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POOR PERFORMANCE OF PUBLIC SECTOR BANKS IN INDIA: SOME OPTIONS TO REVAMP

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Abstract

Public Sector Banks (PSBs) play a vital role in India's economy. Public sector banks, which account for 72.7 per cent of the total banking assets in India, grew at an average of 73.7 per cent during the period 2010-14 (IBEF, 2015), have reported rapid deterioration in its profitability in the recent past. In this article an attempt is made to analyse the financial performance of the public sector banks and certain measures suggested by Government to revamp this ailing sector have been discussed. This paper explores the asset quality aspect of PSBs and finds that Non Performing Assets as a percentage of Net Advances have increased considerably over the past few years and also quite high as compared to Private Sector Banks. Profitability has suffered a lot due to recent clean up drive initiated by RBI to write off Bad debts. The study also found that stocks of most of PSBs are trading below their book value which is a clear indication that if the bank is put up for sale it would not fetch the same value that is shown in its books.

Keywords:Public Sector Banks(PSBs);Indian Bank Association(IBA);Net Performing Assets(NPAs);Earning per share(EPS);Gross non-performing assets (GNPAs);

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Introduction

The public sector banks, which had dominated the banking sector for decades and were considered as the lifeline of the Indian banking and financial systems, are now in bad shape due to certain reasons which are accounting for sudden fall in profits and thereby plaguing them. Since the nationalisation of the Imperial Bank of India and its conversion to State Bank of India in 1955, the banking system in India has largely been under the control and regulation of government of India. Public sector banks have penetrated their services out to the length and breadth of the country, introducing banking concept for the masses and the ordinary. But PSBs are now feeling the heat of the competition from private sector banks and thereby losing ground to private banks which are very young as compared to these matured Public Sector Banks. There are currently 28 public sector banks in India out of which 20 are nationalised banks and 6 are SBI and its associate banks, and rest two are IDBI Bank and Bharatiya Mahila Bank, which are categorised as other public sector banks.

Objectives of the study

1. To measure the performance of Public sector banks in India.
2. To study various options available to reform the ailing public sector Banks in India.

Review of Literature

Table 1: Findings of Various studies conducted on the financial performance of Public Sector Banks in India

Study	Findings
Ram Pratap Sinha (2013):A Comparison of the Performance of Commercial Banks, DEA Evidence for India.	The study evaluates the performance of 49 Indian commercial banks for the period 2006-07 to 2010-11 and finds that the new private sector commercial banks performed the best, followed by the old private sector banks, nationalized banks and the SBI Group.
Mr. M.Karthikeyan & Dr. P.Sivakami (2014):	Thirty ratios related to CRAMEL model were applied in this for the study of the

Performance of Public Sector Banks in India (A Study Using Cramel Model)	select Public Sector Banks, Punjab National Bank was at the top position with CRAMEL average of 3.83, followed by Oriental Bank of Commerce which found to have an average of 5.83. Bank of Maharashtra stood at last (19th) position due to its poor performances in C, A, M and E i.e. Capital Adequacy, Asset Quality,
T.Durai Pandia and P.Vellingirib(2014): Factors determining profitability of public sector banks in india	The researcher has applied the different ratios and found significant of debt to equity, other assets to total assets, fixed assets to total assets, fixed assets to Networth and other liabilities to total assets. In terms of profitability, Majority of the banks has registered above the benchmark (more than one per cent) on ROA, Equity paid up to Networth, Return on capital employed and deposits to total assets. It has been observed that the banking sector in India has responded very positively in the field of enhancing the role of market forces regarding measures of prudential regulations of accounting, income recognition, provisioning and exposure and introduction of CRAMELS supervisory rating system. All the banks has to take necessary steps to improve the overall performance of the banking sector.

Research Methodology:

A sample of 19 Nationalised Public sector banks and 7 banks from State Bank group and two other Public Sector Banks are chosen for the purpose of present study. The secondary data from the annual reports of relevant banks for a period of 3 years (2014-2016) have been used. In addition research papers published in various Journals and statistics issued by RBI, BSE, Indian Banks Association(IBA) have been used. Various indicators of financial performance like asset quality indicators ,stock indicators and market capitalisation indicators have been used to evaluate the performance of PSBs in India.

