Opinion

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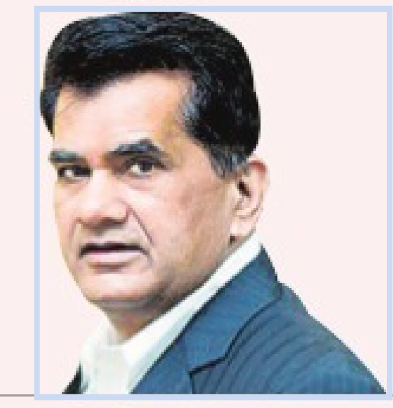

FINTECH FOR RURAL INDIA

NITI Aayog CEO Amitabh Kant

India is in the global top-10 fintech markets. Current fintech offerings are mainly accessible to elite. There is a need to reorient innovative potential to solve problem of the rural & the unbanked

RationalExpectations

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Will VoLTE rescue telcos?

Me-too Jiophones are just what the industry needs, incumbent telcos may want to help defray their costs

THOUGH IT HAS really stretched their bottom-lines, the latest quarter results for incumbent telcos are remarkable in terms of how data volumes have shot up in response to slashing of prices following RJio's entry. In the case of Bharti Airtel, while per MB data realisations have more than halved sequentially, usage per customer just short of doubled in the June quarter. In the case of Idea, per MB realisations also more than halved, and usage rose 2.3 times. The strategy of matching RJio pricing has worked to retain 3G/4G customers—only customers with smart-phones can access the incumbents' 3G/4G networks, the rest are on their older 2G networks where, by and large, tariffs have not fallen as steeply. The challenge posed by the ₹1,500-Jio-VoLTE feature phones, however, is not as easily met by dropping prices.

There are, as a Kotak report points out, 210 million subscribers who, right now, pay ₹140 per month to their telcos. These relatively low-end users could, then, be quite willing to subscribe to RJio's ₹153 unlimited-voice-0.5GB-per-day plan provided they buy the Jiophone since, without a VoLTE phone, they cannot be on its network. While low-end users on 2G networks will ask their service providers to match the RJio offer—if not, they will migrate to RJio—this may not be possible. Many incumbent telcos simply do not have the capacity on the 2G part of their networks to offer unlimited voice and it will get dramatically worse if they have to offer larger amounts of data as RJio does. To get a sense of how demand for voice/data changes as users can pay more or it is free, see the table—as subscribers move from ₹140 per month to ₹279, voice volumes rise from 367 minutes a month to 702, and data from 138 MB to 418 MB.

USER CHARACTERISTICS

Subs (mn)	Spend ₹/month	Voice minutes (per month)	Data usgae (MB/ month)
600	52	140	26
210	140	367	138
101	279	702	418
64	581	1,395	1,112
23	839	1,739	2,012
5	1,182	2,478	3,541
1,002	151	372	424

Source: Kotak Institutional Equities, Oct 2016

If a telco has 6.2MHz of 2G spectrum, it can typically service around 150 million subscribers with around 150,000 base stations; naturally, once the usage rises in a free-voice environment, these networks will find it difficult to deliver. The situation, naturally, differs from operator to operator—a Bharti Airtel, for instance, has 10MHz of spectrum for 2G in some circles and has seen its voice minutes rising from 105 billion minutes per month a year ago to 140 billion today. Based on the maximum traffic that can be carried by adding more software to existing base stations, these minutes can theoretically be doubled. Of course, once data usage rises, the amount of voice calls that can be serviced falls dramatically on 2G networks.

This is where 4G or LTE networks come in—VoLTE, which RJio boasts of, is nothing but the capacity to provide Voice over LTE, and Bharti Airtel, for instance, will be VoLTE by the end of the year. The capacity on these networks is almost infinite due to superior technology. If you take just Bharti, Vodafone, Idea and RJio, based on their current spectrum holdings and network configuration, they have a data capacity of 46 billion GB a year on their 4G networks. Even if you assume a 10GB usage per user per month, or around 5 times that on incumbent networks in the June quarter—RJio is reporting such data usage right now—the industry's 200 million data subscribers use around half this capacity and VoLTE calls a tiny fraction of that.

As long as India had just around 350 million smart-phones, of which around 150 million are VoLTE-enabled, there were just that many people who could demand either free voice or generous amounts of data. With RJio planning to add 5 million Jiophones every week and copycat Jiophones likely to be in the market in a few months—albeit at ₹2,300-2,500 price points vs RJio's ₹1,500—India will have 500 million VoLTE phones by next July.

