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Changing Scenario of Bad Assets in Public Sector Banks in India

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ABSTRACT

The Government of India has merged during last two years thirteen public sector banks (PSBs) into five leaving their total number to eleven in addition to State Bank of India which earlier witnessed merger of associate banks and Bhartiya Mahila Bank in it. This major restructuring has been undertaken by the government with the stated objective of making PSBs stronger and internationally competitive. The rationale is that bigger banks can face challenges of the modern day world, out of which raising of capital and upgradation of banking technology are the most important. This restructuring exercise came at a time when many of these PSBs faced challenges of survival because of huge rise in their bad assets (non-performing loans). But for massive recapitalization many of these banks would have faced insolvency like situation. The present circumstances are still too uncertain to guarantee a return of these banks to good financial health as these continue to face twin challenges of capitalization and reduction of non-performing loans commonly known as Non-Performing Assets (NPAs) in India.

Keywords : Restructuring , PSBs, Mergers, NPA, AQR, PCA, Recapitalization

1.INTRODUCTION

All countries require a robust banking system for their economic development. In our country too the various sectors of economy like agriculture, small and medium industry to large green field projects are all dependent upon banking system for their growth. The entrepreneurs in all sectors have equity of their own but it acts mostly as seed capital. The majority of funding of different new ventures is either done by equity investors or by the banks. The equity investors are shy of investing in new enterprises / industries because of risk of failure of the promoters having no previous track record. The alternative with the first generation of entrepreneurs is therefore to depend upon public sector banks for support as these banks still dominate the banking arena having more than sixty percent share in advances. Their share is high because of the developmental role assigned to them by the owner, the Government of India. It is necessitated to fulfil the objective of economic development of the nation. After many years of

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independence banking system continued to be in the hands of big private business houses and these served their interest only. Finance was made available to only large manufacturing and trading houses in big cities. Large section of the society across the country did not have access to the credit supply from the banks.

The share of financing to Agriculture upto late sixties by the banks in India was negligible (around two percent) as compared to industry which was almost two third of the total credit outstanding of banks. The five biggest cities in the country like Ahmedabad , Mumbai , Delhi, Kolkata and Chennai accounted for almost half of the bank deposits and around sixty percent of the outstanding bank credit in 1969. This compelled the government to deliberate upon the role of scheduled commercial banks in development of Indian economy. It led to a belief that banks were not performing their desired role. As a result of the perception about non-supportive role of banking sector, Government of India nationalized 14 major commercial banks of the country in 1969. At the time of nationalization as many as 617 towns out of 2700 in the country were not covered by commercial banks (ShaktiKanta Das 2019). Opening of bank branches in rural areas was never thought of as a business development plan by the commercial banks. From this scenario of Indian banking one can understand well the need for nationalization of private banks to channelize their resources for economic development of the country.

After nationalization of the major banks, the hitherto neglected sectors of the economy were asked to be given preference and accordingly given the nomenclature of 'Priority Sector' by the Reserve Bank of India, regulator of the banking system in the country. Targets were given to all scheduled commercial banks to lend to priority sector. RBI also designated the bank having high concentration of branches in a district as a Lead Bank to make district credit plans for lending to agriculture, small scale industry and rural poor. Such banks were assigned the responsibility to monitor the progress of various institutions in achievement of targets allocated under district credit plans.

Satisfied with the progress of banks in fulfillment of targets under directed lending, government yet again brought six more banks in its fold in 1980. There was no looking back for banks and these continued to take the country to road of rapid industrialization and all around economic development. Banks moved from class banking to mass banking by accelerated opening of branches. They launched various schemes to attract deposits and while doing the major job of intermediation deployed their resources to needy at a higher rate of interest to make profits. A committee was formed in 1991 under the chairmanship of M. Narasimham for strengthening the financial sector in India and to bring about reforms in Indian economy. These reforms are popularly called LPG meaning Liberalization, Privatization and Globalization.

Early nineties are remembered always for transformation of the Indian economy and its integration with the global economy. Major financial reforms in the banking, capital markets and insurance sectors were initiated by the government which include issuing fresh licences for private sector banks, the deregulation of interest rates, reduction in phases of high statutory liquidity ratio (SLR) and opening of financial, capital and foreign exchange markets. The public sector banks now faced enormous competition by technologically better private sector banks in the area of customer service and better product rendering.

This competition forced merger of many small banks during the reform phase. These mergers resulted mainly due to inherent weaknesses in the banks that were merged like increase in bad loans, inadequacy of capital for credit growth, poor liquidity to keep the bank going and losing confidence of depositors whose hard earned money was at stake. These mergers were however aimed to make banks stronger with sound financials, good branch network, and efficient management with active and alert boards to keep abreast of ever changing

macroeconomic environment. The benefits that accrued to bigger banks after merger were the technological edge, competent staff, reduction in costs due to synergies between merging banks and the enhanced capacity to lend to top rated corporate in big volumes at a competitive pricing besides enhancement of normal operations.

Banks do not have their own money to lend. It is the depositors who trust the banks for keeping their valued savings intact and also to get interest. Banks keep it in Reserve Bank of India (central bank of the country) for statutory reserve requirements to safeguard public interest and also liquidity adjustments (the money is kept in Government of India or State government bonds). A major portion is lent to public by way of credit to industry, agriculture and retail loans. The banks have an important role in development of various sectors of Indian Economy. The financing of especially big sectors like Iron and Steel Industry, Power Generation, Ports, Roads, Airports, Telecom, Infrastructure, Tourism and Airlines in the service sector had a boost by big funding from banks. There was a large scale financing for the economic development of the country after the global financial crisis of 2008 at the behest of Government. Mainly public sector banks were entrusted this job for funding to the developmental projects in the absence of development finance institutions like Industrial Development bank of India (IDBI) and others which had become defunct due to government policy. PSBs did not have the long term funds to finance infrastructure with long gestation and also lacked credit appraisal techniques for thorough assessment of actual requirements of very large projects of different types of industry involving outlay of thousands of crores. The dependence of these banks was mainly on merchant bankers like SBI Capital Markets and some private sector banks like Axis Bank and ICICI bank who performed the task of loan syndication aggressively. This was to earn fee based remuneration in the shape of syndication fees, processing fees, monitoring fees and documentation charges. The new private sector banks kept themselves out of funding to the major infra projects due to their risk aversion and non availability of adequate capital. Rather they concentrated on Non-Fund based business. However some of the big corporate private sector banks (who primarily give big ticket loans to big companies only) also failed to appreciate the high risks associated with big corporate business and poorly managed credit risks. "They have taken unsustainable risk onto their balance sheets and derived too much comfort from being in the herd. They have failed to recognize that in their highly leveraged institutions, upside is limited to a small spread and downside is unlimited. (KVS Manian 2018) "

