

PRODUCTIVE USE OF FINANCIAL RESOURCES

“Roadmap for Economic Rebound”

July 2021

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

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The Associated Chambers of Commerce and Industry of India

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TABLE OF CONTENTS

SR. NO.	TOPIC	PAGE NO.
1	Indian Economy and Financial Institutions.....	01
2	Economic Stimulus Packages announced by the RBI and Government	08
3	Measures announced by the RBI	10
4	Measures announced by the government.....	14
5	Role of financial institutions in supporting the economy during Covid-19	17
6	Impact of Economic Stimulus.....	19
7	Sustainable Financing/ ESG Investing.....	20
8	Privatisation and Digital Lending	24
9	Digital Lending Landscape	33



Indian Economy and Financial Institutions

The outbreak of COVID-19 has impacted nations in an enormous way, especially the nationwide lockdowns which have brought social and economic life to a standstill. This COVID-19 pandemic affected almost all the sectors such as hospitality, tours and travels, healthcare, retail, banks, hotels, real estate, education, health, IT, media and others. The economic stress on the nations and people have started and may grow rapidly. While lockdown and social distancing result in productivity loss on the one hand, they cause a sharp decline in demand for goods and services by the consumers in the market on the other, thus leading to a collapse in economic activity. Policymakers around the world took quick and bold measures through injection of liquidity, reduction in cost of funds, regulatory forbearance, consumption supporting stimulus packages and other measures to contain the immediate adverse effects of the COVID-19 pandemic.

Sectoral Implications of COVID-19 Pandemic in India

In India, the private corporate business sector had been experiencing a deterioration in performance even before the pandemic. This became accentuated with the outbreak of COVID-19. The brunt of the pandemic's impact was concentrated in Q1 of 2020-21. Signs of recovery became visible in Q2 of 2020-21. The contraction in sales at (-) 4.3% was a significant improvement from the precipitous decline of 41.1% in the preceding quarter for listed private manufacturing companies. Enabled by cost cutting as reflected in a larger reduction in expenses relative to sales, the manufacturing sector posted improvements in operating profits and in debt servicing, the latter being reflected in the improvement in their interest coverage ratio.

Sales growth of the IT sector, on the other hand, remained resilient through H1 of 2020- 21. Although profit margins improved across sectors, manufacturing companies reduced leverage during H1 of 2020-21 vis-à-vis the previous half-year and built-up precautionary cash positions. Following table represents the sectoral credit growth in India and their contribution in Gross value added.

Sectoral Credit Growth						
Economic Sector*	Share in Gross Value Added (GVA) (per cent)	Credit growth (y-o-y) (per cent)				
		Mar-20	Jun-20	Aug-20	Sep-20	Oct-20
Agriculture, forestry and fishing	15.8	4.2	2.4	4.9	5.9	7.4
Mining and quarrying	3.2	5.2	4.3	1.2	0	4.3
Manufacturing	19.1	0.9	0.8	-0.8	-1.0	-2.0
Electricity, gas, water supply & other utility services	2.3	-1.6	0.9	-1.8	-0.9	-1.3
Construction	8.5	4.8	5.6	8.1	4.5	5.1
Trade, repair, hotels and restaurants	13.4	5.5	6.9	12.9	12.1	13.9
Transport, storage, communication & services related to broadcasting	6.9	1.9	6.8	5.8	3.5	-0.8
Financial Services #	6.4	25.9	25.7	17.1	12.5	9.2
Real estate, ownership of dwelling & professional services	16.8	13.8	11.4	9.7	7.4	7.3
Other Services	7.7	-8.1	1.6	-2.0	7.0	10.5

Note: 1. *Covering the sectors in national accounts other than 'public administration and defence'.
2. # Represents bank credit to the non-bank financial sector.

Source: National Accounts Statistics, MoSPI and RBI Supervisory Returns.



Tourism and Aviation Sector

The tourism industry is the worst affected due to the COVID crisis, internationally. The World Tourism Organization (UNWTO) (2020) estimations depict a fall of 20–30% in international tourist arrivals. Millions of people associated with industry are likely to lose their jobs. More than 100 countries have travel restrictions due to Covid-19 pandemic, which has affected the travel industry the most. In India,

the travel and tourism industry is flourishing and is contributing sizably to the economy. Tourism in India accounted for 9.2% of GDP and had generated US\$247.3 billion in 2018, with the creation of 26.7 million jobs. According to the report, by 2029, the sector is expected to provide employment to nearly 53 million people. Foreign Tourist Arrivals crossed 10 million in 2017. However, the coronavirus pandemic has restricted international mobility and the revenues generated by this sector will take a major toll on the GDP growth rate. The Indian tourism industry anticipated to book an income loss of INR 1.25 trillion in 2020 as a drop out of the shutdown of hotels and suspension in-flight tasks after the beginning and spread of the Coronavirus (Covid-19) pandemic.

The aviation sector in India currently contributes US\$72 billion to India's GDP. Foreign tourist arrival has been down due to the lockdown and had severe impact in H1 of FY2021.

Retail Sector

The Indian retail industry was worth US\$790 billion in FY 2019. It accounts for over 10% of the country's GDP and around 8% of employment. In the past few years, online retail has seen a very rapid growth and the market projections had indicated a 30% growth in online retail in 2020. A lockdown for retail has severely affected their revenues. In the retail sector, the suppressed demand tends to revive very fast and therefore could enable the sector to recover the losses once the complete lockdown is lifted. Online retail was operational in some parts of the country during the lockdown period, and this could help in offsetting some of the losses for the industry.

Manufacturing industry

The development of materials, just as fuels and people, has overall reached a sudden stop. MSMEs solely flexibly different industries, which have likewise quit working, bringing about decreased interest and abrogation of requests as no matter how you look at it, except for bottom line industries. In any case, their demands for fundamental contributions from superfluous industries can't be met.

Gold industry

In the same way as other industries, the gem business also has been hit hard attributable to a considerable rundown of dropped or deferred occasions, shows, displays, and weddings for the following span of months. People are not spending money on luxury items and more concentrated towards putting their money on hygiene stuff or grocery products. As the Coronavirus alarm held purchasers, the gems and adornments industry lost its sparkle. As a prudent step, the administration has urged the citizens to delay wedding capacities and endeavor out for fundamental commodities during the lockdown- the Indian gems market blossom with weddings.

IT Industry

IT is also having a share of impact as major Software Companies impacted as technological spending reduced from US and Europe amid lockdowns across the globe. There could be pricing pressure and reduced revenue, client bankruptcies due to lower spending in the market.

Oil Industry

The Indian Oil & Gas industry is quite significant in the global context – it is the third-largest energy consumer only behind USA and China and contributes to 5.2% of the global oil demand. The complete lockdown across the country slowed down the demand of transport fuels (accounting for 2/3rd demand in oil & gas sector) as auto & industrial manufacturing declined and goods & passenger movement (both bulk & personal) fell. Though the crude prices dipped in this period, the government increased the excise and special excise duty to make up for the revenue loss, additionally, road cess was raised too. According to the RBI, India's Current Account Deficit (CAD) remains at 0.2% of GDP, as of December quarter in FY20 when contrasted to 2.7% of the same quarter in FY19. Since, India imports over 80% of its oil utilization, lowering oil prices are probably going to diminish the CAD considering the economy.

Automobile Sector

The carmakers in India were under pressure as sales had sharply fallen in Q1 of FY2021. Since automobiles are discretionary items, vehicles sales will largely depend on consumer sentiments. At the moment, consumer sentiments remain weak among citizens and the demand for non-essential items are likely to fall further. This could have a negative impact on the passenger vehicle segment. However, a greater number of people are looking to buy personal vehicles (two-wheeler and four-wheeler) to avoid crowds in public transport. This could prove beneficial for the vehicle makers in the near term. Used vehicles market has also been gathering pace for the same reason.

Real estate and Construction Sector

Real estate and construction sector activity faced disruption during the lockdown, as a large number of migrant workers left urban areas. The lack of labourers has hit both housing and construction projects in urban areas.

Start-Ups and Micro, Small and Medium Enterprises

Micro, Small and Medium enterprises, which have created more than 90% of the jobs in India, employing over 114 million people and contributing 30% of the GDP, are at the risk of having a severe cash crunch due to lockdown. Many of these MSMEs have loan obligations and monthly EMIs to pay. Many of them might just disappear if their cash cycle is disturbed because of the lockdown, with fixed costs dangling over them. They need a moratorium for loan repayments. In addition to that, movement of perishable goods is hampered and thus, these businesses stare at huge losses. India cannot have a real and sustainable growth without having a thriving MSME sector. The COVID-19 crisis will also test the resilience of start-ups in India. Start-ups have to rely on cross-border fund raising. Several founders are seeing their businesses grinding to a halt. Receivables are spiraling and they have to undertake painful cost-reduction measures in their ventures. Government will have to make funds available to this sector, as venture capital firms may take a little longer to come and support because of the restricted global capital flows.

Banking sector

The potential adverse impact of the pandemic, especially if a severe third wave surfaces, on India's already stressed banking sector, which is saddled with legacy non-performing assets, remains of concern. Experts fear a fresh wave of bankruptcies that add stress to the books of commercial banks, and that loan repayment schedules could be further delayed. India's non-banking financial sector – which has traditionally lent to small and medium enterprises likely to be most affected by first and second wave lockdowns – could also contribute to the stress on the banks that lend to them. Similar fears hold about how pressure on microfinance institutions could systemically affect the banking sector.

Food and Agriculture

Since agriculture is the backbone of the country and because it was under essential category, the impact is likely to be low on both primary agricultural production and usage of agro-inputs. Several state governments had allowed free movement of fruits, vegetables, milk etc. Online food grocery platforms were heavily impacted due to unclear restrictions on movements and stoppage of logistics vehicles.

