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Bank Privatisation

Why, How, When?

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There is a buzz in the air about privatisation of some of the public sector banks (PSBs). There has been talk of privatising Industrial Development Bank of India (IDBI Bank) in financial year (FY) 2020–21. Of the disinvestment target for the year of Rs 2.1 trillion, Rs 90 billion was to have come from stake sale in Life Insurance Corporation of India (LIC) and the privatisation of IDBI Bank.

The media has also reported proposals to privatise PSBs that were not part of the mega-mergers announced earlier this year, namely Punjab and Sind Bank, Bank of Maharashtra, UCO Bank, Bank of India, Indian Overseas Bank and Central Bank of India.

Then, a decision is awaited on whether banking should be designated as a "strategic" sector. If it is, then there can be a maximum of four PSBs in banking. The rest will have to be consolidated or privatised.

The government has not provided any rationale for the proposed privatisation of PSBs. There is a presumption that privatising PSBs will be good for the economy, meaning private ownership is to be preferred to public ownership.

Performance of Banks

In the public discourse, one hears two arguments in favour of privatisation. The PSBs have underperformed private banks by a wide margin over the years. So, privatising PSBs will mean a more efficient banking sector. Two, the PSBs run up large amounts of bad loans from time to time and, hence, make unending demands for capital for the government. Privatising them is necessary in order to contain the demands for capital on the government. Let us take up these arguments in turn.

Wishing You a
Happy New Year
and
Pongal Harvest
Festival

Most comparisons of PSB and private bank performance look at a snapshot of a small period, at times of just one year. They compare PSB and private bank numbers on standard metrics—return on assets, net interest margin, non-performing asset (NPA)/total loans, etc—and come to the conclusion that private banks (or new private banks) fare better.

A rigorous comparison of performance would cover longer periods. It would also examine whether differences between the two ownership categories are statistically significant. A number of academic studies have made such comparisons for the post-liberalisation period. These studies mostly point to a trend towards convergence in performance in the post-liberalisation period and up to the early 2000s (Ram Mohan 2014).

The divergence in performance has happened in the last decade, 2010–20, that is, after the global financial crisis (GFC). In 2010, the gross NPAs/gross advances ratio was 2.3% at PSBs and 3% at private banks. By March 2020, the position had changed dramatically: the respective numbers were 11.3% and 4.2%. The change may be ascribed to the boom in PSB lending in the run-up to the GFC of 2007–08. A high proportion of the loans that PSBs made in that period has gone bad. It could be argued that this points to poor loan underwriting and risk management at PSBs.

The reality is a little more complex. The boom in lending before the GFC was the result of lending to infrastructure (power and telecom) and related sectors, namely mining, iron and steel, textiles and aviation. These five sectors accounted for 29% of all advances at PSBs and 14% of advances at private banks. Investment in these sectors was mostly private in character and it accounted for the economic boom of 2004–08. Private investment substituted for government investment in these sectors, given the financing constraints faced by the government.

If private investment in infrastructure goes bad and PSBs face NPAs as a result, the government has to duly recapitalise PSBs. Such recapitalisation needs to be seen as deferred government spending on infrastructure, a sector that has significant externalities.

The bad loan problem at PSBs cannot be ascribed entirely to poor appraisal or risk management. In the global economic boom that preceded the GFC, there was a rush to invest and bankers everywhere too got carried along. Following the GFC, cash flows of corporates turned out to be much lower than anticipated, and this was duly reflected in a rise in NPAs. As the *Economic Survey of 2016–17* noted,

> *the vast bulk of the problem has been caused by unexpected changes in the economic environment: timetables, exchange rates, and growth rate assumptions going wrong.*

Other factors beyond the control of management contributed:

(i) The mining sector was affected by adverse court judgments.

(ii) Steel was affected by dumping by China and the absence of reliable fuel linkages.

(iii) Power projects and roads faced delays in land acquisition and environmental clearances.

(iv) The telecom sector was adversely affected by the cancellation of 2G licences.

In short, there was an improvement in the performance of PSBs until about 2010. Thereafter, there was a deterioration on account of the GFC, other extraneous shocks, and the fact that PSBs had taken the lead in financing key

sectors of the economy. These facts point to a possible conclusion: PSBs as a category cannot be said to be chronic under-performers or incapable of reform. It is important also to recognise that, amongst PSBs, there are disparities in performance among PSBs and that generalisations about PSB as a category can be misleading.