Everything was going good initially after the global crisis of 2008 but the greed, inefficiency and the intense competition amongst public sector banks to show bigger balance sheets took over. The result of aggressive lending came to the fore. The borrowers started signs of sickness as the cash flows expected from the projects did not materialize as per projections and their loan accounts were moving toward classification as NPAs. Public Sector Banks which constituted seventy five percent of the advances of banking system in 2015 were growing and had gross non-performing assets (GNPAs) of 5% only at that point of time. This was big achievement as NPAs seemed to be under control even with huge credit growth. "However the 5% number was deceptive. Like an iceberg only a fraction of the real bad loans was visible as NPAs (Rajiv Kumar)". The Asset Quality Review (AQR) by Reserve Bank of India from Dec. 2015 analyzed large loan accounts and started bringing out the true classification of standard restructured assets as restructuring was just a gimmick to extend their repayment period. All scheduled commercial banks were hiding the NPAs under the carpet by the ever greening (not reflecting true classification of loan assets) route. The NPAs for all the scheduled commercial banks peaked in 2018

causing ringing of alarm bells for the Government of India.

2.Review of Literature

The studies on NPAs have sought to examine the multiple reasons for accumulation of such bad assets. Many authors have attributed macro-economic factors including directed loans (Priority sector lending) for the growing incidence of NPAs in banks whereas others have observed the reasons internal to the behavior of the bank borrowers. Inefficient management of credit portfolio is also described as one of the reasons of burgeoning of NPAs in banks by many authors.One of the most prominent causes for NPAs, as often observed by RBI Inspectors, is the slackness on the part of the credit management staff in their follow up to detect and prevent diversion of funds in the post-disbursement stage (Muniappan 2002). Some of such studies are enumerated below:

Hippolyte Fofack (2005) investigated the leading causes of NPLs during the economic and banking crises that affected the large number of countries in Sub-Saharan Africa in the 1990. The results highlight a strong casuality between these loans and economic growth, real exchange rate appreciation, the real interest rate, net interest margins and interbank loans consistent with the casuality and econometric analysis which reveal the significance of macro and microeconomic factors. **Richard (2010)** however observed that the unfavourable economic environment specifically the national economic downturn leading to the depression of business to be perceived as a major factor causing NPLs is not established. Rather diversification of funds and weak credit analysis were the major factors contributing to NPLs in Kenya.

Chaudhuri (2005) observed that presence of NPAs indicate asset quality of the balance sheet and hence future income generating prospects. This also requires provisioning which has implications with respect to capital adequacy. Declining capital adequacy adversely affects shareholder value and restricts the ability of the bank/institution to access the capital market for additional equity to enhance capital adequacy. Low capital adequacy will also severely affect the growth prospects of banks and institutions. **Ghosh (2014**) raised many questions on rising NPAs of Indian Banks including whether macro-economic variables play a more significant role than bank specific factors in determining NPA levels and whether corporate governance factors like board composition and ownership affect NPAs. **Chavan and Gambacorta (2016**) on a study of the banks in India observed that quality of loan is a concern . It has been impacted after GFC and thereafter turned severe after 2011. It can be attributed to high growth period after the crisis period. It is found that a one-percentage point increase in loan growth is associated with an increase in NPLs over total advances (NPL ratio) of 4.3 per cent in the long run .The non performing loan ratio of banks is sensitive to the interest rate environment and the economic growth.The decline in loan quality was mainly on account of public banks, but private banks and foreign banks also contributed to it. It is observed that the decline in loan quality was sharper in the case of particularly infrastructure and core industries.

Sengupta and Vardhan (2017) emphasised that an early recognition of stressed assets and timely action on their resolution mitigates the damaging impact of a crisis. To enable banks to take such prompt action, strong governance and proactive banking regulation is critical. This will ensure that the subsequent NPA resolution has minimal effect on the banks' capital. Regulatory forbearance does not facilitate resolution and can actually worsen the banking crisis by providing incentives to the banks to defer NPA recognition and delay action. It is suggested that restructuring of a loan should be the commercial decision of a bank. **Gupta and Gautam (2017)** found that the level of NPAs both gross and net is having an increasing trend. They also found that there is a

negative relationship between Net profits and NPA of PNB. They viewed it because of mismanagement and wrong choice of client.**Tandon et al. (2017**) examined bank specific macroeconomic determinants of non-performing loans and their impact on the banking profitability. Multivariate panel data analysis for 35 Indian public and private sector banks over the period 2007-2016 concluded that NPA management in public sector banks needs attention as it affects the efficiency and profitability exponentially. **Mishra et al, (2020**) analysed macro-economic determinants of non-performing assets in the banking system, using panel data regression analysis and proved that public sector banks can be considered as less efficient in NPA management as compared to private sector banks. **Asha Singh (2013**) observed that the banking sector has been facing the serious problems of the rising NPAs. In fact public sector banks are facing more problems than the private sector banks. The NPAs in public sector banks are growing due to external as well as internal factors. One of the main causes of NPAs in the banking sector is the Directed loans system under which commercial banks are required to supply 40% percentage of their credit to priority sectors.**Swamy (2013)** offered a different view by expressing that share of priority sector credit is not significant in affecting the NPAs contrary to the general perception. **Mukhopadhyay (2018**) again asserted that in India, priority sector lending (under priority sector lending banks extend credit to agriculture and SMEs) is often stated as a significant reason for the accumulation of NPAs. However, it is established that for both public sector banks and private sector banksaccumulated NPAs in the priority sector is relatively small compared to the accumulated NPAs in the non-priority sector.

