# Has India’s financial sector lost the plot?

**Bandi Ram Prasad** | Updated on November 27, 2019 Published on November 26, 2019

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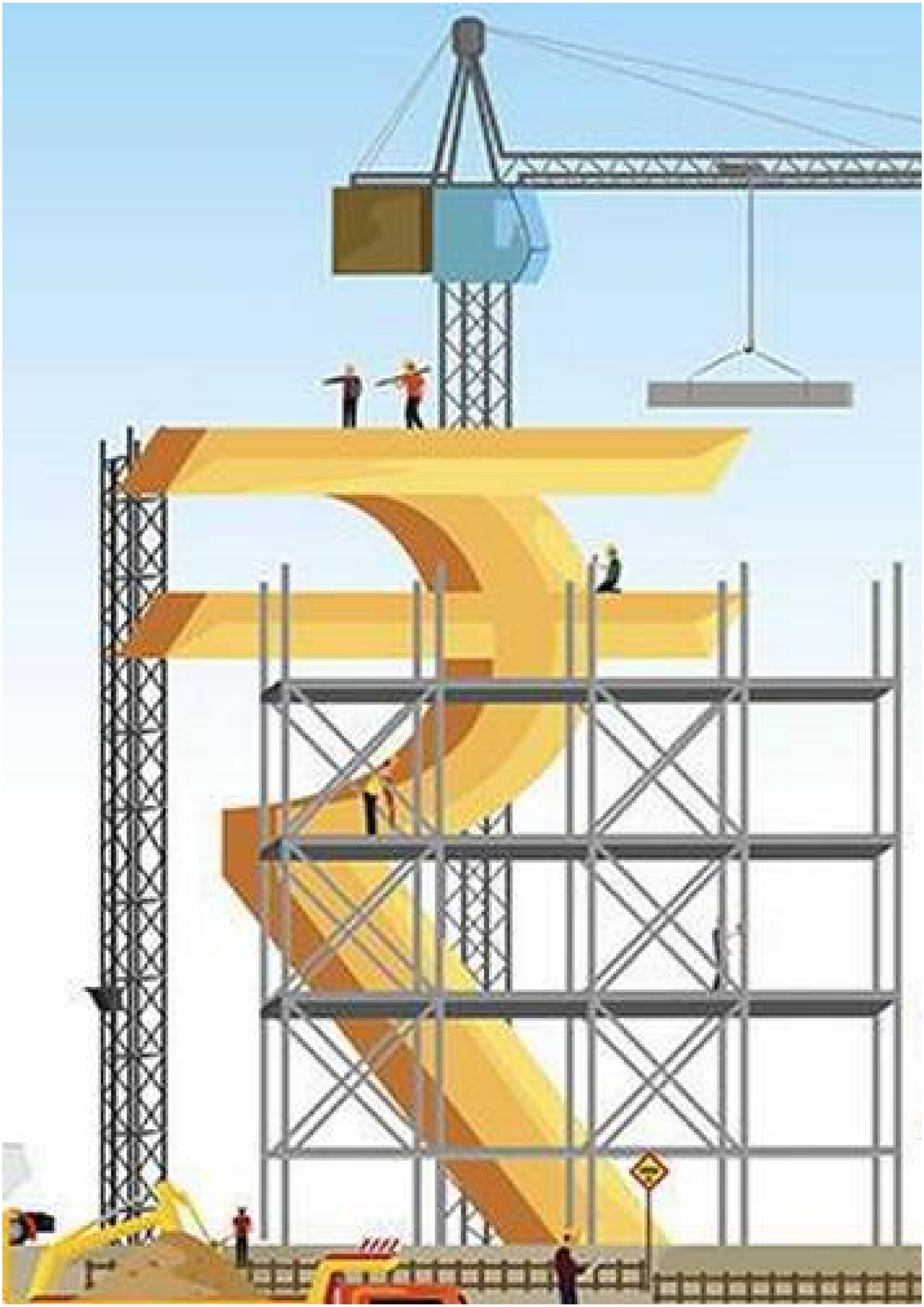

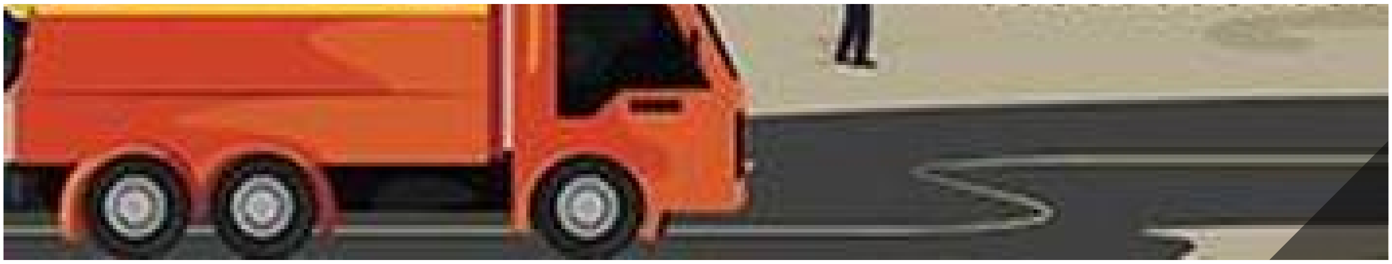

Reforms have failed to boost public investment or provide relief to financial institutions. A comprehensive review is needed

The outcome of reforms in India, in a broader sense, is remarkable. The breadth and depth of finance have vastly increased — be it in banking, financial markets, insurance, or fund management. Investment opportunities have grown with newer asset classes, an expanded market infrastructure and innovative distribution.