Let us turn to the second argument for privatisation, namely the inability of the government to keep pouring funds into PSBs.

Newspapers carry screaming headlines about the capital required by PSBs. These headlines can be misleading. They indicate not the equity capital that the government needs to put in, but the total requirement of equity (from the government as well as private investors) and bonds. The rating agency, Moody's, estimates that PSBs will need around ₹2 lakh crore of capital over the next two years, or about ₹1 lakh crore in each of the next two years. This translates into ₹50,000 crore of equity capital, of which approximately half or ₹25,000 crore must come from the government. The correct figure to look at is ₹25,000 crore and not the headline figure of ₹2 lakh crore. The requirement of ₹25,000 crore does not seem prohibitively large, given that the government has already allocated ₹20,000 crore towards PSB recapitalisation in FY 2020–21.

Critics say that since 2010, the government has pumped in over ₹4 trillion into PSBs. The amount could have been deployed for other purposes. They overlook the fact that governments everywhere have stepped in to rescue private banks as well. In 2008 and 2009, the United Kingdom (UK) government had to infuse £45 billion (about ₹4,50,000 crore) to rescue the Royal Bank of Scotland. This amount nearly equals the amount spent by India on recapitalising PSBs since the commencement of liberalisation.

The Vickers Commission in the UK estimated that financial crises impose a cost of 19%–163% of the gross domestic product (GDP), with a median cost of 63% (Vickers Commission 2011). These are costs imposed by private banking systems. The commission reckoned that if a banking crisis happened once in 20 years, the annual cost would be 3% of the GDP. So, it was worth spending 3% of GDP every year in order to prevent a crisis. India's cumulative recapitalisation cost over the post-liberalisation period of nearly 25 years would be a little over 3% of the GDP!

The notion that public sector banking systems make endless demands on the exchequer and that these demands somehow would not happen in private banking systems is a sheer delusion. The way banks are designed today, banking systems impose a cost on the exchequer quite independently of ownership. And it is the taxpayer who ends up picking up the costs even under private ownership.

So much for the "why" of bank privatisation. Next, we need to address the "how" of it. We need to judge how feasible privatisation of PSBs is in our conditions. One option is to sell a controlling stake to a private entity in India. Within the financial sector, there are not many entities that have the deep pockets to buy PSBs. Many of the leading private banks have large branch networks of their own and do not need to buy PSBs in order to extend their reach. The potential buyers of PSBs are corporate houses that are keen to enter banking.

An internal working group (IWG) of the Reserve Bank of India (RBI) has, in a recent report, raised the possibility of corporate houses entering banks. These include corporate houses that already own non-banking financial companies (NBFCs). However, the entry of corporate houses bristles with conflicts of interest, including

interconnected lending. The IWG has said that the Banking Regulation Act must be amended to give the RBI adequate scope to track interconnected lending and to supervise conglomerates that may enter banking. Given the risks to financial stability, the sale of PSBs to corporate houses does not commend itself, nor is the RBI likely to rush into this territory.

A second possibility is for the government to let its equity stakes in PSBs drop below 50%. This can happen through the sale of the government stake or by the issue of fresh capital to which the government does not subscribe. This is the Axis Bank model advocated by the P J Nayak Committee (Nayak 2014).

Those who advocate this route say that the dropping the government's stake in PSBs below 50% would free them from constraints on executive compensation as well as the purview of the Central Vigilance Commission. Bank managers would be better placed to take risks in lending and would be suitably rewarded for doing so. The government would reduce itself to a passive owner and leave it to boards of PSBs to manage the entities.

There is a problem with this approach. India lacks a culture of professionally managed firms accountable to institutional shareholders. The leading firms that we have are overwhelmingly promoter-managed. The promoter is either the government or a corporate house. If neither is present in a bank, the responsibility for monitoring managers falls entirely on the boards.

Performance of Boards

The performance of the boards fails to inspire confidence even in advanced economies where institutional investors are relatively active. It is unrealistic to expect much of boards in a context such as ours where institutional investors are seldom as active. Boards in India have failed to prevent failure, as at Global Trust Bank or Yes Bank. The board was found wanting even at a leading bank such as ICICI Bank. At Axis Bank, the change to passive ownership by the government happened when the bank was relatively small in size. We lack the confidence to entrust PSBs, in general, to professionally managed boards. At best, we could experiment with this approach in the case of two or three PSBs and watch how things pan out over four or five years.

