Chapter V

Analysis of Recapitalisation of PSBs

5.1 Rationale for Capitalisation of PSBs

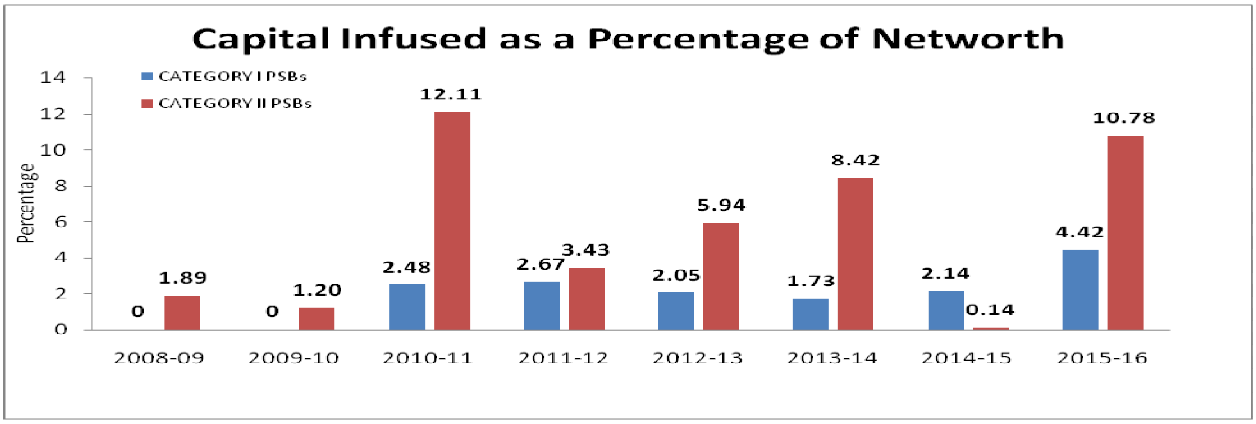
GOI infused capital in PSBs during the period 2008-09 and 2016-17 with the expectation that the PSBs would have an enhanced capability to extend credit, while maintaining regulatory capital requirements as per the Basel/RBI norms. Maintenance of pre-determined benchmark level of GOI shareholding (@58 *per cent* in December 2010 and @52 *per cent* in December 2014) was also envisaged for enabling PSBs to tap markets for additional capital requirements. For the year 2014-15, capital was infused to reward performance of PSBs.

5.2 Segregating PSBs into Two Categories

DFS had conducted (July 2016) an analysis of the performance of PSBs for determining their efficacy vis-à-vis capital infused, by segregating PSBs into three categories based on GOI capital infusion over 2008-16 as a percentage of their then net-worth; - Category I being PSBs which received capital less than 25 *per cent* of their then net worth over 2008-16; Category II being PSBs which received capital between 25 and 50 *per cent* of their present net worth and Category III being PSBs which received capital more than 50 *per cent* of their net worth.
Audit adopted this categorization segregating the PSBs into two categories by merging categories II and III to generate the two following categories of PSBs, -

- **Category I**: PSBs which received capital infusion during 2008-16 below 25 *per cent* of their net worth (as on 31 March 2016). Twelve PSBs, - Allahabad Bank, Andhra Bank, Bank of Baroda, Canara Bank, Corporation Bank, Indian Bank, Oriental Bank of Commerce, Punjab & Sind Bank, Punjab National Bank, State Bank of India, Syndicate Bank and Union Bank of India, fell into this category.
- **Category II**: PSBs which received capital infusion during 2008-16, 25 *per cent* or above 25 *per cent* of their net worth (as on 31 March 2016). Nine PSBs, - Bank of India, Bank of Maharashtra, Central Bank of India, Dena Bank, IDBI Bank, Indian Overseas Bank, UCO Bank, United Bank of India and Vijaya Bank, fell into this category.

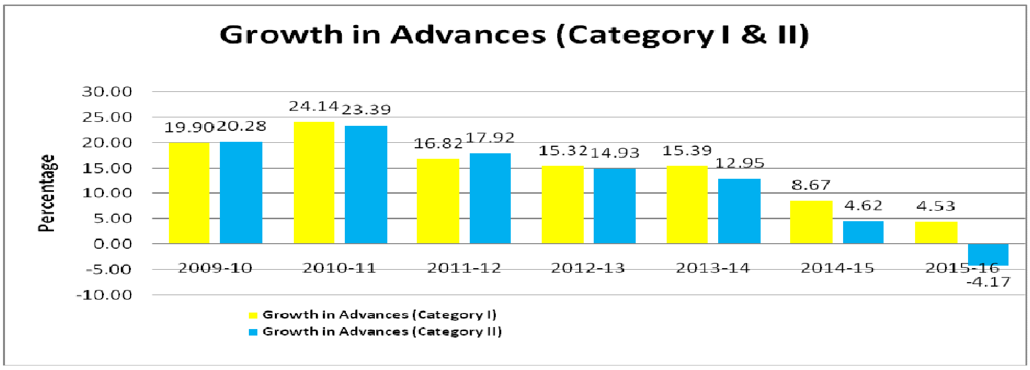
  The chart on the next page shows that for each year of the analysis, with the exception of 2014-15 (when capital infusion was done based on profitability of the PSBs), Category I PSBs received a lower share of capital (as a proportion of net worth) as compared to Category II PSBs.



