India's bank privatisation agenda may not enthuse investors as yet, say experts

Potential investors may not want to take on issues of a large pool of bad assets in state-run banks and pressure from bank unions

SIDDHI NAYAK

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PM Narendra Modi with FM Nirmala Sitharaman (Image: PTI)

The government may have been a little too ambitious with its intent to completely exit state-run banks. It's unlikely to draw much interest from investors, multiple investment bankers and analysts say.

The reasons? The large pool of non-performing assets (NPA) weighing down state-run banks and pressure from bank unions.

“While privatising a bank, investors have to frontload costs, tackle bank unions, assess the NPA problem and potentially overhaul the existing systems and processes in the bank,” said Varun Khandelwal, director and fund manager at Bullero Capital.

Khandelwal that the government’s proposal coincides with a potential slowdown in Indian economic growth, fears of a recession in the US and the end of the easy money era with central banks raising interest rates.

The government is currently preparing to push the privatisation agenda in state-run banks. On June 28, The Economic Times **reported** that the government is likely to introduce amendments to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, during the monsoon session of parliament to enable full divestment of its stakes in state-run banks.

India currently has a dozen state-run banks. In the **Union Budget** for FY21, finance minister **Nirmala Sitharaman** had announced the privatisation of two state-run banks, besides **IDBI Bank**. As per the new public sector enterprises policy, announced in 2021, central public sector undertakings (PSU) will maintain only a minimal presence in four strategic sectors, which includes banking. If this Bill gets passed, it is possible that the government may propose the privatisation of more banks.

“This amendment probably is to test the market potential for privatisation vis-à-vis its fiscal position,” said Bullero Capital’s Khandelwal. “Even if the amendments go through, there will be very little interest from investors at this stage and complete divestment in state-run banks is unlikely in the near term. In the banking space, the government has repeatedly stated it wants to privatise IDBI Bank, but there is hardly any progress on the same."

Tackling NPAs

To be fair, support measures provided by the **Reserve Bank of India** (RBI) during the COVID-19 pandemic, along with the government's credit guarantee scheme, helped arrest the NPAs of state-run banks.

These banks have also made sufficient provisions for bad assets and raised equity and debt capital to protect their balance sheets.

As at the end of FY22, the gross NPA ratio of state-run banks stood at 7.6 percent compared with 9.5 percent at the end of FY21, according to RBI data. However, in a severe stress scenario, the banking regulator sees gross NPA ratios of state-run banks increase to 10.5 percent by the end of FY23.

"Even though the asset quality of these banks is improving, the NPA ratio is still uncomfortably high for private equity players to bid for these banks. Why will any investor want to take on that," an investment banker said on condition of anonymity.

"At most, we think that a complete divestment of State Bank of India may be feasible given the reach it has, but it is unlikely that the government will want to divest even a part of its stake in this bank. There will be a lot of political opposition," the banker said.

According to Aditya Acharekar, Associate Director at CARE Ratings, the government may be aiming at divesting its stake completely in relatively weaker banks that have high NPAs and moderate profitability. A high portion of NPAs will be a challenge despite the money set aside to cover loan losses, he said.

The so-called bad bank, or **National Asset Reconstruction Company Limited** (NARCL), is an entity set up to absorb the stressed assets of banks, and has finally come into existence. Once the chronic bad debt cases move to NARCL, state-run banks will have much cleaner balance sheets. NARCL was registered in July 2021. It has missed its March 31 deadline to complete the acquisition of 15 stressed assets worth Rs 50,000 crore from banks.

“Apart from quantum, type of NPAs, age and possible recovery from these NPAs will weigh on the valuation at which potential investors may be looking at,” added Acharekar. “Some clean-up of NPAs by transfer to NARCL is expected; however, the process till date has been slow.”

Even if the government doesn’t divest its stake in one go and phased, investors would seek clarity on the kind of ownership they would gain, experts said.

Currently, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, requires the government to hold at least a 51 percent stake in state-run banks. The earlier thinking was that the government should retain at least 26 percent during privatisation and that this could be brought down gradually.

“The RBI permits promoters of private sector banks to hold up to 26 percent of the paid-up share capital, the same extent of ownership limits could become a possible cap for PSU banks as well,” said Aashay Choksey, Assistant Vice President- Financial Sector Ratings, ICRA. “Full divestment will depend on the profile of the new promoters.”

“A strong promoter group may prefer limited government ownership, while in other cases, they could prefer government ownership to ensure stability of liabilities post the divestment.”

In addition, Jyoti Prakash Gadia, Managing Director at Resurgent India, a Gurugram-based investment banking firm, said the RBI's discomfort with industrial houses owning banks meant a sizeable set of prospective buyers were completely ruled out from making any bids. Gadia also sees state-run banks' huge employee base and the public sector work culture adding to the government's difficulties in selling these lenders.

Moreover, employee unions of state-run banks are dead-set against privatisation. They have argued that privatisation of state-run banks would lead to huge lay-offs.

"For disinvestment, one of the main issues could be related to human resource," said Aniket Dani, Director, CRISIL Research. "If this can be tackled and the public sector bank systems and processes can be made more agile, it could provide a good opportunity for private investors."

A complete privatisation of state-run banks would only be possible if the NPA problem is solved through an effective asset reconstruction mechanism. At the same time, appropriate measures are needed to boost investor confidence, said experts.

"Investors will only appreciate or welcome this move from the government if there are proper institutions or departments to take care of proper evaluation and encashment from asset reconstruction of bad assets and management of human resources," said Rahul D Thalia, Director at Sarffin Financial Advisors.