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INNOVATIVE STRATEGIES, ADVANCES AND CHALLENGES IN COMMERCE AND MANAGEMENT

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Mission Indradhanush: Recapitalisation of Public Sector Banking in India.

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Abstract:
Recapitalisation of Public sector banks is going to be beneficial for the banks as the capital base of the banks would be enhanced to a great level. Simultaneously, where government is allowing the banks to trade the Bonds in the secondary market, it will help them to raise alternate capital from the market and bolster their loan book. Mission Indradhanush could be said as one of the most comprehensive reforms undertaken by the Indian Government since Nationalization of Indian Banks in the year 1970.It is also to be noted that, though the consolidation has been on the RBI's agenda from the last few years, there have not been any significant mergers in the banking sector except that of six SBI Associate Banks and Bhartiya Mahila Bank with the SBI.Now, the Central Government has also constituted an Alternative Mechanism for consolidation of the Public Sector Banks. (PSB's) under the chairmanship of the Union Finance Minister, whose role would be to approve schemes of amalgamation of banks.
Mission Indradhanush 2.0 a comprehensive plan for Recapitalization of Public Sector lenders, with a view to make sure they will remain solvent and fully comply with the global capital adequacy norms., Basel III.However it will only be finalised after a detailed analysis of the Asset Quality Review (AQR) conducted by RBI.
Key Words : Recapitalization, consolidation , mergers, capital adequacy, amalgamation.

Introduction :

It has been decided by the Government to infuse around 2.11lakh crores over the next two years for the Public Sector Banks, for the amendments made to the Insolvency and Bankruptcy Code (IBC) and for focusing on Mergers of PSB's, for which an alternative mechanism was set up for fast track consolidation of PSB's.
Government plans to come out with 'Indradhanush 2.0', a comprehensive plan for recapitalisation of public sector lenders, with a view to make sure they remain solvent and fully comply with the global capital adequacy norms, Basel-III.'Indradhanush 2.0' will be finalised after completion of the Asset Quality Review (AQR) by the Reserve Bank, which is likely to be completed soon.The RBI had embarked on the AQR exercise from December 2015 and asked banks to recognise some top defaulting accounts as non-performing assets (NPAs) and make adequate provisions for them. It has had a debilitating impact on banks' numbers and their stocks. The central bank has set a deadline of March 2017 to complete the AQR exercise. "Post Asset Quality Review (AQR) exercise by the RBI to clean up the balance sheets of PSBs, the numbers are being re-looked at and a revised programme of capitalisation will be issued as part of 'Indradhanush 2.0'," said a Finance Ministry document. Under Indradhanush roadmap announced in 2015, the government had announced to infuse Rs 70,000 crore in state-run banks over four years while they will have to raise a further Rs 1.1 lakh crore from the markets to meet their capital requirement in line with global risk norms, known as Basel-III. In line with the plan, public sector banks were given Rs 25,000 crore in 2015-16, and similar amount has been earmarked for the current fiscal. Besides, Rs 10,000 crore each would be infused in 2017-18 and 2018-19. The government has already announced fund infusion of Rs 22,915 crore, out of the Rs 25,000 crore earmarked for 13 PSBs for the current fiscal. Of this, 75 per cent has already been released to them.A total of 2.11 lakh crores will be infused by the government in the coming two years.

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Reasons for the Weak State of PSB's :

PSBs face **three stark realities** and their weak governance is the underlying cause.

- Government owns PSBs so social welfare, Financial inclusion has to be there although they are largely uncompensated for pursuing such goals — it's difficult to argue that the government's style of running its banks has served either itself or the banks well.
- High leverage of PSBs, politically connected wilful defaulters, the burgeoning stress in the balance sheets and the consequent deterioration in the supporting capital, declining profitability and productivity ratios and the dwindling market share of PSBs, are debilitating these banks and making them unequal competitors vis-a-vis their private-sector counterparts.