Singh, V (2016) is of the view that as profitability of Indian banks is highly dependent on income from interest on funds lent, GNPAs impact the profitability of banks. Also the NPA level of our banks is still high as compared to foreign banks. The government should make more provision for faster settlement of pending cases and it should reduce the mandatory lending to priority sector as this is a major problem creating area. **Tripathi and Syed** (2017) observed that public sector banks have major share in NPA growth because of low interest rate and government pressure of giving creditto priority sectors and also because of weak collection procedure by public banks. **Das and Dutta (2014**) studied NPA, its causes as well as its impact on the banking sector and the economy as a whole. The study was done on the State Bank of India and its associates and the other public sector banks based on the secondary data from 2008 to 2013 through ANOVA to find out whether there is any difference in the NPA occurrence between the various banks during the period of the study. It is concluded that there is no significant difference between the means of NPA of the banks. **Dhananjaya andRaj (2017)** studied the Inter Bank Disparity in Non-Performing Assets management in Indian Public Sector Banks. The accumulation of NPAs and the provision coverage ratio (PCR) of different banking groups like State Bank Group, Nationalised Banks, Private Sector Banks and the Foreign Banks was evaluated. It was observed that there is deteriorating asset quality of particularly Public Sector Banks which are in deep trouble in terms of rising NPAs and the consequent impact on their profitability. **Mishra and Pawaskar (2017)** did a ratio analysis by using Net NPA Ratio, Total Provision Ratio, Substandard Ratio and Doubtful Assets Ratio for the period 2011-16 of Bank of Maharashtra to obtain bank's trend of NPAs **.** It was observed that the bank needs to be proactive in the selection of clients and customers while improving performance in several key areas.Various analyses were used by **Nachimuthu and Veni (2019) to** find out the impact of NPAs on the profitability of the scheduled commercial banks for the period 2007-08 to 2016-17 and concluded that the profitability of the banks has reduced due to rise in the non-performing assets of scheduled commercial banks in India. **Garg (2019**) observed that due to the presence of a huge set of NPAs it has become difficult for the banks to

finance huge and fresh investments to the private sector. Lots of remedial measures need to be taken to revive lending. A critical review of non-performing assets in the Indian banking industry was done by **Agarwala V and Nidhi (2019)** who concluded that growth rate in the NPA level shows that the problem is evident not only with small-sized banks but also with big names in the banking space.. The NPAs not only impact the profitability level of these banks but also affects the shareholders' wealth. **Devika (2020**) observed that the public sector banks have defective lending process as they are not followed by cardinal principles. The recapitalization benefits public sector banks and reduces the stress level of loans. But growing Non-Performing Assets will make capital infused less effective and valuable for only a small period. **Wadhwa and Ramaswamy (2020**) in their research studied banks with highest NPA ratios for the period 2015 to 2019. Correlation analysis and multiple regression was applied to compute the impact of different financial heads on NPAs. The results revealed that NPA was negatively correlated with Net profits in the selected banks except HDFC Bank With the help of regression analysis it was also revealed that there was significant impact on Net Profits due to NPAs.

3. Growth of NPAs, Remedial Action and Analysis

The central bank of the country being the regulator of banking entities had created enough ways to correct stressed assets scenario of banks in India. This included creation of Corporate Debt Restructuring (CDR mechanism) in 2001, Refinancing 5:25 Scheme in 2014 and Strategic Debt Restructuring Scheme (SDR) in 2015. However the banks were still not making proper classification of assets and the unscrupulous promoters continued to take undue benefit of all these restructuring schemes. Banks were to blame as many large NPAs continued to be shown as standard accounts. The reasons were two fold. One was to show good balance sheets and the other was to escape the eye of investigating agencies as public money was at stake. RBI therefore decided to put an end to the forbearance before it was scheduled to end as banks were still hiding NPAs and also not following uniform procedures for classification of their loan portfolio. Many a time even in consortium lending some member banks were showing an account as NPA whereas others were projecting it as Non-NPA. Due to paucity of capital they were not making adequate provisions for their NPAs.

Banks could have taken out many accounts out of stress by giving due support but fearful of projects' even chances of revival after a second dose of financial support they did not help the promoters to put the projects back on track due to mistrust as the promoters failed to bring on steam the projects with the original project financing. Banks also apprehended chances of further diversion of funds. This slackened their credit growth affecting their financials like Operating Profit, Capital Adequacy, Return on Assets, Net interest Margin and Gross NPAs.

RBI had to initiate Asset Quality Review (AQR) in 2015 and inspected a large number of accounts to especially ascertain signs of ever-greening. Team of supervisors was assigned the job of cleaning up balance sheets of banks by inspecting the large borrowal accounts to check their classification as per prudential norms. As per economic reports about 200 accounts were identified as non-performing. It is interesting to see the growth of Non-performing assets of PSBs and Private Sector Banks before and after AQR from Figure 1 and Figure 2:

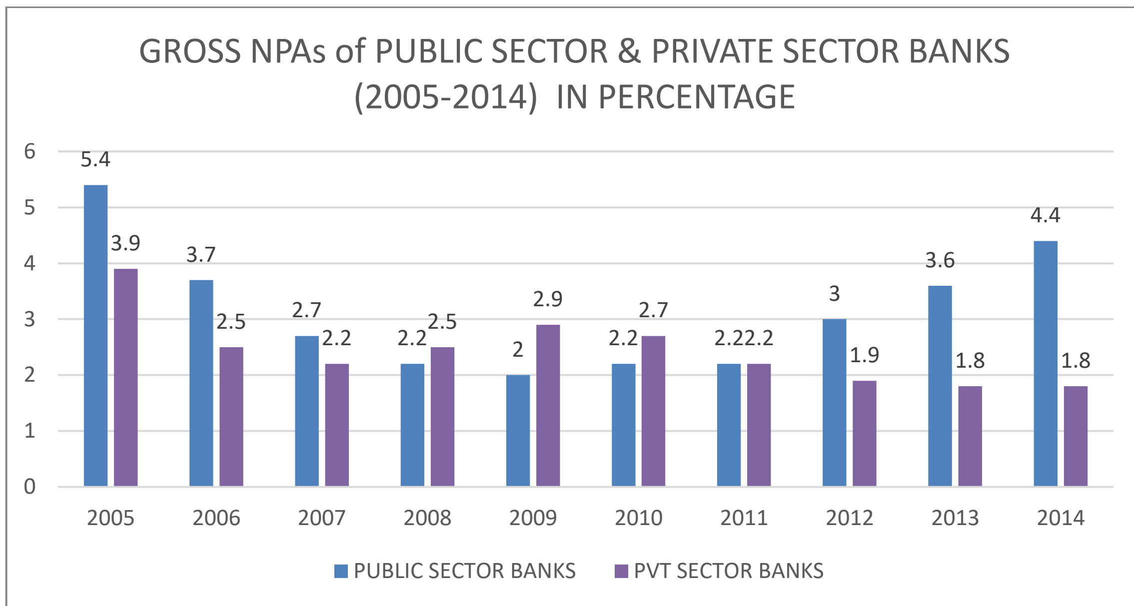

Figure 1 : Gross NPAs of PSBs & Private Sector Banks (2005-14)