Data Analysis and Interpretation:

1. Asset Quality Indicators

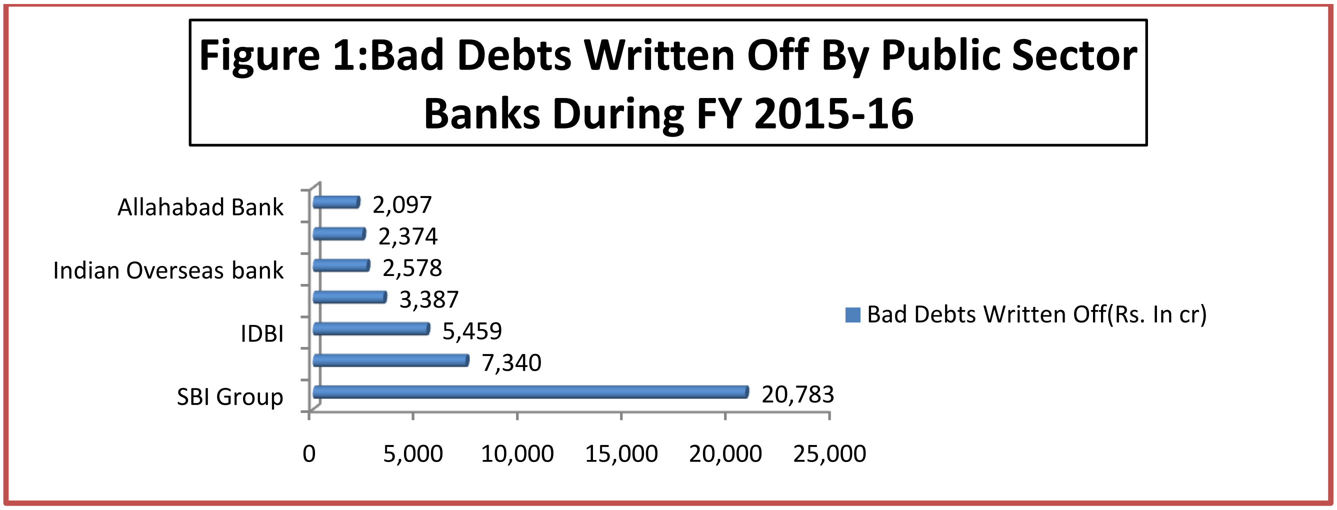
Table 2: Asset Quality Indicators of Public Sector Banks

	2014	2015	2016
Total assets of Public sector Banks(Rs. in crores)	**79,68,416**	**86,78,833**	**90,61,723**
Total assets of Private sector Banks(Rs. in crores)	**19,89,797.09**	**22,58,810.08**	**25,34,558.26**
Gross NPA of Public Sector Banks(Rs. in crores)	**2,27,264**	**2,78,468**	**5,25,348**
Net NPA of Public sector Banks(Rs. in crores)	**1,30,360**	**1,59,952**	**3,21,375**
Net Advances of Public Sector Banks(Rs. in crores)	**51,01,142**	**54,76,250**	**55,93,577**
Net NPA as % to Net Advances of Public Sector Banks	**2.56**	**2.92**	**5.75**
Net NPA as % to Net Advances of Private Sector Banks	**.52**	**.66**	**.89**
Bad Debts written off BY Public Sector Banks(Rs. in crores)	**34,409**	**52,542**	**59,547**

