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Public Sector Banks and their Recapitalization: A Policy Analysis

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ABSTRACT

Public Sector Banks (PSBs) play a pivotal role in India's financial architecture, accounting for a significant portion of total banking assets and credit disbursement. However, over the past decade, PSBs have been plagued by mounting non-performing assets (NPAs), weak balance sheets, and declining profitability. In response, the Government of India has implemented several rounds of recapitalization to restore the financial health and lending capacity of these banks. This research paper critically analyses the policy framework, objectives, implementation, and impact of PSB recapitalization in India. It traces the evolution of recapitalization policies from post-2008 financial crisis initiatives to the Indradhanush Plan and the subsequent Enhanced Access and Service Excellence (EASE) reforms. Using data from the Ministry of Finance, RBI, and published bank reports, the study evaluates the effectiveness of capital infusion in improving asset quality, credit growth, and operational efficiency. It also examines the interplay between recapitalization and governance reforms, highlighting gaps in structural changes that impede sustainable recovery. The paper argues that while recapitalization has provided short-term relief, it must be accompanied by deeper institutional reforms, including professionalized bank boards, stricter risk management practices, and rationalization of government ownership. The study concludes by offering policy recommendations to align capital support with accountability, transparency, and long-term financial stability. This analysis is intended to contribute to ongoing policy debates on the future of PSBs and the strategic direction of public sector banking in India.

Keywords: *Public Sector Banks, Recapitalization, Non-Performing Assets (NPAs), Banking Reforms, Policy Analysis*

I. INTRODUCTION

Inefficiency in resource utilisation, tolerance for waste, and slothfulness at branches all contribute to banks' low production, which is typically reflected in high spreads. The important task of managing transition would be for the banking sector to go from high operating costs,

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low productivity, and high spread to being efficient, productive, and competitive.[3] Rightly pointed out by the former governor of RBI because when we consider the service sector around the world, the banking sector is one of the most regulated industry, considering its major and direct role in economic growth and development. Consequently in the recent years many effective researches have been in tandem to "measure efficiency and productivity of the banking industry."[4] Meanwhile when the financial system lacks certainty during the crisis having limited private capital the government fearing that the banks would fail in large number, tries to plan for restructuring and recapitalising the banks in order to mitigate the negative effects of a imbalanced banking system on economic growth and wealth. Utilization of the public funds to strengthen bank capital simultaneously additional operational and financial restructuring of banks would restore public confidence in the banking sector to some extent.[5] Moreover it would reduce uncertainty, give effect to resolution of banking crisis, and help in promoting economic recovery through reorganisation of banking and payment services, and looking into the apt business which can fund their operations. The main objective the government is to augment "socially valuable bank lending while minimizing the deadweight losses from raising new taxes."

The recapitalisation of public sector banks has been conjointly accepted as a good step on the part of the government though it involves criticism by many economists that it puts extra burden on GDP and is the main reason in the augmentation of fiscal deficit. The current regime has decided to spend a major share of money to overhaul the banks though it might result in obvious risk of "moral hazard that bank bailouts across the world have inevitably faced." The point of the continuous budgetary area changes effective and aggressive money related framework with a definitive effectiveness of assets through operational adaptability, enhanced fortifying. In this specific situation, the essentialness of bank the setting of monetary deregulation in a developing economy like India can't be ignored. Since 1991 reforms there has been 3 major policy documents which are considered to be game changer of the Indian financial system. Though the recommendations of the Narasimhan committee, 1991 and 1998 and Raghuram Rajan committee, 2009, are not being implemented fully but they did set the "ball

[3] Bimal Jalan, former Governor of the Reserve of India, at the Bank Economists' Conference
[4] Abhiman Das and Subal C. Kumbhakar, Productivity and Efficiency Dynamics In Indian Banking: An Input Distance function Approach Incorporating Quality Of Inputs And Outputs, Journal Of Applied Econometrics, Vol. 27, No. 2 (March 2012), p. 205
[5] Charles Enoch, Gillian Garcia and V. Sundararajan, Recapitalizing Banks with Public Funds, IMF Staff Papers, Vol. 48, No. 1 (2001), p. 58

rolling for a structural transformation of Indian banking."[6]

This paper analyses the bank's decision to "forgo profitable lending because of debt overhang which reduces payments to households."[7] Consequently this increases household defaults and thus worsens other banks' debt overhang. Secondly, this paper would highlight the role of government interventions in which government directly facilitate the banks with certain capital. However, there are limited options on the part of government. The government primarily avoids regular bankruptcy procedures, possibly because a large-scale restructuring of the financial sector would trigger runs on other financial institutions and impose large costs on the nonfinancial sector. Moreover, this paper discusses about the brief overview regarding the financial reforms. Meanwhile estimating the reforms main focus would be given on the different norms and regulation made by central bank and followed by commercial banks.