The last question relates to the "when" of privatisation. The timing of the sale of public assets is important if the government is to realise the best price. Today, most of the PSBs are trading below book value, thanks to the overhang of NPAs. Selling PSBs at distress prices will not only spell poor revenues for the government, it is very likely to raise allegations of a "scam" that will paralyse all decision-making related to PSBs. At the very least, the government should wait for the economy to recover from the impact of the pandemic. That would give PSBs some time to address their NPA problem and improve their valuations.

Whichever way you look at it, any large-scale privatisation of PSBs appears fraught. In the medium term, there is little alternative to improving governance at PSBs. This requires steps that are by now well-known: getting top appointments at PSBs right and on time, providing adequate tenure to chief executive officers, giving directions to the PSB management through government nominees on the board and not directly from the Department of Financial Services and ensuring that independent directors on PSB boards are of good quality. The good news is that some progress on these has already happened. It needs to be continued.

IBOA (TN&P) EXECUTIVE COMMITTEE MEETING HELD ON 20.12.2020

(Through Video Conference)

The Executive Committee meeting of our association was held on 20 12 2020 (Through Video Conference) at 11.00 AM to review the issues relating to our officers and also the Industry level issues .

The meeting was presided over by Com S Mohanraj, President of our Association. In his opening remarks he briefed on conclusion of Salary Revision, Government's proposals for privatising some of the PSBs and the issues faced by the officers at the field level etc.,

After the Presidential address, General Secretary Com R Sekaran requested the committee members to observe a minute of silence to pay tribute for the great personalities and our colleagues who passed away during this period. Then he narrated on the impact of pandemic on the economy and livelihood of people, especially the poor, briefed on the journey of salary revision that witnessed series of struggles and efforts of the association and solidarity of members from the day of handing over the charter of demand to the day of signing ceremony. He also narrated on the Bank level issues and Industry level issues and ensuing General Council of AIBOC at Kolkata, the status of Association's Land disposal etc.,

Then the President requested the members to deliberate on the issues of the members and other related issues. The following were the broad areas the members deliberated upon.

- **Inadequate manpower in the branches of Chennai, Kancheepuram, Cuddalore and Kumbakonam Zones**
- **The need for improvements in Furniture Policy in quantum and change in depreciation percentage etc.,**
- **Scrapping of CIBIL score for staff loans.**
- **Late sitting at some of the RMPCs and Zonal Offices.**
- **shortcomings in the functioning of RMPC and CAPC which leads to dissatisfaction of customer at Branch level.**
- **Branches are being asked to re-lend to the OTS settled KCC account holders.**
- **High level customer dissatisfaction due to TDS on cash withdrawal, which was introduced without any prior warning/information to the customers.**
- **Severe problems faced by the branches due to threshold limit issues and the need for a comprehensive guidelines from the Bank in this regard.**
- **Continuous tele-calls from the administrative offices which is very much disruptive to the Branch functioning and performance.**
- **Reduction of Staff Housing Loan Interest Rate.**

- **Provisional confirmation to be given to Probationary Officers on completion of 6 months which would help them to avail benefits available to the confirmed officers.**
- **Issues faced from Heritage TPA in cashless treatment.**
- **Explanation called under section 19(2) for not reaching the target.**

After the deliberations, Com R Sekaran, General Secretary spoke on all the points raised by the members and assured to escalate to the Management. With regard to issues raised in the functioning of RMPC and CAPC, he sought a detailed write up from the committee to take up with the Bank Management to reduce difficulties for the customers. He also informed the house that shortly Zonal Consultative Committee Meetings will be commenced where the zonal level issues will be taken up for resolution.

The following proposals for co-option were placed before the committee and unanimously approved.

