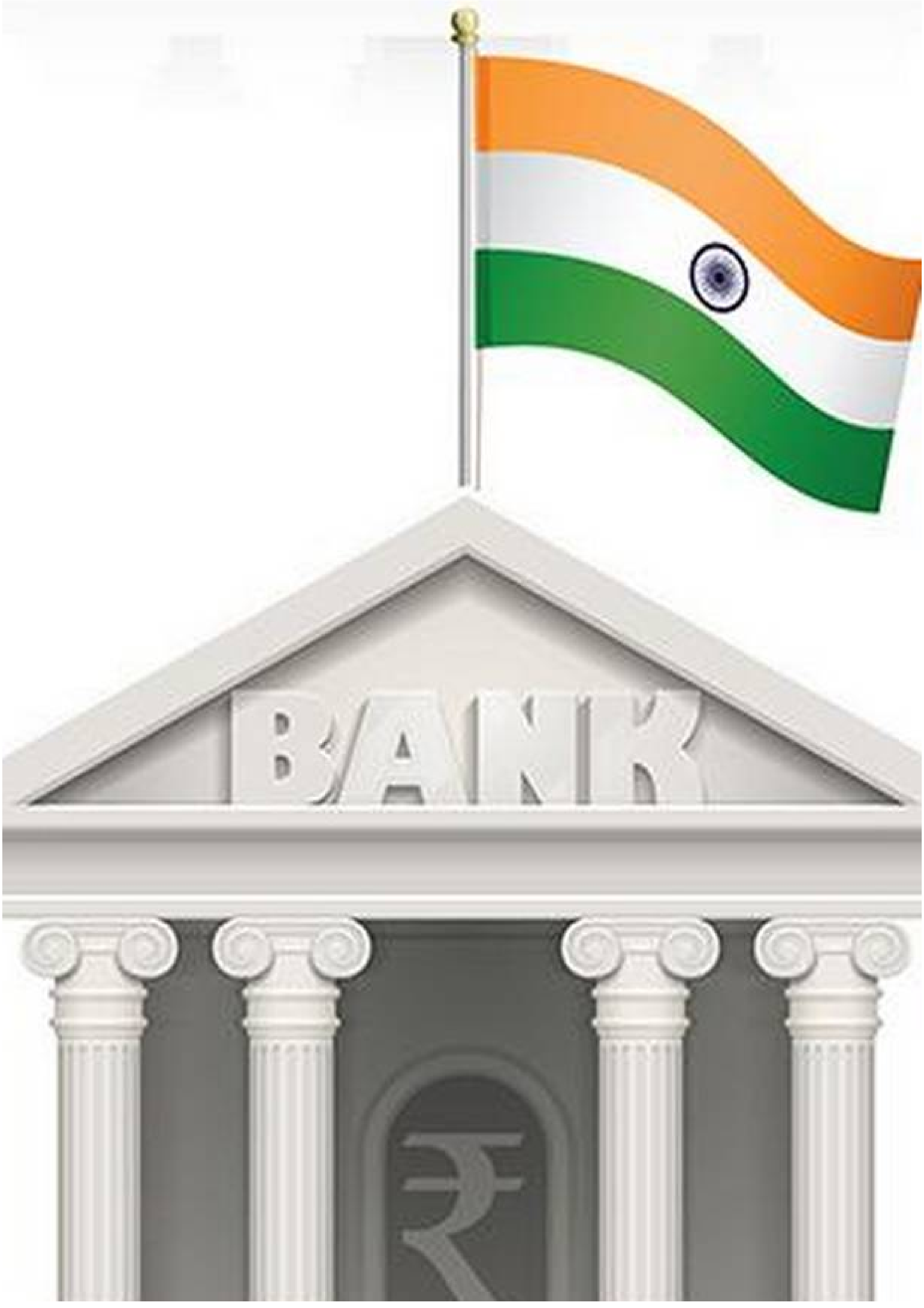
Indian banking sector caught in the middle of despair and hope

Andy Mukherjee | Updated on September 17, 2019 Published on September 17, 2019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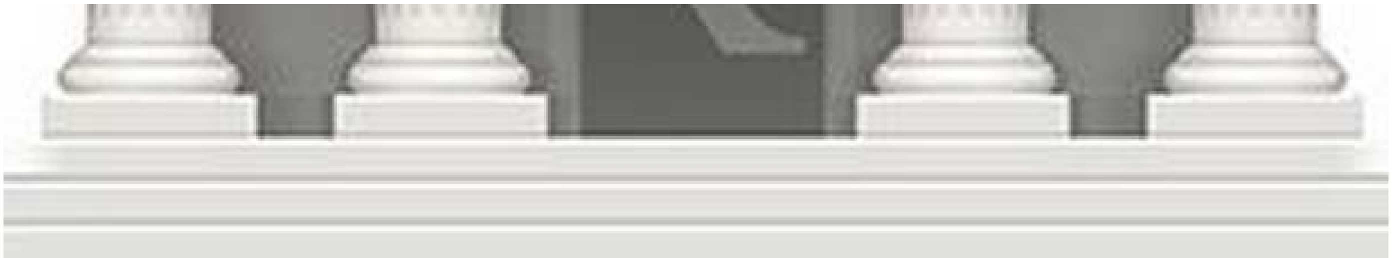