II. Indian banking system: brief overview with respect to public sector banks

The Indian Banking System consists of commercial and cooperative banks. Out of these two banks, commercial banks maintain around 95% assets of the banking system. In turn, the commercial banks comprise of 20 nationalized banks and the State Bank of India and its six associates. The public sector banking system in India is constituted by these 27 banks, they nearly account for an average over 70% of the commercial banking assets.[8] The economic and social development has always been dependent upon the well-being of the Public sector banks thus it may be considered as vehicle to move towards different facets of development. Moreover, these institutions are easily accessible to the general public of all sections and offer banking facilities to them without paying much heed towards profitability. Meanwhile the main role of these banks is to carry forward the social schemes for poverty alleviations, skill development, livelihood, financial inclusion etc. which are being announced by the government. It provides an efficient channel to implement these schemes. However, their performance is not so satisfactory due to the burgeoning burden of non-performing assets. The main contention is how to improve their performance as they are the most important part of the Indian financial system. Considering their role in the financial system the government tries to

[6]Pradnya Garad, Bank recapitalization in Indian context, International Journal of Advanced Research and Development, Volume 2; Issue 6; November 2017; p. 138
[7]Thomas Philippon And Philipp Schnabl, Efficient Recapitalization, The Journal of Finance, Vol. 68, No. 1 (February 2013), p. 2
[8] Supra Note 3, p. 207

ameliorate the condition of these banks through recapitalization.

Financial Liberalization

During early 1990s, a series of financial liberalization process took place in the form of well-sequenced, extensive and coordinated policy which aimed at developing the financial sector more competitive, efficient, productive and profitable financial service industry operating within the environment of "operating flexibility and functional autonomy." Considering the inception of reforms, an efficient mechanism was created to overcome the externalities related to interest rate regime, administered by the banks. It helped in coping up with the high level of pre-emption through reserve requirements, and allocation of credit to certain sect of industry. However, it was noticed that the dominance of the state-owned banks was brought down to a level due to their acceptability to raise additional capital from the stock market. One of the major source of discipline and improved accountability was the "diversification of ownership." With the emergence of competition with the other banks including foreign banks, the efficiency and productivity of the banks were enhanced. Moreover, this helped in the consolidation and restructuring of the banking sector which resulted in the better profit ratio. In the second half of the 1990s the main focus was given to "strengthen the financial system and introduction of structural improvements."

With the introduction of **operational flexibility,** the banks evolved with great pace and the growth in balance sheet helped to banks to establish their stakes more effectively. Enhancement in capital efficiency and better asset quality was reflected after the improvement in the financial health of the banking sector. The profit of public sector banks increased from minus Rs. 44 billion in 1993-94 to Rs. 158 billion in 2004-05. Consequently the performance parameters of the Indian Banks are now moving towards international standards and they can be considered as the better performers in the growing market group.[9] Thus both international and international competition is increasing the Indian banks need more efficiency to grow at certain pace and strive for more profit as well as public welfare.

The growth of the economy depends upon the increased investment, continuous inflow of foreign capital, and technologies with fair competition and less state intervention.[10] The mindful way to achieve economic growth is to strictly following the "macroeconomic stability" with command over the "inflation and budget deficit", including careful "management of debt",

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[9] Mohan R. 2005. Financial sector reforms in India: policies and performance analysis. Economic and Political Weekly 40: 1106-1119.

[10] Surendra Kanshik, India's Democratic Economic Transformation, Challenge, Vol. 39, No. 5 (SEPTEMBER-OCTOBER 1996), p. 58

and efficient utility of "equity markets" to finance growth.[11] Considering all the factors the government endeavors to promote the growth of public sector banks by recapitalization and restructuring. Meanwhile the government's role in uplifting the status of state owned banks cannot be overlooked, however these banks are considered to be a channel to implement government schemes. Thus if the performance of the banks is not at par with the certain standards they might fail in implementation and competing with other financial institutions.

III. Role and behaviour of bank capital: recapitalization issues

The banks' behavior can be construed by many theoretical studies which relates to the solvency of the banks. The capital is always the main focus of the bank's regulations involving the theory and practices. One of the main characteristics of the banks is that their balance sheet which consolidate the liabilities that can be withdrawn at any time. This puts the banks at verge of risk due to the change in depositor's confidence and they become susceptible to run. However the theory translates that failure to achieve safe banking system depends on the result of asymmetric information.[12] Usually in relation to asset portfolios, the banks are required to hold certain amount of capital according to capital standards. They try to ensure that there is less loss to the creditors. The "risk averse behavior" inducted by the bank managers, correspondingly "engender more confidence in the banking system among depositors."[13]