Telecom

There has been a significant number of changes in the telecom sector of India even before the COVID 19 due to brief price wars between the service providers. Most essential services and sectors have continued to run during the pandemic thanks to the implementation of the 'work from home' due to restrictions. With over 1 billion connections as of 2019, the telecom sector contributes about 6.5% of GDP and employs almost 4 million people. Increased broadband usage had a direct impact and resulted in pressure on the network. Demand has been increased by about 10%. Telecom sector will benefit the most due to work from home culture which could continue even for a longer term.

Pharmaceuticals

The pharmaceutical industry has been on the rise since the start of the Covid-19 pandemic, especially in India, the largest producer of generic drugs globally. With a market size of \$55 billion during the beginning of 2020, it has been surging in India.

There has been a rise in the prices of raw materials imported from China due to the pandemic. Generic drugs are the most impacted due to heavy reliance on imports, disrupted supply-chain, and labour unavailability in the industry, caused by social distancing. Simultaneously, the pharmaceutical industry is struggling because of the government-imposed bans on the export of critical drugs, equipment, and PPE kits to ensure sufficient quantities for the country. The increasing demand for these drugs, coupled with hindered accessibility is making things harder. Easing the financial stress on the pharmaceutical companies, tax-relaxations, and addressing the labour force shortage could be the differentiating factors in such a desperate time.

Overall Impact on India

Economic Survey 2019–2020 had laid out a plan to promote exports of network products, to integrate ‘assemble in India for the world’ into Make in India and to create 40 million jobs by realizing the aspiration of a 5 trillion economy by 2025. The COVID-19 pandemic has forced us to rethink on these strategies. Integration with global supply chains also makes the nation susceptible to global supply shocks. Global firms, in an attempt to bring down costs, have left themselves dangerously exposed to supply chain risks. The global industry relies on ‘Just in Time’, refurbishment of products and thus, they maintain very low inventories. China is a manufacturing powerhouse with a 16% share in global exports and 7% of global mining imports. Indian firms should also assess their supply chain risks before they start sourcing from the world or integrate their supply chains with global supply chains.

A choice between the health of the people and the health of the economy is a hard one to make for any government. A probable third wave and to contain that if again lockdown is imposed that would be a big blow to poor people and small businesses. Economists argue that if the poor do not die of corona, they will die of hunger. Indian economy has a unique structure. 50% of the Indian households still depend upon agriculture either directly or indirectly. The people in the subsistence sector do not claim unemployment benefits because they are not a part of social security net. During hard times, they expect the government to take care of their food and shelter. Government will have to make the relief measures efficient, so that the poor and the vulnerable do not suffer.

India needs to rethink on its developmental paradigm. Equal access to Health and Education is an important condition for equitable development. An important lesson that the COVID-19 pandemic has taught the policymakers in India is to provide greater impetus to sectors which make better allocation of resources and reduce income inequalities. COVID-19 has also taught a lesson that in crisis the population returns to rely on the farm sector. India has a large arable land, but the farm sector has its own structural problems.

A greater support to MSMEs, higher public expenditure on health and education and making the labour force a formal employee in the economy are some of the milestones that the nation has to achieve.

Conclusion

The spiraling and pervasive COVID-19 pandemic has distorted the world’s thriving economy in unpredictable and ambiguous terms, and it will continually disrupt the world economy until at least half of the population is fully vaccinated. The pandemic results loss of millions of jobs in all industries and has a much broader impact than the recession in the year 2008. But it significantly indicated that the current downturn seems primarily different from recessions of the past which had jolted the country’s economic order. Whereas the nations, conglomerates, corporations and multinationals continue to understand the magnitude of the pandemic, it is undoubtedly the need of the hour to prepare for a future that is sustainable, structurally more viable for living and working.

While the unprecedented situation has caused a great damage to the economy, especially during periods of lockdown, the nation will have to work its way through it, by introduction of fiscal measures.

As the national government envisions, protection of both lives and livelihood is required. The economic activity must begin gradually after screening of the labour force. Strict preventive measures should be implemented by the industry in order to safeguard the health of the workers. While policy and reforms should be doled out by the government adequately to salvage the economy, the industry, civil societies and communities have an equal role in maintaining the equilibrium. Government assistance to those most in need (largely constituted of unorganised sector, migrants and marginalised communities) is a critical measure to save many lives.

However, every crisis brings about a unique opportunity to rethink on the path undertaken for the development of a human being, community and society. The COVID-19 pandemic has a clear message for the Indian economy to adopt sustainable developmental models, which are based on self-reliance, inclusive frameworks and are environment friendly.



Economic Stimulus Packages Announced by the RBI and Government

First Stimulus package announced by the government (Atmanirbhar Bharat package):

1. Pradhan Mantri Garib Kalyan Package: INR 1.70 lakh crore package for poor to help them fight against Corona virus. It included Insurance cover of INR 50 Lakh per health worker, 5 kg wheat or rice per person and 1kg pulses for each household for 80 crore poor people, INR 500 per month for 20 crore women Jan Dhan account holders, Increase in MNREGA wage to INR 202 a day from INR 182 to benefit 13.62 crore families, Ex gratia of INR 1,000 to 3 crore poor senior citizen, poor widows and poor Divyang, etc.
2. For MSMEs: the government provided INR 3 lakh crore collateral free automatic loans, INR 20000 crore subordinate debt for stressed MSMEs, INR 50000 crores equity infusion for MSMEs through fund of funds, etc.
3. For NBFCs/HFCs/MFIs: The government launched INR 30000 crore special liquidity scheme.
4. Liquidity support to farmers and rural economy: INR 86600 crore loans approved in agriculture in March and April 2020, INR 30000 crores additional emergency working capital funding for farmers through NABARD, INR 2 lakh crore concessional credit boost to 2.5 crore farmers through Kisan credit cards, etc.
5. Various schemes such as free food, shelter to migrants and labours, one nation one ration card, INR 1500 crore interest subvention for Mudra-Shishu loans, INR 5000 crore special credit facility for street vendors, etc.

6. INR 1 lakh crore agri infrastructure fund for farm-gate infrastructure for farmers, INR 10000 crores for formalization of micro food enterprise, INR 20000 crore for fishermen, INR 15000 crore for animal husbandry infrastructure development fund, etc.
7. Various policy reforms in agriculture, coal mining, power sector, civil aviation, defense production, mineral sector, corporate laws, online education, etc.

Steps taken by the RBI: Reduction in CRR resulted in liquidity enhancement of INR 137000 crores, Targeted long-term repo operations of INR 100050 crores, special refinance facilities to NABARD, SIDBI and NHB for a total amount of INR 50000 crore, etc.

Some of the schemes in Second Stimulus package (announced in November 2020) are provided below:

1. INR 1.46 lakh crore to boost manufacturing sector with production-linked incentives for 10 sectors such as mobile manufacturing, electronic components and pharma.
2. INR 18000 crore outlay for PMAY.
3. INR 1.1 lakh crore platform for infra debt financing with INR 6000 crore equity infusion in NIIF debt platform.
4. INR 65000 crore for subsidized fertilizers.

Some of the steps taken by the government in third stimulus package are as follows:

The total financial implications of the package, which included the reiteration of some steps that were already announced such as the provision of food grains to the poor till November 2020 and higher fertilizer subsidies, is at INR 6,28,993 crore.

The government announced an expansion of the existing Emergency Credit Line Guarantee Scheme (ECLGS) by INR 1.5 lakh crore, a new INR 7,500 crore scheme to guarantee loans up to INR 1.25 lakh to small borrowers through micro-finance institutions, a fresh loan guarantee facility of INR 1.1 lakh crore for healthcare investments in non-metropolitan areas and sectors such as tourism. A separate INR 23,220 crore has been allocated for public health with a focus on pediatric care, which would also be utilized for increasing ICU beds, oxygen supply and augmenting medical care professionals for the short term by recruiting final year students and interns.

Indirect support for exports worth INR 1.21 lakh crore over the next five years, free one-month visas for five lakh tourists, new seed varieties for farmers and additional outlays over the next two years to expand broadband to all Gram Panchayats, were also included in the package.

Conclusion

In all the stimulus packages, a large portion is announced by way of credit guarantee schemes where there is no immediate outflow. However, the government has provided the benefits to all the sectors which are severely affected due to Covid-19. Small retailers and wholesalers are also severely affected due to lockdowns and timing restrictions. Direct transfer or Credit guarantee to these people would have helped them in managing their livelihoods and sustain rural economy further.

RBI MEASURES TO FIGHT COVID-19



Measures Announced by the RBI

The Reserve Bank of India (RBI) announced a slew of measures to help India tackle the unprecedented Covid-19 crisis during the second wave.

As part of the measures, the RBI eased lending and restructuring norms for all stakeholders, especially those smaller businesses and MSMEs that have been impacted by the second wave.

Priority lending facilities have also been announced for vaccine manufacturers and firms engaged in providing key medical supplies to hospitals during the pandemic.

Term liquidity of INR 50,000 crore for emergency healthcare services

The first measure announced by Shaktikanta Das was 'Term Liquidity Facility' of INR 50,000 crore to ease access to emergency health services. The RBI also proposed "On-tap liquidity" of INR 50,000 crore with tenor up to three years at repo rate.

Under the scheme, banks can provide fresh lending support to a wide range of entities including vaccine manufacturers, importers and suppliers of vaccines and priority medical devices, hospitals and dispensaries, pathology labs, manufacturers and suppliers of oxygen and ventilators, importers of Covid-related drugs, logistics firms and also patients for treatment.

Banks will be incentivised for quick delivery of credit under the scheme through the extension of priority sector classification to such lending. This facility will be available till March 31, 2022.

These loans will be continued to be classified under the 'priority sector' till repayment or maturity, whichever is earlier.