India's fragile financial system is swinging between despair and hope. Two separate incidents, both featuring YES Bank, recently underscored the drag of past underwriting follies as well as the lift from a digital reset. It will take time, but good things will come to Indian banking as a result of the present crisis.

Start with the sudden default by financier Altico Capital India on a $2.8-million interest payment to Dubai-based Mashreqbank. Clearwater Capital Partners-backed Altico, which borrows money from banks and mutual funds to make loans to property developers, called the situation a liquidity crisis. And that made YES Bank investors gloomy.

Based on January data, the mid-size Indian bank had a ₹450-crore exposure to Altico, the third-highest after Mashreq and HDFC Bank. While HDFC Bank, the country's most valuable lender, has the capital and current profit to take the occasional credit hit, YES' capital cushion is already frayed by dodgy loans to beleaguered shadow banks and troubled tycoons. Both these borrower groups have found it hard to refinance debt since the collapse last year of IL&FS Group, a large Indian infrastructure financier and operator.

Altico's unravelling shows that an end to credit woes is not yet in sight.

India overtakes Italy

At more than $200 billion, India's world-beating pile of bad loans is bigger than Italy's. State-run Indian banks are carrying the bulk of the burden, but at least they are getting dollops of taxpayers' money and being merged into fewer banking groups.

A private sector lender like YES does not have a formal public backstop. If it can't fend for itself, the central bank could step in and force an arranged match with a better-run bank. The terms won't be favourable to YES shareholders.

To avoid such a fate, YES needs to raise growth capital by convincing new investors that the worst is over. And that brings us to the week's other big incident. YES shares jumped 13.5 per cent after reports that One97 Communications, which owns the Indian digital payments network Paytm, may buy out a 9.6 per cent stake in YES from Rana Kapoor, the lender's co-founder.

Kapoor was forced to step down as CEO early this year by the Reserve Bank of India amid a controversy over bad-debt accounting. New CEO Ravneet Gill, brought in to clean up the mess, told Reuters last week that YES was looking to sell a minority stake to one of the world's top three technology companies that had not previously invested in a bank.

Stocks rise

Investors pushed the stock higher despite their many misgivings. Only two years ago, YES had a high price-to-book multiple and an even bigger price-to-truth ratio, a term I coined to describe shareholders' refusal to question the subterfuge at India's private sector banks.

Although the banking regulator had found bad loans to be four times what YES had disclosed in audited results, very few analysts believed something could go seriously wrong, given Kapoor's substantial stake, his skin in the game.

That was then. Now, YES is a battered lender gasping for capital. Despite the many regulatory hurdles on the way to a possible alignment with Paytm, which the latter hasn't confirmed, a deal could help the bank break free of its chequered past and re-emerge as a digital lender.

Payments business

If Paytm can monetise the data of its 350 million mobile wallet users by giving them point-of-sale loans using the balance sheet of a bank, whether YES or someone else, the payment firm will get a second wind. Paytm founder Vijay Shekhar Sharma had an early advantage as India's mobile payments pioneer, but Walmart-owned PhonePe, as well as Alphabet's Google Pay, are giving him stiff competition. Paytm's losses are ballooning and it's becoming evident that without old-fashioned lending, there may be no other path to profitability for a pure payments business.

Mukesh Ambani, India's richest tycoon, plans to use his rapidly growing Jio telecom network to offer customers discounts and vouchers that would be honoured even by neighbourhood stores. But for extending point-of-sale credit, Ambani would also need to borrow the balance sheet of a bank.

For YES, point-of-sale financing could be a growth avenue at a time when the turmoil in India's formal and shadow banking sectors refuses to end. It has put the brakes on what authorities were until recently claiming to be the world's fastest-growing major economy.

A new model?

But alongside the despair, hope is building for a new model, led by supply-chain credit, asset securitisation, digital lending, and joint underwriting by finance companies (which know their borrowers) and banks (which have stable deposits). The tug of war between the past and the future of banking in India is getting interesting.

What happens to YES could be a gauge of which way the balance of power is shifting. **Bloomberg**

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COMMENTS

Will RBI be YES Bank's white knight?

With a decline in YES Bank's income and the risk of rising NPAs, the RBI may soon have to facilitate a merger or acquisition

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