Even in the absence of regulatory constraints, banks would want to maintain a specific capital-to-asset ratio. Although bank shareholders may urge the bank to take on hazardous projects in the hopes of making a big profit, it is in the best interests of both shareholders and bank management to avoid insolvency. The bank's capital and risk are subject not only to conscious decision-making (banks moving in the direction of their target capital and target risk or conforming to regulatory criteria), but also to shocks, i.e., changes in the bank's balance sheet that are not caused by the bank.[14]

Banking Policy Issues

The autonomy of the public sector banks is always in issue wherefore it's the time to accept such autonomy is impossible to achieve due to political restraints which staggers the discretion of the banks. The loan waiver schemes to favored industrial groups is the main reason behind

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[11] Ibid.

[12] Diamond, D and P H Dyvbig (1983): 'Bank Runs, Deposit Insurance and Liquidity', Journal of Political Economy, 91, pp 401-419.

[13] Nachane, D M (1999): 'Capital Adequacy Ratios: An Agnostic Viewpoint', Economic and Political Weekly, January Special Nos 3 and 4 on Money, Banking and Finance, pp 155-160.

[14] Saibal Ghosh, D. M. Nachane and Partha Ray, Behaviour of Bank Capital: Issues and Evidence from India, Economic and Political Weekly, Vol. 39, No. 12, Money, Banking and Finance (Mar.20-26, 2004), p. 1291.

this lag. However, banking is the only sector where the private sector lags behind the public sector. Thus it might be considered that the reliance of public on these banks is more due to their association with the non-profitability activities. The history of bank recapitalization can be traced back to 1990s. The first tranche of recapitalisation bonds was issued by the Indian government in 1994. In the 1993-94 Union Budget, the then finance minister Manmohan Singh announced provision for a large capital contribution of Rs. 5,700 crore to the nationalized banks to protect "the viability and financial health of the Indian banking system". After the 2008 global financial crisis, the first signs of stress in Indian banks were seen in 2010 and since then, the government has pumped in Rs 67,734 crore capital to keep the public sector banks running, apart from the Rs 70,000 crore fund infusion plan under the so-called Indradhanush plan, over a period of four years between 2016 and 2019. Of this, Rs 52,000 crore has already been infused. The remaining Rs 18,000 crore has been included in the latest package. The Indradhanush plan (announced in August 2015), also outlined Rs1.1 trillion being raised by the banks from the market. Of this, the banks till now have raised a little over Rs 21,000 crore. The government expects them to raise Rs 58,000 crore in next two years. If the enthusiasm of the investors is anything to go by, none would dare to dub it as too ambitious a target."[15]

While the government will "continue to retain majority ownership, and therefore effective control" in these banks, Singh stated in the same budget that the government would permit State Bank of India and other nationalised banks to join the capital markets for the purpose of raising new equity. An additional Rs 5,600 crore was allocated for these banks' capital contributions in the form of government bonds in the 1994–1995 budget. In both cases, the government paid the interest costs even though there was no immediate financial strain.

Sudden surge was seen in the magnitude of the recapitalization. Till 2009-2010, the consolidated recapitalization was amounted to Rs. 230 billion, meanwhile it went up to astonishing Rs. 1,081 trillion which broke all previous records for year between 2010-2011 and 2016-2017.[16] In order to revitalize few ailing public sector banks government is intending to invest Rs. 880 billion. This move of the government to safeguard the fortunes of the public sector banks is different from the traditional and routine recapitalization practiced over the years, as this time, financial support has been linked to specific performance metrics. Hence, the bank recapitalization warrants a holistic critique without dismissing the sceptics.

[15] Supra note, 5.

[16] Mehra, A., & Das, M. (2018, January 25). *Banking reforms must complement bank recapitalisation plan*. Retrieved from http://www.livemint.com/Opinion/v6UvWTJYA0UaXZ- 4RNtHDrL/Banking-reforms-must-complement-bankrecapitalisation-plan.html

IV. Concept and rationale of bank recapitalization: action plan & reaction, issues & challenges

In a systemic crisis, recapitalizing banks is a very "complex medium-term process" which involves significant intervention of the government and a diligent management at both individual and strategic bank levels. The approaches of recapitalization have a varied "mixes of direct capital injections and asset purchases and rehabilitation that countries choose."[17] In order to "minimize the expected present value of government outlays net of recoveries", an appropriate mix of approach is necessary.

In 1994 budget session while introducing the recapitalization plan, then Finance minister said: *"While undertaking such a large injection of capital into the banks, specific commitments will be required from each bank to ensure that their future management practices ensure a high level of portfolio quality so that the earlier problem does not recur."* If this had been followed efficiently then the scenario of recurring bailouts of India banks could have been avoided.