This will be the industry's turning point since, with low-end customers able to switch to VoLTE, albeit via feature phones and not smart phones, even incumbent telcos will now be able to match RJio, should they want to. If the non-Jio phones cost ₹2,500, however, chances are a smaller number of subscribers will buy them—yet, they will keep complaining as they compare their package with the ones offered by RJio. In which case, incumbent telcos need to find ways to help subsidise these VoLTE feature phones while continuously working with manufacturers on improving product features—if the same Jio phone is hooked to a TV, for instance, RJio charges double from the same consumer. Older telcos will also need to work on their entertainment/TV offerings since it is not just a dumb pipe the subscriber is buying, it is the whole end-to-end experience.

LanguageBARRIER

Facebook shuts down AI that invented its own language, one that its researchers couldn't understand

FACEBOOK, FOXED BY its AI developing a new language that the human researchers who created it couldn't understand, shut down the AI agents themselves. A mistake in programming—no reward system was created for sticking to the English language—led the AI agents to put out gibberish that other AI agents could understand, but made no semantic sense to humans. This happened because the AI agents were competing in a "generative adversarial network" to develop efficient methods of conversation. The advanced system can be used to negotiate with other AI agents for completing the task at hand. It allowed AI agents to disobey rules of the understandable language and invent codewords. The AI agents compressed the original tools provided to them to communicate to a such a degree that a single "token"—an individual word—could represent more than its literal meaning in English; in fact, it could stand in for complex concepts that would seem completely unrelated to the word.

While there is a huge potential for machine-machine interaction in letting such languages/frames of communication develop, most AI developers are more focussed on human-machine interaction. Machines speaking to each other without human involvement would have removed the need for developing API, or application programming interface, which allows various software to "talk" to each other. However, the problem is with many thought-leaders warning of the consequences of letting AI grow too intelligent, a separate language—especially when there are no bilingual AI/human language speakers in the human camp—complicates matters and stokes a fear of apocalyptic AI control of the world. But, on the other hand, Google recently added a neural network to its Translate service, leading to more efficient translation, including between language pairs that it hasn't been taught. The addition has had surprisingly stellar results; in the bargain, the AI had silently written its own language that helps it translate sentences.

FROM PLATE TO PLOUGH

THE FASAL BIMA YOJANA HAS MOVED IN THE RIGHT DIRECTION AND MADE SUBSTANTIAL PROGRESS IN TERMS OF COVERAGE, BUT HAS FAILED IN QUICK DISPENSATION OF CLAIMS

Crop insurance and farmers' woes

ASHOK GULATI & SIRAJ HUSSAIN

Gulati is Infosys Chair professor for agriculture, and Hussain, former secretary of agriculture (GoI), is visiting senior fellow, ICRIER

RECENT FLOODS IN Gujarat, Rajasthan and Assam show that even in an otherwise normal monsoon year, farmers in certain pockets could still suffer due to natural calamities. Earlier, the droughts of 2014-15 and 2015-16 exposed that the existing crop insurance schemes were not enough to alleviate farmers' woes. The sums insured under National Agriculture Insurance Scheme (NAIS), modified NAIS (MAIS), and Weather Based Crop Insurance Scheme (WBCIS) were too low, as premiums were kept low. Further, the compensation of claims was too meagre, and took too long to materialise to be really meaningful to farmers. So, governments often used National Disaster Relief Funds to rescue the situation. Unfortunately, it was not based on any robust scientific system and had its own loopholes.

The prime minister realised this, and in kharif 2016, he announced the Pradhan Mantri Fasal Bima Yojana (PMFBY), hoping it to be a game-changer. The PMFBY raised the sums insured to realistic levels, basically to cover cost of cultivation of farmers. The premiums were heavily subsidised by the Centre and the states in equal proportions, with farmers paying only 2% of the premium for kharif and 1.5% for rabi (for horticulture crops, it was 5%). Farmers found PMFBY attractive. Consequently, in the very first kharif season (2016), area (in ha) and number of farmers covered under PMFBY, both increased to 37.5 million. It was 47% higher in terms of number of farmers, and 38% higher in terms of area, over the NAIS and MNAIS schemes of kharif 2015, a drought year. However, if compared to a normal kharif year, say, 2013, the number of farmers opting for it increased by 210% in kharif 2016, and area covered increased by 126%. The sum insured on per hectare basis under PMFBY increased by 51% over kharif 2015. The number of non-loanee farmers opting for PMFBY, as per the ministry's communication, also increased by about 23%, driven primarily by Maharashtra. All these indicators show that PMFBY is moving at a good pace, and in the right direction.