Source:IBA

- If we see the amount of bad loans on PSB books then we are shocked to learn that PSB that account for three-quarters of India's banking sector, (Venkataramakrishnan, 2016) had a whopping Rs 3,21,375 crore in net non-performing assets (which is bad loans, minus the cash set aside to deal with losses) as of march, 2016. An NPA is a loan where interest or principal has not been paid for more than 90 days, according to the Reserve Bank of India (RBI)
- Gross non-performing assets (GNPAs) of banks soared to Rs. 5, 25,348 crores in the year 2016 against Rs. 2,78,468 crores in the year 2015 registering an increase of 89% . The Net NPA of the Public sector Banks which was 2.56 per cent of the Net advances at the end of March,2014, rose to 5.75 per cent by March, 2016 against 0.89 % in case of Private Sector Banks .
- The difference between the operations of private sector banks, which have fewer stressed assets, and public sector ones, make it clear that the bad loans are holding public sector banks back from growing rather than the other way around as Public sector Banks faced losses of Rs.17,992 crore in the year 2016 whereas Profits of Private Sector Banks reached Rs.38,219 crore in the year 2016 against Rs. 28,995.43 crore in the year 2014 viz. a hike of 76%. This is despite the fact that Total Assets of Public Sector Banks are 3.6 times the assets of Private Sector Banks i.e. quite high at Rs. **90,61,723 crore a**gainst Rs. **25,34,558.26 c**rore assets of Private Sector.

- Public sector banks (PSBs) have written off loans worth Rs 59,547 crore in 2015-16. Of the total, State Bank of India (SBI) Group alone has written off Rs 20,873 crore worth loans.
- Among the nationalised banks, Punjab National Bank has written off Rs 7,340 crore, followed by IDBI Bank (Rs 5,459 crore) and Canara Bank (Rs 3,387 crore), Indian Overseas Bank (Rs 2,578 crore), Bank of India (Rs 2,374 crore) and Allahabad bank (Rs 2,097 crore).



- RBI Governor Raghuram Rajan recently announced a March 2017 deadline for banks to clean up their balance sheets which are plagued by high incidence of bad assets. This might be reason that some of the banks have witnessed erosion of profitability in the short run due to cleaning of books.

Table 3: Profitability (Net profits) of Public Sector Enterprises

Public Sector Bank	**Net Profits**			**Public Sector Bank**	**Net Profits**		
	2014	**2015**	**2016**		**2014**	**2015**	**2016**
Allahabad Bank	1,172	621	(743)	Punjab & Sind Bank	301	121	336
Andhra Bank	436	638	540	Punjab National Bank	3,343	3,062	(3974)
Bank of Baroda	4,541	3,398	(5396)	Syndicate Bank	1,711	1,523	(1643)
Bank of India	2,729	1,709	(6089)	UCO Bank	1,511	1,138	(2799)
Bank of	386	451	101	Union	1,696	1,782	1352

Maharashtra				Bank of India			
Canara Bank	2,438	2,703	(2813)	United Bank of India	(1213)	256	(282)
Central Bank of India	(1263)	606	(1418)	Vijaya Bank	416	439	382
Corporation Bank	562	584	(506)	SBI Group	**13,669**	**16,302**	**11,590**
Dena Bank	552	265	(935)	IDBI	1,121	873	(3665)
Indian Bank	1,159	1,005	711	Bhartiya Mahila Bank	12	20	2
Indian Overseas Bank	602	(454)	(2897)	**Total**	**37,019**	**37,540**	**(17992)**
Oriental Bank of Commerce	1,139	497	156	**Net Profits of Private Sector Banks**	**28,995.43**	**33,754.10**	**38,219.35**

Source: IBA

- The combined net loss of 27 public sector banks (PSB) stood at Rs 17992 crore for the year ended March 2016 as bad loans situation worsened. PSBs registered net profit of Rs 37,540 crore in the corresponding year ago.
- Punjab National Bank and Bank of Baroda together reported net loss of Rs 9370 for the year 2016 against net profit of Rs 6460 crore in the year 2015.
- The financial results of Public Sector Banks show that out of 27, 12 banks have sunk in the red in the year 2016, though they registered profits during the same period last year.

