India Needs Financial Sector Reforms for Developmental Outcome

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Financial sector must support real economy for the growth and development of nation. Current regulations protect financial investors but not the entrepreneurs, who have invested the seed capital. In future, they will prefer financial investment instead of engaging in productive activities. If so, who will drive Indian economy?

Generating jobs for the youth must be the top agenda for development of India. For this, India must achieve unhindered double digit GDP growth for two decades. GDP will grow through hassle free operation of existing productive assets, and thereafter by adding new capacities. Simultaneously, India must invest heavily in infrastructure assets, failing which, growth will not be efficient and sustainable. India must invest at the rate of 40% of GDP, which cannot be done by the government alone. We need a team of entrepreneurs to invest in seed capital and manage assets. Capital market must support by providing equity and banks must provide adequate and low cost debt. Currently, financial sector regulations are deviating from this objective. These regulations need reforms, giving emphasis on the developmental outcome.

Raising equity from capital market has become too difficult. Number of public issues is abysmally low, that too, limited to mega corporate. Even government is facing problem in disinvestment target. What to speak of small and medium corporate? Too many regulations for listed companies have crafted barriers on new entries. Capital market needs structural reforms so that risk capital is available to economy, particularly to small and medium corporate. Normally, they depend upon debt route, which is not any more business friendly.

In India, borrowing rate for an average mid-size company is about 13-14%. Repayment tenure is 5-7 years, except for infra projects. Debt servicing outflow (interest & repayment) is exceeding 30% pa in most cases, which is too high compared to other countries. In developed countries, borrowing rate is below 5% and repayment tenure is flexible matching the need. Hence, temporary defaults in debt servicing are unavoidable in India. Such instances have increased with long recession. The problem is somewhat aggravated with capital intensive industries, real estate sector and infrastructure projects. Infusing liquidity and relaxing NPA (Non-Performing Asset) norms are the emergent needs, failing which, new investment will not mature. More so, banks will also land into problem, which will shake the Indian economy.

No doubt, regulations should prevail protecting the depositors. But it is equally important to protect borrowers who have invested their entire savings and mortgaged personal assets, failing which, entrepreneurs will stop borrowing. Rather, they will convert to financial investors. Similar thoughts are already cropping up, which is never good for the growing economy. For growth, we need a team of entrepreneurs who can invest risk capital and manage productive assets.

Every regulator is worried about rising NPAs in banks. But there is no worry for the industries in deep stress. Instead of resolving problems, responsibility is shifted to entrepreneurs and bankers. On top of it, policing action has commenced. An environment of mistrust is prevailing and genuine problems are being overlooked. This is indeed demotivating to both bankers and entrepreneurs. With this, how can India develop?

As per current regulations, delay by one day in debt servicing downgrades credit rating and blocks new loan. Three months' delay converts loan account to NPA and shuts all doors, making the unit sick. Fine prints of rule books pose many other problems. For SME, new rules are notified categorizing delay of 30 & 60 days as SMA-1 & 2 (Special Mention Accounts), somewhat similar to NPA. Temporary delays are causing permanent stress on productive sector. All such stiff norms are instigating frustration among entrepreneurs, which will indeed be fatal for economy.

India adopted these norms from developed countries overlooking the development phase of those countries. Why don't we adopt their interest rates and repayment tenures? Are India's economic policies and business laws comparable with those countries? Are we comparable on the global index of 'Ease of Doing Business' and 'Global Competitive Index'? If not then India should adopt regulations matching to Indian environment. Any norm and regulation is not sacrosanct. They must be changed as per economic needs of the nation and must be framed with a sole motto of developmental outcome.

Now, several corporate are in a debt trap. Metal, core sector, realty sector, power and infrastructure are the worst victims. Will closing down these units and building new capacities be prudent? Resource requirement for reviving these units will be much lesser compared to new capacities. We must acknowledge that all productive assets are national assets, irrespective of management control. These assets contribute to national income and government revenue. If so, why don't we protect them in adversity? With the current mindset, direct investment will be indeed difficult, domestic or global.

We must examine true reasons for the down cycle and take remedial measures in quick manner. During interim period, responsibilities must be shared by all instead of imposing entire burden on the entrepreneurs. Banks are engaged in lending business and no business is free of risk. But alas! Banks are not sharing risk and not extending adequate support. Its adverse impact will travel to all stake holders including bank employees, suppliers, shareholders and the whole nation.

A time will come when entrepreneurs will desist taking risks. They will prefer investing in financial instruments which will provide a hassle free life with better returns. In most cases, average return on net-worth (RONW) is below interest rate. This could be another reason for shifting their investment from productive activities. Will this be good for the nation?

It makes no prudence deserting productive assets on temporary defaults. Prevention and curing are the better options. Instead of imposing imported norms, banks may be permitted framing norms for asset classification and loss provisioning. Long term viability and debt serving capability must be the main criteria. Temporary defaults arising due to recession or slowdown of economy or any unforeseen reason must not dominate in declaring loan assets as NPA. Indian banks are matured and conversant with ground realities. Regulators may intervene in case of major variance of a particular bank from other banks.

Interest rates for productive activities must be slashed down radically to single digit, which is a major cause of current scenario. It is surprising that consumption is funded at a lower rate compared to production. This must be reversed. Difference between government borrowing under SLR mechanism and private borrowing is too high. This must also shrink. Statutory liquidity ratio (SLR) must reduce and be at par with developed countries.

While reducing interest rate for depositors, interest income on cumulative deposit may be exempted from tax. While investing in equity, capital gain on investment beyond one year is exempted. If so, why don't we give similar incentive on bank deposits? This will boost deposit and lending capacity of banks to amazing levels.

Repayment tenure must be longer particularly for capital intensive industries. In adversity, restructuring of loan must be quick and liberal; subject to long term viability. Quick infusion of working capital loan is most important need in such adversity. That will be the life line for productive assets. Eventually this will also prevent loan assets becoming NPA.

While sharing risks, banks should increase capital adequacy by raising additional equity and bonds from capital market. Some tax incentives may be given to the retail investors contributing to such public issue. This will be a far better option compared to direct capital infusion by government.

Financial investors and entrepreneurs are the two wheels of an economy and must be acknowledged. Structural reforms in financial sector must match Indian condition instead of importing from other countries. Developmental outcome must be the single motto for any reform. Failing which, our dream of development will not fulfill and young India will continue to struggle for jobs. ■