A. Concept and Rationale

Recapitalization can be termed as the capital injections of common equity, conditionally convertible bonds and preferred stock from both government and private investors.[18] The restructuring of the banks is a way to manage the equity and debt which should be the mix of "a stable and optimal capital structure." The profitability and the eventual survival in the financial market is often linked to the recapitalization. Three critical elements which are crucial at the time of the distress is safety, stability and confidence. The first line of defence is the capital which helps during the losses, and the scarcity of the capital during the crisis may result in the difficulty to raise equity affect the earnings which would result in the capital inadequacy.[19] Non-Performing Assets are the main reason of crisis in the banking sector. In order to mitigate the effect of NPAs the process of recapitalization is preferred by the government, this provides the bank a new "lease of life" which helps them grow further and make profit. Bad loans and the toxic assets can be wiped out through infusion of new capital with more efficiency and maintain support and safety with respect to new lending including the other activities.[20] However it cannot be said that the process of recapitalization is only carried out only during crisis. It has been rightly stated by Tomec and Jagric: "*Even if the bank*

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[17] Supra note 4, 58

[18] Tomec, M., & Jagric, T. (2017). Does the amount and time of recapitalization affect the profitability of commercial banks? *Czech Journal of Economics and Finance*, *67*(4), 318–341.

[19] Kok, C., & Pancaro, C. (2015, May). Bank profitability challenges in Euro Area Banks: The role of cyclical and structural factors. *Financial Stability Review*, 134–145.

[20] Supra note 19.

is in a relatively good condition with regard to the level of its capital, it is likely that it will need to strengthen capital because of the high level of interconnectedness among financial institutions. As seen in the crisis, stability and confidence in the financial sector can be very fragile in times of crisis, with significantly negative consequences. Prompt and efficient recapitalization increase the positive effect on profitability, which is in the interest of financial institutions and for the economy as a whole."[21]

Sometimes political compulsions are attributed to be the reason for the recapitalization of the banks. Banks which are undercapitalized are always at the verge of closure. The process of squeezing the cash is started by these banks which results in the mutual separation of poor borrowers from the bank and banks are compelled to "collect low cash than the maximum amount they can from liquid borrowers."[22] Even after doing the squeezing process the banks cannot opt for closure as the depositors money is at risk. Moreover, these banks generally stop all the social sector initiatives as from these branches there is less profit and cost is high.

B. Roadmap for Recapitalization and Reaction

The banks' day to day business like lending and spurring investment is being incapacitated due to lack of liquid funds during the crisis of NPAs. Banks differ on two dimensions, one is the quality of their existing assets and other one is their investment opportunities. The severity of debt overhang is determined by asset quality, and due to lack of high quality investment opportunities the general welfare losses occur. Thus it is the task of the banks to look over the investment opportunities rather than relying on the government.[23] The market has wholeheartedly accepted India's "decisive public sector bank recapitalization." Around 30% of the equity index of the PSU banks have jumped. However, this is the result of the government's commitment towards releasing capital for the banks, highest over the past decade. Consequently, this raises few questions regarding: "Has enough 'resolution capital' been provide to adequately solve the problem? Has enough 'growth capital' been provided to boost PSB lending, which is the whole point of the exercise? How do we prevent 'moral hazard'? To what extent can PSB lending sustainably pick up, given migration to private banks and non-bank sources of funds?"[24]

Has enough 'resolution capital' been provided? The package for the bank recapitalization

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[21] Ibid.

[22] Diamond, D. W. (2001). Should banks be recapitalized? *Federal Reserve Bank of Richmond: Economic Quarterly*, *87*(4), 71–96.

[23] Supra Note 6, p. 2

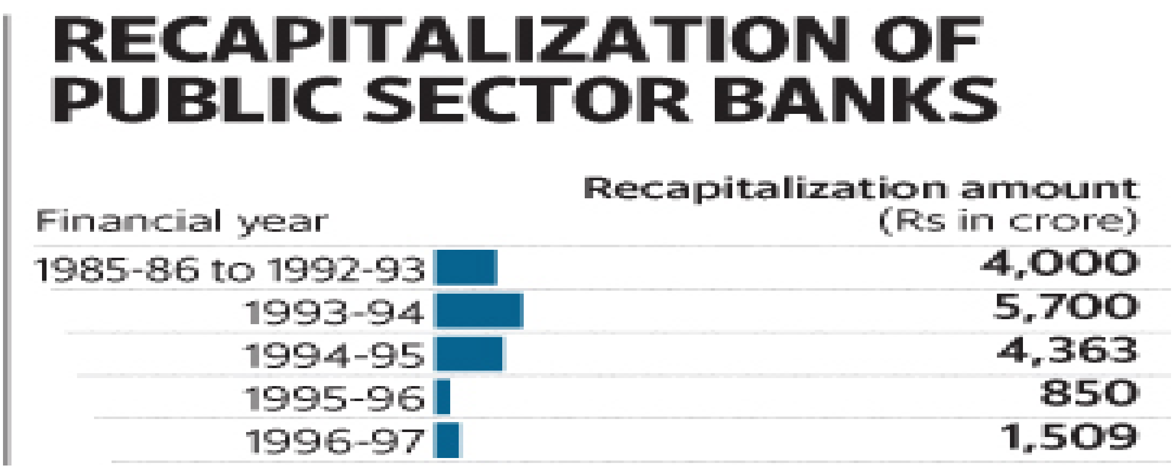
[24] Sajjid Chinoy & Toshi Jain, Taking bank recapitalisation to its logical conclusion, Nov 13, 2017, https://www.livemint.com/Opinion/qsGtawVl5RUmEf2bHM5WMO/Taking-bank-recapitalisation-to-its-logical-conclusion.html

