Original Research Paper

Volume - 10 | Issue - 11 | November - 2020 | PRINT ISSN No. 2249 - 555X | DOI : 10.36106/ijar

Economics

THE COLLAPSE OF YES AND PMC BANK

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KEYWORDS :

On September 23 2019, RBI took regulatory action against a major co-operative bank, PMC Bank, restricting its banking operations for six months. The bank was eventually liquidated due to inadequate capital and no-scope of revival. Depositors of this bank still haven't recovered their deposits. Recently, Yes Bank, India's fourth largest private sector bank, was put under a similar moratorium by RBI. The sudden and unexpected collapse of these banks has raised significant questions against India's banking system, which has always been considered to be well anchored and foolproof. However, the events that led to this eventual collapse have much more to do with the internal operations of these banks, than with the economy or the banking system. There are uncanny similarities between the collapse of these banks, something that I wish to highlight through this research paper.

Yes Bank

Yes Bank was established by industry veterans - Rana Kapoor, and his brother in law, Ashok Kapur in 2004, soon after the government started allotting banking licenses to the private sector. The experienced and efficient management helped the bank to expand across the country. The highly profitable quarterly and annual reports validated the bank's exceptional performance and brought in high volume investments from across the globe. Year after year, the bank reported heavy profits constantly pushing up its share price leading to wealth generation and a high degree of investor satisfaction. Consequently, the bank was honored with various banking awards and Yes Bank was hailed as one of the most trusted banks in India. The deposits were flowing in at an increasing pace, the bank was catering heavy loans to top tier companies, the management was strong, the future of Yes Bank looked very promising.

In 2008, however, the exceptional growth of Yes Bank faced a major setback when one of the co-founders, Ashok Kapur, died in the 26/11 Mumbai terrorist attacks. His unfortunate death instantly crashed the share price and led to subsequent unpleasant and relentless legal battles between the two families. These legal battles drastically weakened the management of the bank and surrounded its future with uncertainty. While the lawsuits were being fought, Rana Kapoor, enjoyed total control of the board of directors. Under his control, the bank soon adopted a liberal credit policy wherein the bank aggressively aimed to increase its lost market share. The bank provided risky loans looking at hefty upfront commissions and higher interest rates. Through this approach, Yes Bank increased its interest income and upfront commission significantly, however, this approach was speculative because the bank started extending high volume credit to even stressed companies.

Despite wobbly management and increased exposure to risks, Yes Bank continued to grow at an excellent rate. By 2014, the share price was touching an all-time high (the stock was at an all-time low in 2008). The bank also reported an insignificant 0.31% NPA's or bad loans, this meant that the bank was able to recover most of the credit it extended. The investors were pleased with the bank's financials and were confident about continued strong profits in the quarters ahead. Yes Bank's market value soon crossed 1 lakh crore INR.

Trouble began post-demonetization era when companies faced a cash-crunch and stressed companies started defaulting. The bank was directly exposed to the bankruptcy of companies like IL&FS and Jet Airways, this led to huge losses. The liberal credit approach initiated by Rana Kapoor started taking its toll on the financials of the company as more and more companies started defaulting. In September 2017, Yes Bank's NPA's had more than doubled from 0.83% in the previous quarter to now 1.84%. This was an unprecedented increase that brutally shook the investors. Soon, RBI conducted an audit on Yes Bank NPA'S it reported that Yes Bank had under-reported its NPA's by around 6355 crores! (equivalent to a divergence of 200%) This news completely eroded investor faith in the company and the share price plummeted. Rana Kapoor was later superseded by Ravneet Gill as CEO.

(list Of Major Yes Bank Defaulters)

#	Companies	Amount INR (in Crores)
1	Reliance (ADAG)	12,800
2	Essel	8,400
3	DHFL	4,375
4	Omkar Realtors & Developers	2,710
5	ILFS	2,500
6	Radius Developers	1,200
7	Jet Airways	1,100
8	Kerkar Group	1,000

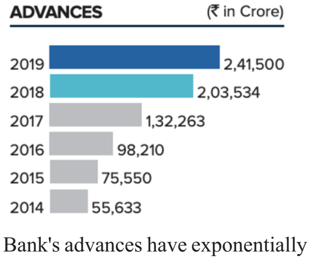
The change in management seemed to have had a negligible effect on the financials. The NPA's as per the annual report of 2019 were 3.22% of the total loans extended. In the fourth quarter of 2019, the bank reported a heavy loss of 1507 crores. The bank was heavily in debt and was unable to raise equity to pull itself out of this clutter. The share price which was around 400 INR in 2018 had fallen to 16.20 INR as of March 6 2020.