(Data Source : RBI)

It can be observed from Figure 1 that gross NPAs of public sector banks were below 5 percent in all years except 2005 whereas for private sector banks it was below 4 percent. The banks were able to keep the ratio low by ever greening of very large accounts. The position took an adverse turn after the AQR (Figure 2):

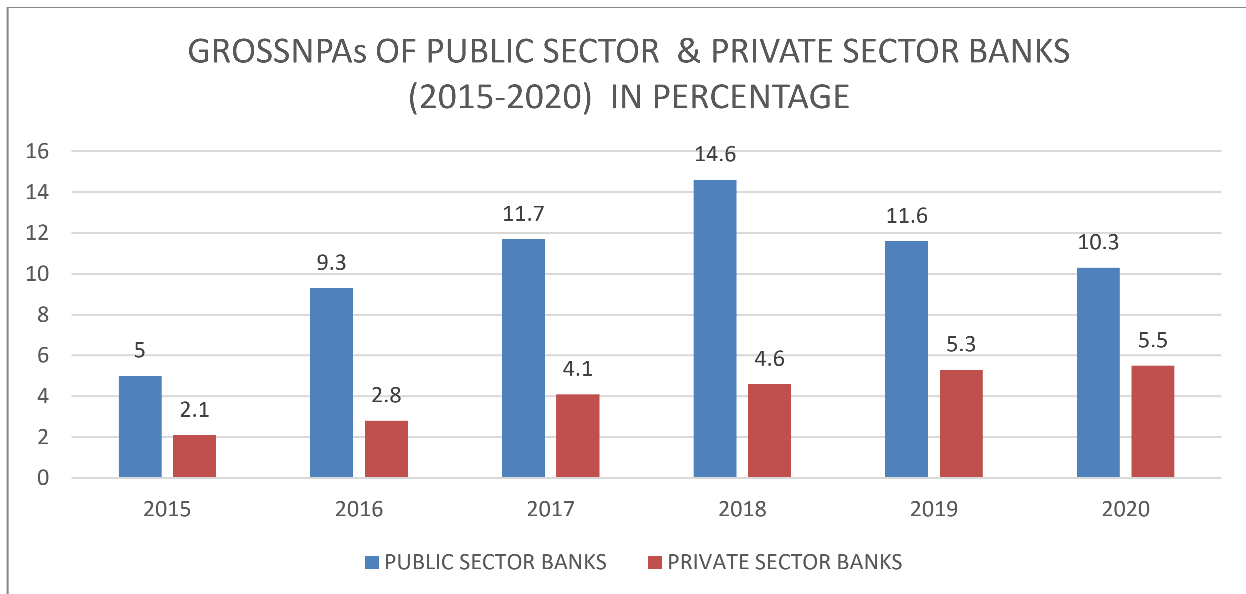

Figure 2 : Gross NPAs of PSBs and Private Sector Banks (2015-20)

(Data Source: RBI)

The above figure explains the sudden spurt in Gross NPA ratio of banks: It is quite clear that after RBI inspected the books of many banks and directed to classify many big accounts as NPA, the ratio slipped to 9.3 percent in 2016 and to 14.6 percent in 2018 for public sector banks. Similarly it slipped to 4.6 percent in 2018 and 5.5 percent in 2020 for private sector banks. The impact of AQR on individual banks can be seen from Table1:

Table 1:GNPAs of Selected Public Sector Banks

(In Percentage)

YEAR	PNB	OBC	UBI*	CORP	DENA	IOB	CBI**	UCO	BOI
2016	12.90	9.57	13.26	9.98	9.98	17.40	11.95	16.09	13.07
2017	12.53	13.73	15.53	11.70	16.27	22.39	17.81	17.12	13.22
2018	**18.38**	**17.63**	**24.10**	**17.35**	**22.04**	**25.28**	**21.48**	**24.54**	**16.58**
2019	15.50	12.66	16.48	15.35	21.07	21.97	19.29	**25.00**	15.84
2020	14.21	12.67	13.40	13.80	-----	14.78	18.92	16.77	14.78

(Data Source: RBI)

*United Bank of India **Central bank of India

It is established from Table 1 that in some of the public sector banks the incidence of NPA reached alarming proportion. In United Bank of India (UBI), Indian Overseas Bank and United Commercial Bank (UCO) it was about 25 percent which means one fourth of total advances were bad. The situation was worrisome as most of NPAs were destined to become Loss assets in next few years.

The classification of loan assets is depicted in Table 2:

Table 2: Classification of Loan Assets of PSBs

(In Percentage)

YEAR	STANDARD	SUB-STANDARD	DOUBTFUL	LOSS
2011	97.8	1.0	1.0	0.2
2012	97.0	1.6	1.2	0.2
2013	96.3	1.8	1.7	0.2
2014	95.6	1.8	2.4	0.2
2015	95.0	1.9	2.9	0.2
2016	90.7	3.4	5.6	0.3
2017	88.2	3.0	8.4	0.4
2018	85.4	3.5	**10.2**	**0.9**
2019	88.4	2.2	**8.2**	**1.2**
2020	89.7	2.1	**6.4**	**1.8**

(Data Source: RBI)