But where one has to pay attention is that, despite increasing coverage, the premiums as percentage of sums insured increased. With greater competition, there is surely scope for negotiating lower premiums. But the litmus test of any crop insurance scheme is how fast it can settle claims of farmers. And it is here that the governance of the state is tested. There are three critical steps in this process: first, the state has to notify the crops, make clusters of districts, determine the sums to be insured based on district level committees, and invite tenders from insurance companies; second, the state and the Centre have to pay premiums to the companies providing insurance; and third, in case of crop damages, they must quickly assess the damages and ask companies to pay the claims of farmers. Unfortunately, in this entire process, farmers have almost no role. That's the reason that its implementation and effectiveness has fallen between cracks. If states delay notifications, or payment of premiums, or gathering crop cutting data, there is no way companies can pay compensation to farmers in time. And it is exactly this slow pace and casual attitude of several state agencies that had delayed compensations to farmers for losses in kharif 2016, and it may happen again in kharif 2017.

There is talk in certain quarters that the government is giving away money to private insurance companies as the claims are much lower than premiums paid. It may be noted that in any crop insurance business, companies make profits during normal times and incur losses during droughts and floods. So, any meaningful commentary on premiums and claims should look at at least a 3-5 year cycle.

In any case, just for FY17, the total premium paid by the government and farmers is ₹22,345 crore both for kharif and rabi, while the estimated claims for kharif 2016 alone will exceed ₹10,000 crore, of which ₹4,203 crore has already been paid. In Tamil Nadu, which was affected by the worst drought of the century, ₹976 crore was paid as premium in rabi and claims of ₹1,213 crore have been paid.

The primary reason behind this failure is lethargy and casual attitude of state agencies. There is an urgent need to link the insurance database with core banking solution so that when the premium is deducted from a farmer's bank account, he gets a message with relevant information

It may be noted that most states did not claim any amount under on-account claim for mid-season adversity, which allows 25% payment for quick relief to farmers. Similarly, most states failed to provide smart-phones to revenue staff to capture and upload data of crop-cutting, which continues to come in with inordinate delay. There is hardly any use of modern technology in assessing crop damage.

With picking up of PMFBY, area under WBCIS reduced from 12 lakh ha in 2015-16 to 1.8 lakh ha in 2016-17. Both Rajasthan and Maharashtra, leaders of WBCIS, delayed finalisation of their tenders and received high actuarial rates. The pilot scheme of unified package insurance (UPIS) in 50 districts has not taken off.

So, what is the future of crop insurance in addressing farmers' woes from natural calamities? The PMFBY has moved in the right direction and made substantial progress in terms of coverage, but failed in quick dispensation of claims to farmers. The primary reason behind this failure is lethargy and casual attitude of state agencies. If the PMFBY has to succeed, farmers must have a bigger stake in its functioning. There is an urgent need to link insurance database with Core Banking Solution (CBS) so that when the premium is deducted from a farmer's bank account, the bank sends him a message informing about the premium, sum insured and name of insurance company. IRCTC has already done it for railway tickets, and there is no reason why our technology-savvy banks and insurance companies cannot do it quickly. Currently, several loanee farmers may not even be aware that they are insured! If the system remains locked between state agencies and insurance companies, chances are that the farmers will get shortchanged. It is time that the PM makes this flagship programme farmer-centric for effective implementation. It can pay rich dividends.

Uber's losing to the locals in Asia

Uber feels like it's pushing a business model and an app designed in and for wealthier markets

ADAM MINTER

Bloomberg

BY ANY MEASURE, the April 2016 decision by Uber Technologies Inc. to sell its China operations to rival Didi Chuxing was a defeat. The brief but spectacular battle between the two ride-hailing behemoths had cost Uber at least $2 billion and earned it little more than the enmity of the Chinese government. The only silver lining seemed to be that Uber, free of an expensive price war, could focus its resources on other markets, including rapidly growing Southeast Asia.