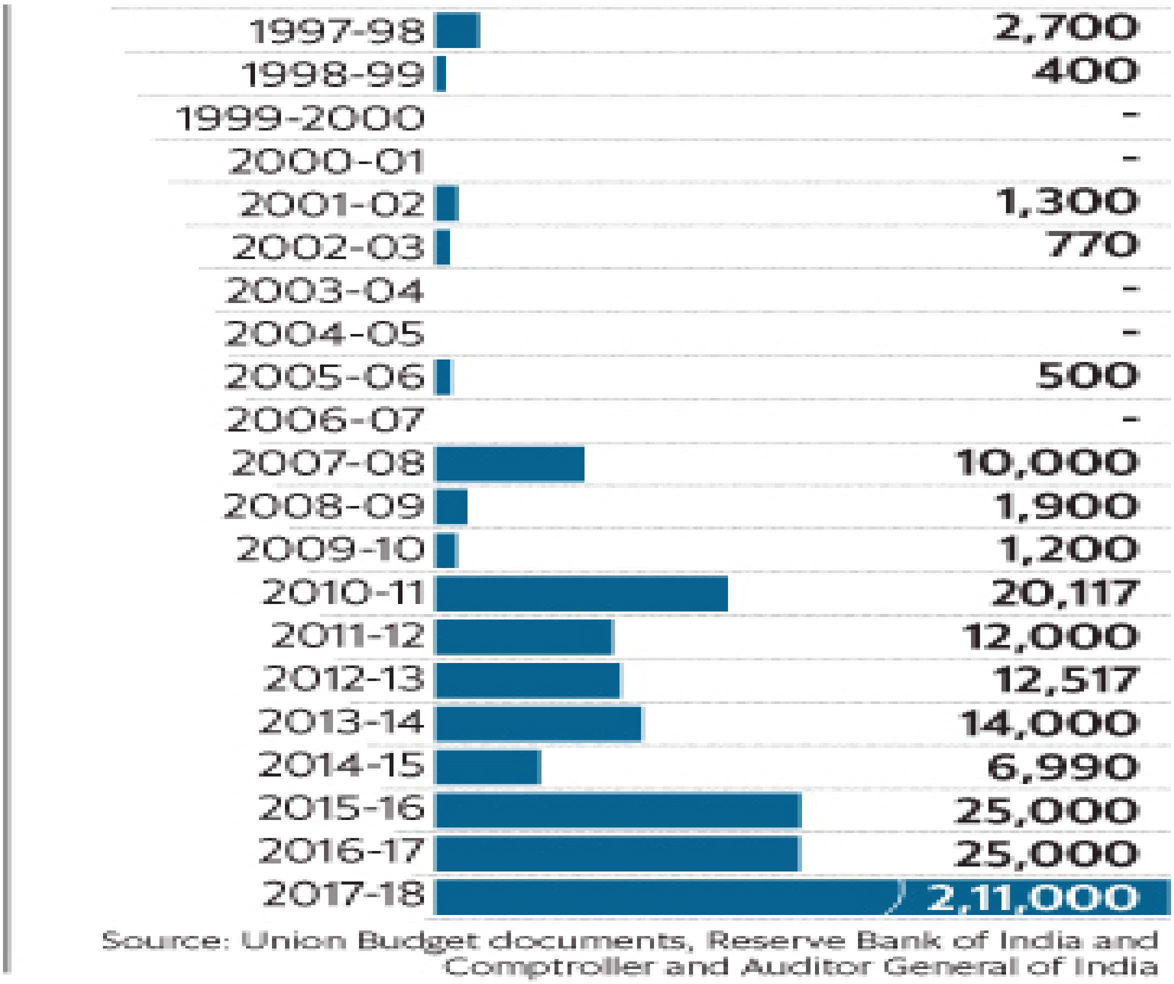
by the government is very large, around Rs.2.11 trillion, or GDP's 1.3%. Considering that some amount would be raised through the market but the major infusion of capital would carried out by the government which is Rs.1.72 trillion, this cut includes cash from budget, recapitalization bonds and interest on the recapitalization bonds.