[Source : Data from the RBI (Domestic Operations) and records of DFS]

5.3 Capital Infusion and Credit Growth

As already discussed in Chapter 1, the period from 2008-09 to 2015-16 had seen a deceleration in credit growth (growth of advances) across all PSBs, even as GOI capital was being infused in them. Audit compared the credit growth rate of PSBs across the two categories (category I with GOI capital infusion less than 25 *per cent* and *category* II banks with GOI capital infusion 25 *per cent* or more than 25 *per cent*). It is seen that the rate of growth of advances has, in general, been lower in case of category II PSBs compared to category I PSBs (except two years 2009-10 and 2011-12) as seen from the chart below:



(Source: Database of the RBI: Statistical Table relating to Banks in India)

The credit growth had sharply fallen in 2014-15 and 2015-16, turning negative for category II PSBs in 2015-16.

5.4 Capital Infusion and Performance of PSBs

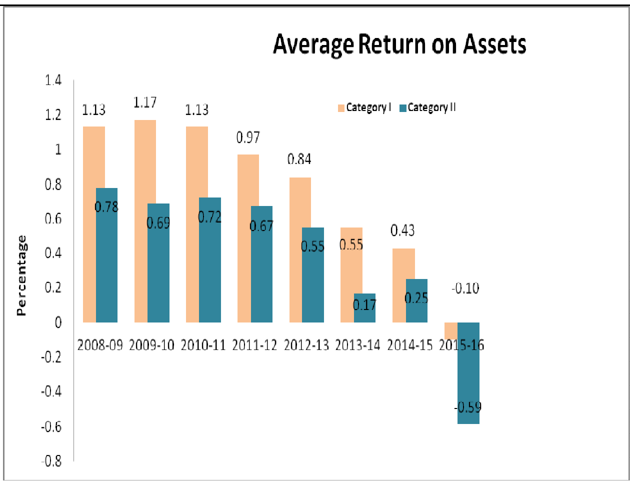
5.4.1 Profitability is a measure of performance of a bank. Two of the commonly used parameters for measuring profitability of a bank are the Return on Assets (ROA) and the Return on Equity (ROE).

- ROA of a PSB is a financial ratio which measures net income as a percentage of average total assets of the bank. It indicates how efficient the management of the bank is, at employing its assets to generate profits.

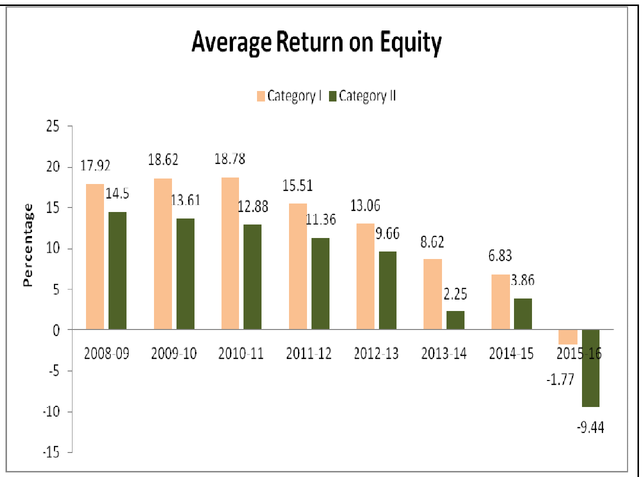
- ROE of a PSB is the ratio of net profit to shareholders' equity. This ratio is monitored by the market as shareholders of the bank track ROE which is an indicator for the bank's performance.

As the bank under-performs, its ROA and ROE go down. A low or negative ROA/ROE of a bank indicated its reduced ability to generate profits internally. As a part of the profits go to enhance the bank reserves (post pay-out of dividends) and hence capital, this implies lower/ non-enhancement of reserves/ capital. Besides, a falling ROA/ ROE reduces market confidence and makes it more difficult for the bank to raise capital from the market.

