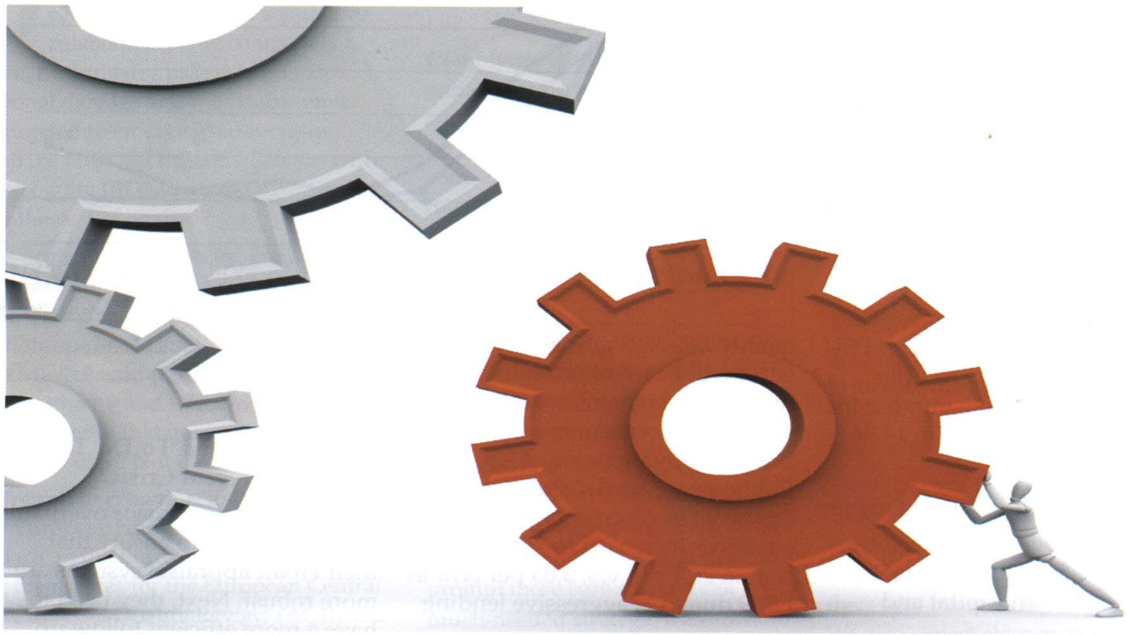
Public Sector Banks

Challenges Galore



Capital infusion by the government works in the short-term, but is evidently not the solution. We need to ideologically decide on public holding in these banks so that they should be able to access the market on their own to raise resources. This will also help them to become more competitive, avers Rajesh Mokashi, Deputy Managing Director, CARE RATINGS, Mumbai.

Public sector banks, being the dominant group in the system, run the risk of losing out to competition on account of a relatively stable growing cake being distributed among more banks. Therefore, entry of new banks will lower their market share progressively, which was witnessed even earlier when the first set of private banks came in. This said, they still retain the advantage of rural spread and given their high levels of penetration would continue to have an advantage in terms of meeting the requirement of inclusive banking which is a challenge even for existing private banks which have to invest more in this area.

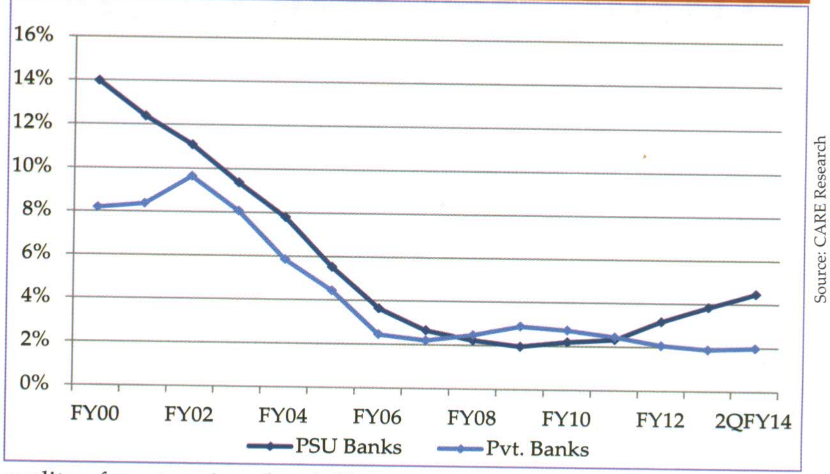
NPAs – Only to Rise!