SLTRO FOR SFBs

The second measure relates to special long-term repo operations (SLTRO) for small finance banks (SFBs), which primarily lend to micro, unorganised and small industries. It was decided to conduct special 3-year long-term repo operations (3-year SLTRO) of INR 10,000 crore at repo rate for SFBs.

The facility will help them with fresh lending of up to INR 10 lakh per borrower and it will be available till October 31, 2021.

Priority lending by SFBs to MFIs

The RBI also added that SFBs lending to micro-finance institutions (MFIs) will be classified as priority sector lending. The classification has been proposed in view of the fresh challenges brought on by the pandemic and to address the liquidity problems faced by smaller MFIs.

Simply put, SFBs are now being permitted to lend to smaller MFIs with asset size of up to INR 500 crore and this is likely to help individual borrowers on priority. This facility will be available up to March 31, 2022.

Credit to 'unbanked' MSME entrepreneurs

The RBI also proposed an extension of a measure for incentivising the flow of credit to MSME borrowers. The measure was first announced in February 2021, and it allowed Scheduled Commercial Banks (SCBs) to deduct credit disbursed to new MSME borrowers from their net demand and time liabilities (NDTL) for calculation of cash reserve ratio (CRR).

In order to further incentivise the inclusion of unbanked MSMEs into the banking system, this exemption currently available for exposures up to INR 25 lakh and for credit disbursed up to the fortnight ending October 1, 2021, was extended till December 31, 2021.

Resolution 2.0 for individuals, small businesses

Shaktikanta Das said that the resurgence of the Covid-19 pandemic in India has led to disruption in economic activity due to localised restrictions. This has again hurt vulnerable category borrowers including individuals, small businesses and MSMEs.

The RBI has allowed borrowers (individuals, small businesses and MSMEs) with aggregate exposure of up to INR 25 crore – who have not availed restructuring under earlier frameworks and classified as 'Standard' on March 31, 2021 – shall be eligible to be considered under Resolution 2.0 framework.

Restructuring under the proposed framework may be invoked up to September 30, 2021 and shall have to be implemented within 90 days after the invocation.

The RBI also allowed lending institutions to extend the restructuring window for borrowers who have already availed modification of their loans under the Resolution 1.0 framework.

In respect of individual borrowers and small businesses who have availed restructuring of their loans under Resolution Framework 1.0, where the resolution plan permitted moratorium of less than two years, lending institutions are being permitted to use this window to modify such plans to the extent of increasing the period of moratorium and/or extending the residual tenor up to a total of 2 years.

Rationalisation of KYC compliance requirements

The RBI has also rationalised certain compliance requirements in view of the Covid-19 second wave. These include

- 1) The scope of video KYC known as V-CIP (video-based customer identification process) for new categories of customers such as proprietorship firms, authorised signatories and beneficial owners of Legal Entities and for periodic updation of KYC
- 2) Conversion of limited KYC accounts opened on the basis of Aadhaar e-KYC authentication in non-face-to-face mode to fully KYC compliant accounts
- 3) Enabling the use of KYC Identifier of Centralised KYC Registry (CKYCR) for V-CIP and submission of electronic documents (including identity documents issued through DigiLocker) as identify proof
- 4) Introduction of more customer-friendly options, including the use of digital channels for the purpose of periodic updation of KYC details of customers
- 5) In view of Covid-19 restrictions in various parts of the country, regulated entities are being advised that for the customer accounts where periodic KYC updating is due/pending, no punitive restriction on operations of customer account(s) shall be imposed till December 31, 2021, unless warranted due to any other reason or under instructions of any regulator/enforcement agency/court of law, etc.

Relaxation in overdraft facility for state governments

The RBI also announced certain relaxation with regard to availment of overdraft facility by states.

The maximum number of days of OD in a quarter is increased from 36 to 50 days and the number of consecutive days of OD from 14 to 21 days. This facility will be available up to September 30, 2021.

Apart from these, the RBI announced additional measures to tackle the impact of the second wave of Covid-19 on the economy and financial markets.

On tap liquidity window for contact intensive sectors

A separate liquidity window of INR 15,000 crore is opened till March 31, 2022, with tenures of up to three years at the repo rate and kept unchanged at 4 per cent. Under this, banks can provide fresh lending support to hotels, restaurants, travel agents, tour operators, aviation services, private bus operators, car repair services, event or conference managers, spa clinics, beauty parlours and salons.

Special liquidity facility to SIDBI

To further support the funding requirements of MSMEs, special liquidity of INR 16,000 crore is extended to the Small Industries Development Bank of India (SIDBI). The service to be available at the prevailing repo rate for up to one year and could be further extended depending on its usage.

Enhancement of exposure thresholds under resolution framework 2.0

To extend the benefits of resolution framework 2.0 (announced by the RBI on May 5) to a larger set of borrowers, the coverage of borrowers under the scheme is expanded by enhancing the maximum aggregate threshold from INR 25 crore to INR 50 crore for MSMEs, non-MSMEs, small businesses and loans to individuals for business purposes.

Placement of margins of government securities transactions

To ease operational constraints faced by foreign portfolio investors (FPIs), authorised dealer banks are allowed to place margins on behalf of their FPI clients for transactions in government securities, within the credit risk management framework of banks.

Facilitating flexibility in liquidity management

Regional rural banks (RRBs) are allowed to issue certificates of deposit (CDs) to ensure greater flexibility in raising short-term funds by RRBs. Also, subject to certain conditions, issuers of CDs are permitted to buy back CDs before maturity.

Availability of NACH extended

For customers' convenience, NACH, currently available only on bank working days, is proposed to be made available throughout the week effective from August 1, 2021. NACH is a prominent mode of direct benefit transfer (DBT), which facilitates credit transfers such as payment of dividend, interest, salary, pensions, etc., as well as payments related to services like electricity, gas, telephone, water etc.



Measures Announced by the Government

The government announced a slew of measures to provide relief to diverse sectors affected by the second wave of Covid-19 pandemic. The measures announced also aim to prepare the health systems for emergency response and provide impetus for growth and employment.

- A total of INR 1.1 lakh crore **Loan Guarantee Scheme for sectors affected by COVID-19**, wherein INR 50,000 crore is allocated to the health sector for scaling up health infrastructure and INR 60,000 crore is allocated to other sectors.

Further, maximum loan amount for the health sector is INR 100 crore, with the interest rate cap being 7.95%. The interest rate cap for other sectors is at 8.25%. The coverage will be changed based on evolving needs.

- Credit line **Emergency Credit Line Guarantee Scheme (ECLGS)** given as part of Aatmanirbhar Bharat Package has been extended by another INR 1.5 lakh crore. Scope of scheme itself has been enlarged and the overall cap has been increased from INR 3 lakh crore to INR 4.5 lakh crore.
- **New Credit Guarantee Scheme** launched to provide loans to small borrowers, via Micro Finance Institutions (MFIs), where the maximum loan to individuals will be INR 1.25 lakh at an interest rate below 2% – as prescribed by the RBI.

Further, with focus on new loans, stressed borrowers except non-performing assets will now be covered. The loan duration will be for three years. This scheme has been announced, in order to reach out to smallest of the small borrowers in the hinterland, including in small towns.

- **New Scheme to revive Tourism** where financial support will be extended to more than 11,000 registered tourist guides and Travel & Tourism Stakeholders (TTS). Under this, TTS will get up to INR 10 lakh loan, while Licensed Tourist guides will get up to INR 1 lakh loan. This scheme is intended to help the tourism stakeholders survive the second wave of COVID-19.
- Once tourist visa issuance is resumed, **first 5 lakh tourist visas to be issued totally free of charge**. This will apply till March 31, 2022, or till the first 5 lakh tourist visas get covered, whichever is earlier. One tourist can avail the benefit only once.
- **Aatmanirbhar Bharat Rozgar Yojana extended**: The scheme was launched to incentivise job creation and restoration has now been extended from June 30, 2021, to March 31, 2022. More than 21.4 lakh people of nearly 80,000 establishments have already benefited from the scheme.
- Farmers to get additional **protein-based fertilizer subsidy** of nearly INR 15,000 crore.
- Free food grains will be provided to the poor from May to November 2021 (as provided last year), under **Pradhan Mantri Garib Kalyan Anna Yojana (PMGKY)**. Total financial implication of the scheme is nearly INR 94,000 crore, making the total cost of PMGKY nearly INR 2.28 lakh crore.
- INR 23,220 crore allocated for **public health, with sharp focus on child and paediatric care**. The amount is to be spent in this financial year itself. The scheme will include human resource augmentation to rope in medical students, nurses, strengthening of infra like ICU beds, ambulances, O2 supply, equipment, and medicines.
- **21 Climate-resilient and bio-fortified special varieties of crops** to be released by the Indian Council of Agricultural Research. These crops with high nutritional content, without having to add supplements will greatly help farmers increase income. It signals a shift from yield to nutrition and climate-resilience.
- The **North Eastern Agricultural Marketing Corporation to get INR 77.45 crore revival package** for financial restructuring and fund infusion. This is aimed to help plan and give higher price to farmers, bypassing middlemen.
- **National Export Insurance Account** to get additional financial support over 5 years. This will allow the NEIA to under-write additional project exports worth INR 33,000 crore and will immediately ramp up India's capacity to extend cover to project exports.
- Equity to be infused into Export Credit Guarantee Corporation, to provide credit insurance services for merchandise exports. This will enable ECGC to extend insurance cover up to INR 88,000 Crore for merchandise exports.
- More than **INR 19,000 crore additional outlay for Bharat Net Project** which will enable extension of Bharat Net broadband connectivity to all remaining villages. Notably, more than 1.56 lakh out of 2.5 lakh gram panchayat are already connected or service-ready.
- **Production Linked Incentive Scheme** to incentivise large-scale electronics manufacturing has been extended by one year, till 2025-26. Thus, investments made in 2020-21 will continue to be covered. Companies can opt to choose any five years for meeting production targets.

