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Nifty **CLOSED**
12,226.65 **-55.55**



NSE Gainer-Large Cap >

Adani Green Energy ...
192.60 **9.15**



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Gold (MCX) (Rs/10g.)
40,132.00 **855.00**



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Market Watch

PSU banks may adopt new corp lending practice

BY SUGATA GHOSH, ET BUREAU | UPDATED: JAN 03, 2020, 06.50 PM IST

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MUMBAI: After decades India's government-owned banks are likely to change the way they lend. Since the 1970s, public sector banks have given out most working capital loans — required for day-to-day operations of a business — on the basis of net current assets of corporate borrowers, a flawed system that is believed to have resulted in over-funding to some and under-funding to others.

The outdated practice may soon change, with the country's largest lender, [State Bank of India](#), proposing a transition from an 'asset-based lending' model to 'cashflow-based lending' — a mechanism that, among other things, may reduce misuse of funds by borrowers and enable banks to figure out ability of borrowers to service loans on time.

The shift will require borrowing entities to share their cashflow statements more frequently with banks.

A committee headed by Madhav Kalyan, chief executive officer of JPMorgan, has been constituted to look into the matter, two people aware of the development told ET.

"The matter was mentioned at a meeting of the Indian Banks' Association in December. Though proposed by SBI, it has to be a collective decision by the industry," said one person.

Public sector banks have a more than 55% share of the loan market.

"Assets don't help companies to repay loans. It's their cashflow that makes a difference. It's high time state-owned banks migrate to a cashflow-linked system to finance working capital... private and MNC banks have been doing it for over a decade now," said a senior banker.

Small and medium-sized businesses, which often do not receive payments from buyers for four to six months, draw less bank finance than they need. Compared with this, large companies, whose distributors promptly pay up and have other avenues of finance, end up being over-funded by banks.

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THE ISSUE
Need to change 40-year-old working capital funding system of PSU banks

WHY?
Funds are given based on assets, not cashflow

HOW WILL A CHANGE HELP?
It will reduce under-funding and over-funding. Borrowers can be tracked better

DO ALL BANKS FOLLOW THE SAME SYSTEM?
Private, MNC banks follow cashflow-based lending. So do PSU banks for some loans



Except for some seasonal industries such as sugar, public sector banks arrive at a company's working capital requirements by considering the difference between the borrower's current assets (receivables, raw material stock, finished goods) and current liabilities (payables like loan interest, taxes, payment to vendors and workers).

While 25% of the working capital gap (the difference between assessed gross working capital assets minus gross working capital liabilities) is met by the company, banks fund the remainder, though in many cases, they end up funding more. Most of the working capital finance is in the form of cash credit, a system where companies freely draw (and service interest) within a certain limit or drawing

power fixed by the lender.

Against this, in cashflow-based lending, banks will have to consider actual cash inflows and outflows of a company in deciding the drawing power. Inflows would be sales realisation, fresh borrowings, repayment by debtors, new capital infusion and sale of fixed assets, while outflows would include salaries, taxes and loan repayments.

“India is probably the only country with cash credit system of funding working capital requirements of commercial borrowers,” according to veteran banker PH Ravikumar.

“The world over, funding is through loans repayable by instalments (repayments coming out of operating profits); cash credit system is, in a sense, perennial funding and hides symptoms of financial difficulties of corporates; banks would do well to fund a larger proportion of the working capital funding through loans and minuscule proportion through overdrafts or cash credit products.”

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