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Reforming PSU Banks beyond Recapitalization

Why in news?

Union government has allocated Rs.70,000 crore for recapitalisation of public sector banks (PSBs) during budget.

What is union government's plan on recapitalization?

- Non-performing assets (NPAs) in the banking system have come down, the Insolvency and Bankruptcy Code is enabling recovery, and the flow of bank credit has improved.
- According to the Reserve Bank of India's latest Financial Stability Report, the bulk of NPAs has been recognised and the cycle appears to have turned.
- However, the PSBs might take more time to recover as their gross NPAs are still in excess of 12%.
- Union government has allocated Rs 70,000 crore for recapitalisation of public sector banks (PSBs) in the Budget, in which the market is expecting about Rs 40,000 crore.
- Depending on which bank gets how much, the additional infusion is expected to be used as growth capital by the PSBs.

What are the expected outcomes and concerns with this plan?

- Essentially, from the PSBs' standpoint, there is progress on recognition, resolution and recapitalisation.
- But the fourth R-Reform (from the government's 4R approach) is still missing.
- If wider reforms are not initiated, the need for recapitalisation will keep resurfacing.
- It is evident that the asset quality problems did not arise only because of misplaced optimism and excess borrowing by the corporate sector.
- It is also due to the inability of banks, particularly in the public sector, to properly evaluate the risks.

What measures need to be considered?

- To improve the operational efficiency of the PSBs, the government will

need to work on multiple levels.
- For instance, PSBs need to be freed from dual control of the central bank and the finance ministry.
- The regulation should be on par with banks in the private sector.
- Further, it is important to have professional boards in the PSBs, with complete operational independence.
- This will help make them more accountable.
- In an environment of growing complexity in business and finance, banks need manpower with specialised skills to manage risks.
- The PSBs need a major overhaul in the way the human resource is managed.
- It is important that wages are market- and performance-linked. This will enable the PSBs to attract the right kind of talent.
- At the same time, it is important to protect bankers in the public sector from investigating agencies when commercial decisions go wrong.
- A meaningful change can perhaps only happen if the government shareholding is brought down significantly.
- But this is something that does not seem to be on the agenda.

What lies ahead?

- Domestically, weak PSBs will impede the efficient allocation of capital and make the goal of increasing India's gross domestic product to $5 trillion by 2024 more difficult.
- Since the government now wants to take a part of its borrowing overseas, increasing liability and the weak state of the PSBs can put pressure on both Indian bonds and ratings.
- Budget constraints will not allow the government to keep recapitalising the PSBs, and frequent use of recapitalisation bonds will erode market confidence in India's fiscal management.
- Given India's fiscal situation, the government would soon need to take a call on what it intends to do with the PSBs.

Source: Business Standard