- **Reform Based Result Linked Power Distribution Scheme** to get total allocation of INR 3.03 lakh crore for power infrastructure creation and upgradation. It consists of state-specific intervention and will include 25 crore smart meters, 10,000 feeders, 4 lakh km of low tension overhead lines.
- **New Process for PPP Project** will consist of 'Appraisal, Approval, Monetization' for speedy clearances, to bring in private sector efficiency and streamline the process, in place of long and multi-level approval process. This will be for core infrastructure projects, including through Infrastructure Investment Trusts.



Role of Financial Institutions in Supporting the Economy during Covid-19

The COVID-19 pandemic arrived suddenly in a world that was unprepared for such an event and impacted the global economy severely and at pace. While global markets have become accustomed to economic shocks over the past century, the COVID-19 pandemic crisis was different in one material respect – it stemmed from a global health crisis that quickly morphed into an economic crisis.

The combined force of these crises was unprecedented in many ways as it has severely impacted markets and individuals globally. Millions have been unemployed or furloughed at home. Companies and businesses, especially smaller ones, have been crippled by low or no revenue. Governments at the national and local levels have struggled to meet health care and other needs while facing significant shortfalls in tax revenues.

In such crisis, decisive actions of the RBI and the government are critical in stabilizing markets. The funding programs, liquidity support and regulatory changes have played a key role in mitigating economic fallout to a large extent.

Access to credit: The sharp and sudden reduction in economic activities created an immediate need for financial services, particularly lending. To offset the revenue shortfalls, significant amount of funding could be sought from the banks.

Capital raising: While bank lending is an important source of credit and finance in the economy, public securities markets also provide the economy with an important source of funding. Bond issuance also play a vital role in dealing with significant revenue shortfalls precipitated by the pandemic. Primary equity issuance, while initially substantially lower in the early months of the pandemic, rebounded strongly, and in fact the third quarter of 2020 turned out to be the most active third quarter for IPOs.

Support for government related programs: The onset of the pandemic necessitated strong and decisive action by the government. As we saw in the earlier section, many of the support measures taken by the government have been supported banks and financial institutions such as NABARD, SIDBI, NHB, etc. which played an important role in facilitating these programs. Banks and NBFCs took considerable steps to provide support to households and businesses by temporarily deferring loan repayments and providing additional support measures during the pandemic.

Conclusion

In this crisis, the financial sector and the large financial institutions that provide credit, facilitate access to capital and support secondary markets have been a key part of the solution. In combination, the actions discussed above helped cushioned the initial impact of the economic shutdown, provided much-needed liquidity to customers and helped to rapidly restore confidence, thereby significantly limiting the extent of the economic impact of the pandemic.

Impact of Economic Stimulus

The economic relief packages announced till now lacks direct measures. India's relief packages have differed significantly from the ones announced by other major economies, which offered huge financial aid to households, businesses and people who lost jobs. India, on the other hand, has relied on pumping funds into infrastructure and state-guaranteed loans. The only direct relief has come in form of free food grain distribution, while all other measures have been heavily focused on low-cost lending. Such lending is likely to help businesses recover temporarily, but it may not guarantee recovery in the long run. A scheme allowing small businesses to borrow money would be of no use if consumer sentiment and demand remain subdued.

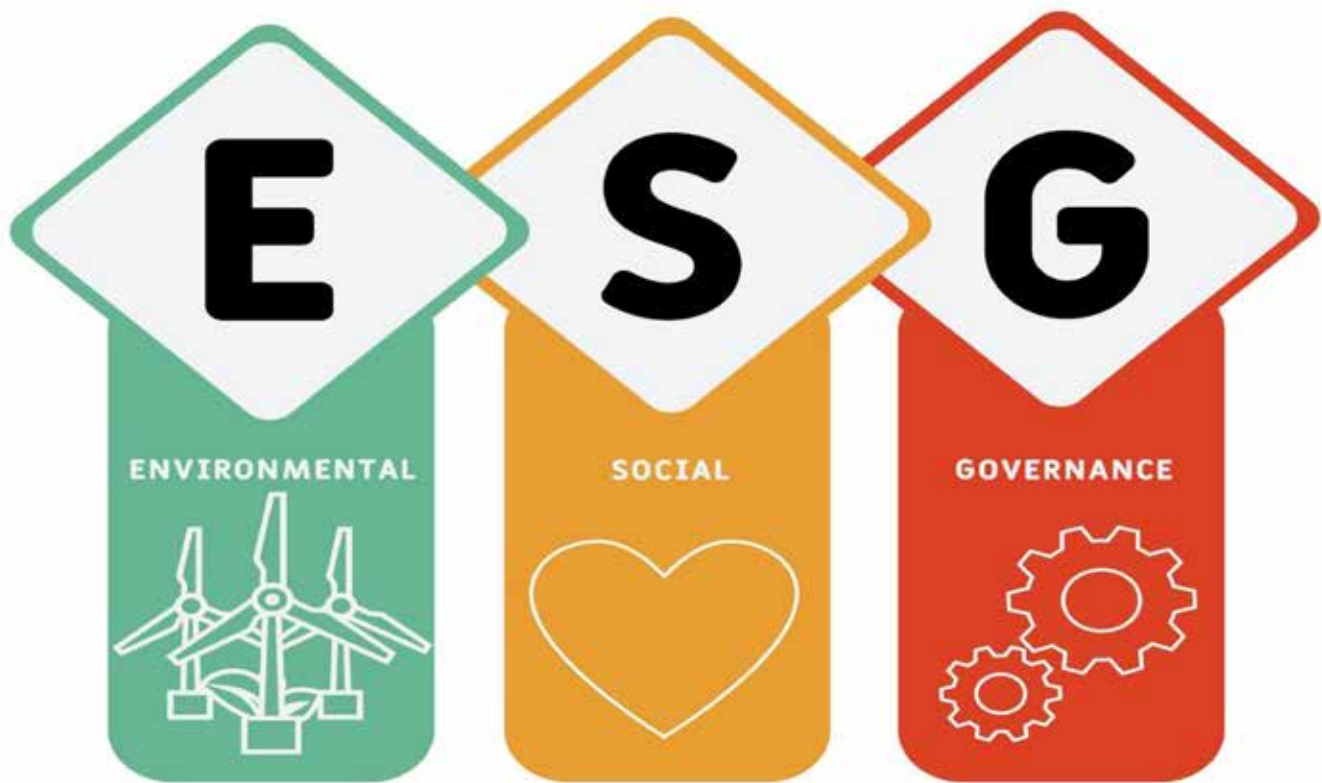
The government's economic relief package rightly taps key sectors such as healthcare, agriculture, tourism, manufacturing, micro finance, etc. it's unclear if these supply-side measures alone can trigger the needed demand boost. The human misery that unfolded recently due to the second wave of Covid-19 has shifted healthcare expenditure as a routine policy option to an economic necessity.

Agriculture, which cushioned the shock for Covid-19, got a leg up by way of better seeds and fertilizer subsidies. These efforts could help increase crop productivity and hence farmers' income. The relief measures comprising credit support to tourism and other sectors complement the RBI's earlier decision to open a special window for contact-intensive sectors. The largest item in the package is a provision of INR 3 lakh crore to guarantee loans to the micro, small and medium enterprises (MSME) sector to be made by commercial banks. While this is creative from a financial viewpoint, it is similar to the RBI's existing liquidity-enhancing initiatives. Thus, a little over half the package comprises liquidity provision, by RBI and the Government of India. These, such as the proposal aimed at expanding infrastructure for agriculture, cannot be faulted, but their impact may reasonably be expected only in the medium-term. The provision of loans amounting to INR 90,000 crore from power public sector units to distribution companies in the electricity sector is imaginative too, but it remains a supply side intervention.

Credit guarantees do not tantamount to fiscal outlays and the government will cut a cheque only when the guarantees are revoked. It means, the headline impact for the government is little and so the fiscal deficit slippage could be minimal. The incremental cash outgo is likely to be much smaller, given (1) some schemes have a multi-year focus (e.g. the PLI scheme), (2) some may face implementation delays (e.g. the additional capex outlays), (3) some may see a spill-over of expenditure into the next year and (4) some may be funded by repurposing of expenditure. There is a need for direct stimulus like cash transfers to poorer households that have suffered during the pandemic. People from low-income families are literally spending more than they earn, given the elevated prices of essential items and fuel.

Some of the schemes are exceptional, such as the extension of the 100% credit guarantee scheme to 26 stressed sectors with credit outstanding in the INR 0.5-5 billion range. Additional credit to these firms can be up to 20% of outstanding credit, payable over 5 years. The extension of the Production Linked Incentive scheme to ten new sectors is also likely to boost manufacturing over the medium term.

Infrastructure spending uniquely creates structures that raise productivity and extends spending power to the section of the population most affected by the lockdown, namely daily wage labourers. The substantial increase in the allocation for the Mahatma Gandhi National Rural Employment Guarantee Scheme is a stimulus, but by itself, may not make much difference.



Sustainable Financing/ ESG Investing

ESG investing, or investing based on environmental, social and governance parameters, is an investment philosophy that has gained popularity across the world in the past few years. ESG investing is synonymous with sustainable investing. It is an umbrella term for investments that seek positive returns by engaging with ethical firms.

ESG is not just about socially responsible business, but a much broader way of capturing sustainable business practices. Investors can bank on ESG analysis to identify the long-term sustainability of a business as well as any risks involved with it.

A healthy ESG practice helps an organisation to maintain good credibility or reputation. They carry lower risk probability because they incorporate sustainability as a core value. This results in steady and more long-lasting performance for the business over the years. On the contrary, organisations with a weak ESG run the risk of instability, high risks and more significant potential for sudden losses over the long term.

