RECAPITALIZATION OF PUBLIC SECTOR BANKS

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ABSTRACT

Banks act as major role players in the functioning of a financial system in the economy. The growing NPA of Public Sector Banks in India over the period of time has led to the major reform action of recapitalizing these banks by the government. Besides that, the banks must have to adopt the differentiated business strategies and exit from non-core businesses and focus on their core competencies for their growth and revival in the upcoming years. The main aim of this research paper is to highlight the steps taken by the government of India on account of Recapitalization of PSB's and the projected implications of these steps in the long run.

Index terms: Public Sector Banks, Recapitalization, Non Performing Assets.

I. INTRODUCTION

Banks act as an agent for financial intermediation that allows mobilization of surplus funds to the deficit sector of the economy and holds a great importance to the activities within the economy. Thus, a well functioning financial system is crucial aspect for the development of an economy. Recapitalization is a term used for any change in a company's long-term financing mix. Recapitalization involves a major change in the funding structure of a bank, either through issuing new shares or getting loan from government. This improves the banks' bank balance and prevents them from going bust [1]. Loan funding would not solve the purpose though the bank can only improve its liquidity, but at the same time the liability to pay it back stands still.

According to the Economic Survey 2015, Indian banks have been facing a lot of problems on account of policy issues, involving the issues related to SLR and private sector's lending policies, and structural issues, involving the rise of NPA's and lack of diverse funding sources for infrastructure. To resolve these issues, Mission Indradhanush, a 7-pronged plan has been launched by the Government of India to boost up the functioning of Public Sector Banks to enable them to compete with the private sector banks.

The 7 reforms taken up besides appointments, Banks board bureau, de-stressing, empowerment framework of Accountability and Governance, also include Capitalization. In a move that will help PSU banks deal with their NPA problem, the government, on 24th October 2017, announced to take a bold step to infuse ₹ 2.11 lakh crore in PSU banks enabling them to write off their bad debts and improve their capital position. Of this, ₹ 1.35 trillion will come from the sale of so-called recapitalization bonds and the remaining ₹ 76,000 crore will be through budgetary allocation and fund-raising from the markets.

Another concern with recapitalization is to restore confidence. If people have confidence deposits are secure, they won't want to withdraw them. But, if they feel bank may go bankrupt then they will want to withdraw money. A recapitalization can assure depositors their savings are safe – preventing a bank run.

II. MAJOR HIGHLIGHTS

Following are the things to be known about recapitalization of PSU banks:

1. The government proposed to infuse ₹ 2.11 lakh-crore to before March 31 to boost lending and to revive growth by recapitalizing the public sector banks over the period of two years, 2017-18 and 2018-19. The recapitalisation of banks worth ₹ 2.11 lakh crores has been proposed to be done in three ways: Budgetary allocations: ₹ 18000 crore; Raised from the market through the issue of equity shares by banks: ₹ 58000 crore and Issue of Recapitalisation bonds by the Government: ₹ 1.35 lakh crore.
2. The finance ministry has not decided the structure in which the bonds will be issued but the banks are expected to buy the bonds themselves.
3. Till now, an amount of ₹ 88,139 crore has been induced by the government in 20 Public Sector Banks, out of which 80,000 crore has been allocated through recapitalization bonds and another ₹ 8,139 crore from the Budget to recapitalise the banks.
4. The banking sector in India is staring at 10 lakh crore worth non-performing loans, which pose a major hindrance in the lending capability of banks. Public sector banks account for the bulk of the non-performing assets (NPAs) [11].

5. IDBI Bank, the lender with the highest stressed-loan ratio, will get the biggest chunk of the money of ₹ 10,610 crore. Top lender State Bank of India (SBI) will get receive ₹ 8,800 crore, while second-biggest Punjab National Bank (PNB) will get ₹ 5,473 crore[11].
6. Indian Bank was the only bank that hadn't been allocated any capital till now, being a profitable lender.
7. Here is the list of 20 PSU banks and their capital infusion

