Government will have to take strategic decision on PSU banks: Uday Kotak

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MUMBAI: The government will sooner or later have to make the difficult choice between putting more money into public sector banks or making some 'strategic' decisions for these lenders besieged by rising bad loans and paucity of capital, Uday Kotak founder and vice chairman of Kotak Mahindra Bank said in the bank's annual report.

"The time has now come to bite the bullet. The state, sooner or later, may have to make the difficult choice between putting in more good (tax payers') money after bad or being open to 'strategic' choices. I wonder whether that can happen now or sometime after 2019," Kotak said in his letter to shareholders.

Total stressed loans in the Indian banking system currently stand at more than 12 lakh crore. Stressed loans include loans that have been restructured and also those that have also turned bad. The amount of bad loans in the banking sector crossed Rs 7 lakh crore in the quarter ended March 2017 largely from sectors linked to infrastructure and metals like steel and power.

Private sector banks like Kotak Mahindra which have very few infrastructure loans and which depend on retail banking and working capital loans to make their money, are much better placed. But Indian banking is still dominated by public sector banks.

Kotak said the current Banking industry's current structure is not sustainable. "The system's inability to recognise the inconvenient truth that banking is an economic and commercial activity with high leverage, and that years of 'kicking the can down the road' in high risk areas, mixing of social objectives and weak governance have all contributed to bringing this industry to a weak position."

He was pointing to the failed attempts by banks to restructure these toxic loans instead of taking a hit and moving on and concentrating on accounts that are more sustainable.

In March the RBI issued a new prompt corrective action (PCA) framework for banks which will tighten restrictions on banks' capital raising, dividend payments and branch expansion if they slipped on any of the four parameters, namely asset quality, capital adequacy, return on assets and core capital.

A report by rating agency ICRA later in April said that a total of 16 public sector banks out of 21 and two out of 16 private banks will require corrective actions based on these measurements.

Kotak said that the errors of commission in the banking industry are significantly more expensive than errors of omission. "At the same time, while we have relaxed entry norms in many areas of financial services, including banking, we need to give more thought to mortality and exits in this sector with potential systemic risks," he said.