For ESG investing, the environment stands for a company's environmental disclosure, environmental impact and any efforts to curb pollution or carbon emissions. Social refers to the workplace mindset such as diversity, human rights and management. This also includes any relationship surrounding the community – philanthropy and corporate citizenship. Governance accounts for shareholder rights, compensation and the relationship between management and shareholders.

ESG investing has gained currency across the world in recent years, with funds following the model surpassing USD 1 trillion in assets in August 2020. ESG accounts for one quarter of all the professionally managed assets around the world.

In India, too, ESG investing increased manifold over the last several years, due to better policy reforms and awareness. Several factors have led to the growth of ESG investments in India.

Under the Paris Agreement, in 2015, India filed its Nationally Determined Contributions, for the period 2021-30. This states an investment of an estimated USD 2.5 trillion between 2015-30. India is also committed to achieving the Sustainable Development Goals (SDGs) to carry forward its mission of development without destruction.

Factors like business ethics awareness, corporate governance and business risks, are prompting businesses to be more proactive. More companies now know the benefits of ESG investing. Incidentally, global ESG funds are also investing in India. According to the Global Sustainable Investment Alliance (GSIA), 41 Global E&S seeking funds have invested on an average 25% of their funds in India equities. In the future, there could be more ESG investing in India.

Increasingly, domestic investors such as SBI, Quantum, Avendus, Kotak Mahindra are taking a significant part in ESG investing. They are warming up to sustainable investments. Asset management companies are signing up to UN-supported principles for responsible investment. Over the last few years, the Indian investment market has seen the entry of quite a few ESG funds.

India has been witnessing a slew of reform measures to drive investments in emerging sectors such as renewable energy, several voluntary and mandatory guidelines to drive ethical corporate behaviour and reporting on material ESG factors.

In recent years, quite a few indices have come up to track, monitor and measure the ESG performance of various companies. Some of those are S&P BSE Greenex, S&P BSE Carbonex, S&P BSE 100 ESG Index, NIFTY 100 ESG Index, NIFTY 100 Enhanced ESG Index.

These developments and measures have led to the growth of ESG investing in India and the world. In the US, net flows into sustainable funds reached USD 20.6 billion in 2019, more than 4 times that in 2018. In India, the size of the Socially Responsible Investment (SRI) asset base stands at USD 28 billion, which is 0.1% of the global SRI assets. Domestic asset managers mainly drive this growth.

An EY research has said that financial services companies will have to increase their focus on ESG and will also have to share data around it with all its stakeholders in the post Covid pandemic time. The report said that integrating investor expectations on ESG parameters as a part of stakeholder engagement practices and sustainability initiatives will be a key in the post pandemic times.

There has been a shift in focus of many businesses and investors from profits to people as the pandemic unfolded. The most concerning issue was the safety of the people. Issues like access to healthcare and societal welfare were topping the list. The transmittance of this instability has affected the carbon economy the most. Industries intensive on carbon, including airlines, mining, steel, etc. were drastically impacted. However, it is believed that in the post-pandemic era, ESG factors will remain central to driving the economy upwards.

ESG challenges such as climate change have profound implications for businesses, the economy and society at large, thus offering opportunities for both, the society and businesses, to achieve long-term economic and social growth. The financial sector is in a great position to drive this transition to a sustainable economy and a stable future.

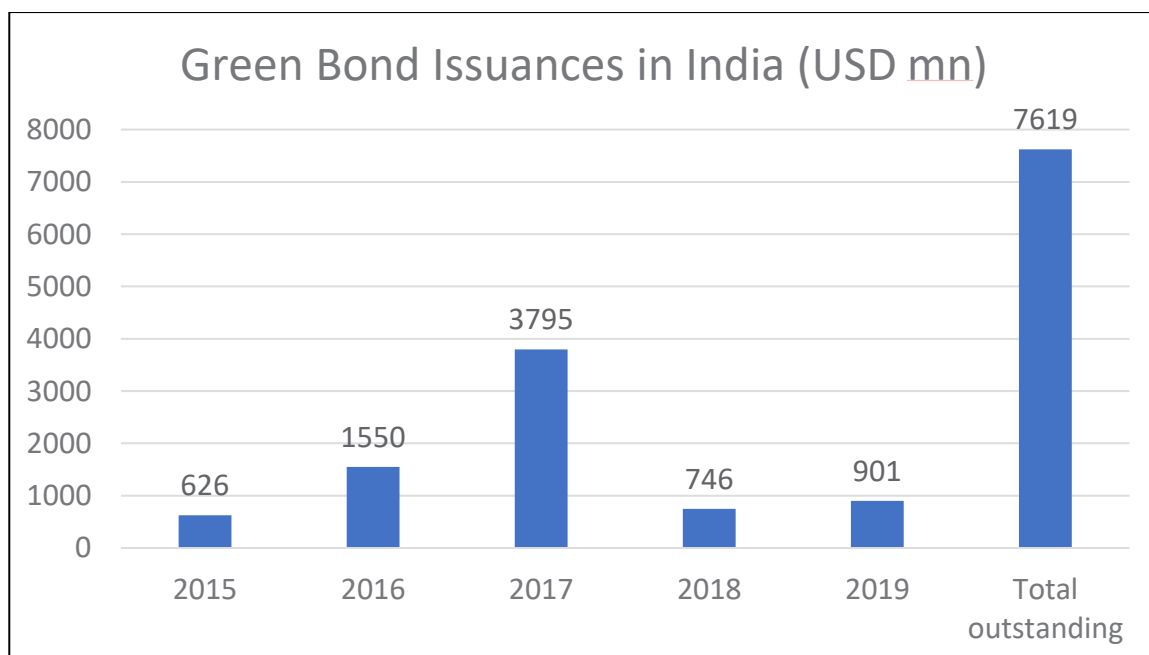
One of the challenges that corporate India has to contend with and will continue in the future (which is great for investors) is the fact that regulations are going to get stricter and adherence to them is going to get tougher. Be it environment norms or impact on society or actual accounting bells and whistles, the regulators are going to come down hard on companies who flout the rules and penalize those who are out of line.

If the company adheres to the highest standards of ESG, then there are advantages of investing in those companies. They do not need to incur any additional costs and are on a safer wicket if the regulator tightens norms. An ESG compliant company can take advantage of the situation to increase market share while other non-compliant companies struggle due to violating strict regulatory protocol. Being ESG compliant enhances the reputation of the company multi-fold, not only amongst investors, but customers and stakeholders alike.

ESG is good for companies, investors and the society, thereby achieving a triple bottom line and could be the 'new normal' in the world of investing.

Green Bonds

In the last few years, green bonds have become quite popular among Indian and global issuers. The market for labelled green bonds stood at USD 167.6 bn in 2018. Of this, the largest share in 2018 issuances was led by US (20%) and China (18%), followed by France (8%), Germany (5%) and Netherlands (4%).



It was in 2015 that India stepped into the green bond market with YES Bank issuing the first green bond for financing the renewable and clean energy projects. Over the years, this market has expanded to several state-owned commercial banks, public sector undertakings, state-owned financial institutions, corporates, and the banking sector. 2018 saw SBI enter the market with a USD 650 mn green bond, as part of a larger program to raise up to USD 3 bn via green bonds. At the end of 2018, India ranked as the second largest among emerging markets in issuing green bonds.

Privatization and Digital Lending

Changes in economy and banking sector have culminated into changes in banking landscape for public-sector and private sector banking

Public-sector banking is undergoing changes in the form of mergers and privatization, while private sector lending is turning to digitization



Privatisation and Digital Lending

Privatisation

Bank mergers and Privatisation has been the key word for the government since the dawn of the banking reform era '2019'. The efforts draw an inspiration from Government's efforts to improvise public-sector banks operations and eventually monetise the assets. India, being a democracy, has received mixed response from such efforts from all the stakeholders and public in general, with the expected very negative response from the public-sector employees association. All other stakeholders are taking it in lukewarm manner. The current privatisation plan could be viewed as an extension of the government's broader agenda to reform the Indian banking sector and reduce the number of state-owned banks further, which have come down from 27 in 2017 to 12 in 2020 after three successive rounds of consolidation.

Before dissecting the Government's decision to privatise banks, there should be few things that should be considered: How shall privatisation help in uplifting the already down public banks? Will private funding resolve all the problems for the banks? Is funding and governance the main issue being faced by the banks? Any alternatives to privatisation like public private partnership?

The above questions lead us into a deeper understanding behind the privatisation of banks and why it should be done. We understand the case for privatisation by comparing the performance of public sector banks (PSBs) and private sector banks (PVBs). Further we understand the key challenges

faced for privatisation, who can be potential investors – how can governance for banks be improved along with funding by private participants? How can private and foreign investments be promoted in PSBs.

Comparative Performance review:

In 2019-20, India's commercial banking sector consolidated the gains achieved after the turnaround in 2018-19. Financial performance was shored up in H1:2020-21 by the moratorium and the standstill in asset classification. The overhang of stressed assets declined, and fresh slippages were reined in. With improvement in margins and recoveries of delinquent loans, the banking system turned profitable after a gap of two years. At the same time, capital buffers were strengthened, partly aided by recapitalisation of public sector banks (PSBs) and capital raising in the market. The immediate impact of lockdowns on the financial performance of commercial banks was mitigated through timely policy actions by the RBI.

Operating Performance

How operating performance has fared?

