N.P.A. LEVELS OF PRIVATE SECTOR VIS-À-VIS PUBLIC SECTOR BANKS

"Slowdown in credit growth is largely because of stress in the public sector banking and not because of high interest rates."

-Raghuram Rajan

One really wonders why the NPA levels of private sector banks are lower than that of public sector banks when both have been operating in the same economic environment. Some of the financial sector wizards have placed it on record that private sector banks have more to suppress than public sector banks. Before one gets into analysis and reasoning mode, it is necessary to understand the age of these banks, corporate & retail portfolio, dynamic nature of change in strategy, availability of talent, regulatory framework for lending and profitability aspects. Multiple factors could be attributed to the asset quality deterioration and the ability of the banks to curb NPAs besides economic downturn.

PRIVATE SECTOR BANKS:

First of all, have a look at the age of the new generation private sector banks that has not gone beyond 23 years except ICICI Bank where reverse merger of the parent ICICI took place. Known as Development Financial Institution, ICICI had commenced business in the 1950s. So ICICI Bank carried on the legacy of its parent ICICI. Kotak Bank and Yes Bank are late entrants among private sector banks, which are part of Table I. When one takes a closer look at the total advances level of these banks – Axis, HDFC, and ICICI stand out whereas others are about one-third or less than that of the top 3 private sector banks. Some of these banks have grown organically whereas others had inorganic growth viz HDFC Bank acquired Times Bank and Centurion Bank of Punjab, ICICI Bank acquired Bank of Rajasthan, Bank of Madura and Single Bank whereas Kotak Bank acquired ING Vysya Bank. In case of IndusInd Bank, the process of merger with Bharat Financial (erstwhile SKS Microfinance) is on. Axis Bank and the Yes Bank have registered organic growth as these banks have not yet acquired any Bank.

Total Advances, Corporate & Retail and Asset Quality of Top Private Sector Banks as on 30.06.2017

Bank Name	Year Established	Existence in years	Total Advances	Corporate	%age Share	Retail	%age Share	Gross NPA%	Net NPA
Axis Bank	1994	23	385,481	208,203	54	177,278	46	5.03	2.30
HDFC Bank	1994	22	580,976	278,149	46	302,827	54	1.24	0.40
ICICI Bank	1994	23	464,075	216,723	47	247,352	53	7.99	4.86
Kotak Bank	2003	14	142,359	85,831	60	56,528	40	2.58	1.25
Yes Bank	2004	13	139,972	125,275	89	14697	11	0.97	0.39
IndusInd Bank	1994	23	116,407	69,312	60	47,095	40	1.09	0.44

On an analysis of Table I data, considering large advances portfolio, HDFC Bank stands out in terms of asset quality amongst private sector banks. It could be attributed to the inception strategy of lending to top Indian companies for building corporate loan book. The retail focus of the bank is evident from the fact the retail loan book constitutes more than half of the advances portfolio. Such large proportion of Retail book is appreciable when housing finance to the customers is majorly covered by its parent Housing Development Finance Corporation Ltd (HDFC). In other words, HDFC Bank is not focussing on housing loan segment, which constitutes more than 50% of retail loan book for all other Banks. ICICI Bank carried legacy of its parent ICICI and gradually shifted its focus to Retail and aggressively grew its Retail Lending book. Axis Bank kept its focus on SME as part of corporate lending in the beginning, and post Y2k it shifted focus on the retail liability for bolstering retail franchise. Advances growth gear of Axis Bank shifted to retail lending post economic slowdown of 2008. The late entrant Kotak Bank has a 60:40 proportion of corporate and retail loan book. IndusInd Bank is as old as top 3 private sector banks, but it went into consolidation mode after an aggressive start. It has been able to resurrect itself now and its corporate to retail loans proportion is identical to that of Kotak Bank. Yes Bank is the only bank among private sector banks, which is tilted towards building corporate loan book and retail lending constitutes mere 11%.

It could be inferred that private sector banks, which have/had a strong focus on corporate loan book, have a higher proportion of delinquency as compared to others. It remains to be seen how Yes Bank would sustain its asset quality with a higher concentration on corporate advances.