Table 1. Capital Infusion (in ₹ Crore) in Public Sector Banks by the Government of India (2008–2009 to 2016–2017)

Bank	2008–2009	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014	2014–2015	2015–2016	2016–2017	Total
Allahabad Bank	–	–	670	–	–	400	320	973	451	2,814
Andhra Bank	–	–	1,173	–	–	200	120	378	1,100	2,971
Bank of Baroda	–	–	2,461	–	850	550	1,260	1,786	–	6,907
Bank of India	–	–	1,010	–	809	1,000	–	3,605	2,838	9,262
Bank of Maharashtra	–	–	940	470	406	800	–	394	300	3,310
Canara Bank	–	–	–	–	–	500	570	947	748	2,765
Central Bank of India	700	450	2,253	676	2,406	1,800	–	535	1,397	10,217
Corporation Bank	–	–	309	–	204	450	–	857	508	2,328
Dena Bank	–	–	539	–	–	700	140	407	1,046	2,832
Indian Overseas Bank	–	–	1,054	1,441	1,000	1,200	–	2,009	2,651	9,355
Indian Bank	–	–	–	–	–	–	280	–	–	280
Oriental Bank of Commerce	–	–	1,740	–	–	150	–	300	–	2,190
Punjab National Bank	–	–	184	655	1,248	500	870	1,732	2,112	7,301
Punjab & Sind Bank	–	–	–	–	140	100	–	–	–	240
Syndicate Bank	–	–	633	–	–	200	460	740	776	2,809
UCO Bank	450	450	1,613	48	681	200	–	935	1,925	6,302
Union Bank of India	–	–	793	–	1,114	500	–	1,080	541	4,028
United Bank of India	250	300	558	–	100	700	–	480	1,026	3,414
Vijaya Bank	500	–	1,068	–	–	250	–	220	–	2,038
State Bank of India	–	–	–	7,900	3,004	2,000	2,970	5,393	5,681	26,948
IDBI Bank	–	–	3,119	810	555	1,800	–	2,229	1,900	10,413
Total	1,900	1,200	20,117	12,000	12,517	14,000	6,990	25,000	25,000	118,724

Source: Bandyopadhyay and Bhattacharya (2018).





It can be evidently seen in the image that how capital has been infused by the government from 2006 to 2018, which should be considered as enough. However, the main contention arises on the size of the haircut. By March 2018, the Reserve Bank of India (RBI) projects that the overall non-performing assets (NPAs) of PSBs will range between 13.2 to 14.2% of advances under various stress scenarios. The overall PSB NPA pool will be Rs. 8.7-9.3 trillion if you include some restructured loans that are becoming non-performing assets. During the resolution process if one assumes a 50% haircut, including the incremental capital adhering to Basel III norms by April 2018(estimated around Rs.40k-60k crore), Rs.2.7 trillion would be the total capital requirements. In addition to this the latest package of Rs.1.7 trillion would be added to the total resource which would extend to Rs.4.4 trillion. However, this is still Rs.60k crore less than what is required. Assertions could be made that this amount may be raised through market. But it might not happen as there are more chances of increment in the haircut from 50% to 60% that would surely raise the capital requirements, which would not be a plausible amount to raise from the markets. So "the quantum of the haircut is absolutely critical."

The question remains who will issue the recapitalisation bonds (the government or a special purpose vehicle that can be floated for this purpose), the maturity of such bonds and the coupon. Whether they will add to the fiscal deficit or not will depend on who is issuing the bonds, and what kind of instrument it is. However, the interest outgo on the bonds is likely to add to the deficit, since the government will pay that. At current market rates, the annual interest cost for the government would be about Rs. 9,000 crore-less than 0.1% of the GDP.

Under International Monetary Fund norms, recapitalisation bonds are not added to the accounting of the fiscal deficit as they are squared off by buying shares in banks. In India, however, such bonds in the past were taken into account since the government pays interest and eventually redeems them. If they are issued by quasi-government institutions, such bonds will be treated as contingent liabilities of the government.[25]

Has sufficient 'growth capital' been allowed?

The nominal GDP growth of the public sector bank had slowed down sharply, whereas the market share of the private sector banks and other non-bank sources has gained impressively. So, one should not hope for any unexpected boom in PSB credit growth. Consequently, if the growth continues to be at this pace it would require additional capital. This recent capital should not be thought as "beginning of the end" rather it should be "end of the beginning". Thus it could be inferred that "more resources are needed to take this process to its logical conclusion."

