

Banking in India

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Date: 9th August 2014

Most of the PSU banks/Scheduled Commercial banks, sitting on Public money are less equipped to understand the nuances of any business that they fund. This promotes the bankers to fall for safe heavens, which is either Heavy collateral/security based credit or "Mob Approach" to funding. Mob approach here means – either subscribing to some consortium bank or extending credit where other banks have taken a good stake. This will at least save them from fingers pointing at them in case things go bad.

What happens in this approach is that Bankers land up extending credit to businesses, which have a poor business model.

.....*Picture this....* A gentleman named "A" walks into the bank, seeking loan for a project. Around the same time another gentleman "B" walks into the same bank and approaches loan for putting up similar kind of a project in the same category. Assuming he can extend loan only to one person as industry exposure limitation starts setting in, the assessing officer will apply his credit rating skills, which will broadly hover around the following criteria's namely: a) Whether Project is profitable b) Whether Promoter putting in adequate Equity c) Whether proper Security is extended or not d) And some other issues like environmental issues etc.....

Borrowers who have visited banks will agree on the above parameters being very important – however there is one factor, which gets overlooked grossly despite being the most crucial. And that is the capability and skill of the promoter. And here lies the point...

Assuming "A" is a skilled person and can employ the money in a much better way, but could still land up getting his proposal rejected vis-à-vis gentleman "B" who is not so efficient but can afford to give some collateral or good security cover. This approach leads into extending PUBLIC money for business, which is laggard in converting them into Finished Goods translating into less GDP per rupee employed for the country as a whole. We completely overlook that Public MONEY is a scarce resource of the nation. We might individually claim to be owners of this money – but it belongs to the nation on a collective basis and we need to judiciously use it. Are we doing it? I have my huge doubts!

The promoter who can bring the best ROCE (Return on Capital Employed) is sidelined for the promoter who can bring in the best Security cover. An absolute contrast view that an Equity fund would take in a similar situation. One can always argue that this difference is bound to be there, since one is DEBT and other is EQUITY... And here lies the disconnect!.....

Both are SOURCES of FUNDS for the project and cannot be placed separately. What differentiates them is only in the reward that they receive at the end. There cannot be any difference in their REASONS of being invested/loaned at the first place. The rewards will vary depending on the risk parameters. Otherwise the SKILL of the promoter remains the major deciding aspect instead of the security cover extended many times over....which is the normal practice adopted presently by most of the bankers.

We hear lot of cases like the recent Syndicate bank episode – which is a clear example of "Mob Investing approach" – since others have invested so let's invest. The case with Kingfisher and Deccan Chronicle – the beastly dragons of the NPA problem is a ghastly example of above approach... The second example for Security cover lending can be seen when money is lent to various Governmental organizations like Air India – which might be safe (Govt. guaranteed and good security cover) but look at the GDP creation per rupee loaned...Should not we seriously think in revising our models of lending....