Another aspect is the availability of domain experts and talented manpower, which is not an issue for private sector banks due to market-linked compensation structure. Private sector banks are also offering performance-linked variable pay and ESOPs (selectively) to credit proposal sourcing personnel and credit appraisal officers. There is a well-defined career path for these experts and mobility is also not very high. Although attrition happens for these cadres of officials, but majority of the private banks believe in retaining the talent. Human resource department in these banks regularly undertakes the exercise to identify talented manpower and develop their skills by imparting specialized training in India as well as overseas. These banks also carry out recruitment of personnel from top business schools in India.

It would be pertinent to mention that each of these private sector banks like PSBs has to necessarily open a branch in tier V or tier VI (unbanked) centres for every 3 branches opened in metro and urban centres. These banks are also required to meet RBI guidelines of 40% of the priority sector lending target within which 18% to the agriculture sector and other segmental targets for economically weaker sections and export credit.

Private sector banks are also part of the financial inclusion objective of RBI and these banks are also engaging banking correspondents to offer banking services to rural populace.
About capital requirements to meet credit expansion, all private sector banks are adequately capitalised and are free to raise capital from domestic as well as overseas markets. The proposed implementation of Basel III norms by RBI might be deferred as balance sheet cleaning up process is still not complete for banks. In terms of valuation, the private sector has been quite successful in enhancing shareholder's wealth and HDFC Bank is the top Indian Bank in terms of market capitalization. The business model of each of these banks plays a vital role in controlling the NPA levels. All these private sector banks function in the form of verticals, broadly divided into corporate segment comprising large & mid-corporate, corporate agriculture, SME and retail segment constitutes retail liability, retail assets, and retail agriculture. The branches form part of the retail distribution network, mainly rendering customer service besides acquiring liability business and cross-selling investment products to its existing customer base. Whereas lending process is undertaken by respective verticals, leading to a uniform appraisal system, committee decisions on loan proposals rather than individuals, strong risk management policies and centralised disbursal system.

PUBLIC SECTOR BANKS:

All public-sector banks were established in the pre-independence era by private promoters and these were catering to the financial needs of rich segment till nationalization rather than masses. Imperial Bank of India was formed in 1921 when 3 Presidency banks namely, Bank of Bengal, Bank of Bombay and Bank of Madras were merged. Imperial Bank of India was renamed State Bank of India on 1st July 1955, with Reserve Bank of India owning 59% stake, which was transferred later to GoI in 2008.

The government of India announced nationalization of 14 banks on 19th July 1969 whereas 6 more banks were nationalized on 1st January 1980. The objective of nationalization was to extend finance & banking services to the poor and needy masses.
While Punjab National Bank took over New Bank of India in 1993-94 it was SBI's turn to merge State Bank of Saurastra and State Bank of Indore with itself. Merger of remaining 5 associate Banks took place w.e.f. 1st April 2017, making SBI a behemoth in Indian banking sector. Indian Overseas Bank acquired Bharat Overseas Bank in 2007. Parent development financial institution IDBI got reverse merged with Private Sector IDBI Bank and turning itself into a nationalized Bank, as GoI stake in the new Bank exceeded 50%.
On a perusal of market share of advances portfolio, it could be noticed SBI holds more than 20% market share and nationalised banks hold 45% of the market share. But the worry stems from the fact of dwindling market share of public sector banks, which has come down to 69% ever since new generation private sector banks came into existence. A market survey by credit rating agency ICRA, in the recent past, depicts market share in advances of private banks to move up to 38-40% by 2020, that sends a warning signal to public sector banks. Another startling fact that gets noticed is the speed of acquisition of the business in advances by top 3 Private Banks, top 2 of them have already overtaken all public-sector banks, except SBI, by a fair margin whereas Axis is almost catching up. One cannot overlook the nascent age of private banks vis-à-vis their counterparts in the public sector. Of course, public sector banks have been diligently lending under various Government sponsored schemes, thereby meeting social objective, where delinquency rate is on the higher side.
On a closer look at the corporate and retail advances portfolio composition of public sector banks, one notices the tardy pace in switching gears from corporate lending to retail lending post economic slowdown of 2008, which would have spurred the growth of advances portfolio.