How should the recapitalisation bonds be designed?

The design of the recapitalisation bonds should not be restricted so as to make it more viable for all purposes as it would decrease the incremental demand for other bonds. Thus to minimize this effect, the recapitalization bonds should be designed as "imperfectly substitutable to other bonds as possible, on all dimensions: liquidity, statutory liquidity ratio status and tradability." Thus there might be some application of temporary restriction on trading as Indonesia did primarily allowing only 10% of the bonds to be traded, and progressively liberalizing that fraction.

C. Issues and Challenges

The main aim of recapitalization is to provide banks a kind of stability in this whimsical market and enable to carry out the lending process without any lag due to rising NPAs. Due to the regulations of the RBI, the banks do not have many choices even after infusion of fresh capital. Differing from the standards, RBI enjoys 9% Capital to Risk (Weighted) Assets Ratio (CRAR), whereas it is globally accepted at 8%. NPAs are one of the main problems of the banks as the

[25] Ibid.

banks are in no way getting any interest on those moneys which needs to be set aside. This affects the ability of the banks to use the fresh capital in an efficient way.[26]

The Twin Balance Sheet (TBS) Challenge

The plight twin balance sheet problem has over leveraged the companies. As rightly pointed out by Arvind Subramaniam, the chief economic advisor to the government the two aspects of this challenge are: "***a)*** *Over indebtedness in the corporate sector which makes them unable and unwilling to borrow, depressing the demand for spending and investment;* ***b)*** *Stressed bank balance sheets especially in public sector banks (PSBs) that make them unwilling and unable to supply credit to finance spending by the corporate and household sectors."* [27]

This stagnates the economy, consequently it deprives the oils and feeds the required demand of lubrication. "Countries that experience the TBS witness prolonged and weak growth. Growth only revives if the TBS challenge is swiftly and decisively addressed."

What the TBS challenge requires

Recognition- The combined amount of stressed and non-performing assets (NPAs) in the banking sector is approximately Rs 10 lakh crores, and the Asset Quality Review has greatly aided us in understanding the full scope of the issue. However, a word of caution. Always and everywhere, the amount of stressed assets is at least 10–20% higher than what is always and everywhere stated. Therefore, even while we are aware of the extent of the underlying issue, it would be wise to presume that we have not found it all.

Recapitalization- The capital position of the banks must be protected through infusion of equity.

Resolution- It is necessary to sell or rehabilitate the corporate sector's underlying stressed assets. To encourage resolution, the government approved an ordinance in May 2017. On June 13, 2017, the RBI took quick action by deciding that 12 loan accounts will be opened under India's new bankruptcy law, which has strict timelines and a well-defined settlement procedure. About 25% of the current non-performing assets (NPAs) in the banking sector are these loans, not the total amount of stressed assets. Since then, another 30 to 40 cases have been added to the list, and they might also go through the bankruptcy process if a settlement cannot be reached. Market players have, however, noted that procedures are still in their infancy and have

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[26] Amiya Kumar Mohapatra, Srirang Jha, Bank Recapitalization in India:A Critique of Public Policy Concerns(April 16, 2018), FIIB Business Review, Sage Journals, Vol 7, Issue 1, 2018
[27] Arvind Subramanian on bank recapitalization, Morningstar, 30 Oct, 2017, <https://www.morningstar.in/posts/43518/arvind.aspx>

not been explored, even in minor cases. It has been suggested that if debtors have the ability to contest the processes in court, even if the system functions effectively, it may not result in resolutions.[28]

Reform- To prevent a recurrence of the issue, future incentives for corporations and the private sector must be properly set. A vision of where we believe the banking industry should be in five to ten years, funding a double-digit expanding economy, must drive reforms.

Current Scenario-

Considering the amount of NPAs, the banks are required and expected to utilize the money received in recapitalisation scheme as much as they can. The package generally facilitates the banks to use the money aggressively without looking into the implications to resolve the bad loan problems. Moreover, to meet the demands of international Basel III norms, capital is used efficiently though this norm will kick in April 2019.

