ISSN 2231-1629
Knowledge Resonance

IMPACT FACTOR 8.072

July – December 2021- Vol. 10 No. 2

RATIONALE BEHIND BANK RECAPITALIZATION

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Abstract:

This study is necessary to understand about the concept of bank recapitalization. The study will be of immense benefit as bank recapitalization policy can lead to economic expansion and development. Recapitalization gives the banking system to enhance its credit mechanism. The higher the capital is above the regulatory minimum, the greater the freedom banks have to make loans. The closer bank capital is to the minimum, the less inclined banks are to lend. If capital falls below the regulatory minimum, banks cannot lend or face restrictions on lending. So, bank recapitalization plays vital role for survival of the banks. After knowing bank recapitalization, its potential benefits will be understood. How big is bank recapitalization and whether it is increasing or decreasing will be understood?

Keywords:

Bank, recapitalization, credit mechanism, economic expansion

Introduction:

Bank plays vital role in economic development. Banks work within the financial system to provide loans, accept deposits and provide other services to customers. A strong banking system is the foundation for sustainable economic growth, banks being the centre of the credit process. Banks provide services to consumers, small and medium-sized enterprises, large firms and governments, both at a domestic and international level. Bank contribute to economy; banks are often regulated to protect public interest. The banking sector comprises commercial and cooperative banks with commercial banks accounting for the bulk of banking assets. The commercial banks comprise 21 Public Sector Banks, 26 private sector banks, 43 foreign banks and 56 regional rural banks. The commercial banking structure primarily comprises scheduled commercial banks (SCBs), which are included in the second schedule of the Reserve Bank of India Act, 1934.

SCBs primarily include the following:

- Public sector banks (PSBs) including State Bank of India and its associates and other nationalized banks
- Private sector banks
- Foreign banks
- Regional Rural Banks

The banking sector reforms as given by the Government simply have one main objective, which is to ensure that there is efficiency and soundness in the banking system.

PUBLIC SECTOR BANKS:

Public Sector Banks (PSBs) account for over 70 per cent of the deposits received in and advances made by Scheduled Commercial Bank (SCBs).The capital requirement of PSBs is driven by credit growth in the economy and prudential regulatory requirements. The regulatory framework for banks is globally framed by the Basel Committee on Banking Supervision which is adopted by RBI for Indian banks.

INDRADHANUSH PLAN:

In August 2015, as a part of a seven step 'Indradhanush' plan, the government assessed the capital requirement of the PSBs at Rs 1, 80,000 crore. It would be raised over the next four years until 2019. The government would infuse Rs. 70,000 crore and the balance Rs 1, 10,000 crore would be raised by banks. The government infused capital of Rs. 59,435 crore in PSBs under the Indradhanush plan. It will help to adequately capitalise all PSBs.

The year wise capital infusion projected is as follows:

Financial Year	Amount(Rs in crore)
2015-16	25,000
2016-17	25,000
2017-18	10,000
2018-19	10,000
2019-20	14,500

Source: Indradhanush Plan document

RECAPITALIZATION:

Public Sector Banks have been viewed as vehicle of growth of economy considering its significance, Government recapitalizes them. Recapitalization means infusing capital in banks that are facing problem of shortage of capital. It involves major change in the way bank is funded.

A change in a company's long-term financing mix is termed as recapitalization. In the Indian context, the public-sector banks were recapitalized on 19th July 2016 where the Central Government announced a total of Rs. 22,915 cores to recapitalize the public-sector banks. This was done to boost the credit growth of economy. Bank recapitalization is therefore, a very aspect, as it adequate recapitalization can impact the profits of the bank Recapitalization is a major way a public sector bank capital infused.

OBJECTIVES OF STUDY:

The objective of the study is to assess the relevancy of bank recapitalization policy. So the objectives are as follows:

- To identify the benefits of bank recapitalization.
- To understand reasons for bank recapitalization.
- To know the current scenario of bank recapitalization.

CAPITAL STRUCTURE:

The capital structure of a PSB comprises different types of liabilities which are incurred to fund the lending and investment activity of the bank on the asset side of the balance sheet:

1. **Shareholders' funds:** This includes equity capital of the PSB (both common equity and preference shares), accumulated reserves and surplus, retained earnings from previous periods. These are the bank's "own" source of funds for financing investments depicted on the asset side.
2. **Borrowings:** It include borrowings from the market are made through inter-bank lending, repurchase agreements, money market borrowings and the issuance of bonds. Their access is subject to market liquidity and the bank's own credit-worthiness. Borrowings could be secured or un-secured.
3. **Deposits:** It include deposits from customers comprise the major funding source for the bank which are the senior most contractual liabilities of the bank, available at the lowest cost.