Broad Objectives of Indradhanush :

1) **Appointments:** Separating the **post of MD and CEO** of PSBs and bring a new post of a **"non-executive chairman"** which is a measure to bring accountability
2) **Bank boards Bureau:** The top posts of PSBs will be appointed by Bank boards bureau which will replace the existing mechanism.It will have members,1 chairman,3 officials and 3 experts(2 experts should be in the field of banking sector).
3) **Capitalization:** Capitalisation of 70,000 crores in the next 4 years for meeting **Basel -III and RBI norms.**
4) **De-stressing banks:** Presently there is a huge amount of **NPAs**.An**institutional mechanism** will be brought to manage NPAs.
5) **Empowerment:** Indradhanush has stressed on empowerment of banks.This includes more **autonomy** for PSBs and **less interference from govt** side in day to day functioning of banks.

ABrief on Bank Board Bureau .(BBB) :

The Banks Board Bureau has its genesis in the recommendations of The Committee to Review Governance of Boards of Banks in India, May 2014. Thereafter, on February 28, 2016, the Government of India, announced the constitution and composition of the Bureau. The Bureau started functioning from April 01, 2016 as an autonomous recommendatory body. As part of its mandate, and guided by a spirit of collaboration, the Bureau is engaging with various stakeholders. The objective of such engagement being to help prepare the banks in the public sector universe to take on the competition, have the ability to appropriately manage and price risk across business cycles, develop resilience to generate internal capital and have the capacity to generate external capital warding of the moral hazard in counting on the scarce budgetary resources of tax payers. The Bureau is also engaging with the Public Sector Banks (PSBs) to help build capacity to attract, retain and nurture both talent and technology - the two key differentiators of business competencies in the days to come. In its endeavour, the Bureau is mindful of the need to have a fully empowered board in each and every PSB. While the Bureau is working towards attracting the best personages on the boards, it is these boards which should drive the overall strategy of a bank within its risk capacity and also act as custodians who should reconcile the diverse interests of various stakeholders.

Functions of the Banks Board Bureau

1. To be responsible for the selection and appointment of Board of Directors in PSBs and FIs (Whole-time Directors and Non-Executive Chairman);
2. To advise the Government on matters relating to appointments, confirmation or extension of tenure and termination of services of the Board of Directors of the above mentioned levels;

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3. To advise the Government on the desired structure at the Board level, and, for senior management personnel, for each PSB and FI;
4. To advise the Government on evolving suitable training and development programmes for management personnel in PSBs/FIs; and
5. To advise the Government on the formulation and enforcement of a code of conduct and ethics for managerial personal in PSBs/FIs;

Drivers of bank recapitalisation

The regulatory requirements of capital adequacy and credit growth are the two main drivers for bank capitalisation. The regulatory architecture is globally framed by the Basel Committee on Banking Supervision—a committee of bank supervisors consisting of members from representative countries. Its mandate is to strengthen the regulation, supervision and practices of banks and enhance financial stability.

So far, three sets of Basel norms have been issued. The Basel I norms were issued in 1988 to provide, for the first time, a global standard on the regulatory capital requirements for banks.

The Basel II norms, introduced in 2004, further strengthened the guidelines for risk management and disclosure requirements.

This called for a minimum capital adequacy ratio (CAR)—or, capital to risk-weighted assets ratio (CRAR) as it is the ratio of regulatory capital funds to risk-weighted assets—which all banks with an international presence were to maintain.

These norms were revisited again in 2010—known as Basel III norms—in the wake of the sub-prime crisis and large scale bank-failures in the US and Europe.

Basel-III emphasized on capital adequacy to protect shareholders' and customers' risks and set norms for Tier I and Tier II capital.

The Tier I capital, or core capital, consists mainly of share capital and reserves; Tier II capital, also known as supplementary capital, consists of certain reserves and specific types of subordinated debt.

RBI has adopted Basel II and set the norms for all commercial banks, including PSBs, a notch higher in accordance with its usual cautious approach.

Broadly, the assets of a bank generally carry three categories of risks: credit risk, market risk and operational risk, apart from other associated risks.

