

Capital infusion in banks falls short

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The Centre has stuck to its earlier commitment of infusing Rs 25,000 crore into public sector banks in 2016-17, under its Indradhanush plan. But this is insufficient given the recent sharp rise in bad loans, after the RBI's asset quality review.

The [Finance Minister](#) took forward its reforms to materially improve the governance in public sector banks. The proposal to set up a Banks Board Bureau that was laid out in the previous Budget will be operationalised during 2016-17 according to the Finance Minister.

The Centre also proposes to come out with a roadmap for consolidation of PSU banks. As a test case to reduce its stake in PSU banks, the Budget stated that it has started the process of transformation of IDBI Bank, and would reduce its stake to below 50 per cent.

The background

The Centre has been meeting the capital needs of state-owned banks in the past. After infusing Rs 14,000 crore in 2013-14, the government became tight-fisted in 2014-15 and infused just Rs 6,990 crore into these banks based on performance. While the Budget last year had laid out a meagre Rs 7,000 crore for capitalisation, the Centre revised this amount up during the latter part of this fiscal and infused an additional Rs 20,000 crore into PSBs, given the sharp increase in bad loans and their weak capital position.

Bad loans have gone up sharply across all banks in the latest December quarter due to RBI's latest asset quality review, that has forced banks to recognise certain loans as bad. The sharp increase in provisioning requirement has eroded the earnings and capital of most PSBs. Hence the proposed Rs 70,000 crore capital infusion between 2015-16 and 2018-19 under the Indradhanush plan may not be sufficient.

Market players estimate that the Centre should infuse Rs 1.8 lakh crore in to all banks.

The proposal to set up a Banks Board Bureau (BBB) was made during the last Budget to usher in improved governance of public sector banks. One day ahead of the Union Budget 2016-17, the Centre announced the appointment of former Comptroller and Auditor General (CAG) of India Vinod Rai as the Chairman of the Banks Board Bureau. The constitution of an independent Banks Board Bureau will bring in independent selection process for top bank officials.

But for truly autonomous boards, the Centre needs to dilute its stake in PSU banks to below 51 per cent. For this the Centre has to repeal the special Acts under which banks such as the SBI are constituted. As a test case, hence the Budget has stated that it will start the process of dilution at IDBI Bank. While government owns 80 per cent stake in IDBI Bank, the bank is governed by the Companies Act — not applicable to other PSBs.

The verdict

In the near term, banks that have very low capital ratios and weak asset quality will find it difficult to grow and meet their Basel II requirement. Dena Bank, United Bank, IOB, Syndicate Bank, Allahabad Bank, Central Bank of India, are some of the banks that have Tier I capital of just above the mandated 7 per cent.

The move to operationalise BBB in 2016-17 will impact all PSU banks positively. However, the Centre has to ensure that the BBB is well ring-fenced from political interference. It should be empowered to induct independent directors and make the strategic decisions necessary to set their house in order.

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