Capital Adequacy

Capital adequacy comparison with private sector banks and despite the capital infusion by Government

Return on Equity and Return on Asset

Return on assets and equity to the Government comparison

1. Operating performance

	Public sector banks		Private sector banks		Foreign banks		SFBs		Payment banks		All SCBs	
	2019	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019	2020
Operating Profit	1,49,603	1,74,390	1,26,526	1,61,684	26,728	32,829	2,163	4,139	-	-446	3,05,019	3,72,595
	(-3.9)	(16.6)	(13.6)	(27.8)	(10.3)	(22.8)	(67.1)	(91.4)			(4.2)	(22.2)
Net Profit	-66,608	-26,015	27,621	19,111	14,508	16,180	1,082	1,968	-	-334	-23,397	10,911
			(- 33.9)	(- 30.8)	(33.7)	(11.5)	(264.4)	(81.9)				
Net Interest Income (NII)	2,30,962	2,48,198	1,62,380	1,90,528	31,093	37,863	5,147	9,020	-	32	4,29,581	4,85,641
	(12.6)	(7.5)	(23.9)	(17.3)	(6.9)	(21.8)	(61.0)	(75.3)			(16.6)	(13.0)
Net Interest Margin (NIM)	2.33	2.37	3.26	3.42	3.23	3.26	7.62	8.34	-	1.95	2.7	2.8
Performance of PSBs has remained below PVBs, foreign banks and SFBs specifically in terms of net profit and net interest margins generated.												

2. Capital adequacy

With capital infusion by the Government, PSBs improved their CRARs despite the increase in risk weighted assets (RWAs). With the budgeted capital infusion of ₹70,000 crores in 2019-20, the Government has infused ₹3.16 lakh crore in the last five years in these banks. SCBs shored up their capital position to strengthen loss-absorption capacity against imminent COVID-19 induced loan delinquencies. Apart from internal capital generation and recapitalisation (in case of PSBs) by the Government, banks raised capital from the market through public issues, preferential allotment, qualified institutional placement (QIP) and by selling non-core assets. PSBs abstained from public issues due to depressed valuations.

Component-wise Capital Adequacy of SCBs (March INR Crore)								
	PSBs		PVBs		FBs		SCBs	
	2019	2020	2019	2020	2019	2020	2019	2020
Capital Funds	6,38,553	6,99,872	6,01,046	6,54,772	1,69,598	1,88,660	14,09,197	15,43,304
Tier I Capital	5,18,963	5,65,830	5,27,007	5,80,718	1,59,184	1,72,883	12,05,154	13,19,431
Tier II Capital	1,19,590	1,34,042	74,039	74,054	10,413	15,777	2,04,043	2,23,873
Risk Weighted Assets	52,32,524	54,46,253	37,39,838	39,56,956	8,74,432	10,65,869	98,46,793	1,04,69,078
CRAR (1 as % of 2)	12.2	12.9	16.1	16.5	19.4	17.7	14.3	14.7
Of which: Tier I	9.9	10.4	14.1	14.7	18.2	16.2	12.2	12.6
Tier II	2.3	2.5	2.0	1.9	1.2	1.5	2.1	2.1
CRAR has been low for PSBs when compared to PVBs and FBs. Thus the depressed valuation and capital inadequacy for the PSBs.								

3. Return on assets and return on equity comparison:

Return on assets and return on equity for SCBs has been described as below. When compared with PVBs, foreign banks and SFBs, the performance of PSBs has been abysmally low.

Return on Assets and Return on Equity of SCBs – Bank Group-wise (percent)												
Bank Group	PSBs		PVBs		FBs		SFBs		PBs		All SCBs	
	2018-19	2019-20	2018-19	2019-20	2018-19	2019-20	2018-19	2019-20	2018-19	2019-20	2018-19	2019-20
Return on Assets	-0.65	-0.23	0.63	0.51	1.57	1.55	1.59	1.70	-	-25.39	-0.09	0.15
Return on Equity	-11.44	-4.16	5.45	3.30	8.77	8.76	12.59	15.00	-	-58.19	-1.85	0.78

The low return on assets and equity has been a driver for low valuation for PSBs. How such valuation affect the stake sale and privatisation is a difficult question to face. Further, factors such as capital inadequacy indicate inefficient management of funds – a grave factor to establish long-term stability on part of these banks. If the Government and regulators expect to bring in long-term investors, the banks must have also displayed long-term growth potential. The outreach, branch network, accessibility, infrastructural assets are some of key strengths of the PSBs to be cashed on.



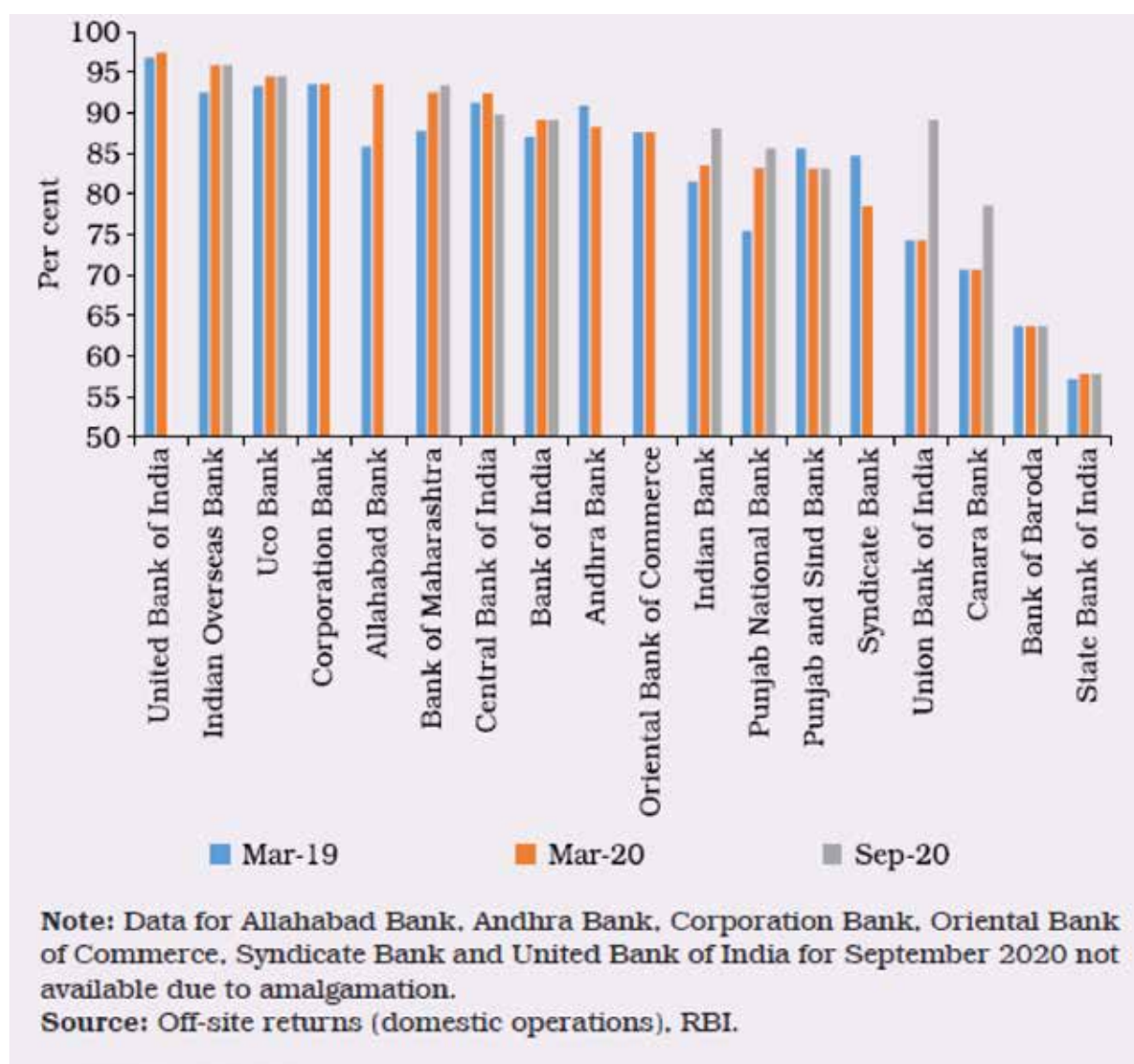
4. Ownership pattern of PSBs

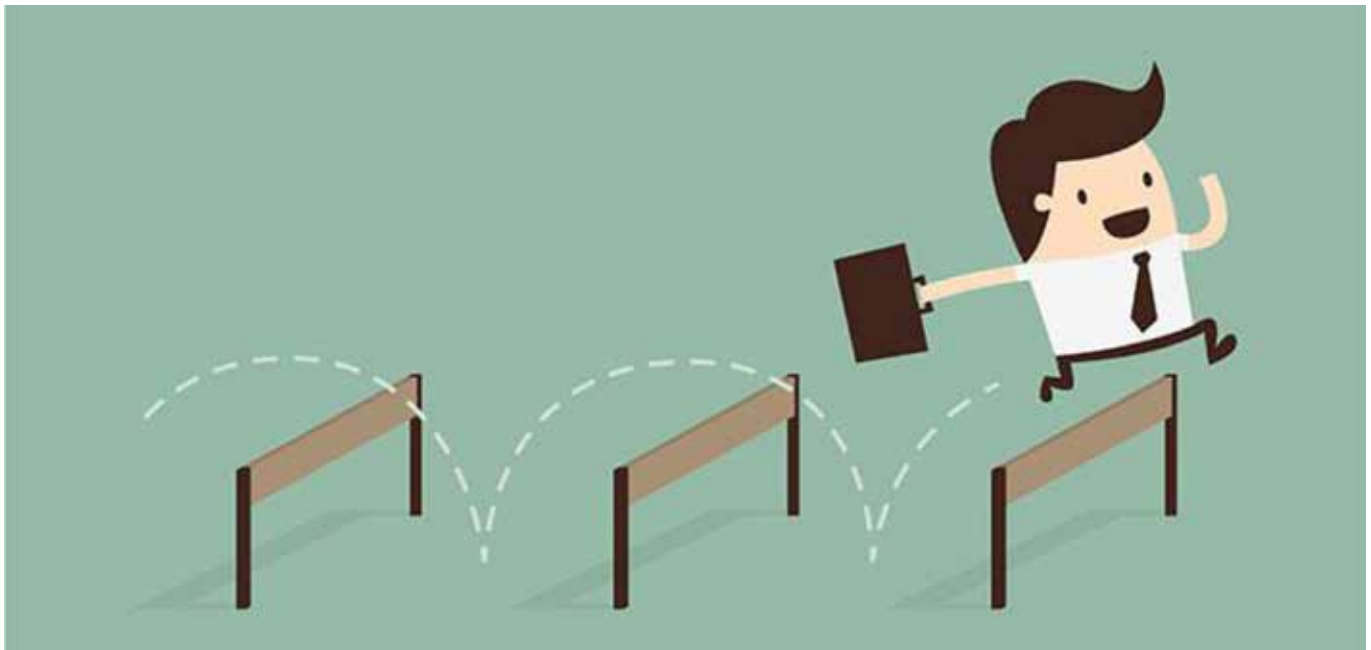
Except for Andhra Bank, Punjab and Sind Bank and Syndicate Bank, the Government's shareholding in other PSBs during 2019-20 either increased (due to recapitalisation) or remained static. Amalgamation of 10 PSBs into four, effective from April 1, 2020 brought about significant changes in ownership structure.