Based on the riskiness of the asset, a specific risk weight is assigned to it and the asset value is adjusted as per the risk weight—the risker the asset, the higher the risk weightage and the lower its value. In India, RBI prescribes risk weights for different assets and sectoral/individual industry exposures. For instance, the risk weight on a government bond is zero, but it could be as much as 100% for banks' exposure to real estates.

There has always been a time-gap in the adoption of the Basel norms in India. For instance, Basel I norms (1988) were adopted in 1996, Basel II norms (2004) were adopted in 2008 even as the transition to Basel III norms (2010) commenced in September 2013 and is expected to be complete by 31 March 2019.

The Basel III norms are a comprehensive set of reform measures to strengthen the regulation, supervision, risks and capital management of the banking sector that evolved after the global financial crisis of 2008.

RBI has always been a conservative central banker, and its norms have mostly been more stringent than the Basel norms. For instance, against the Basel norms of minimum CRAR of 8%, RBI prescribed a 9% CRAR for Indian banks. At present, the minimum CRAR prescribed by RBI is 9%; in addition to that, banks are required to have 2.5% capital conservation buffer—mandatory capital that banks are required to hold in addition to other minimum capital requirements.

The implementation of Basel III norms is coinciding with the subdued economic growth in India and the rising bad assets of banks. Banks do not earn any interest on their non-performing assets, or

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NPAs; on top of that, they need to provide for them or set aside money, which could have earned interest if lent.

This has been bleeding PSBs, leading to losses at many banks and eroding their capital base and restricting their capacity to lend to make profit. Two main indicators of the performance of banks, among others, are return on assets (RoA) and return on equity (RoE). RoA indicates how profitable a bank is, relative to its total assets; it measures the efficiency of utilizing the bank assets to generate profit and is worked out by dividing net income by average total assets. A higher RoA indicates a better managed and more efficient bank. The profit, when ploughed back, adds to capital, and also improves a bank's ability to access the markets for additional funds for the purpose of further lending. RoE, on the other hand, reflects a bank's efficiency to utilize its shareholder's funds. A higher RoE also adds to the capital of the bank through reserves and surpluses. A higher ratio indicates better management of shareholder capital and a low or negative RoE reduces the ability of the bank in tapping the capital markets to raise additional funds to meet its regulatory capital needs.

RoA of PSBs has been consistently lower, compared with other scheduled commercial banks, while RoE of PSBs has been lower since 2012-13. In 2015-16, both RoA and RoE for most PSBs have been negative, indicating a loss to the banks and a concern for the government.

After a high credit growth rate regime during the expansionary phase of 2004-07, in tandem with India's high economic growth rate, the advances of public sector banks between 2008 and 2016 have more than doubled from Rs22.59 trillion to Rs55.94 trillion even though the rate of increase in advances has tapered in recent years—2.14% rise in 2015-16 against 19.56% in 2009-10.

The rise in advances, coupled with the stringent capital adequacy requirements imposed by RBI in the wake of the Basel III norms, high levels of NPAs and the poor performance of PSBs have led to significant capital erosion and requirements for further capital—both for replenishment of the base eroded by NPAs and fresh ones for giving loans.

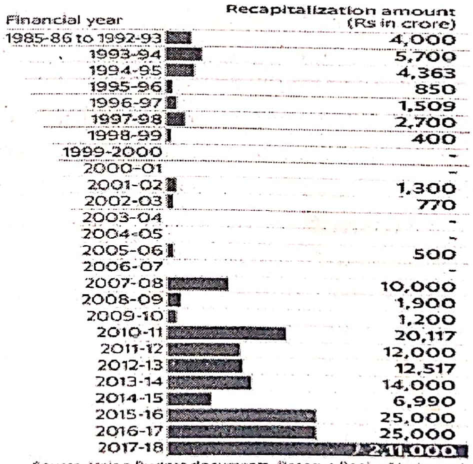
GOVERNMENT OF INDIA AND LIC'S SHAREHOLDING IN PUBLIC SECTOR BANKS AS ON 31 MARCH