3. Stock Performance:

Table4: Book Value Vs Market Value of Public Sector Banks

Company	Last Price	% Chg	BV *	Disc. to BV
Oriental Bank	122.00	3.26	388.79	68.62
Bank of India	111.45	1.00	333.29	66.56
Punjab & Sind	50.80	2.11	149.10	65.93
Dena Bank	38.00	1.74	107.08	64.51
Andhra Bank	61.35	0.99	161.41	61.99
IOB	27.55	2.99	70.28	60.80
Corporation Bk	41.30	0.98	104.51	60.48
United Bank	22.20	1.14	48.01	53.76
Union Bank	137.10	3.55	295.44	53.59
UCO Bank	43.55	-0.68	93.50	53.42
Syndicate Bank	75.00	1.42	153.75	51.22
Allahabad Bank	79.05	1.61	159.40	50.41
Bank of Mah	31.90	0.95	64.12	50.25
Canara Bank	259.25	0.80	481.75	46.19
Vijaya Bank	39.25	1.03	66.05	40.58
State Bk Travan	515.90	0.94	846.80	39.08
State Bk Mysore	628.00	0.22	972.86	35.45
IDBI Bank	69.50	1.91	107.41	35.29
PNB	123.50	0.86	180.61	31.62
State B Bikaner	670.30	1.66	963.26	30.41
Indian Bank	202.00	2.12	280.63	28.02
Bank of Baroda	157.65	1.22	172.49	8.60

Source: Dion Global solutions limited

- Stocks of most PSU banks trading below book values. T he book value of most of the PSU banks is almost three times that of their market price showed the above data. It shows that investors have lost faith in these Public Sector Banks to generate future profits. A book value is the value of the company on books and is usually different from the market price. Market price is relevant at the time of making investment decisions. When book value is more than market it is an indication that if the bank is put up for sale it would not fetch the same value that is shown in its books.

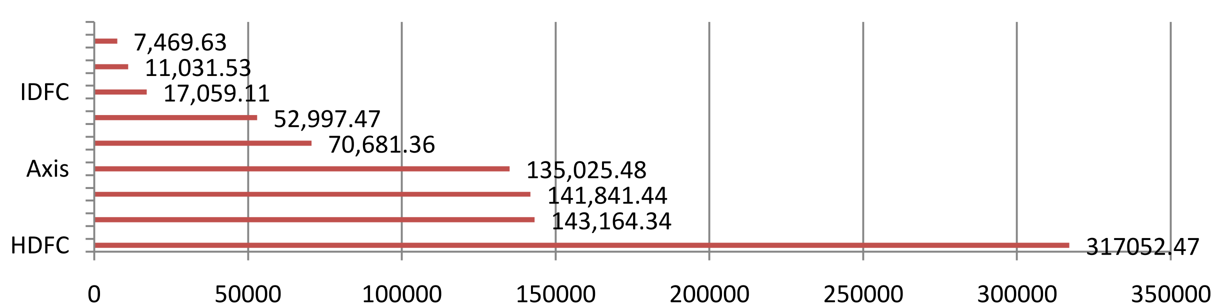
- There are other indicators of the worsening situation of India’s government-owned banks. For instance, the earnings per share—the profit available for each share—of public sector bank stocks is very less as compared to Private Sector Banks. This means they are just not making enough money.

Table 5: Comparative Earning Per Share of public Sector Banks and Private Sector Banks

Public Sector Bank	EPS	Private Sector Bank	EPS
State B Bikaner	51.20	**Yes bank**	64.58
Union Bank	19.66	**HDFC Bank**	50.58
Indian Bank	16.73	**Karur vysya**	47.54
SBI	12.82	**IndusInd Bank**	40.64
Punjab & Sind	8.39	**Axis Bank**	32.67
Andhra Bank	7.93	**Karnatka Bank**	22.68
Oriental Bank	4.51	**ICICI Bank**	15.44
Vijaya Bank	4.01	**Kotak Mahindra Bank**	14.39
Bank of Mah	0.86	**Lakshmi Vilas**	11.18

4. Market capitalisation

Figure 2:Market capitalisation 0f Top 10 Private Sector Banks as on 5/08/ 2016 (Rs in crores)