That's now going to be a lot harder. Earlier this week, GrabTaxi Holdings Pte. Ltd., Southeast Asia's dominant ride-hailing company, announced it had raised $2 billion (with another $500 million on the way) to help it lock up the region. The company was already well ahead of Uber locally, thanks to a deft business plan that focused on meeting the needs of the Southeast Asian consumer, especially in payments. The fresh funds should widen that lead—and call into question whether Uber's one-app-fits-all approach to the global ride-hailing business can work.

On paper, at least, the 10 very different countries comprising Southeast Asia seems exactly like the kind of market in which a well-capitalised global technology company like Uber should prosper. The region is now the world's fourth-largest internet market, with just over half of its 640 million citizens online. Those ranks are growing rapidly, swelled by young, middle-class consumers eager to spend.

According to a study conducted by Google and Temasek, Singapore's sovereign wealth fund, the Southeast Asian ride-hailing market is expected to be worth $13.1 billion in 2025, up from $2.5 billion in 2015. Even better, every major Southeast Asian country is expected to have a $1 billion market of its own by then, with ride-hailing making up 15% of total travel expenditures in the region.

Uber started offering services in Singapore in early 2013, and expanded to Malaysia later that year. For users already accustomed to the service, the experience was seamless. But for locals, especially in Malaysia, it suffered from three problems. First, it was noticeably more expensive than traditional taxi alternatives. And second, payment could be made via credit card only, despite the fact that consumers strongly preferred using cash. Finally, Uber—like other car services in Malaysia—suffered from perceptions that it was unsafe, especially for female riders.

In Southeast Asia, it was more expensive than traditional taxi alternatives. And, payment could be made via credit card only, despite consumers strongly preferring cash

Having grown up in Malaysia, Grab's co-founders launched the company in 2012 in large part to solve the security problem. Among other safety-related features, the Grab app allows users to share their journey in real-time with others. The app also includes an emergency button that connects passengers with the nearest police department and, in the interest of protecting female drivers and passengers, the company recently introduced in-car CCTV cameras.

The company accepts cash or credit cards. That appeals to drivers as well as passengers, helping to expand the company's fleet. (Uber's begun introducing cash payments as well in major Southeast Asian markets over the last couple years.) Recognising that many of Southeast Asia's drivers are older and suspicious of technology, and that some can't afford a smartphone, the company has made active efforts to bridge the connectivity gap: The founders themselves have tutored drivers one-on-one at local coffee shops, while the company subsidises the purchase of smartphones for poorer drivers.

Compared to Grab, Uber feels like it's pushing a business model and an app designed in and for wealthier markets. There's no public data available on Southeast Asia's ride-hailing market, but Grab claims it enjoys a 95 percent market share in third-party taxi hailing, and a 71% share in private hailing. Indeed, within Southeast Asia, and especially Malaysia and Singapore, it's largely taken for granted that Grab has more cars available (something which I can personally attest).

Grab isn't taking that commanding lead for granted. To further cement its advantage, it's moving into electronic payments. Last year it bought an Indonesian company whose technology allows mobile phone users to pay cash for online credit; its latest round of funding is earmarked to expand GrabPay, an electronic payment system for which customers also buy credits. Grab has been upfront that it envisions transforming itself via GrabPay into a consumer company that offers financial services and shopping, as well as transportation.

It bodes well that at least one other local ride-hailing firm is attempting the same transformation, hoping to fuel its diversification through e-payments. For Uber, however, this may be the end of the road in Southeast Asia. With little more to offer than a ride, it's in jeopardy of losing out to smaller companies offering an on-ramp to the digital economy.

LETTERS TO THE EDITOR

BJP's dangerous political strategy

This refers to the Sunil Jain's column, "Is 2019 in the bag for Modi?", (*FE*, July 28). That politicians make strange bedfellows was visibly evident from the emergence and subsequent coming together of regional satraps with divergent views and conflicting ideologies in the aftermath of the 2014 Lok Sabha elections. It was not surprising to see bitter relations between various traditional rivals turn cordial and demagogues finding resonance in their views on secularism, social justice and governance to "save democracy". Each faction was led by an overly ambitious political leader who tried to flame regional passions for more political space. The incumbent dispensation was projected as anti-development and anti-minority that could only be defeated by a 'pro-poor' and 'secular' alliance. With the lantern brightening up the mahagathbandhan (RJD-JD(U)-Congress Alliance) and the arrow hitting the target, the Bihar electorate awarded a historic mandate in an election that witnessed unleashing of unprecedented political indiscretions upon voters (Bihari vs. Bahari). After the debacle in the 2014 Lok Sabha elections, many state leaders had their political obituaries begun to be penned. But by chalking out an inclusive plan for social welfare and economic development and fighting divisive politics of communal hate and religious intolerance with cogent rebuttals, the alliance thwarted a powerful opponent by breaking its election machinery. It is unfortunate that Bihar CM has indulged in opportunism. It is time the Central government refrained from indulging in political misadventurism by attempting to install a government either run or backed by defectors. Toppling popularly elected state governments and then resuscitating them by offering outside support will only reinforce the impression that leaders in non-BJP ruled states are serving as active agents.