If that is the impression of the whole, what is happening in the individual parts may not seem impressive. The critical concerns are often camouflaged under the glare and glamour of markets. Distortions that are creeping into the fabric of finance could pose a hazard of pushing it away from the very purpose for which it was reformed.

Let us begin with the bias in banking. In 1990, rural areas accounted for 15 per cent of deposits and 24 per cent of credit, both of which fell to 10 per cent in 2018. Metro areas sucked in a large part of business — with deposits jumping from 39 per cent to 51 per cent and bank credit from 37 per cent to 59 per cent. Semi-urban/urban areas saw some minor changes.

The decline in rural banking may slow the pace of development and the achieving of the UN's Sustainable Development Goals, despite interventions like the Jan Dhan Yojana. It would not do much good for public sector banks to overlook rural and semi-urban areas, which are traditional venues for raising low-cost deposits. The scene on the side of markets, too, is discomforting. For a benchmark index that accounts for about 70 per cent of domestic market cap, only half of the companies listed in stock markets are traded on any day; liquidity concentration in a few stocks only, in the absence of independent research to promote newer companies that hold potential, is considered routine. There are structural issues that are gaining gravity and need scrutiny.

## Resource mobilisation

Three sectors — banking, finance and insurance — mobilised anywhere up to 60 per cent of the resources from the primary markets during 2010-18, leaving questions on how 'Make in India' will be made possible as manufacturing hardly has a fair share. Regional inequities become glaring as the western and northern regions account for 80 per cent — the South and the East are way behind with 14 per cent and 6 per cent respectively — of resources mobilised.

Reforms are meant to expand the base of investors in public markets. India's public markets have not widened the investor base enough to the potential it holds, as could be seen from resources mobilised in the private placement corporate debt market (seven times higher), and Qualified Institutional Placements accounting for about 50 per cent of the primary market issuance, during 2010-18.

This surely is a distinction for Indian markets, but the lingering concern is about its questionable contribution to either economy or development, when the notional value traded in equity derivatives (mostly index options) is 30 times the size of spot market turnover, the benefit of which is largely derived by a small fraction of smart traders specialising in the zero-sum game of taking complex bets using sophisticated strategies supported by latest trading technologies.

## Banking woes

NBFCs depend on banks for up to 30 per cent of fund requirements, and many at present are in dire straits. The write-downs from this put additional strain on banks' profitability.

New private sector banks began with a big bang in the early 1990s with less than a handful turning successful. While four of them chose to merge, from the others, two are now facing governance issues and two — licensed recently — are yet to stir up any excitement.

Older private banks are struggling under various types of stress. Urban cooperatives are primarily meant to be local, but management lapses are hurting their sustained growth.

Commercial banks still struggle to fulfil demands for short-term finance, but were made to lend long-term under the lure of universal banking — this hit them badly.

While the likes of China Development Bank, with $2-trillion assets; BNDES of Brazil, $272 billion; and the recently-formed VEB.RF of Russia, $50 billion; are playing a pivotal role in providing development finance for their respective markets, India had lost this important opportunity by neglect and the conversion of a couple of strong development banks into commercial banks that are now under different degrees of stress. DFIs in India were doing two-thirds of total disbursals in industrial finance prior to their conversion.

## Development finance

Mutual funds began to increase awareness (*Sahi hai*) when they found two of the big players deferring redemption obligations, stoking investor concerns. Corporate finance faced intense pressure. Private equity flows have surged from $4.5 billion in 2009 to $16.8 billion in 2017, but remained unchanged in 2018 as start-ups began to see a struggle ahead.

Of the $512 billion of climate bonds issued globally till 2018, India could make $7.2 billion, as the pace of green finance began to stutter after an initial start. SME capital markets could barely raise ₹5,000 crore in the last five years.

Recapitalisation and merger of PSBs, rehabilitation and resolution of distressed companies, tax concessions, and adhoc support to stressed sectors at best could provide temporary relief on the side. India has yet to come up with a wholesome plan and clear strategy how to make finance work for the country

Where could it start? To begin with, an honest review of the fault lines of finance by a truly independent commission with interests of India at the core and domestic economy as the priority, without the peddling of worn-out Anglo-Saxon models. Second, finance should be dealt with utmost sanctity and integrity, avoiding shocks like demonetisation that severely dent the public's trust and confidence.

Third, public capital markets must be entrusted with a charter, with capital raising being the key responsibility, not just showcasing of technology prowess or excessive indulgence in speculative products. Fourth, banks should be made frontline providers of finance for SMEs, and consumption should be boosted by creating specialised institutions for long-term finance for various reasons.

Fifth, India could strive to promote a subcontinental perspective in financial development, that could enhance its regional influence and power of engaging with global financial policy. Sixth, the government and the public sector must be the trend-setters and display financial discipline and corporate governance, rather than being shielded through the various exemptions and exceptions.

Now is the time to review and retrospect in right earnest. It would do a lot of good for a course correction.

*The writer runs the consulting firm 'Growth Markets Advisory Services'. Views are personal*

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