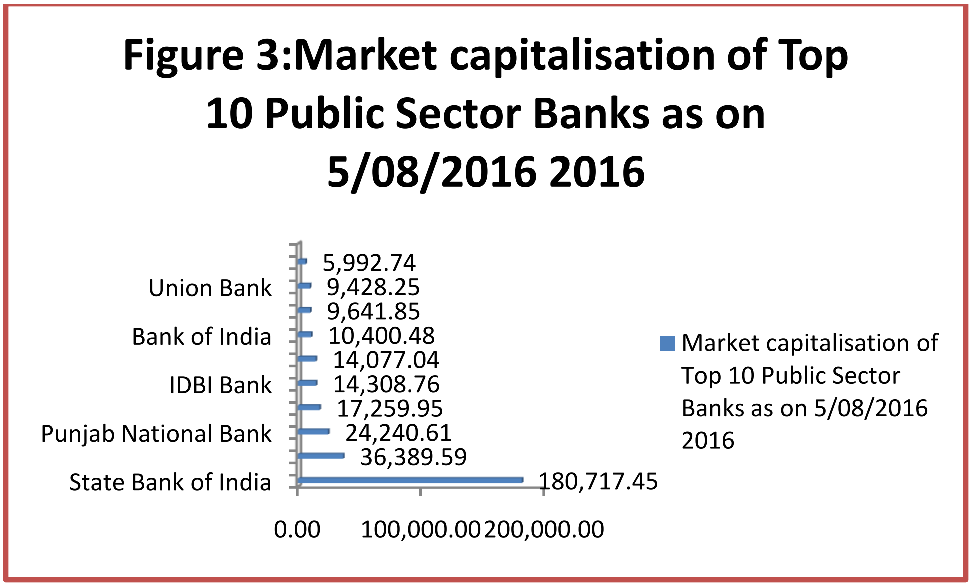


Figure 3:Market capitalisation of Top 10 Public Sector Banks as on 5/08/2016 2016

Source; www.moneycontrol.com

- Deterioration in profitability of Public Sector Banks due to bad assets is keeping equity investors away. The numbers shown above in the Figure provide enough evidence.
- A look at the market capitalisation—total market value of all the shares of a company—of public sector banks shows how badly stock valuations have been doing.
- Excluding the State Bank of India, India's largest lender—as of March.2016,the market cap of all other 9 top public sector banks taken together comes out to be just Rs 1,41,739.27 crore. Now, compare this with Rs 1,41,841 crore market cap of just one private sector player, Kotak Mahindra Bank, India's third largest private lender in terms of Market Capitalisation.

Options to Revamp Public Sector Banks in India:

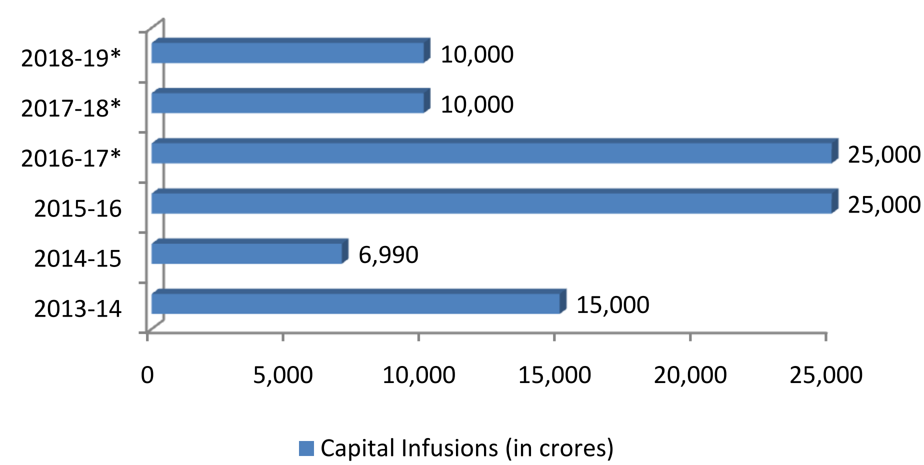
1. Fresh Capital Infusions:

Public sector banks which suffered heavy losses due to a sharp rise in bad loans have seen their capital erode. Raising fresh capital is a great challenge for these banks.It has been estimated by S&P that to implement Basel III norms, the banks will need fresh capital of Rs 1.4 lakh crore for fiscal 2016-2019. Additional Rs 80,000 crore will be required to make provisions for non-performing loans and slippages from standard restructured loans.