Name	Position	Branch/Zone
Kalitheerthan A	Deputy General Secretary	West Mambalam
Thiagarajan V S	Vice President	Thousand Lights
Santhanam V	Vice President	Srirangam
Sakthivel V	Secretary	CO:ITD
Umapathy R	Secretary (VTKP)	SCSVMV BR, Enathur
Patrick Suresh P	Zonal Secretary, Coimbatore	Lawly Road
Manoharan M	Zonal Secretary, Trichy	ZO: Trichy
Mahendra Prabhu	Zonal Secretary, Madurai	High Court Branch, Madurai
Ranjith Kumar	Zonal Secretary, Puducherry	Marakkanam
Senthilnathan S	Zonal Secretary, Kancheepuram	Sankara Mutt
Vilvam Praveen Kumar	Zonal Secretary, Poonamallee	Maduravoyal
Thanigaivel M S	Committee Member	Podaturpet
Prabhu Raj D	Committee Member	Gnanaolipuram
Guru G	Committee Member	Thuverankurichi
Dinesh S	Committee Member	ZO:Puducherry
Vignesh Jayaraman Pasupati	Committee Member	ZO:Chennai North
Vigirtheeswaran G T	Committee Member	Corporate Office, Accounts Department
Bharathiraja R	Committee Member	Corporate Office, Marketing Department
Saravana Gandhi N	Committee Member	Tirunelveli Junction
Vigneshwaran C	Committee Member	ZO: Chennai South

The meeting concluded after transacting all the listed items.

Retirements

Sl.No.	NAME	DESIGNATION	BRANCH
1	Com UDAY KUMAR S	Dy. General Manager	IC Bengaluru
2	Com UMA D	Asst. General Manager	Corporate Office
3	Com SUBRAMANI M	Asst. General Manager	Fgm Office, Coimbatore
4	Com SELVAM K	Chief Manager	Corporate Office
5	Com ARUP KUMAR BANERJEE	Chief Manager	Fgm Office, Kolkata
6	Com BHUMIDHAR BARO	Senior Manager	Beltola
7	Com CHANDRASEKARAN S	Senior Manager	IC: Chennai
8	Com RAFIZUDDIN S K	Senior Manager	Zonal Office : kolkata I
9	Com KUNNETH SURESH	Senior Manager	Mahe
10	Com UDAY PRAKASH GUPTA	Senior Manager	Zonal Office : Ranchi
11	Com SATYENDRA K SINGH	Manager	Kanpur
12	Com SHASHIKANT NAMDEO ADHIKAR	Manager	Zonal Office : Mumbai West
13	Com VENKADESWARAN G	Asst. Manager	Rmpc Coimbatore
14	Com SANTANU BANERJEE	Asst. Manager	Kolkata Zonal Office S
15	Com SUBIR BASAK	Asst. Manager	Jalpaiguri
16	Com IYER CHANDRA GOPALAKRISHN	Asst. Manager	Nallasopara
17	Com ANTHONY T	Asst. Manager	East Abhiramapuram
18	Com RANABIR BHATTACHARJEE	Asst. Manager	Zonal Office : Guwahati
19	Com SWAMINATHAN V	Asst. Manager	Agarapodakudy
20	Com JAYARAJ J	Asst. Manager	Lawspet

AIIBOA Wishes the above Comrades a Very Happy, Healthy and Peaceful Retired Life.

Retirement

Important Events in Banking - 2020

Month	Event
January	RBI had allowed a one-time restructuring of existing loans to MSMEs
February	Budget has increased the deposit insurance cover to ₹5 lakh from the existing ₹1 lakh.
March	The RBI placing restrictions on the withdrawal of deposits from YES Bank at ₹50,000
March	YES Bank rescue plan - SBI and other lenders infuse Rs.10000 crore capital into the Bank
March	Insolvency Bankruptcy Code- Threshold has been increased to Rs.1 crore
March	RBI slashes REPO rate and unleashes other tools to tackle COVID
April	Despite Corona virus lockdown, merger of 10 PSU banks come into effect from 1st April.
April	RBI announces 3 month moratorium on payment of instalments on Term Loan
May	Government notified Rs. 3 lakh crore emergency credit line for MSMEs
May	Government announced blanket 1 year ban on fresh insolvency under IBC
May	RBI cuts REPO rate and extension of moratorium on loans by another 3 months.
June	Bankers as COVID warriors are with their customers to meet their banking needs and more
June	Interest rate on Bank deposits and small savings reaches multi decade low level
June	PIL has been filed in the Supreme Court that Interest should not be charged during the moratorium period
October	Centre appointed Shri. Dinesh Kumar Khara as new Chairman of SBI
October	Government filed affidavit in SC promosing interest compounding relief for 6 month moratorium period to mitigate the COVID effects
October	Equitas Small Finance Bank IPO subscription open
November	RBI proposed a scheme of amalgamation of LVB with DBS Bank India
November	RBI internal working group for Bank Licence to Corporates
November	11th Bi partite settlement / 8th Joint Note on Officers wage Revision concluded.