RECAPITALIZATION OF PSB

By Avinash Singh

To tackle the problem of NPA’s and poor lending by public sector banks Govt. will infuse fresh funds into banking system –Rs. 2.1 lakh crore capital from which Rs. 1.35 lakh crore would come from recapitalization bonds. Infusion of additional capital by govt. to PSBs is the "Recapitalization".

Whenever an organization is going through troubled times, it's the responsibility of its major stakeholders/owners to sort out those issues and to make it run smooth without incurring loses. For this, sometimes structural changes are needed, sometimes policy changes required, and sometime extra capital is necessary to offset the losses and put on right track.
Since Govt. of India is the major stakeholder of Public Sector Banks (PSB), it's government's responsibility to infuse extra capital in order to overcome the difficulties faced by these PSBs

What is the Twin Balance Sheet Problem of India?
Twin Balance Sheet Problem (TBS) deals with two balance sheet problems. One with Indian companies and the other with Indian Banks. TBS is two two-fold problem for Indian economy which deals with:
� Overleveraged companies – Debt accumulation on companies is very high and thus they are unable to pay interest payments on loans.
� Bad-loan-encumbered-banks – Non Performing Assets (NPA) of the banks is 9% for the total banking system of India. It is as high as 12.1% for Public Sector Banks. As companies fail to pay back principal or interest, banks are also in trouble.

What is the source of funds for Recapitalization by government?

� Of the ₹2.11 trillion package, ₹1.35 trillion will be towards issue of recapitalisation bonds. PSBs will subscribe to these bonds. The government will plough back the funds into banks as equity.
� Another ₹180 billion will be provided as budgetary support.
� The remaining ₹580 billion will be raised from the market.

It is believed that the package should enable banks to provide adequately for NPAs and support modest loan growth. Once PSBs have enough capital, they can liquidate excess holding of government securities and use the cash to make more loans.

Indian PSBs: NPAs and capital needed

Higher cost, lower revenues, greater financial costs-all squeezed corporate cash flow leading to NPAs in the banking sector.
� 'Capital' is a combination of equity, equity-like instruments and bonds.
� For a given balance sheet, there is a certain minimum of capital that banks must hold. This is called 'capital adequacy'. The higher the capital is above the regulatory minimum, the greater the freedom banks have to make loans. The closer bank capital is to the minimum, the less inclined banks are to lend. If capital falls below the regulatory minimum, banks cannot lend or face restrictions on lending.
� When loans go bad and turn into non-performing assets (NPAs), banks have to make provisions for potential losses. This tends to erode bank capital and put the brakes on loan growth.
� 'Stressed advances' (which represent non-performing loans as well as restructured loans) have risen from a little over 10% in 2012-13 to 15% in 2016-17. This has caused capital adequacy at PSBs to fall.
In this context, for bailing out of stressed Banks, the role recapitalization is very significant.

> "The overall package of PSU bank recapitalisation is expected to kick-start the credit cycle, especially to small and medium enterprises, reviving stalled private investments and creating jobs in the medium to long term. However, the regulators and the government should back this up with a series of structural reforms around governance in banks."
>
> **Abizer Diwanji**
> Partner and National Leader - Financial Services, EY India

EY
Building a better working world

Other measures to revive banks

� Public Sector Bank chiefs and their managing/executive directors must have a fixed tenure of at least five years.
� Performance based incentives
� The banking boards need to be manned by professional directors rather than political nominees.
� Appointment of statutory auditors
� We need to pick NPAs from PSBs of each sector, park them in one place by creating an entity like a SUUTI (specified undertaking of the Unit Trust of India), fund the banks and invite international and national investors to dispose of the assets.

Conclusion

� In the last three years, banks have written off ₹1,88,287 crore. We have to bear in mind that when banks lose money or when the government recapitalise PSBs, it is all people's money and out of public savings kept in trust in the banks. People's money should be for people's welfare and not to fund corporate default or to recapitalise the banks to adjust these bad loans.

� This capital infusion is a welcome step but there are issues that should have been dealt with first. The good part is that after putting this capital, the government's equity would be close to 70-80% in each PSB. The government could make a huge profit by selling this equity after improving the management of PSBs.

� Recapitalisation could give the banking system a good breathing time to enhance its credit portfolio and restore value out of the NPA accounts.