

NPAs crisis: Now, private banks do not look good anymore

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The recent jump in NPA disclosures at private banks following an RBI review has added a new dimension to current banking crisis in India. (Reuters)

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The recent jump in NPA disclosures at private banks following an [RBI](#) review has added a new dimension to current banking crisis in India. The revelations run contrary to narratives that private sector banks have superior skills and governance bandwidth to evaluate risks in large projects, especially long-term infrastructure ones. Rather, the features of these fresh NPAs appear remarkably similar to those in public sector banks (PSBs). For most part, the troubled entities are common, the sectors alike, as also are past non-disclosures, subsequent reclassification of assets and increased provisioning. The connections are so stark—many of the



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assets reclassified as 'bad' are consortium loans—it is hard to spot any difference! Then, what explains the rising delinquencies at private banks?

This is critical as the current narratives squarely blame public sector bank management for pure bad lending—either being coaxed by the then UPA government to finance its ambitious infrastructure investment targets or colluding with large corporates to fund unviable big projects. If private banks in their wisdom and assessments were willing partners when co-lending in many of these projects, then why raise fingers at their counterparts? To the contrary, private banks' participation in these projects would have given public banks additional comfort that their due diligence was in order—given the overwhelming presumption that their partners possess superior risk-assessment skills, while being accountable to their watchful shareholders!

Though we do not intend to show both in the same light, the observation is inescapable that both bank groups either lacked skills to assess large and long-term infrastructure projects or could not anticipate the depth and duration of the business cycle downswing. This is not to make a case that mala fide lending did not happen in public sector banks; but to see each case of NPA with a tinted glass runs the risk of wrong diagnosis. The only case that could be made against public banks is their relatively larger exposure to such failed projects. What was the rush in doling out so much funding to such high-risk projects?

Poor project-appraisal skills or job thrust amidst a vacuum?

To appreciate the current state of affairs, one must rewind to December 30, 2003, when the first NDA government amended the Industrial Development Bank of India (IDBI) Act, 1964 to convert the country's largest long-term financial institution into a virtual bank. The overwhelming consensus then was that concessional funding provided by the RBI to IDBI for long-term project lending must end. A year before in 2002, Industrial Credit and Investment Corporation of India (ICICI), the other major term-finance institution in the private sector had merged with its own bank. Two other smaller term-finance institutions had also run into oblivion: Industrial Investment Bank of India (IIBI) was closed down and Industrial Finance Corporation of India (IFCI) became insignificant in its operations.

To fill up the vacuum, especially to support long-term infrastructure finance, the government had propped up Infrastructure Development and Finance Corporation (IDFC) in 1997. IDFC's dismal track record in fulfilling its objective was testified when it meekly admitted its failure and converted into a commercial bank. The track record of India Infrastructure Finance Company Limited (IIFCL), another such institution set up by UPA government in 2006, is a living testimony to how government-led institutions were a non-starter! Neither did the much-fancied corporate bond market take off as envisaged. As infrastructure ambitions were scaled up, banks were asked to step in despite obvious limitations in lack of capacity to evaluate long-term projects and structural asset-liability mismatch. Until then, banks mostly extended collateral-based working capital and retail credit. Banks were coaxed into acquiring these skills in exceptional circumstances and within a shorter time frame, including securing debts with expected revenue streams instead of physical collateral.

Not surprisingly, the bulk of infrastructure credit came from public sector banks, assigned a key role in India's 'inclusive development'. The rapid scaling-up reflects in a 39% compound annual growth rate (CAGR) of outstanding bank credit to infrastructure in 15 years or 104 times (RBI Deputy Governor NS Vishwanathan, November 2016). Adjusting for the recent slowdown, the CAGR is 43.4% (from Rs 72.4 billion 1999-2000 to Rs 7,860.5 billion by 2012-13) compared to a corresponding 20.4% CAGR of bank finance to all industries in the period (speech by KC Chakrabarty, Deputy Governor, RBI, August 9, 2013). Percentage shares of infrastructure bank credit rose from 1.6% of gross bank credit to 13.4% over 2001-2013. Successive governments from 1999-2000 and RBI encouraged this: the former by eliciting private sector participation as public investment retreated; the latter, by numerous concessions/relaxations, e.g. raising single/group borrower limits, guarantee issuance favouring other lending institutions, asset classification benefits in restructuring guidelines, conditional funding of promoter's equity, financing registered SPVs set up for infrastructure projects, allowing debts due under PPPs to be considered secured to the extent assured by project authority in concession agreements, and so on.

The relevant point is that the burden of infrastructure financing devolved upon public sector banks, not really private ones, hence the higher NPA levels. Lopsided conclusions about public banks' abilities for screening, risk-analysis of project loans have overlooked this rapid role transformation and the weight of financing a high risk, uncertainty-ridden segment like

infrastructure. There was little appreciation that no one, including national and international agencies, anticipated such a prolonged slowdown in economic growth momentum, nor many are willing to admit that many NPAs were the result of unanticipated policy shocks such as sudden cancellation of coal-block allocations, hardening of environmental clearance stance, new land acquisition rules and structural transformation in monetary policy stance that adversely affected corporate debt burden—for which bankers should have been the last one to blame!

Adverse fallout: Who will finance large infra projects?

Current policy focus is rightly focused on resolution of NPAs and recapitalising public sector banks to restart lending. While markets have appreciated these efforts, they are largely disheartened the government has not shown any inclination to privatize some public sector banks as also introduce significant governance reforms in these banks. Hopefully, some of these measures would be under the government's considerations. With a Rs 2.11 trillion recapitalisation package, market expectations are now high that public sector banks would soon resume lending. Hopefully, they will. But, the real question is what type of lending? Will they be inclined to lend to long-term infra projects or simply retract back to their old shelf, limiting exposure mostly to working capital and retail loans? With a bank like HDFC, the star model in town, that specialises in retail lending, who would risk lending to long-term projects, except housing finance?

The narratives that showed public banks in poor light over accumulation of NPAs have already led to unpleasant outcomes. Risk-aversion set in as public gaze turned upon bankers. These actions triggered fear of lending, froze decisions, choking off further infrastructure credit. Banks now restrict lending to retail, while industry demand languishes; income and profitability parameters have worsened. With private consortium partners who now face similar defaults likely to come under shareholders' scrutiny, they too will hesitate to touch a high risk, uncertain segment like infrastructure ahead. The experience and damaging accounts of these loan failures will take their toll upon both bank groups as far as large projects and infrastructure financing goes. Banks, public or private, are unlikely to engage meaningfully in any such projects.

Who then will finance long-term infrastructure such as 'Sagar Mala' and 'Bharat Mala' going forward? Government led, tax funded, infra spending will soon hit its limit since the oil windfall