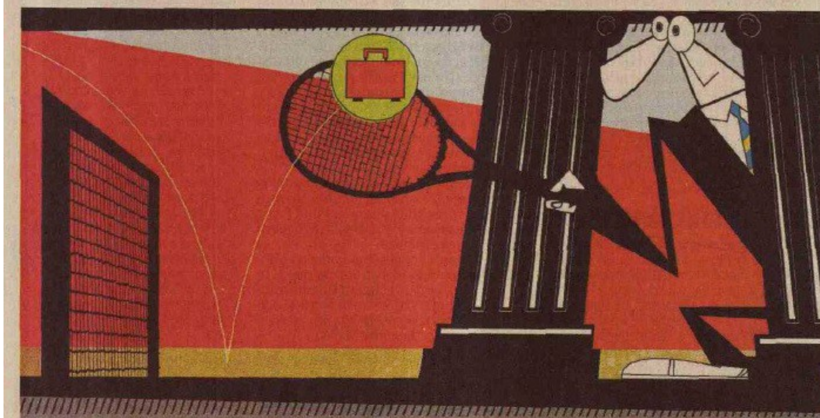
JAITLEY THROWS BALL INTO BANKS' COURT

No Pain, No Gain

PSU Banks' Moment of Truth

With a meagre ₹10k cr allocation, lenders are in for a tough time as asset quality is on a steady decline and mitigating factors like Sarfaesi, loan rejig, securitisation fail to fire up, writes Atmadip Ray



ANIRBAN BORA

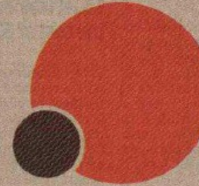
Capital Allocation Programme under Indradhanush

2015 -16
₹25,000 cr

2016 -17
₹25,000 cr

2017 -18
₹10,000 cr

2018 -19
₹10,000 cr



Source: finance ministry

Performance Metrics of Different Banking Groups

	RETURN ON ASSETS		RETURN ON EQUITY	
BANK GROUP	2014-15	2015-16	2014-15	2015-16
Public Sector	0.46	-0.20	7.76	-3.47
Private Sector	1.68	1.50	15.74	13.81
Foreign Banks	1.84	1.45	10.24	8.00
All SCBs	0.81	0.31	10.42	3.59

Source: RBI

Gross NPA ratio as on March-end

2012 3.10
2013 3.20
2014 3.80
2015 4.80
2016 8.40

If at all there was a blunt message for anyone in the Union Budget, it was for state-run banks – no more doles.

After setting financial parameters to achieve with his Indradhanush in August 2015 on infusion of fresh capital, finance minister Arun Jaitley has sanctioned just ₹10,000 crore for banks shows his resolve to see results from banks before opening his purse strings.

For a segment that needs at least ₹75,000 crore in the next two years as estimated by ratings company India Ratings, the sanctioned amount is just a drop in the ocean which may not be sufficient to fund the economic growth aspirations. And it is not going to be easy for these banks to raise funds from the market unlike their private peers.

"The government should have focused much more on additional recapitalisation of state-owned banks, which is crucial for the growth of economy and infrastructure sector," says Ramesh Bawa, managing director at IL&FS Financial Services.

Jaitley's sanctions should not have shocked at all given that the finance ministry's thought process was articulated by Chief Economic Advisor Arvind Subramanian in his Economic Survey a day earlier.

The thought process in the government seems to be that if you keep pouring capital into banks without them stepping on the gas on recovery, for whatever reasons, it was just going into a black hole.

"Recapitalisation, for all its importance and attention received in public discourse, is not the need of the hour," says Subramanian. "Not the main need at any rate. If the government promises unduly large funds in advance, the banks may grant excessive debt reductions." But if banks do not receive sufficient assurance on funding, they will not be able to grant companies enough debt relief.

While the government may have been recapitalising banks more than what it promised, there seems to be a growing feeling that the banks are not doing enough on recovery. Any tightening in recapitalisation may make them go after the defaulters and ensure that evergreening of loans do not happen with innumerable restructuring schemes.

"Asset quality improvement will be the single most important factor, especially for PSU banks. They need to expedite NPA resolution and make their credit appraisal and governance structure robust to get the benefits of reform measures," said Naresh Makhijani, partner and head of financial services, KPMG in India. "Recapitalisation is equally important at this juncture."

Despite liberal restructuring plans from the RBI, banks were not able to lift many companies out of debt trap as projects have become unviable and the debt-to-equity structures are so bad that they just cannot be redeemed. Banks have to take harsh steps. They could do this only if the judiciary is willing.

Consider this: While banks had referred 46,54,753 cases involving ₹2,21,474 crore to Lok Adalats, debt recovery tribunals and through Sarfaesi (the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act) channels in 2015-16, they could recover only ₹22,768 crore, or just about 10% of the total.

Public sector banks need at least ₹75,000 crore in the next two years, according to an estimate by ratings company India Ratings

Non-performing assets ratio in banks almost doubled to 8.4% on March 31, 2016 from 4.8% a year back.

"Considering asset quality and consequent profitability pressures on PSU banks, it was expected that the government would step up quantum of recapitalisation, but it was maintained at ₹10,000 crore," says Nilesh Parikh, associate director, Edelweiss Securities.

The government and the RBI may have set the stage for banks to address their biggest worry – deteriorating credit quality – with a series of reform measures such as setting up of the Insolvency and Bankruptcy Board and the forced clean-up of balance sheet, but banks now need to pull up socks and deliver.

The latest in the reforms list is the Budget announcement to allow listing and trading of security receipts issued by a securitisation or a reconstruction company under the Sarfaesi Act. This will boost fund flows into the capital-starved securitisation companies and offer larger headroom to buy sticky loans from banks.

Indian bankers may need to act like their counterparts in the West where taking a hair-cut to the value of loan asset and selling it to asset reconstruction companies at a loss are just normal.

Exploring avenues like securitisation for capital enhancement is another step for banks in boosting capital. Despite the market being in vogue for over a decade, banks have not reaped the benefit of securitisation to the fullest. Unlike in the US, where 50% of the home loan market is securitised, just about 5-6% of the ₹5 lakh crore of India's housing finance loans are securitised.

"It is important that banks keep their costs under control, widen their customer base and increase revenue per customer. Banks need to change their role to an intermediary to their customers," said Kalpesh Mehta, partnet ar Deloitte India.

Bankers are spooked by the recent arrests of IDBI Bank executives in connection with the Kingfisher Airlines loan. They may be going into a shell due to insufficient backing from the government for their official actions and investigation agencies with not much exposure to financial decision making going on offensive against the officials.

The activation of the Insolvency and Bankruptcy Code is just a hope and it may be a while before it becomes the choice of bankers like the bankruptcy courts in the US and the famous Chapter 11 filings.

The asset quality challenges are not going to end in the next few quarters, said Crisil Ratings director Rajat Bahl. "While the annual review by RBI went a long way in identifying bad assets in the bank's books, there are still many stressed assets in the corporate and MSME books of PSBs that could put further pressure on asset quality," Bahl said.

But the flip side of it may be that the government is reconciled to providing more capital to banks as it has done in the past when it had given more than budgeted funds, but bringing it into the Budget document might have led to higher fiscal deficit numbers.

"The Budget has provided ₹10,000 crore for recapitalisation of banks in 2017-18, but what is reassuring is the FM's statement that more will be given if required," says Arundhati Bhattacharya, chairman, State Bank of India.