5.4.2 As already noted in chapter 1, ROA and ROE measures for all PSBs declined over the period 2008-09 to 2015-16. The charts below indicate that PSBs which received a relatively higher share of GOI capital infusion (category II PSBs) had, in fact, performed worse than Category I PSBs:



(Source : Annual Reports of PSBs/Presentation of PSBs)



(Source : Data from the RBI (Domestic Operations)

While, the ROA and ROE of both categories progressively decreased, the average ROA and ROE of category II banks were lower than category I; - the average ROA of category II banks was -0.59 *per cent* vis-à-vis -0.10 *per cent* of category I banks in FY-2016 while the average ROE of category II banks was -9.44 *per cent* vis-à-vis -1.77 *per cent* of category I banks in the same year. Thus, a higher proportion of capital infusion (compared to the networth of the bank) has not translated into better profitability of the bank.

5.5 Capital Infusion and GOI Shareholding

As can be seen from the chart in Para 1.3.2 in chapter I, GOI holding in all PSBs was consistently above the benchmark (52 *per cent* decided in December 2014). As on 31 March 2017, United Bank of India had maximum GOI holding at 85.23 *per cent* while Oriental Bank of Commerce had the lowest percentage of GOI holding at 58.38 *per cent*. The following table categorizes PSBs by GOI share in them:

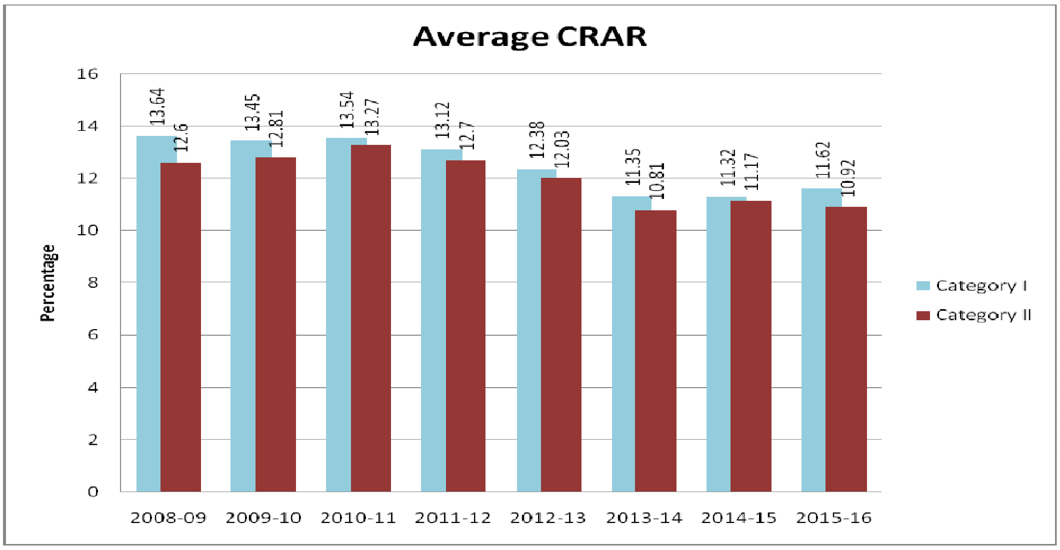
Table 5.1 : Categorization of PSBs by range of GOI shareholding

Range of GOI shareholding (in *per cent*)	**PSBs**
<58	None
>58 & <65	Andhra Bank, Bank of Baroda, Oriental Bank of Commerce, State Bank of India, Union Bank
>65 & <75	Allahabad Bank, Bank of India, Canara Bank, Corporation Bank, Dena Bank, Punjab National Bank, Syndicate Bank, Vijaya Bank, IDBI Bank Ltd
>75 & <85	Bank of Maharashtra, Central Bank, Indian Overseas Bank, Indian Bank, Punjab and Sind Bank, UCO Bank
>85	United Bank of India

(Source : BSE and NSE websites)

5.6 Capital Adequacy of PSBs

One of the primary objectives of GOI capital infusion in the PSBs was maintenance of the capital adequacy as per regulatory requirements (Basel norms/ RBI norms). Audit compared the Capital to Risk Weighted Assets Ratio (CRAR) or Capital Adequacy Ratio (CAR) of both categories of PSBs as shown in the chart on the next page:



[Source: Annual reports of PSBs and Statistical Tables Relating to Banks in India (RBI Database)]

The chart indicates that the average CRAR of category II banks was consistently lower than that of category I banks even after relatively higher proportion of GOI capital infusion. It was noticed that category II banks required frequent infusion of GOI capital to meet the regulatory capital adequacy requirements. Six out of the nine banks in category II had been infused with capital in six or more years out of the nine years that have been reviewed by Audit, as shown in the table below :

Table 5.2 : Category II PSBs and Frequency of Fund Infusion

Category II PSBs	Frequency of fund infusion	No. of PSBs
Central Bank, UCO Bank	8 out of 9 years reviewed	2
United Bank of India	7 out of 9 years reviewed	1
Bank of Maharashtra, IDBI, IOB	6 out of 9 years reviewed	3

(Source : Records of DFS)

This points to the continued dependence on GOI capital infusion for these banks.