There are two alternatives to increase the capitalisation of Public Sector Banks. These are:

a. Government's capital infusions: Many of the banks have a reduced ability to generate internal capital, largely because of the pressure on asset quality in the past few years. In a report titled 'India's Capital Infusions For Public Sector Banks Are Just A Breather', S&P said the standalone credit profiles and ratings on some PSU banks remain "vulnerable" to any further deterioration in asset quality, capital, and earnings."The Basel III-related capital requirements could lead weaker PSU banks to lose market share to better-performing banks in the private sector, public sector," Therefore the government's capital infusions will be an important lifeline for PSU banks. The government announced in July, 2016 an infusion of Rs 70,000 crore in PSU banks through four years till 2018-19. Of this, Rs 25,000 crore would be injected in the fiscal year 2016-17, says Standard & Poor. This extraordinary support will be given to banks because they have very important role to play and have very important link with the government. (Press Trust of India, 2015)

Figure 4:Capital Infusions by Government



*Capital that the Government has committed to invest in state run banks.

The funds will help the banks in increasing their lending, raising additional funds and clean up balance sheets. However infusing more funds by Government of India goes against the spirit of fiscal discipline.

b. **Raising funds from Market:** Besides, the report by S&p says that the PSU banks would raise an additional Rs 1.10 lakh crore from the markets in the next four years. However there are three key challenges being faced by government-run banks with regard to raising additional capital which are low equity valuations, overcrowded market and regulations.

1. low equity valuations: Shares of many PSU banks are being traded at a discount to their book value and “it is unlikely to change unless the banks make significant progress in resolving asset quality, profitability and governance issues.

2. The banks will have to adopt a staggered approach to avoid overcrowding of bank issues in the equity market.

3. It added that under the current regulations, government equity cannot go below 52 per cent, which will restrict their ability to tap equity market for funds. (PTI, 2015)

2. **Consolidation of Indian Public sector banks into few large Lenders:** The consolidation of Indian state-run banks is gaining policy momentum as the government aims to strengthen the banking system. In its report, On 15 June, 2016 the cabinet approved the merger of the five associate banks of SBI with the parent bank. Global Credit Rating agency FITCH has also called for consolidation of Indian Banks into a few large lenders as it is believed that it will augment bank’s lending capacity and improve their position to support growth in the country. These large banks in a consolidated banking system will enjoy benefits of scale leading to better diversification of risks and stronger overall profitability contributing to higher credit ratings as per Fitch. In its report the rating agency Moody also said that the Indian government’s ultimate aim is to reduce the number of PSBs to about 8-10 from the current 27. Assocham also feels that hampered by the fragmented nature of the banking industry, Indian banks are not able to compete globally in terms of fund mobilisation, credit disbursal, investment and rendering of financial services.The balance sheets of top 10 Indian banks suggest the greater scope of consolidation to reap the benefits of large sized globally competitive Indian banks. Assocham has called for Bank’s consolidation without any delay despite dithering of Reserve Bank of India on the issue. (Is consolidation of Indian Banks, the need of hour?)

Advantages of Consolidation (Global Credit Research, 2016)

1. From a credit perspective, industry consolidation would strengthen the banks' bargaining power.
2. It will help save costs and improve supervision and corporate governance across the banking system.

These potential benefits, however, are outweighed by multiple downside risks, Moody's said.

Risks involved in consolidation:

The government's proposal to consolidate public sector banks creates risks that -- in the current weak economic environment -- could offset the potential long-term benefits, global ratings agency Moody's said.

a. "India's banking system has witnessed an increase in stressed assets since 2012, with the result that no PSB currently has the financial strength to assume a consolidator role without risking its own credit standing post- merger," says Moody.

b. One of the toughest challenges that the government will face while merging banks is from the employee unions and the employees who may fear identity loss. Moody also sees considerable challenges from potential opposition from employee unions, which could hamper merger efforts and drive up costs. For example, SBI estimates that its merger with the associate banks will cost up to Rs 30 million due to differences in employee pension schemes

c. The other problem area is the technology platform as a criteria for identifying banks for merger. Different banks have different technology platform which are developed by IT majors like Infosys and Tata Consultancy Services, to name a few. The merger of two banks having different platform, could be a challenging task. . (Saha, 2016)