— Shreyans Jain, Delhi

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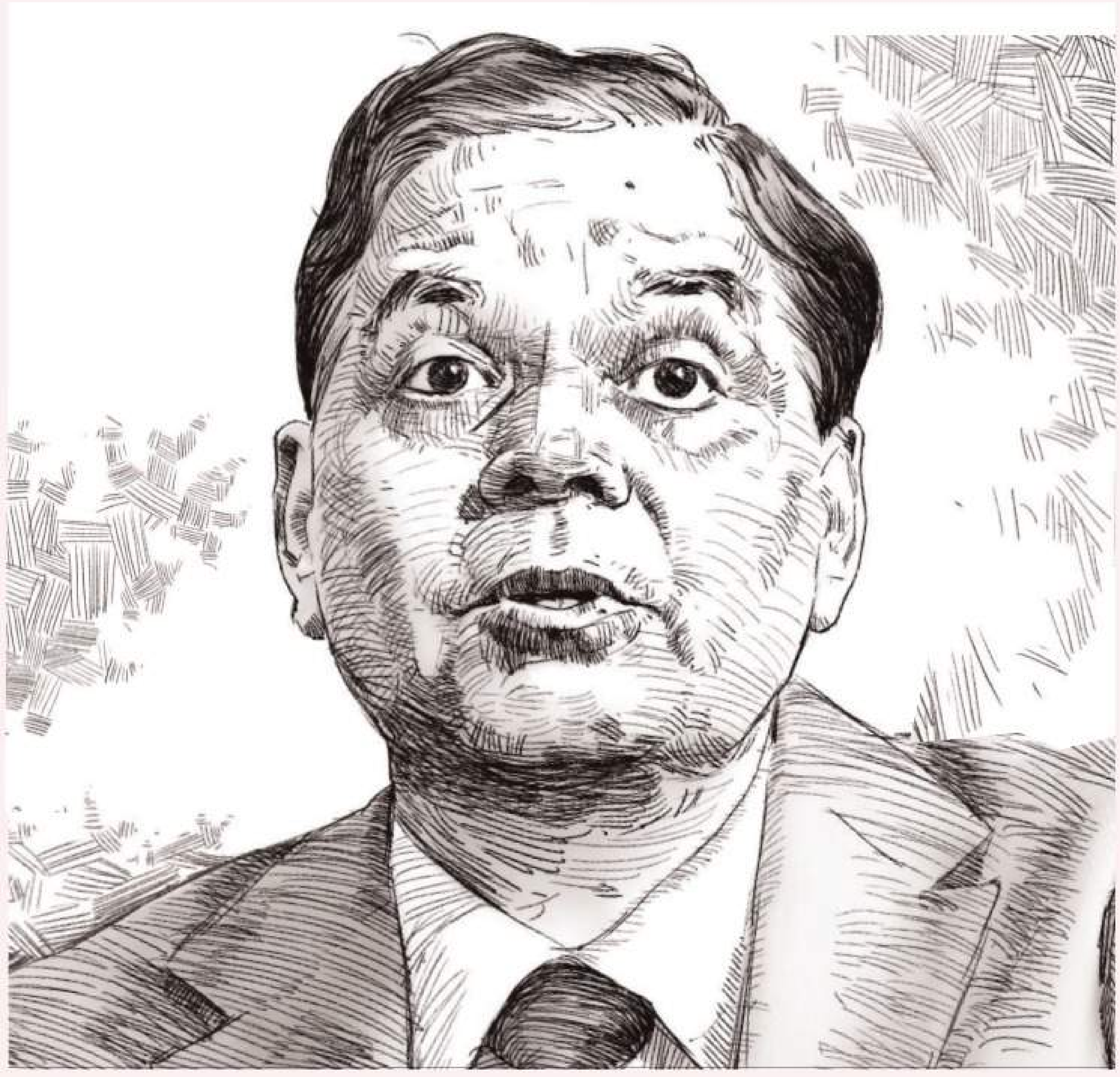