With respect to the classification of loan assets it is significant to observe that out of Non-performing Assets, Loss Assets (where there is 100 percent erosion of value) of public sector banks, continue to rise regularly over last few years (from 0.2 percent in 2011 to 1.8 percent of total advances in 2020). The doubtful assets (which are non-performing for more than 12 months) which were hardly 1 percent in 2011 went upto10.2 percent in 2018 and in 2020 have moderated to 6.4 percent of total advances of PSBs which implies that providing for these doubtful assets and loss assets continues to be a challenge for PSBs and requires massive recapitalization. The amount wise classification is depicted in Figure 3:

(Amount in Rs Lakh Crores)

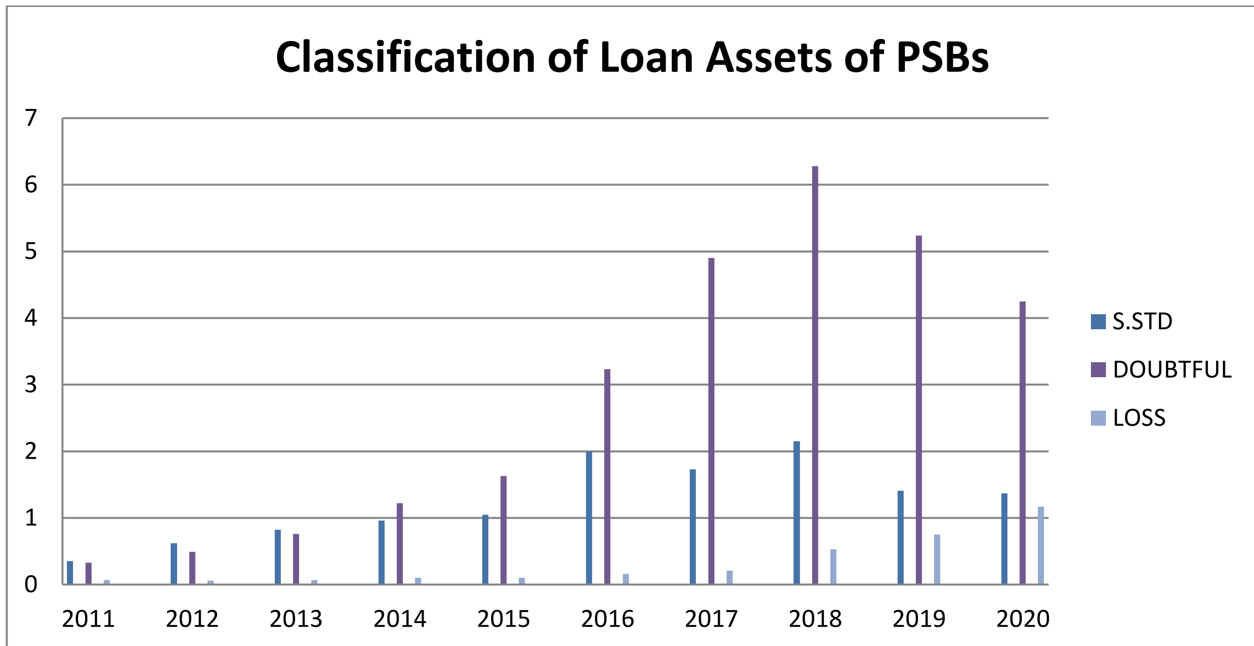

Figure 3: Classification of Loan Assets of Public Sector Banks

(Data Source: RBI)

The doubtful assets which were only Rs 33200 crore in 2011 reached an alarming proportion of Rs.627712 crore in 2018 and have since reduced to Rs 424828 crore in 2020 (as these shifted to loss assets). Similarly the loss assets which were only Rs 6500 crore in 2011 reached to a dangerous level of 116638 crore in 2020 after having risen continuously for the last ten years.

The serious fallout of rising NPAs and their continuous downgrading to loss assets in different banks is that their capital is eroded to a large extent. Equity capital is a protection against asset losses of an entity. It is the primary source of loss absorption and gives a sense of comfort to all stakeholders. The anticipated losses can be absorbed by a high level of capital. Banks in India were deeply impacted by very high level of NPAs and due to this reason their capital adequacy also took a deep cut. The inadequacy of capital leads an entity to bankruptcy and exposes the unsecured creditors (Depositors) of a bank. The depositors have only a limited insurance of Rs 5 lakhs from Deposit Insurance Guarantee Corporation of India (DICGC) and deposits beyond this limit are unsecured. As such the insolvency of a bank can pose a systemic risk to the economy (systemic is defined as a situation where problems affected banks which in aggregate hold at least 20 percent of the total deposits of the banking system -Dziobek and Pazarbasioglu 1997).

3.1 . Prompt Corrective Action

To check the high NPAs the Reserve Bank of India invoked Prompt Corrective Action (PCA) in April 2017. PCA is born out of the regulatory intervention which is enforced on banks in U.S.A. PCA works on the core principle of structured early intervention for corrective action on banks to check their financial deterioration (V.V. Acharya). It was invoked on many banks whose thresholds were breached relating to CRAR (regulatory Capital to risk-weighted assets ratio), Asset Quality, Profitability and Leverage. RBI had introduced PCA earlier also known as PCA Old-2002 but in 2017 it was named as PCA-Revised and implemented rigourslyon various banks. It has again been revised on Nov 2, 2021. The provisions of the revised PCA Framework will be effective from January 1, 2022.Eleven public sector banks which form a fifth of the total banks' credit and deposits were

placed under the PCA of 2017. Most of these banks had high GNPA ratios and had also breached thresholds as mentioned above by the regulator.

The rapid credit growth especially of the PSBs during 2010-2012 was mainly responsible for their stressed assets and consequent huge rise in NPAs. The reason was lack of strong credit appraisal and post sanction monitoring of disbursal of funds which were generally diverted to group companies and not utilized for completion of projects for which these were meant. The effect of being put under PCA was that these banks have to restrict expansion of their risk weighted assets. There are other restrictions like non-declaration of dividends and not to access/ renew costly deposits besides special audits of the bank. Due to PCA the growth of advances of these banks came to a halt.