V. BANK RECAPITALIZATION: PUBLIC POLICY CONCERNS

The recent announcement by the government regarding recapitalization in public sector banks has received mixed feelings among critics. On one hand they might correspond for the excessive authority of the state to use taxpayers' money to cover up the inefficiencies and fraudulent acts of the banks. Simultaneously there are few on the other side who believe that it is the government's duty to help the ailing banks whenever in need. As state is the highest stakeholder in these banks so it is the moral obligation of the government to provide financial assistance whenever they run short of capital. Sceptics have good reason to doubt the government's decision to continuously recapitalise banks when the proper course correction should primarily concentrate on enhancing institutional efficiency and a robust monitoring system to control the threat of bad loans and fraudulent transactions, which occasionally surface through the media.[29]

It's interesting to note that as of September 2017, public sector banks' gross non-performing assets (NPAs) was at 13.5%, while the percentage of stressed advances that could become non-performing assets (NPAs) was 16.5%. The estimated amount of bad loans accumulated in the nation between 2016 and 2017 was around $10 trillion, which is more than the gross domestic product of several other nations. As a result, the situation with regard to NPAs is concerning. It is anticipated that any bank will approve a loan following a thorough risk assessment and only release funds after obtaining the original collateral documents. When approving and

[28] Ibid.
[29] Supra Note 25.

distributing the loan, a bank officer is expected to exercise due diligence. In general, risk assessment is based on an objective point system and is scientifically designed.

The first Narasimham committee had said that India should move towards a three-level structure of banking. Four huge moneylenders were to be created as worldwide banks, 10 banks were to end up across the nation as universal banks and indigenous banks that would focus on explicit areas. It isn't important to outline the future in such granular detail, however the hidden issue of managing an account structure is an imperative one.

Because of the disruption that would result from closing the weakest banks all at once, this is not feasible. Nonetheless, there is a compelling argument to turn at least a few of them into narrow banks that purchase government bonds with all of their deposit money. Instead of becoming the more conventional financial intermediaries, they might actually become into big payments banks. The concept of narrow banking requires careful consideration. India must transition to a financial system where smaller businesses rely more on banks for funding while larger corporations are mostly financed via the bond markets. Some of this has already occurred, as businesses have raised funds from the bond markets during periods of stagnant bank lending. The issue is that only a small group of investors hold the majority of corporate bonds to maturity, making the market still illiquid. It is essential to deepen the corporate bond market.[30]

Maintaining financial stability was one of the most daunting tasks at the time of global financing crisis by any country. Increase in credit creation motivated people to opt for loan, resulting in bad loans on their default. Even countries like Japan which are Bank-led financial systems have been in trouble. The economic growth and the job creation areas are strongly affected by the unstable financial system. "The fiscal costs of bailouts can also be staggering."[31] The fraudulent conduct on the part of staff and officers has led to tarnishing the reputation of the public sector banks. It has been found that, a bank staffer is held for fraud at every four hour.[32] Moreover it is very unfortunate to consider that sometimes these fraudulent act of omission and commission are being unearthed for years, which facilitates the offenders a shield.

Thus it can be concluded that how the banks are at the very verge of mismanagement and

[30] Supra note, 5.
[31] Kok, C., & Pancaro, C. (2015, May). Bank profitability challenges in Euro Area Banks: The role of cyclical and structural factors. *Financial Stability Review*, 134–145.
[32] Kumar, C. (2018, February 17). Every 4 hours, 1 bank staffer held for fraud. *The Times of India*. Retrieved from https:// timesofindia.indiatimes.com/india/every-4-hours-1-bankstaffer- held-for-fraud/articleshow/62965664.cms

maladministration which makes people to rethink over the sanctity of these institutions. Meanwhile the government should also take into consideration the current status of the banks and is recapitalization is the only solution to help these ailing banks.

VI. CONCLUSION

A systemic crisis can be considered as the inception point for a reform. So it can be said that the recapitalizing and restructuring of banks is the end result of a systemic crisis. However, it is a complex process that usually requires the intervention of the government and takes labor in the form of designing and implementing the scheme. In order to be effective, the process shall be efficiently coordinated, it must be prompt though it requires care and diligence while preparing the scheme considering the reconciliation of financial and human resources. Moreover, it must be noted that this process requires careful management not only at strategic level but also at the individual bank level. This requirement would ensure the maximum return on the part of the government's investment and an "emerging and sound banking system" can be achieved through efficient end of the process.

The merits of recapitalization cannot be denied but it is possible that this process "might fuel credit off-take" and result in the slow growth in the economy of the country. The second contention arises that is bailing out the banks through recapitalization might lead to moral hazard and the whole banking system will revolve around its vicious cycle. There is a lack of concerted effort on the part of the banks to improve their financial health before reaching to the government for help.

Moving towards the rising problem of NPAs, the root cause of NPAs must be addressed timely to prevent further deterioration in the credit market and thus braking the vicious circle of financial distress. There should be viable regulatory standards to ensure effective Risk management and Credit appraisal. Stricter compliance of procedures in lending, effective supervisory steps to tackle the defaulters and management of stressed assets through understanding and cooperation between government and the banking sector would pave for strong financial sector in India.

All the efforts of capital infusion might not result in success unless the government's accountability structure is unchanged. Many analysts have suggested that the boards of the public sector banks should be given some sort of authority to deal with their crisis. The boards need sufficient "functional autonomy and operational flexibility."

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