FUNDAMENTAL ANALYSIS OF YES BANK

Analysis: Key Parameters

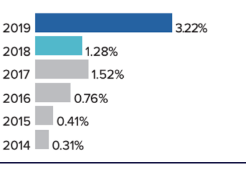
1. Advances
2. Net NPA
3. Gross NPA
4. Provisions and Contingencies (Related to NPA)
5. Interest Income
6. Cost to income ratio
7. CASA RATIO (Proportion of current and saving deposits in total deposits)
8. Shareholder's Funds
9. Net Profit

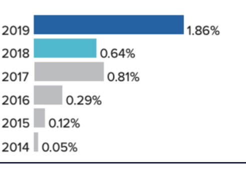
Advances: Increase YoY



Observation: Yes Bank's advances have exponentially increased from 55,000 crores in 2014, to 2,41,500 crores in 2019.
Conclusion**:** This highlights the aggressive lending policies that the bank adopted under the authoritarian control of Rana Kapoor.

NPA's: Gross and Net





Observation: The aggressive lending policies of Yes Bank have directly affected the non-performing assets over the years.

Conclusion: Riskier loans led to higher defaults which led to a continuous spike in NPA's.

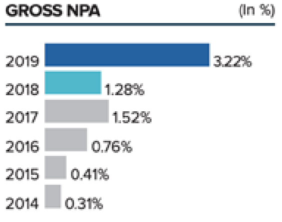
Provisions And Contingencies

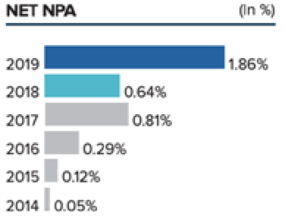
Provisions and contingencies	57,775.60	15,538.04	271.8%

Observation: Provisions are basically created to meet up with the losses caused due to NPA's. Provisions directly affect the profitability of a firm.

Conclusion: In Yes Bank's case the provisions tripled from 2018 to 2019, significantly decreasing the bank's profitability.

Interest Income

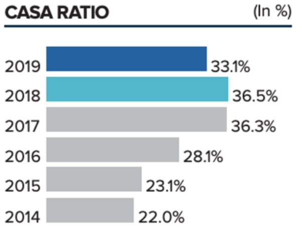




Observation: It can be observed that Yes Bank's net interest income has been constantly rising.

Conclusion: The reason behind this incremental increase is the aggressive lending tactics. The more the bank lends the more it earns through interest.

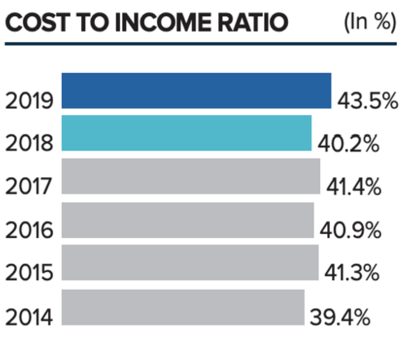
CASA Ratio



Observation: CASA ratio of a bank is the ratio of deposits in current and saving accounts to total deposits. Because the bank provides a lower rate of interest on savings and current accounts, a higher CASA Ratio indicates lower cost of funds. A lower CASA Ratio means that a bank has a higher number of fixed deposits, indicating higher expenses in deposits.

Conclusion: Yes Bank's CASA Ratio was consistent during 2017-2018, however in 2019 it declined, further stressing the bank's financials.

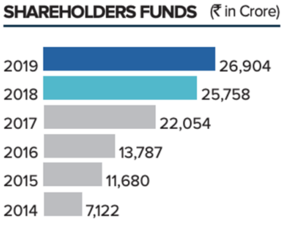
Cost To Income Ratio



Observation: This ratio is calculated by dividing the operating cost by the operating income. A higher ratio indicates lower profitability.

Conclusion: In Yes Bank's case this ratio has been constant since 2014, however it increased 3% YOY in 2019 indicating higher operating cost and lower profitability.

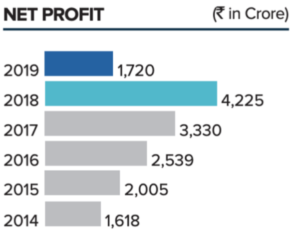
Shareholder's Funds



Observation: This threshold is important to consider because Yes Bank desperately needed to raise capital in order to deal with the increasing NPA's.

Conclusion: However, the bank failed to attract investment, further stressing its condition.

Profitability



Conclusion: The increasing NPA's, provisions, and operating expenses significantly pulled down the bank's profit, the bank has seen a whopping 41% decline in profits YOY.

