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Recapitalising PSBs

What is the issue?

- Finance Minister said that the Centre will not infuse any further equity into public sector banks (PSBs).
- So, the market-based fund-raising and higher retail ownership is the way forward.

Why this decision is welcomed?

- This is welcome given that Covid-related business disruptions are widely expected to escalate capital requirements for PSBs.
- Their actual capital needs will depend on many moving parts.
- Estimates suggest that PSBs may require new capital between ₹35,000 crore and ₹85,000 crore in the second half of this fiscal, to maintain their capital buffers.
- Funding this will certainly stretch the fisc at a time when the priority is resuscitating the economy.
- But weaning PSBs away from their government dependence is desirable for other reasons as well.

What happened in the past?

- In the last three years, the Centre has already infused ₹3.5-lakh crore into PSBs with very little to show for it.
- Each round of capital infusion is made with the intent of improving credit flow to the economy.
- But, in practice, the bulk of capital tends to be absorbed by bad loan provisions, while bankers continue to display endemic risk aversion.
- Attempts to make these infusions selective and contingent on individual PSBs' performance have not worked either.
- This is because the tottering banks need to be shored up before eroding depositor confidence can pose systemic risks.
- This situation results in a moral hazard where the government is forced to commit ample taxpayer money towards PSB recapitalisation every year with very little payback.

What is the challenge?

- There can be no doubt that the government cutting its apron strings in PSBs is the best way forward.
- But, getting public shareholders to subscribe to these offers will be no mean task.
- There were sluggish credit growth and loan losses in the recent past.
- Due to this, even leading PSBs have poor profitability and return ratios that compare unfavourably to private sector peers, with their stock prices languishing well below book value.

What could help?

- Infusing fresh capital at these bargain-basement valuations, apart from diluting earnings for existing investors can actively deter new ones.
- Kicking off long-pending governance reforms can partly solve this problem.
- It will shore up market valuations and investor sentiment towards PSBs.

What are the suggestions?

- The PJ Nayak committee suggested a few of the reform measures.
- It suggested creating an umbrella holding company to house government stakes in all PSBs.
- It also suggested distancing the government from commercial decisions by appointing independent boards and CEOs.
- Other suggestions include extending top management tenure and ushering in performance-linked pay at PSBs.

Source: Business Line