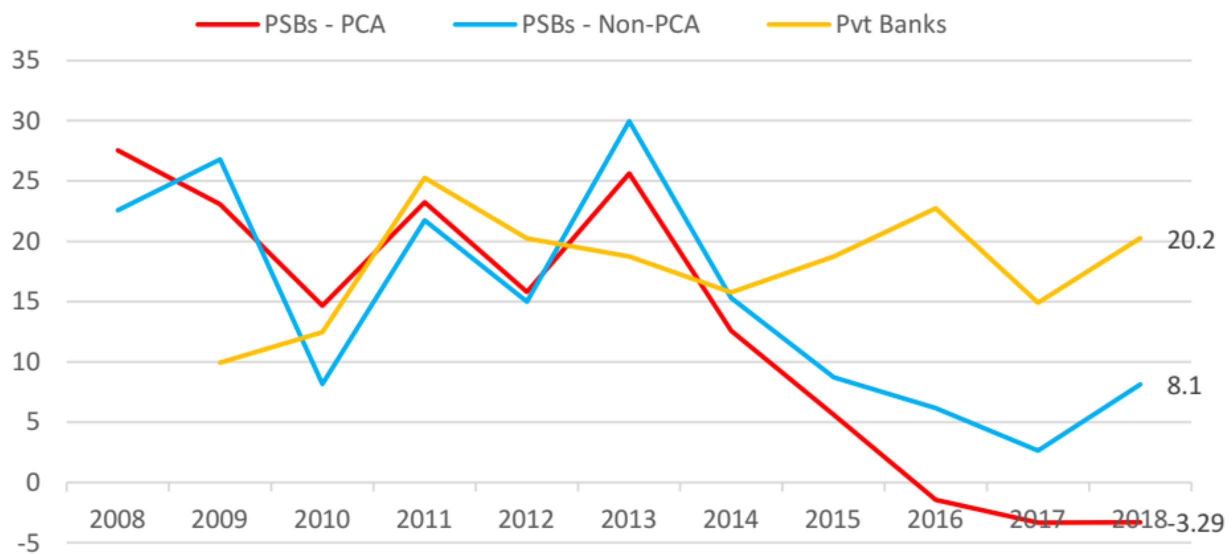

Figure 4: Yearly Growth of Advances (Percentage)

It can be observed from figure 4 that PSBs under PCA had a negative growth of advances in 2016-18 as there were restrictions imposed on them for further lending. Their share in banking sector advances had also gone down (Table 4):

Table 4: Bank Group wise share in Advances

(In Percentage)

Year	Public Sector Banks	Private Sector Banks	Foreign Banks
2000	79.41	12.56	8.03
2005	74.25	19.21	6.54
2010	77.24	18.08	4.68
2015	74.28	21.26	4.46
2020	59.80	36.04	4.16

(Data Source: RBI)

Table 4 indicates that share of public sector banks in credit has come down to 59.80 percent from 74.28 percent due to PCA. Many banks went slow on lending due to intervention of the regulator and paucity of capital required for credit expansion. The share of private sector banks has gone up from 21.26 percent in 2015 to 36.04 percent in 2020.

3.2. Recapitalization of Public Sector Banks

Given their significant share in the overall banking sector, the stability and solvency of Indian PSBs is of paramount importance. It is important that this group of banks being the major and dominant player in the economy of India is always well capitalized to offset any potential losses due to non-performing loans and frauds. Also adequate capital helps them to drive higher credit delivery expected from them. Basel committee on banking supervision (BCBS) also recommends to member countries to ensure that their banking system follows capital adequacy norms laid down by it .The last such recommendation for capital adequacy was made through Basel-3 in 2010 which was to be fully implemented by 31-3-2020.

Public sector banks at their own were not able to raise capital from the market due to their deteriorating financials. They had also invited the lens of the regulator due to not reflecting the true financial position of their affairs. However support was necessary to strengthen banks which were now undercapitalized due to keeping hefty provisions for bad loans some of which had to be completely written off. The government had been recapitalizing the public sector banks regularly though in small measures being the majority owner of these banks.

In order to build up the capital adequacy of the PSBs the Government of India, as the majority shareholder, infused Rs.1,18,724 crore from 2008-09 to 2016-17 in PSBs as reflected below:

Table 5 : Recapitalisation of Public Sector Banks (Rs. In Crores)

YEAR	AMOUNT
2008-09	1900
2009-10	1200
2010-11	20117
2011-12	12000
2012-13	12517
2013-14	14000
2014-15	6990
2015-16	25000
2016-17	25000

(Source: CAG Report No.28-2017)

It can be noticedthat Government of India had to regularly step in and recapitalise the PSBs by using taxpayer's money. It is incumbent upon the government to safeguard the capital of such banks to enable them to fulfil the laid down objective of social upliftment by catering to credit needs of the economy.It has been observed by the Comptroller General of India that the Government of India (Department of Financial Services) did not follow the basis for capital infusion in different banks as per an understanding reached with PSBs in 2012. Rather the capital infusion was done to comply with the BASEL requirements of maintaining capital as per the accepted norms.

In view of continuous rising of NPAs and massive erosion of capital of public sector banks, Government of India therefore had to again give a booster dose of capital to PSBs by announcing a recapitalization plan for public sector banks in October 2017 for Rs 2.11 lakh crore. Again in FY 22 the government had set aside Rs.20000 crore in the budget for capitalization of Public Sector Banks

An RBI internal working group has recommended to allow large corporate houses to become bank promoters. Many recommendations of this group have been accepted and accordingly the country can

witness new private big banks in future. For last many years the banking industry in India is not having a reasonable growth (during 2010-15 the credit growth used to be between 20-25 percent). Since it is now widely known that this unbridled growth was due to large scale financing of unviable units, it can be construed that it may take years to revive credit growth in the economy. So it looks logical to enhance corporate business houses participation in banking in India as government may be on back foot for recapitalizing PSBs by tax-payers' money. There may be a requirement of 4-5 lakh crore of recapitalization needs for public sector banks in the next 3-4 years if growth targets for credit are to be revived and the target for a $ 5 trillion economy is to be achieved by 2025. Since opening up of banking sector further to big corporate houses (it contradicts strongly the theme of nationalization enunciated in 1969) has political overtones, it may take quite a few years for this to take shape. Meanwhile a major step has been taken by the Government of India is to restructure public sector banks by merger in 2018-2020.