CAPITAL REQUIREMENT:

- The bank's own capital becomes crucial which can absorb the losses without leading to bank failure.
- The primary function of bank capital is to support the bank's operations, act as a cushion to absorb unanticipated losses
- Capital funds absorb large losses, so that depositor funds are not adversely impacted. The higher the bank capital, the higher the degree of protection to depositor's funds.
- Thus, banking regulations therefore require banks to meet stringent minimum capital requirements so as to maintain bank solvency, safety and soundness of the banking system.

The RBI follows the Basel norms, though the RBI norms are often more stringent than the Basel norms. The BCBS issued Basel I norms in 1988 to provide, for the first time, a global standard on the regulatory capital requirements for banks. This was imposed through a minimum Capital Adequacy Ratio (CAR), expressed as the ratio of regulatory capital funds to risk weighted assets (RWA), which internationally active banks would be required to maintain. The CAR is also called Capital to Risk-Weighted Assets Ratio (CRAR). Subsequently, Basel II norms were introduced in 2004 which further strengthened the guidelines for capital adequacy, risk management and disclosure requirements.

The norms were further revised to Basel III norms in 2010.

1. The regulatory capital funds of banks as defined under the Basel norms include Tier I and Tier II capital.

Tier I capital: It consists mainly of share capital and disclosed reserves. It is deemed to be of the highest quality because it is fully available to cover losses. Hence, it is also termed as core capital.

Tier II capital: It is also known as supplementary capital, consists of certain reserves and specific types of subordinated debt. Tier II items qualify as regulatory capital to the extent that they can be used to absorb losses arising from a bank's activities. Tier II's capital loss absorption capacity is lower than that of Tier I capital.

There has been a gap in adoption of the Basel norms:

- Basel I norms (1988) were adopted in 1996
- Basel II norms (2004) were adopted in 2008
- Transition to Basel III norms (2010) commenced in September 2013.

The RBI norms have, however, been more stringent than the Basel norms

The evolution of the Basel capital adequacy norms are summarized in the table below:

	Basel I	Basel II	Basel III
Application (BCBS)	1988	2004	2010
Regulatory Capital – Definition	Tier I: Common Equity, Reserves and Surplus, Retained Earnings Tier II: Subordinated Debt	Tier I: Core Capital– Common Equity, Reserves and Surplus, Retained Earnings Lower Tier I: Preference Shares (PNCPS), Innovative Perpetual Debt Instruments (IPDI) Tier II: Upper Tier II Bonds, Preference Shares, Subordinated Deb	Going Concern Capital • CETI: Common Equity, Reserves and Surplus, Retained Earnings • AT1: Preference Shares (PNCPS) and Perpetual Debt Instruments (PDI) with loss absorption and PONV triggers Gone Concern Capital: Long dated subordinated Bonds and Preference
RWA Coverage	Credit Risk Weighted Assets for on and off balance sheet positions	Credit, Market and Operational Risk Weighted Assets for on and off balance sheet positions	Credit, Market and Operational Risk Weighted Assets for on and off balance sheet positions, greater risk coverage
RWA Methodology	Standardized, not risk sensitive	Standardized and Advanced Model Based Methodologies, more risk sensitive	Standardized and Advanced Model Based Methodologies, more risk sensitive
Minimum CRAR (BCBS)	eight per cent	eight per cent	8 per cent plus 2.5 per cent Capital Conservation Buffer

The Basel II norms were based on three pillars: -

- Minimum capital requirement
- Supervisory review
- Market discipline which were further strengthened in Basel III norms.

BENEFITS OF BANK RECAPITALIZATION:
The following are potential benefits of bank recapitalization policy:

• Credit Mechanism
• Maintaining Sound Payment System
• Maintaining Financial Stability
• Economic Stability
• Structured Banking System
• Improvement of Liquidity
• Boosting Investor Confidence
• Customer Base
• Reviving Demand
• Better Regulation
• Improved Financial Intermediaries

REASONS FOR BANK RECAPITALIZATION: The following are the reasons for bank recapitalization:

• Stabilization of Capital Base
• Capital Adequacy
• Profitability
• Lending Activities
• Protection of Depositors
• Increase Loan Capacity
• Lowering of Risk
• Poor Earnings
• Enforcement of Reforms
• Financial Inclusion
• Development of Medium and Small Enterprises
• Strong Banking System

CURRENT SCENARIO OF BANK RECAPITALIZATION:

• Macro financial risks from banking sector weaknesses decreased
• Due to substantial capital injections, public sector banks have been in better position to extend credit to the economy
• After peaking in March 2018, capital adequacy ratio of PSBs improved to 12.2%

• Bank credit growth picked up in 2018, peaking at 14.3% in December 2018
• In early 2019, five of 11 PSBs Bank of India, Bank of Maharashtra, Oriental Bank of Commerce, Allahabad Bank and Corporation Bank exited from Prompt Corrective Action framework launched in 2017
• In 2019, Government announced additional recapitalisation and plan to merge some of PSBs reducing their number to 12 along with further government reforms
• In 2018-19 government had pumped Rs 1.6 lakh crore which boosted credit growth
• Budget 2019 announced Rs 70,000 crore bank recapitalisation to boost capital and credit flow
• In 2020, Yes Bank has gone from collapse to being revived with the help of the State Bank of India Its activity has been temporarily stopped by central bank through official agreement
• Sitharaman's comments came just as the Reserve Bank of India unveiled a draft revival plan.
• Furthermore, in 2020 Government may have to infuse capital into LIC before Initial Public Offering

This study analyses the funds infused by Government of India and changes in funds infused into Public Sector Banks. It seeks answer to question that whether the Government support has increased over time period.

		(Rs cr)	(Rs cr)
S.No.	Bank Name	2016-2017	2017-2018
1	State Bank of India	5681	8,800
2	Dena Bank	1046	3,045
3	UCO Bank	1925	6,507
4	IDBI Bank	1900	7881

Source: Annual Report of banks

• The above table summarises bank-wise capital infusion for years 2016 & 2017 undertaken by Government of India directly.
• Capital infusion showed an upward trend for State Bank of India.
• It was Rs crore 5681 in the year 2016-17 which increased to Rs crore 8800 in 2017-18
• It increased by 54.9%
• Capital infusion an increasing trend for Dena Bank which increased to Rs crore 3045 in 2017-18 than Rs crore 1046 in 2016-17 It increased by 191.11%
• Capital infusion is showed an rising trend for UCO Bank which increased to Rs crore 6507 in 2017-18 than Rs crore 1925 in 2016-17 It increased by 238.03%
• Capital infusion is showed an rising trend for IDBI Bank which increased to Rs crore 7881 in 2017-18 than Rs crore 1900 in 2016-17 It increased by 314.79%

SUGGESTIONS:

- Efforts should be taken to increase the quantum of capital.
- There should be effective monitoring system.
- Capital Adequacy Ratio should be increased
- Well-equipped mechanism is needed
- There should be improvement in credibility of PSBs
- A focus on Basel III norms should be there to maintain minimum capital.
- Criteria for fund infusion should be consistently applied to all PSBs
- Fulfilment of intended objectives of fund infusion should be ensured
- There should be new performance framework for banks based on efficiency and capital optimization.
- Check should be there on conditions attached to recapitalisation were complied with and check consistency of their application across all PSBs
- Capital Restoration Plan should be submitted

CONCLUSION:

- Capital infusion was higher in State Bank of India in 2017 than 2016 by 54.9% Capital infusion was higher in Dena Bank in 2017 than 2016 by 191.11%
- Capital infusion was higher in UCO Bank in 2017 than 2016 by 238.03%
- Capital infusion was higher in IDBI Bank in 2017 than 2016 by 314.79%
- Total fund infusion was higher in 2017 than 2016 by 744%
- Government of India has infused capital in PSBs for meeting their capital adequacy requirements or based on their performance
- As per RBI norms, banks should have Capital Adequacy Ratio of 9%
- Banking regulations therefore require PSBs to meet stringent minimum capital requirements
- India's Global rank on getting credit under World Bank's ease of doing business index improved from 44 in 2016 to 22 in 2018
- INR 881 Billion was infused in 2017-18
- Capital injection in 2018-19 was raised from INR 650 Billion to INR 1.06 Trillion
- An additional INR 700 Billion is budgeted for 2019-20

- Bank-wise capital infusion totalling INR 552.5 Billion had already been announced based on assessment of capital requirement
- Furthermore, rapid growth requires rapid investment which is dependent on supply of credit
- Capital infusion was directed for growth and investment of banks
- PSBs must have sufficient capital funds to absorb losses before depositor funds are adversely impacted
- So capital needs has been assessed for restricting the Public sector banks
- Overall, Bank recapitalisation is a positive growth step and welcome move if one looks at it with long term view
- Recapitalisation would ensure genuine borrowers that they get adequate funding and it will help to boost the Indian economy and key to promote GDP level

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