November 21.” There are about two dozen PSBs and government holding in them is from 56.26% to 88.63%. Public sector banks require equity capital of Rs 2.4 lakh crore by 2018 to meet Basel III norms.

Over the next five years, India’s public sector banks could face a major shortage of capital. A recent Reserve Bank of India (RBI) committee looking into the governance of public sector banks has forecast that the state-owned banks require anywhere between Rs 2,10,000 crore and Rs 5,87,000 crore by 2018, depending on how fast their loans to corporates, individuals and farmers grow and to what extent those loans turn into non-performing assets, thus requiring them to be written off. Investment banks have their own estimates — Morgan Stanley, for instance, estimates that the banks will require about Rs 2,98,300 crore by 2019. (Celestine, 2014)

Banks will require the capital for reasons best known in financial circles. It is to fund growth in loans. For each loan they have to set aside a proportion of capital. An economic revival will bring in its wake strong demand for loans for investment, and it’s in the government’s own interest that banks are in a position to make those loans and have that enhanced amount of capital on hand. In fact public sector banks need more capital to write off non-performing assets also to ensure greater transparency in their financial statements.

Public sector banks, which have weaker internal controls and face political pressures to a greater degree than their private sector counterparts, consequently have steeper bad loan problems, too. Finally, banks will need greater funds to implement new norms relating to how to account for loans and how much capital they need to set aside for different categories of loans. Raising these funds, though, will require several steps, apart from legislative changes. Attracting private capital into public sector banks will need

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