3.3. Restructuring of Public Sector Banks

Bank restructuring denotes key changes in their operations, financial engineering and change of management to improve their financial health. This is resorted to meet the expectations of all stakeholders to make banks more profitable and as a consequence to reduce their dependence on shareholders for capitalization needs. If many banks in an economy experience challenges of survival this may also usher into a systemic risk. Banking entities worldwide have been facing the problems of liquidity and non performing loans .They also have to maintain adequate capital for growth and also as a buffer against loan losses. The second Narasimham Committee appointed by the Government in 1997 to suggest reforms in the Banking sector had made its recommendations for bank mergers. The committee submitted a report in 1998 and suggested for merger of banks. It was suggested that there be 2 to 3 banks in India of international size, 8 to 10 banks of national importance besides local banks for deeper penetration and higher financial inclusion in the country. Faced with a systemic risk the government had to implement the said recommendations even though quite late.

The various banks which were merged from **01-04-2019** are as under:

- **Bank of Baroda + Vijaya Bank+ Dena Bank** (Total Business Rs.16.13 lakh cr.)

The wide ranging benefits as claimed by the government from the above merger are growth, rationalization of operations, better technology for new products and capacity for garnering capital resources.

The second merger of nationalized banks which happened with effect from **01-04-2020** are as under:

- **PNB + OBC + United Bank of India** (Total Business Rs.17.94 lakh cr.)

The expected benefits out of the above merger are mobilisation of higher CASA, cost reduction due to consolidation of branches coupled with higher lending ability of the merged entity.

- **Canara Bank+ Syndicate Bank** (TotalBusiness Rs. 15.20 lakh cr.)

The government expects a high cost reduction due to rationalization of branches being south based banks and both having similar culture.

- **Union Bank + Andhra Bank + Corporation bank** (Total Business Rs.14.59 cr.)

The business is expected to increase two to four and a half times besides cost reduction due to merger of branches in near proximity as in case of other mergers.

- **Indian Bank + Allahabad Bank** (Total Business Rs.8.08 lakh cr.)

The rationale behind merger is increase of business to double through enhanced CASA and increase in credit operations.

Before this consolidation, associate banks and Bhartiya Mahila Bank (BMB) were merged with SBI which now has a total business of Rs. 52.05 lakh crore and is ranked at 45 among the top 50 banks of the world. It may be noted that Finance minister has laid down certain objectives for consolidation of PSBs as above but the implementation challenges will remain. Only future will unwrap whether the stated benefits of such merger / restructuring to make PSBs stronger and bigger are achieved. It shall be a worthwhile exercise if the Government does not have to recapitalize these banks and they can access capital markets directly for their requirements.

3.4. Present trend of NPAs

It was expected that Restructuring / Merger of PSBs will have a tectonic impact on reduction of NPAs due to increased profitability and higher capital to provide cushion for cleaning their books. Even though it is only 2-3 years for different set of mergers, there seems to be only a mild effect of the effort put in by the Government. The Table 6 exhibits the position of GNPAs of merged entities and other PSBs not considered for restructuring. The reduction seems to be more in the case of smaller banks not restructured whereas in some of the restructured banks like Canara and Indian bank GNPA ratio increased in 2021 after merger as reflected below:

Table 6: GNPA Ratio of Select PSBs after Amalgamation

(In Percentage)

YEAR	PNB	BOB	CANARA	UNION	INDIAN	BOI	IOB	PSB	UCO
2019	15.50	9.61	8.83	14.98	7.11	15.84	21.97	11.83	25.00
2020	14.21	9.40	8.04	14.15	6.87	14.78	14.78	14.18	16.77
2021	14.12	8.87	8.93	13.74	9.85	13.77	11.69	13.76	9.59
2022*	11.78	6.61	7.51	11.11	8.47	9.98	9.82	12.17	7.89

(Data Source:RBI)

*Figures of Year 2022 taken from respective banks investor presentations and may change after RBI audit.

The performance of unmerged banks like BOI, IOB and UCO is better than the amalgamated banks as these have been able to bring about significant reduction in their NPAs. Performance of the restructured PSBs and unmerged banks though looking better (Table 6) from gross NPA figures can however take a negative turn due to the following reasons:

- The pandemic has aggravated the crisis already being faced by all banks with the surge of NPAs. Due to COVID-19 there was a forbearance allowed to banks to declare NPAs as business activity had come to a halt due to lockdowns and thereafter restrictions on movements. With normalisation of business the moratorium granted earlier for repayment of loans has ended and therefore NPAs may surge.

- The government allowed an Emergency Credit Line Guarantee Scheme (ECLGS) for Rs.4.5 lakh crore (increased by Rs.50000 crore in budget for

FY 23) with a view to support various businesses impacted by the second wave of COVID 19 pandemic. The last date of disbursement under the scheme has now been extended to March 31, 2023. The scheme provides full guarantee coverage to banks and NBFCs to enable them to extend emergency credit facilities to Business Enterprises/ MSMEs having even high turnover to meet their additional term loan/working capital requirements upto 20 percent of their outstanding as on Feb 29, 2020. These relief measures are going to be highly misutilised by majority business units as the same is repayable with a longer tenure of 4 years. The reason is all restructuring schemes in the past have not been successful and huge diversion of funds has taken place. Borrowers are taking advantage of the legal process. Even if there are no stressed accounts, the borrowers take undue benefit of restructuring schemes due to weak checks and balances. These schemes are often used to reduce interest costs by softening the pricing term and elongation of repayment schedules without improving on the basic viability of the borrowing concern. Even Raghuram Rajan Ex- Governor Reserve Bank of India referring to the various restructuring schemes initiated conceded that these failed to bring the desired results towards reduction of NPAs. "Banks now had the power to resolve distress, so we could push them to exercise these powers by requiring recognition. The schemes were a step forward, and enabled some resolution and recovery, but far less than we thought was possible. Incentives to conclude deals were unfortunately too weak "