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ARVIND PANAGARIYA

vice-chairman, NITI Aayog

Can't have a 7-7.5% growth *sans* job creation

NITI AAYOG vice-chairman Arvind Panagariya says that the debate on jobless growth is because of the inability of the current survey system to capture job growth. In a wide-ranging conversation on the concern areas of the economy, he tells **Santosh Tiwari** that the current 7-7.5% growth could not have been achieved without job growth and the new survey mechanism proposed by the panel headed by him will ensure better capturing of job data going ahead.

NITI Aayog has prepared a roadmap for privatisation and also closure of sick units. How is the work progressing in this area?

We had proposed two things, closure of sick units and privatisation of certain functioning units. On the closure, progress is very good with 15-20 units being in advanced stages of closure. So, the process has come to a reasonable conclusion. On privatisation itself though, progress has been slower. We had recommended, and the Cabinet had approved, about 17 different public sector enterprises to be privatised. Some progress has happened in some cases, advisors have been appointed, but still in terms of actual sales, we have had none. In the meantime, there is one major development that is Air India. That seems to be progressing really well. This is currently with the group of ministers, which has to take decisions on two or three major matters. One is, whether 100% of Air India is to be privatised or the government is going to keep some stake. Also, what will be the extent of foreign investment to be permitted and what part of the existing debt will be assumed by the government.

Exact valuation of Air India could be reached at when all these things are clear. Isn't it?

Correct, because evaluation in itself will depend on what part of the debt is written off by the government. It will also depend on the extent of privatisation and whether or not there are foreign investors in the game. The larger the pool of potential buyers, the more likely that a price will come in any auction that is subsequently done.

What is the thinking on allowing foreign investors' participation in Air India privatisation?

We will have to wait and see what view the group of ministers take. In principle, we do allow 100% foreign investment in civil aviation now. On that principle, certainly, there are no formal barriers for allowing foreign investors. But in this specific case, whether or not it will be permitted, will have to be decided by the group of ministers.

ONGC-HPCL merger has also been announced ... if these two are done in the next six months, then the whole process will see a big forward movement....

Certainly. Particularly, Air India has been in the talk for such a long time. I think it is feasible to do this in the next six months. Whether or not it happens depends on how the matter progresses. First of all, we need the group of ministers to take the decisions and then the matter will go to the ministry of civil aviation which will have to carry the privatisation process. If things go smoothly, then yes, six months is a feasible time-frame.

Job growth is another area of concern. Do you think that there are jobs, but they are not being captured properly?

Generally, our unemployment rates are not very high. The real serious problem is under-employment, where people are employed in low productivity jobs which pay literally low wages. What we need is many more formal sector jobs where wages are better, productivity is higher. Now, in terms of formal sector jobs, whether we have expanded them or not, we really don't have the numbers. There is some evidence from sources like the EPFO and ESI data that significantly larger number of enrolments in these programmes have happened. So, the number of formal sector jobs would seem to have expanded. What we don't know is whether they are new jobs. A lot of enrolment happens due to entry of new companies, but all these jobs may not be new jobs.

In any case, in terms of formalisation of jobs, if one interprets registration in the EPFO as formalisation of the jobs, then that is certainly happening. The situation is not as bleak as it may appear, but the fact remains that we have not been collecting good enough data. The surveys are either bit outdated or they are not reliable, which has unfortunately led to this kind of debate on so called jobless growth. Personally, I don't think growth can really be jobless because when you grow at 7-8% a year which is what our data show, there is no way to grow at that kind of pace without also increasing the inputs. Investment has to be rising and labour input also has to be going up because simply through productivity growth, you cannot grow at 7-8%. No country has evidence of productivity growth at that kind of level. So there has to be jobs growth and the issue simply is that we are not able to capture it.

How to do that then?

