Banks ultimately need autonomy

Banks, it is often said, are the fulcrum of a robust economy. Healthy banks are an essential prerequisite for placing the economy on a higher growth orbit. The banking scene in India, however, >presents an absolutely scary picture. A combination of factors ranging from poor credit appraisal to political interference and mismanagement by borrowers have conspired to push the banking industry into a messy cobweb. Bank after bank, especially the government-owned, has come out with poor third-quarter results. The stressed assets (comprising gross non-performing assets plus written-off assets and restructured assets) account for 14.1 per cent of total bank loans as of September 2015, up from 13.6 per cent in March 2015. For public sector banks, the stressed assets were in the vicinity of 17 per cent at the end of September, while the figure for private sector banks stood at 6.7 per cent. The rising stress level, or increase in bad loans, has yielded a twin fallout — of declining profitability at banks and poor credit disbursal. The double effect is already telling on the economy in various ways. For long, banks have either managed to, or rather been allowed to, keep the stress invisible, giving the outside world very little clue as to the happenings inside the industry. The Reserve Bank of India under Raghuram Rajan's stewardship, however, >has decided to clean up banks' books rather than letting them camouflage the real picture. "There are two polar approaches to loan stress," he said at the CII Banking Summit in Mumbai this week. "One is to apply band-aids to keep the loan current, and hope that time and growth will set the project back on track. Sometimes this works. But most of the time, the low growth that precipitated the stress persists. The fresh lending intended to keep the original loan current grows. Facing large and potentially un-payable debt, the promoter loses interest, does little to fix existing problems, and the project goes into further losses." Indeed, legacy problems should be given a burial, and should not be allowed to persist. So hinting, Dr. Rajan articulated the need for surgical action to retrieve the health of the industry.

Forcing banks to recognise a problem is one thing, and finding a viable long-term solution to it is quite another. That requires not just holistic thinking but an out-of-the-box approach as well, especially in the evolving global context. A meaningful fix can happen only if banks are given functional autonomy at various levels. Restricted freedom inevitably leads to a blame game, making it even more difficult to fix responsibility. The concept of arm's- length relationship especially needs to be clearly defined and implemented in letter and spirit in the banking industry. It is not just about how much money the Central government will freshly pump into stressed banks. The litmus test for the government lies in its ability, and capacity, to let go of control. The banking system indeed needs a change in the way it is managed.