Figures in %

Name of PSBs	2010-11		2016-17	
	Govt	LIC	Govt	LIC
Allahabad Bank	58	7.61	65.92	14.17
Andhra Bank	58	8.47	61.26	11.58
Bank of Baroda	57.03	6.44	59.24	10.03
Bank of India	65.86	8.31	73.72	12.83
Bank of Maharashtra	79.24	6.57	81.61	12.72
Canara Bank	67.72	4.71	66.3	13.62
Central Bank of India	80.2	6.55	81.28	13.83
Corporation Bank	58.52	24.81	70.76	18.91
Dena Bank	58.01	6.34	68.55	12.23
Indian Overseas Bank	65.87	9.78	79.56	10.68
Indian Bank	80	1.87	82.1	3.14
Oriental Bank of Commerce	58	10.49	58.38	13.05
Punjab National Bank	58	6.37	65.01	12.52
Punjab and Sind Bank	82.07	-	79.62	0
Syndicate Bank	69.47	10.42	72.92	11.28
UCO Bank	68.13	7.33	76.67	14.5
Union Bank of India	57.07	4.14	63.44	10.24
United Bank of India	85.48	-	85.23	7.3
Vijaya Bank	57.69	6.35	70.33	12.93
State Bank of India	59.4	11.26	62.22	8.96
IDBI Bank	65.13	10.18	73.98	13.87

Source: BSE and NSE websites

RECAPITALIZATION OF PUBLIC SECTOR BANKS



Source: Union Budget documents, Reserve Bank of India and Comptroller and Auditor General of India

The capital can come either from their dominant shareholder (the government of India) or the capital market. Their underperformance and the pile of bad loans leading to low book value come in the way of accessing the capital market. There is a significant gap between the book value and market value of PSB shares, with most PSBs having a lower market value, compared with their book values. Hence, the government as the majority stakeholder needs to step in to rescue PSBs. However, the norms followed for capital infusion seem to be inconsistent, ad-hoc and piece-meal, lacking any consistent policy pattern.

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Governance Reforms :

The process of Governance Reforms started with "Gyansangam" a conclave of PSB's and FI's organized at the beginning of 2015 in Pune which was attended by all the stake-holders including Governor, RBI and CMD's of PSB's and FI's.TheGyansangam recommendations included amongst others strengthening of Risk Management practices. The focus is on improving HR Management practices and removing barriers so that the banks can share and work together on common resources. Various steps have been taken to empower the banks boards.

Conclusion :

One thing is for sure. Along with fighting pitched battles with loan defaulters, bankers will start giving loans anew. For the past three years, credit growth, particularly for the public sector banks, has been tepid.

Some public sector banks have even shrunk their loan books. A weak investment climate has been responsible for this. Over-leveraged Indian companies have had neither the capability nor the inclination to lift bank credit and set up new projects. This is expected to change in 2018.

Better cash flows, higher capacity utilization and a pick-up in some high-frequency indicators are encouraging analysts to anticipate an upturn in private capital expenditure—if not across sectors, at least in some select pockets.

Banks, too, have been reluctant to lend in recent years for fear of piling up more bad assets. Banks do not earn any interest on bad loans; on top of that, they need to set aside money to cover the risk of default on such loans. This hits profitability. Hefty provisions have also pushed many banks into losses and eroded their capital. This is why they have been diffident about lending.

The government has addressed this by announcing a big bang Rs2.11 trillion recapitalization of state-owned banks. This is some 1.3% of India's GDP. While a debate is under way on whether this will be enough to meet the capital needs of public sector banks (keeping in mind the needs under Basel III norms, which will be in place in 2019) and how much of this fund infusion is growth capital, one thing is certain: there will be strings attached to the disbursement of this money. RBI and the finance ministry have been jointly working on this.

Recapitalization is not something new for India's state-owned banks. In the past 31 years, between 1985-86 and 2016-17, the government had infused much less, some Rs1.51 trillion in the state-owned banks.

Historically, the finance ministry, representing the government, the majority owner of this group of banks, decides on which bank gets how much capital. It has been a sort of democratic exercise where banks get funds according to their size and not their efficiency and prospects. For the first time, they would need to earn this money.

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