- Under KV Kamath committee recommendations 26 sectors have been selected which will require restructuring based on their financial parameters. All the major industrial and service sectors of economy are covered for government support. These are mostly the sectors which created maximum NPAs on the books of Scheduled Commercial Banks especially the PSBs during the economic optimism boom of 2009-2014. The financial parameters on the basis of which these sectors are to be restructured relate to leverage, liquidity and debt serviceability. Some of the financial ratios like debt to EBIDTA, Debt Service Coverage Ratio (DSCR), Current Ratio are to be met by the borrowers by fiscal 2023. It is highly unlikely that these benchmarks set by the committee will be achieved by the beneficiary units resulting into the need for second restructuring or slippage to NPAs.
- As per Report on trends and Progress of Banking in India 2019-20 by RBI the GNPA ratio of banks has mainly come down at the end-September 2020 due to resolution of a few large accounts through the Insolvency and Bankruptcy code (IBC).
- The reduction which appears in NPAs of many public sector banks is deceptive. It is due to cleaning of balance sheets of banks by technical write offs as NPAs more than four years require 100 percent capital coverage. Banks have written off Rs 2.02 lakh crore NPAs in FY 21 whereas they wrote off NPAs worth Rs 11.68 lakh crore in the last ten years. In the first six months of 2021-22 bad loans worth Rs 46382 crore were written off. This massive write off certainly reduces the NPA figures of banks. RBI's Financial Stability Report of January 2021, indicates that the GNPA ratio of all SCBs may increase from 7.5 per cent in September 2020 to 13.5 percent by Sept, 2021. If the economic environment worsens further, the NPAs are estimated to rise to14.7 per cent under a severe stress scenario. Though NPAs might reduce by Dec2021, the final classification will be done at year end March 22 after the mandatory annual statutory audit of different branches / banks.
- Bankers may refrain from selling NPAs to asset reconstruction companies (ARCs) due to the fear

of post-facto investigations in their action (Recent Income Tax Department's Search action on four ARCs revealed that they had adopted various unfair and fraudulent trade practices in acquiring these loans. Banks may therefore now depend more on IBC and /or the bank-led National Asset Reconstruction Co Ltd (NARCL). The IBC route initially helped banks for faster time bound resolution of their NPAs but with passage of time got diluted with litigation by both borrowers and banks.

- The bigger banks are finding it difficult to find offtake of their funds by corporates as they are able to raise money successfully from the market by making big Initial Public Offers (IPOs). Unless the loan book of banks grows the percentage of NPAs will not come down.
- There are still many big restructured corporate accounts with public sector banks. Their classification as NPA might have been deferred due to paucity of capital. With passage of time these will surface and add to the NPA kitty of banks.
- The unending war between Russia and Ukraine and the threat of it turning into nuclear has resulted in disruptive supplies and high oil/energy prices. It may adversely impact many of our trading partners and domestic sectors of economy. The surging inflation and soaring prices of commodities without commensurate rise in earnings may impact retail loan segment of banks. The significant depreciation of rupee despite the central bank selling its dollars to curb its free fall and its impact on the capital goods import may affect many a new industrial and service projects and generate new big NPAs in Corporate sector.

4. CONCLUSION

During the global depression of 2008 forbearance helped borrowers to tide over hardship caused due to the crisis. As per the Economic Survey 2020-21 the government should have stopped the restructuring window in 2011when the economy had bounced back after the recession of 2007-08 .The continuance of forbearance resulted in serious damage to the banks, borrowers and the economy in general. The continuation of soft handling of potential NPAs of banks ultimately harmed all the stakeholders. Borrowers benefitting from the banks' lack of proper technical and financial appraisal invested in unviable projects most of which never commenced operations thus adding to the NPA baggage of banks. Similarly the inflated profits of public sector banks due to not reflecting the true classification of their loan portfolio prompted them to pay increased dividends to shareholders (mainly the government).This ultimately led to banks' huge undercapitalization when forced by the regulator after AQR to classify their loan assets as per prudential norms. It is generally said that future is uncertain and generates fear among the mankind. With all good intentions of all stakeholders various measures have continuously been taken in the past to make banks globally competitive. The liberalization and privatization resorted to earlier to integrate the Indian economy with the world has not brought the desired results. The great financial crisis of 2008, unbridled growth during 2009-2014 of mostly unviable projects resulting in massive deadwood for the banks in the shape of NPAs, inefficacy of the legal system for bank recoveries and frauds perpetrated on the system by dubious businessmen (moral hazard) have made banks weak on financials. The present macroeconomic environment does not support growth in manufacturing, mining and infrastructure resulting in everyday declining GDP estimates. COVID-19 and Omicron have taken a heavy toll on all sectors of economy and eroded employment and the resultant consumption by the people. Banks worldwide are embarking upon new Digital Innovations, Artificial Intelligence (AI) and Crypto currencies. All this is very challenging and scary for our enormously weak Indian banking sector. One can

expect many more mergers of the weak links in the system since it impacts our citizens in a big way. In private sector the cases of YES Bank, Lakshmi Vilas Bank and Punjab Maharashtra Cooperative (PMC) Bank are recent examples where the Government of India has been proactive and put efforts to salvage the situation.

With growth in non-performing assets concurrent with likely opening and expansion of the economy, there may be further need for massive capitalization of public sector banks. The government on its part seems not to recapitalize banks by taxpayers' money as it becomes a political issue. It is this reason that in budget for FY 23 there is no budgetary allocation for capitalization of public sector banks. The fact remains that unless the performance of smaller banks improves and they are able to plough back profits or they are capitalized by government support, they cannot be sold to the new investors. This is evident from the fact that privatization of two of the public sector banks (names not disclosed) which were announced by the Finance Minister in the budget for 2022 seems to have been put on hold .As the investors will look for some value in their new acquisitions, the banks with poor financials cannot be privatized. The Government needs to put hardcore professionals at the boards of different banks and also give them a free hand to bring operating efficiencies and the confidence to tackle big NPA accounts without witch hunting. The need of the hour is to study the NPA malaise thoroughly and to rectify situation to make the banking system robust sooner than later. A strong banking system is crucial for a developing economy and its failure is bound to have a dampening effect on other segments of the economy also. Accordingly it is a bigger priority to ensure that the banking system takes early cognizance of the impending stress in the borrowal accounts. There is already a restructured standard advances portfolio of Rs.58424 crore with PSBs as at end of March 2021. Much of this restructured portfolio of public sector banks may be on a threshold of becoming sub-standard or NPA. Proper monitoring of such restructured advances is required to keep these in standard category otherwise it can prove quite damaging to the financial health of respective banks in next few years. Unless the top managements are able to tackle NPAs effectively and bring down the numbers substantially, they will not be able to perform their developmental role for growth of their organizations and the economy.

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