3. Privatisation: In addition to consolidation or mergers, the government can consider another alternative of privatising some of the inefficient PSBs while rewarding profit-making ones. Privatisation will ensure that market discipline forces these banks to rectify their strategy. Privatization will improve the governance standards in banks. According to Shinjini Kumar, director (banking regulations) at audit firm PricewaterhouseCoopers Pvt. Ltd. “The current deterioration in the operations and asset quality of public sector banks would mean that the government is constantly feeding the PSBs but not getting the returns. If you have shareholders with significant stake involved at the board level, this can help to improve the governance standards of banks," said

The committee under P.J. Nayak suggested certain reforms in public sector banks in January 2014. The main thrust of its recommendations was privatisation of PSBs. As part of the bank reforms announced recently, the government plans to set up a Bank Investment Company (BIC), which will acquire the government stakes in its banks. The BIC can dilute its stake in a government bank up to 33 per cent and still retain its control. So it may be privatisation without private control of the management.

This implies that the Public Sector Bank's 60-year-old policy of social welfare needs to be reviewed. The major objectives of social banking under which private sector banks were nationalised in 1969 and 1980 was to ensure opening banks in rural areas and to avoid a nexus between industry and banking.

Arguments against privatisation (Franco, 2016)

- If we see past history of private sector banks then we conclude that privatisation is not the solution. Before 1969, all banks, except the SBI, were in the private sector. Between 1947 and 1969, 559 banks failed. A huge number of people lost their life's earnings. The common man had no access to banks then, and the banks' rural presence was nil. Bank nationalisation took place to make the shift from class banking to mass banking, and make inroads into rural areas.
- Even after nationalisation, private sector banks continued to fail. One of the most prominent examples was the high-profile Global Trust Bank, whose chairman, Ramesh Jolly, was awarded the Banker of the Year award, and the very next year his bank posted a loss of Rs.1,100 crore. GTB was eventually merged with Oriental Bank of Commerce in 2003. Between 1969 and 2014, 23 private sector banks were merged with public sector banks for not working well. In this backdrop, we have to see the performance of PSBs, which have survived the major global economic crisis
- Public sector banks are also sharing government's social agenda like the farm loan waiver, the Jan Dhan Yojana, priority sector lending and lending to small and medium enterprises. These activities bring profitability of Public Sector Banks under pressure, and the

private sector banks have almost nil presence here. They don't share the government's social responsibilities.

Thus, we can see that privatisation is not the solution for problems facing PSBs. The solution lies in making the public sector more efficient .

4. Other Measures:

- The government is focusing on improving the selection of board members and top management. There is need for improvements in governance as well as management in PSBs. PSBs need more professional boards than these have had thus far. The crucial improvement required is a strengthening of management at all levels at PSBs starting with the CEO.
- "Strengthen the banks by empowering them with operational flexibility be it in the area of recruitment, or in differentiation on core capabilities," recommends Working Group of Indian Banks' Association. The group envisages higher empowerment for banks while increasing accountability and offering incentives for good performance at the banks.
- A new key performance indicator (KPI) framework including capital efficiency, business diversification, asset quality management, and financial inclusion will serve the purpose.

Conclusion:

The results in this study indicate a sharp deterioration in the financial health of public-sector banks. The overall stress among public sector-banks is very high as these banks have reported a sharp increase in NPAs. It appears that equity investors are not interested to invest in these companies because of poor stock performance accompanied by very less earning per share compared to Private Sector Banks. While these banks have seen deterioration in performance in the past few years, the extent of losses being reported in FY 2016 is very high due to RBI recent directions to clean balance sheets of these banks by writing off bad debts. There are various options to revamp ailing public sector Banks in India like fresh capital infusion to cover up eroded capital due to drop in profitability. Government of India has come forward to infuse capital in these banks. Raising capital from markets appear to be a tough job given the poor stock performance as PSB's stocks are being traded at the price below book value. Another alternative available is to consolidate public sector banks into larger banks so as to help them stand the heat of competition from private sector. If consolidated they can have larger capital base to face drop in profitability. Besides, privatisation is most argued option facing lot of criticism due to earlier nationalisation of private sector banks which could not survive without government support. Other measures we are left with are following professional approach in running these banks by providing operational flexibility. This study will help policy makers to understand the present financial position of these banks so as to help them to pursue right option to reform them.

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