IDBI Bank Ltd: ₹ 10,610 crore

State Bank of India: ₹ 8,800 crore

Bank of India: ₹ 9,232 crore

UCO Bank: ₹ 6,507 crore

Punjab National Bank: ₹ 5,473 crore

Bank of Baroda: ₹ 5,375 crore

Central Bank of India: ₹ 5,158 crore

Canara Bank: ₹ 4,865 crore

Indian Overseas Bank: ₹ 4,694 crore

Union Bank of India: ₹ 4,524 crore

Oriental Bank of Commerce: ₹ 3,571 crore

Dena Bank: ₹ 3,045 crore

Bank of Maharashtra: ₹ 3,173 crore

United Bank of India: ₹ 2,634 crore

Corporation Bank: ₹ 2,187 crore

Syndicate Bank: ₹ 2,839 crore

Andhra Bank: ₹ 1,890 crore

Allahabad Bank: ₹ 1,500 crore

Punjab and Sind Bank: ₹ 785 crore

This is not for the first time that recapitalization has taken place in India. Following data shows the amount recapitalized in Public Sector Banks over the period of time:

Financial Year	Recapitalization Amount (₹ in crores)	Financial Year	Recapitalization Amount (₹ in crores)
1985-86 to 1992-93	4,000	2007-08	-
1993-94	5,700	2008-09	1,900
1994-95	4,363	2009-10	1,200
1995-96	850	2010-11	20,117
1996-97	1,509	2011-12	12,000
1997-98	2,700	2012-13	12,517
1999-2000	400	2013-14	14,000
2000-01	-	2014-15	6,990
2001-02	-	2015-16	25,000
2002-03	1,300	2016-17	25,000
2003-04	770	2017-18	2,11,000
2004-05	-	2015-16	25,000
2005-06	-	2016-17	25,000
2006-07	500	2017-18	2,11,000

Source: http://www.livemint.com/Opinion/yMw0G0hbU1Ry6RRwjTIAGP/What-bank-recapitalisation-means.html

In the past 31 years, between 1985-86 and 2016-17, the government had infused much less, some ₹ 1.5 trillion in state-owned banks. This puts in place the enormity of the latest bank recapitalization plan. What is interesting is the present government and the Reserve Bank of India (RBI) do not want to treat this as a benefit, as was in the past; they seem to be keen that banking reforms and recapitalisation must go hand in hand. The process and the basis followed in the first two decades of bank recapitalization is not clear, but in the period between 2008-09 and 2016-17 when the government infused cumulatively ₹ 1,18,724 crore in PSBs, money was there for the asking. Neither linked to the banks' performance nor efficiency, it has been a classic story of ad-hocism and absence of any accountable policy guidelines [17].

III. IMPLICATIONS

1. Because of being a cash neutral transaction, fiscal deficit will not be affected much as the government has to bear only the interest cost every year, which can be around ₹ 9,500 crores per year. Though it will increase the debt/GDP ratio (which is already very high) to the extent of issue of bonds and thus increase in repayment obligations.

2. The banks can anytime sell these bonds in the market, raise cash and can use it for lending purposes, whenever they are in need of liquidity. For the present time being in force, the banks can show these bonds as assets in their balance sheet as a part of investment portfolio and can earn interest for the same.

3. However, all the powers won't be vested with the banks, rather it is assumed that the government will put some restrictions on the banks regarding the marketability of these bonds and they won't be allowed to sell all these bonds at a time.

4. No SLR status, HTM (Hold To Maturity) limit dispensation and limited marketability is the most ideal situation as it will reduce bond supply in the market while keeping the demand for SLR bonds intact [13].

   Thus it can be said that it is not a bad news for the bond market as besides the interest cost, there is not much effect on fiscal. But potentially it is a matter of concern, as more bonds will be added in the investment portfolio, which the banks can sell to increase their liquidity. Bond yield will ascend a bit, leading to an overall focus on fiscal situation ultimately.

IV. CONCLUSION

The quantum of recapitalization is a positive surprise and matches estimates of capital requirements for public sector banks for both NPA provisioning and some growth. With recapitalization, the government wanted to boost up the banking sector, since NPA was increasing quarterly and the market was very bearish in the last year because of demonetization, GST and slashing of the rates of properties due to the RERA act [1]. While the current measures will take time to show effect, the medium and long term will be a showcase of the positive impact of these announcements. The government now needs to follow through with reforms aimed at public sector banks. The need of hour is that Banks must have to adopt the differentiated business strategies and exit from non-core businesses and focus on their core competencies for their growth and revival in the upcoming years. Moreover these lenders must adopt some reforms to strengthen the regulation practices and enhance financial stability.

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