Government shareholding in Canara Bank, Punjab National Bank, Indian Bank and Union Bank of India significantly increased due to high government share in the merged entities.

Currently, the foreign investment limit in PVBs and PSBs is 74 per cent and 20 per cent, respectively. While the maximum foreign shareholding in PSBs was 9.8 per cent, it was more than 50 per cent in five PVBs at end-March 2020. Out of 22 PVBs, only three attracted higher foreign shareholdings during 2019-20.

Below given graph provides the Government ownership in the public sector banks:





Key challenges faced

Political pressure:

A stepping stone to bring about privatisation would be to bring legislative amendments to Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and (nationalisation) 1980 and bring the banks under Companies Act 2013. The idea is to remove the policy-related constraint which caps the voting rights at 10% for a non-government shareholder irrespective of shareholding before the government sends out an investment invite for bank privatisation. This could act as a major hurdle for Government to get the bills passed in the parliament.

As per a report by Fitch, there could also be more resistance from the trade unions this time around, who will be against the safety-net withdrawal of state ownership. Success of the plan would also require sufficient interest from investor(s) willing to acquire large stake(s) in state-owned banks and run them.

Weak governance:

State banks in general have long been plagued with muted investor appetite due to structurally weak governance frameworks which have resulted in persistently weak performance, reflected in significant asset-quality problems. The Covid-19 pandemic has further dampened business and consumer confidence, with the impact on reported impaired loans manifesting potentially over an extended timeframe, considering the various forbearance and relief measures by the authorities. State banks have played a more active role in extending these measures (given their quasi-policy mandate) than the private banks, which will make it more difficult to reasonably assess stress for the state banks, thus adding to the risk of weak earnings performance for a protracted period.

Managing state-run banks:

State banks can also be difficult to manage. They have a significantly different culture and organisational practices (eg more bureaucratic) relative to private banks. Similar challenges and the absence of meaningful investor interest resulted in the state ultimately having to sell its majority stake in IDBI Bank to LIC in 2019, which has somewhat been privatisation in letter but not in spirit. However, this could change in 2021 if both government and LIC are able to divest a majority stake in the bank to an external investor, as it may be indicative of broader investor appetite in state banks with adequate loan-loss reserves.

Persistence of poor governance:

Privatisation will have to mean government letting go of major shareholder tag. Otherwise the entire exercise could prove futile. The current framework of governance – at all aspects from risk management, loan disbursements, socio-economic lending contributes to a less-or-no profit lending. PSBs are mostly responsible for managing and monitoring Government schemes which lead to further draining the resources.

Persistent NPAs:

PSBs face huge exposures to important sectors of the economy: mining, iron and steel, textiles, infrastructure (including power and telecom) and aviation. These sectors face largest amount of NPAs, residing in the books of PSBs. In December 2014, these five sectors accounted for 29% of all advances at PSBs and 14% of all advances at private banks.

As per announcement in Budget, NPAs have come down from a high of ₹10.36 lakh crore at the end of March 2018 to ₹8.08 lakh crore at the end of September 2020. In March 2019, NPAs at PSBs were 12.6% of all advances, and the figure for private banks was 3.7%. Return on assets at PSBs was -0.9%, while that at private banks was 1.2%. It is these comparisons that show PSBs in bad light and lead to calls for privatisation. Under these circumstances, it is very difficult to invite attention of investors and 'dress' the banks to appear lucrative.

A comparative view of public-sector banks and private sector banks wrt GNPA and NNPA ratio at end-September 2020 .

Asset Classification as per IRAC Norms						
(As at end-September 2020)						
	As Reported (Per Cent)		As per IRAC Norms (Per cent)		Difference (Percentage points)	
	GNPA Ratio	NNPA Ratio	GNPA Ratio	NNPA Ratio	GNPA Ratio	NNPA Ratio
1	2	3	4	5	(4-2)	(5-3)
Bank of Baroda	9.14	2.51	9.33	2.67	0.19	0.16
State Bank of India	5.28	1.59	5.88	2.08	0.60	0.49
Union Bank of India	14.71	4.13	15.37	4.76	0.66	0.63
Axis Bank	3.94	0.98	4.28	1.03	0.10	0.05
Bandhan Bank	1.18	0.36	1.54	0.72	0.36	0.36
HDFC Bank	1.08	0.17	1.37	0.35	0.29	0.18
ICICI Bank	5.63	1.00	5.36	1.12	0.19	0.12
IDFC First Bank	1.62	0.43	1.87	0.60	0.25	0.17
Kotak Mahindra Bank	2.55	0.64	2.70	0.74	0.15	0.10



Potential investors

One of biggest challenges before Government would be to attract investor attention to privatisation. As far as privatisation goes, there hasn't been an attempt of privatisation at this scale earlier. Going by

the IDBI divestment example, we could see a lukewarm response to the exercise and ended up with LIC owning up majority stake.

Potential investors could include players like foreign banks, strategic investors – asset managers, sovereign funds, private equity funds, etc. These entities shall go through a thorough screening and due-diligence before being invited to express their interests. Further, the Government and investment bankers should take in view the long-term governance and value proposition these investors bring on-board. Without a fundamental inclination towards improvising the operations of the banks, it may be difficult to shortlist the investors.

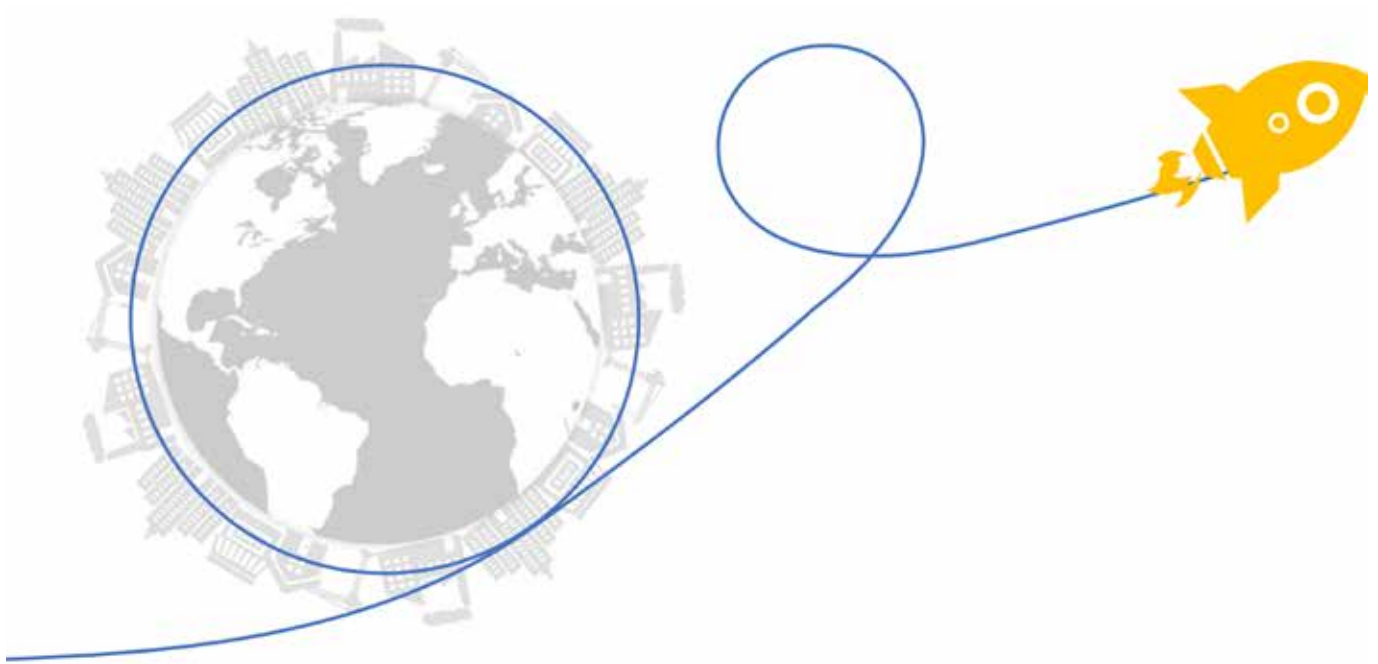
The targeted entities shall have to be pitched with the key aspects of the banking and potential in growth with appropriate governance in place.

Conclusion

With all these perspectives in place, we come back to the issues:

How shall privatisation help in uplifting the already down public banks? Will private funding resolve all the problems for the banks? Is funding and governance the main issue being faced by the banks? Any alternatives to privatisation like public private partnership?