The share of top 6 public sector banks in retail lending in overall advances portfolio ranges from 11% to 26% only whereas top 3 private banks share in retail lending ranged between 46% and 54%.The delinquency in corporate loan book is always on the higher side, particularly when there is an economic slowdown, whereas risk gets diversified in the retail lending portfolio where delinquency is much lower as compared to corporate loan book. Failure of public sector banks to shift focus in time to retail lending in the times of economic slowdown has cost them a lot in terms of advances growth as well as asset quality. Asset quality has deteriorated over a period of time and gross NPAs of public sector banks ranged from 10% to 25% whereas net NPAs have been in excess of 5% going into double-digit for some of the public-sector banks.

Although best of the talent gets entry into public sector banks as job security is very high in these banks but retaining aspiring personnel is a daunting task in the absence of well-defined career path, barring a few banks, inability to offer market-linked compensation, lack of providing performance linked variance pay and ESOPs to the performing personnel dissuades them to continue for long-term or motivation level comes down over a period of time and the talented personnel start looking out for alternate avenues. The recruitment of specialist officers is centralised or outsourced to an external agency, which conducts the written test followed by personal interview. The turn-around-time (TAT) is longer as compared to their counterparts in the private sector where respective department carry out recruitment of experts in consultation with human resources.

Total Advances, Corporate & Retail and Asset Quality of Top Public-Sector Banks as on 30.06.2017

Bank Name	Year Established	Existence In years	Total Advances	Corporate	%age Share	Retail	%age Share	Gross NPA%	Net NPA
SBI	1921	96	18,86,666	13,96,661	74	490,005	26	9.97	5.97
PNB	1894	123	422,452	354,585	84	67,867	16	13.66	8.67
BoB	1908	109	401,324	340,500	85	60,824	15	11.40	5.17
BoI	1906	111	391,062	348,260	89	42,802	11	13.05	6.70
Canara Bank	1906	111	342,815	281,974	82	60,841	18	10.56	7.09
Union Bank	1919	98	295,175	252,818	86	42,357	14	12.63	7.47

Public sector banks are totally dependent on GoI for meeting their capital requirements, as statute doesn't permit government holding to go below 51% mark. Inability to raise fresh capital without government consent act as a hurdle for credit growth, as meeting capital adequacy ratio of 9% based on the risk-weighted assets is mandatory. Government is actively considering consolidation of public sector banks, SBI and associate banks merger could be construed as a precursor to the proposed consolidation plan. The recent mega plan of infusing Rs. 211,000 crores capital in public sector banks over a period of 2 years has revived the sentiments of the market towards public sector banks, which are expecting a re-rating in near future. The proposed capital infusion would help these banks in cleaning up respective balance sheets as well as fuel the credit growth.

Lastly, about the prevalent business model of public sector banks where the entire network of the branches not only acts as retail distribution but also shoulder the responsibility of achieving lending targets. In the absence of domain expert in lending at the branches, the processing of credit proposal lacks scrutiny in a prudent way. The delegation of the lending powers to individuals at the branch level dilutes the quality of the business sourced. Further, public sector banks have 3 or 4 tier structures in the form of branches, regional/zonal offices and central office, which delays the processing of proposals beyond the delegated powers of the branch. Individual lending powers at regional/zonal/central level also dilute the quality of the credit business sourced. Risk management policy though exists but not very effective as delegation prevents adequate coverage.

CONCLUSION:

In the backdrop of what is discussed above, many factors contribute to the higher level of delinquency in public sector banks. Legacy is a major issue for public sector banks, absence of leadership continuity at helm of affairs, business model i.e. delegation of lending powers and absence of verticals, retaining talent in the absence of market-linked compensation structure, social responsibility of lending, inability to discern by switching gears (corporate to retail) in case of economic slowdown, prudent credit risk management application at all levels, higher cost of funds as compared to private sector counterparts, turn-around-time (TAT), customer/client delivery and dependency on GoI for capital requirements are various factors, inter-alia, responsible for higher level of NPAs in public sector banks as compared to private sector banks.

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