On NPA front, the PSBs do have legacy issues. Also due to extraneous interference they have additional pressures unlike the private banks. Further, they also are more active in priority sectors some of which have a higher propensity to turn sour which in turn puts pressure on balance sheet management. This problem will continue to get accentuated as long as the economy is in a downswing, which is the case today. The gross NPA level of the public sector banks has reached ~4.5 per cent in 2QFY14 as compared to the private banks' 2.04 per cent. The gross NPA level is expected to be ~4.3 per cent in FY14e for the overall banking industry. In our opinion, internally PSU banks have to strengthen their systems and ensure they are better prepared with their risk management systems to face this challenge.

Boosting Capital, Another Key Challenge

Capital is one major challenge for the state-owned banks as they are restrained from raising capital in the market given their ownership structures. The Union Budgets will not be able to provide the requisite capital infusion as the government has its own fiscal constraints which will mean that the government has to take a call on disinvestment. With their profit margins under pressure, they will have less recourse to internal funds to shore up their capital for future expansion. Therefore, the government has to take a call on this issue soon or else there will be uneven growth in this sector as the larger ones with deeper internal resources that qualify as capital will be able to grow faster. One must remember that presently low economic growth for three successive years has kept the demand for credit low and once the situation changes banks will encounter this problem. The accompanying table depicts capital adequacy levels of PSU and Private sector banks. The mean capital adequacy of PSU banks is approximately 11 per cent whereas the same number for private banks is more than 14.34 per cent.

Share of PSU and Private Banks NPAs



Are They Heading For Further Troubles?

PSBs will definitely face further pressures on both capital and quality of assets going ahead. The latter will be more pronounced as we have seen that any downturn tends to affect them more seriously than the private banks. Also, Public sector banks' restructured advances as a percentage of gross advances increased to 7.11 per cent in 2QFY14 v/s. 3.03 per cent in FY09 due to 1) aggressive lending during FY07-FY11, 2) inadequate due diligence, and 3) bias towards known borrowers.

Capital Adequacy levels of PSBs (CRAR - BASEL II)

PSU Bank	2QFY13	3QFY13	4QFY13	1QFY14	2QFY14
Indian Bank	12.96	13.07	13.08	13.06	13.27
IDBI Bank	13.91	14.19	13.13	12.58	12.38
UCO Bank	12.27	13.19	14.22	13.72	13.23
BoB	12.91	12.66	13.30	12.70	12.32
SBI	12.63	12.21	12.92	12.12	12.92
PNB	11.73	11.66	12.72	12.44	12.32
Syndicate Bank	11.33	11.38	12.59	11.93	11.94
OBC	12.06	12.25	12.04	12.02	12.09
Andhra Bank	12.39	11.86	11.76	11.46	11.50
P&S	12.75	12.23	12.91	12.64	12.03
BoI	11.15	10.59	11.02	10.66	11.30
Allahabad Bank	12.16	11.96	11.03	11.07	10.72
BOM	10.75	10.70	12.59	11.83	11.67
IOB	12.07	11.65	11.85	11.28	11.01
Canara Bank	13.07	12.64	12.40	11.35	10.96
Corporation Bank	13.05	12.57	12.33	12.10	11.24
Dena Bank	12.05	11.47	11.03	11.12	10.73
CBI	11.51	10.75	11.49	11.43	11.41
UBI	11.39	10.78	11.45	11.14	10.38
United Bank	12.08	11.88	11.66	11.74	10.35

Source: CARE Research

What They Need To Do To Tide Over The Present Crisis?

PSBs need to do a major overhaul of their systems to ensure that their credit appraisal systems are more robust. Next, they need to have a more efficient follow up system of tracking their assets and recognizing problems before they occur. Here I think that the ratings given by external Credit Rating Agencies would provide a lot of information to them which can be used as under Basel II rules; bank loans need to be rated by them. Further, once bad assets are recognized, they should be provided for with alacrity so as to improve the response. This will help to avoid the kind of situation we have seen some banks have gotten into it in the recent past. Increased attention to risk-based pricing and proactive recovery management including timely sale to ARCs (Asset Reconstruction Companies) will help. Capital infusion by the government works in the short-term, but is evidently not the solution. We need to ideologically decide on public holding in these banks so that they should be able to access the market on their own to raise resources. This will also help them to become more competitive.

TGA