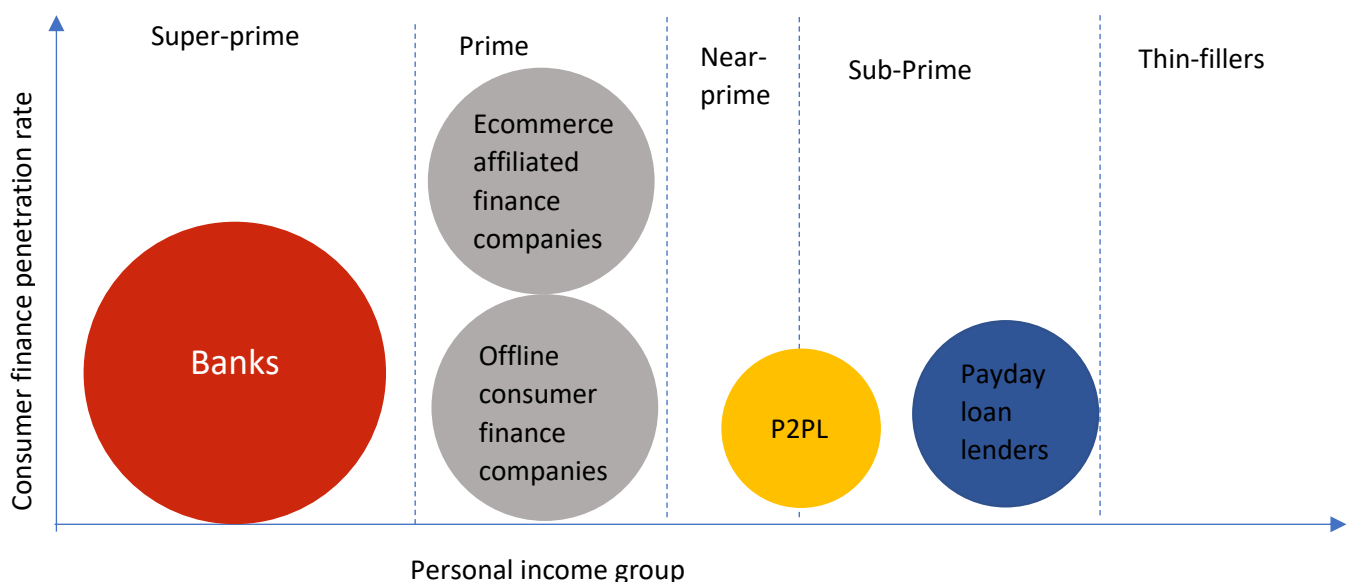
With privatisation, we expect to bring in certain order of governance with a fundamental inclination towards profit maximisation and fundamental stability. Private-sector incursion into banking would lay out a framework for benchmark performance driven by focussed lending. Privatisation would open doors for industry experts and on-boarding competitive talent to further improvise the operations. When considering privatisation, alternatives to privatisation could also be considered like public-private partnerships in areas of risk management, external talent and industry experts, etc. could also be considered. Overall the efforts for privatisation should be expected to impact two key areas of the banks – funding and governance.



Digital Lending Landscape

With the evolving demography and socio-economic conditions, the ways and means for lending and banking in general are also undergoing change. Financial services landscape in India has undergone a major change in last 5-6 years. With an evolving government scouting for returns from public-sector banks through privatisation, the customer segment has also evolved and now seeks comfort in ease of borrowing and money management. The digital lending landscape has evolved tremendously with home-grown and foreign lending start-ups vying for market space.

I. Penetration rate of financial services based on income





Banks and NBFCs typically address only super-prime and prime customers due to a lack of credit information and/ or high cost of customer acquisition through traditional branch models. This indicates potential for FinTech companies to penetrate lower income groups using technology platforms.

II. Access to credit

Although India is one of the world's fastest-growing economies and boasts the world's sixth-largest GDP and a dynamic business landscape, access to credit remains one of the major impediments, resulting in low financial inclusion. As per World Bank data, less than 10% of Indians have access to formal credit.

India's evolving economic landscape consists of about 65 million MSMEs, contributing about 38% of the gross domestic product (GDP) and generating one-fifth of the country's employment, collectively employing more Indians than any other sector, barring agriculture. However, MSME contribution to India's GDP is about 23% lower than that of China and 10% lower than that of the USA. Even though MSMEs in India are vastly wide-ranging, they face a common impediment – the lack of access to formal credit. The MSME sector, though an integral part of India's economic growth, continues to struggle with access to credit, with only 10% of small businesses having access to formal credit. A multitude of MSMEs lack the necessary documentation required to secure a formal loan. Many entrepreneurs cannot offer worthwhile collateral or have under-reported and incomplete financials. Consequently, availing formal credit may get painstakingly time consuming for MSMEs and expensive for borrowers and lenders alike, leaving traditional FIs' lending models incapable of suitably addressing MSMEs' borrowing needs.

III. Cost of credit

Think of a kirana store owner who wants to seek credit to stock up during peak season, a small textile manufacturer who wants to revamp his production floor, or a family that can't afford to pay for medical treatment during an emergency. A considerable amount of people and businesses face such situations today. All these consumers fall under the untapped market as illustrated below. Unsurprisingly, these individuals and small businesses may be coerced to look outside the formal financial system – at friends, family or moneylenders – falling prey to exorbitant terms and conditions for credit borrowed, further restricting them from financial inclusion.

Banks and NBFCs	Unaddressed market	Niche/informal lending
- Typically with credit scores above 700 - Can get pricing of 10-18% - Existing business and credit history	- Scores 600-700 or default score – careful but quick evaluation needed - Varied product needs – short term and medium term - Lack of available suitable products from banks - May not have sound financial history, past credit records or usage of credit card	- Credit scores below 600 or non-existent - Pricing for >25-30% from niche/local lenders - Typically need short-term loans
Able or willing to address <5% of the market	90% of market unaddressed by existing financiers	Able to address <5% of the market

IV. Fintech to overcome challenges of traditional lending

The aversion of traditional FIs to service apparently risky low income but credit-devoid segments has enabled new-age digital lenders leveraging cutting-edge technology and alternative credit assessment models to quickly fill the void and reach out to a wide customer base. With advancement in technology and a conducive policy environment, alternative lending as a service has caught the eye of consumers and investors alike. FinTech lenders have capitalised upon pain points of the consumers across the lending value chain for uncomplicated and simple on-boarding/ KYC processes, prompt decision-making and instant disbursements in a seamless, automated and personalised experience. Digital lending has significant advantages over traditional lending, with the potential to address the present credit-related challenges in India.

One of the most distinguishable advantages of digital lending is speedier approval of credit. Credit evaluations and loan disbursements on digital platforms have visibly quicker turnaround times than traditional loans – particularly for small-ticket credits and advances, which are most common among new-to-credit borrowers. Some of the factors why the disbursement turnaround time is significantly lower in digital lending are replacement of manual form filing by digital data captures, automated evaluations leveraging on technologies like advanced analytics, artificial intelligence (AI) and machine learning (ML) and no or little in-person visits. Traditional credit scores consider repayment records, delinquency, data

related to delay and default on outstanding loans to determine a credit score. This results in a majority of creditworthy unverified individuals and businesses being unable to access credit. The usage and means to make sense of alternative medium of data rather than traditional asset-based data to determine the creditworthiness of an individual/business is the underpinning advantage of FinTech lenders over traditional lenders.

The shift from asset-based data to cash flow-based data and other surrogate data from sources such as telecom, utility and social media, combined with psychometric analysis to evaluate ability and willingness to pay, is augmenting or substituting traditional sources to service credit-invisible strata. Conceivably, another key advantage associated with digital alternative lending models is the operating cost efficacy. The traditional lending models, usually, have high overhead costs, surfacing from deeply entrenched manual processes. FinTech lending models, conversely, do not require physical branch networks, are asset-light and have technology-enabled operating, mostly cloud-based and business models which require minimal human intervention, thus reducing manual operating costs. This model allows FinTech lenders to keep fixed costs nominal and aggregate a multitude of low-value loans, which enables them to serve low-ticket credit individuals in semi-urban and rural areas and previously credit-devoid MSMEs. Furthermore, FinTech lenders are also able to pass on the benefits of lower costs to customers, making their digital lending products more attractive.

Conventional lending examples	Limitations of access to underserved market	How FinTech lending overcomes the limitations
Formal Banks NBFCs Multi-finance cos Co-operatives	Requirement for physical verification and high costs The underwriting process requires a credit history or proof of a steady income or an asset-based collateral. Cooperatives are relatively small in size and lack of competitiveness to attract money suppliers in the market	Utilises digital footprint as a substitution for physical documents for verification and/or usage of third-party data (e.g. e-commerce) in order to define eligibility, which lowers operational costs compared to conventional lending Processes the underwriting assessment through digital processing platform with various data points, to identify typical attributes for interest rates to be charged, without prior collateral. Developed a simple and convenient platform for attracting investment, as most of the processes are completed through digital platforms, which attracts large number of potential lenders.
Informal Loan sharks	Risk of irrational credit and limited funding opportunities	Customised credit assessment models, which employ behavioural data to identify typical attributes for charging interest rates, supported by large amounts of funding from retail and institutional lenders.



Key growth drivers

The following can be said to be the major drivers for growth of FinTech and alternative lending:

- Strategic partnerships and collaborations between traditional financial institutions and new-age FinTechs
- Easy market entry and targeted loan offerings due to availability of large sets of customer data, which can give collective and individual insights
- Government initiatives like launching Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGS), issuing guidelines to banks regarding collateral requirements and setting up Micro Units Development and Refinance Agency (MUDRA) banks which can provide loans at low interest rates to micro-finance institutions and NBFCs
- Better margins than other FinTech business models, such as payments and other financial services
- Changing consumer behaviour and expectations shaped by purchase/transaction experiences offered by e-marketplaces like food delivery, e-commerce and travel portals
- Affordable alternative lending practices can help FinTech leaders explore the huge untapped market for loans and bring in more inclusion; there is a need to 'sachetise' finance – i.e. increase availability of small-ticket size products – to lift people out of poverty.

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