ANALYSIS OF RESULTS

To highlight, a bank accepts deposits and uses these deposits to grant loans. When the loans start defaulting, the bank enters a stressed state wherein it's unable to repay the depositors. The heavy losses, constant defaults, and decreasing share prices were eroding Yes Bank's capital and reputation at an alarming rate. This erosion of capital decreased the amount of liquid funds available with the bank, thereby limiting its ability to meet its obligations. With the current trend continuing, the capital of Yes Bank was becoming insufficient to cover its NPA's, and therefore the bank would eventually become unable to repay its depositors.

It thus became very necessary for RBI to intervene and protect the deposits of customers. The moratorium has caused initial panic, however, it guarantees the safety of deposits. The State Bank of India is to acquire 49% of Yes Bank at 10 rupees per share, which brings up the total cost of investment to 7250 crores. According to this investment, the valuation of Yes Bank is now just around 16000 crores. Alongside SBI, ICICI, Axis, Kodak and, HDFC bank are also expected to infuse capital into Yes Bank.

Punjab And Maharashtra Co-operative Bank

Established in 1984, PMC Bank is the fourth largest co-operative bank in India. The Bank has 137 branches across 7 states, a majority of these branches are located in Maharashtra. The bank caters mostly to small businesses, housing societies and small institutions. Its functioning is regulated by the RBI under Co-operative Societies Act 1912.

Talking about it's financials in FY 2018-19, PMC Bank made a profit of around 99 crores, NPA's were at 3.76% of the total credit extended (8383 crores), which is respectable by Public Bank standards (for comparison NPA's of SBI stand at around 8%). The accounts of the bank were clean, which validated that it was doing exceptionally well. However, the crisis started when a group of internal whistleblowers approached the RBI, and accused the bank of following fraudulent methods to hide the true picture of their NPA's.

When RBI conducted its audits, it was discovered that the bank had shrouded a staggering 73% of additional NPA's from its books (taking the actual NPA's to 77%) . What's more distressing was the fact that these 73% of NPA's belonged to a single party, which was the HDIL group. The bank had disguised the fact that it had extended 6500 crores of loans to the HDIL group, which was totally beyond the bank's authority because as per RBI rules, a co-operative bank can only extend up-to 15% of its total capital to one party and 40% to a group.

To facilitate this fraudulent loan to the HDIL Group, PMC bank created thousands of fake loan accounts which helped them slide under RBI's radar. Subsequently, when the HDIL group started defaulting, the bank completely misreported its NPA's to project a clean balance sheet.

Due the the Insolvency of HDIL Group, PMC bank faced a loss of approximately 4355 crores. Following this, the bank's capital became inadequate to cover its losses and repay depositors, the bank is now set to be systematically liquidated to help the depositors recover some on the money they invested.

The Board of Directors of PMC Bank later confessed to the RBI that they indulged in such fraudulent activities because of strong historical relations with the HDIL Group and a hefty increase in upfront commission and interest income. The managing director of PMC Bank, Joy Thomas, took full responsibility of the bank's functioning. Currently, the board of directors of PMC Bank and the involved promoters of HDIL group are facing trial under the Enforcement Directorate.

There are around 1500 co-operative banks in India, which makes it very strenuous for RBI to keep a check on their functioning. An inherent flaw of our banking system is that RBI doesn't practice a high degree of regulatory control over these co-operative banks and many provisions of the Banking Regulation Act didn't apply to the co-operative sector. This superficial regulation is what helped PMC Bank to continue with its fraudulent practices for years.

It can thus be concluded that a corrupt board of directors (headed by Joy Thomas), indulging in aggressive lending policies overlooking increased risk, and a lack of supervision under RBI is what eventually led to the insolvency of PMC Bank.

CONCLUSION

From the study above, it can be reasonably inferred that both Yes Bank and PMC bank failed due to the aggressive and unrestricted lending policies adopted by them under their authoritative and unprofessional board of directors. To increase their upfront incomes, both of these banks exposed themselves to a considerable amount of risk. In the case of Yes Bank it was through multiple heavy volume loans extended to stressed companies, and in the case of PMC Bank it was due to heavy exposure to a single company (HDIL Group). The eventual defaults increased their NPA's to such an extent that their capital became insufficient to cover the losses. The sudden erosion of capital forced RBI to take instant regulatory action against these banks.

It's appalling that the unrestricted and speculative lending policies of these banks slipped under RBI's radar for a period of years. However, since unanticipated collapse of these banks the parliament has passed various amendments, including extending the provisions of the Banking Regulations Act to the co-operative sector. The similarities between the collapse of PMC and Yes Bank will act as a wake-up call for RBI, compelling them to undertake various measures to enhance the fundamentals of our banking system.

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