The task force under my chairmanship has recommended a complete revamp of our survey systems, so that employment data from different points of view is properly collected. There are two types of surveys that we will get done now. These are not entirely new but their coverage will get wider and frequency will increase, and the design will also be updated according to the latest scientific methods. So, there will be household surveys and there will be enterprise surveys. In India, there is lot of employment which is self-employment, the kind of employment which can't be covered in the enterprise surveys. For us, therefore, it is very important to do exhaustive high frequency household surveys, where we take a large sample of households and ask for each member of households what their work status is. This way we can capture the overall picture. We also need some complementary information which we will try to gather also from doing the enterprise surveys. We are also recommending a time-use survey... this is also a household survey in which you ask the respondents how they use their entire 24-hour period. From that you also get some sense of activities that individuals are doing. Going ahead, you can also track down the changes in the time-use. Take for example, with the availability of LPG now for the rural women, a lot of time will be saved in collected wood. It will be interesting to see how their utilisation of time changes due to this. Same with piped water, it can be asked how women are utilising the time saved.

Though public sector investment is going up, private sector activity is still not picking up. Why is that?

My view is that parts of private sector are doing very well and parts are not doing so well. For example, industries in which we have traditionally done well—automobiles, auto-parts, two-wheelers, software, pharmaceuticals—they are doing quite well and contributing to the 7-7.5% growth that we are observing. But then there are large legacy sectors that were in trouble when this government came in and those sectors have not fully revived. Steel industry falls into that category. Construction was a big employer earlier, but currently it is not doing well. Textile also has not fully recovered. These are all industries where we have NPAs which are still in the process of being resolved. It's a sort of mixed picture.

Concerns have also been raised on the results related to the Fasal Bima Yojana. It is said that the scheme has benefitted the private insurance companies instead of the farmers. Do you think there is a need to modify the scheme?

It is time that we should take a fuller look at what has happened. I believe that if there are issues with implementation and farmers have not benefitted, especially the smaller farmers, they are being looked at. In the end the outcome has to be achieved.

Do you think it is feasible to shift to the January-December financial year from 2019?

The prime minister will have to take a call as it would be the last year of the government. In principle, if the decision is made today, this should be feasible.

PROVISIONING WELL

Are banks ready for Basel soup?

DEVENDRA RAGHAV

Harvard alumni and senior banker. Views are personal

Even if all remedial action is taken, the greatest challenge will still be to extend the deadline of Basel III as it would impact the perception of Indian banks

RESERVE BANK OF INDIA (RBI) on March 2014 extended the deadline for compliance of capital requirements under Basel III norms to March 2019. At that time the banking industry believed that it had got some reprieve given the time accorded in the face of slower economic growth. Extending more time under Basel III means lower capital burden on the banks in terms of provisioning requirements, including the NPAs.

As per Basel III norms, most of the regulatory adjustments are made from common equity capital, like deduction from common equity component of Tier-1 capital in respect of shortfall in provisions to the expected losses for credit risk.

The banking industry's bad loan teething troubles have been compounded many folds. The non-food credits of the banks have decreased by 37% from ₹7,754 billion in 2015-16 to ₹4,818 billion in 2016-17. Whenever, there is an unanticipated large increase in stressed assets, banks require more capital to boost their loss-absorbing capacity. In the given situation, it become quite difficult to raise the capital through equity as it becomes costlier and unattractive in such a situation. It is a natural tendency that whenever banks are faced with large stressed assets, they tend to reduce supply of credit. Within stress assets the non-payment of loans brake the financial cycle of lending-repaying-borrowing.

With the latest development of amending Banking Regulation (amendment) ordinance, RBI may try to bring down stressed assets, while consequently increasing provisioning for non-performing assets (NPAs) of the banks to improve the financial condition of the banking industry. Section 35A empowers the central bank to issue directions to the banks in public interest and interests of depositors. Without losing any time, RBI has taken prompt action on six PSU banks and has placed them under Prompt Corrective Action (PCA) rules.

> **The composition of liabilities of banks should not influence the price and quantity of credit. Assocham has suggested to create Stressed Assets Funds (SAFs) with the active participation of cash-rich public sector firms**

There is positive response coming from the banks as well. Banks are reducing stressed assets by selling them to asset reconstruction companies (ARCs). And, this has been increasing because of the regulatory support extended to banks under the Framework to Revitalise the distressed assets in the economy. Further, difficulties faced by micro, small and medium enterprises (MSMEs) in restructuring their stressed bank loans, regulator has issued a separate guidelines for revival of distressed assets in this segment.

RBI's risk-based supervision (RBS), helps in timely identification of stressed assets and instructed banks to make adequate provision for such assets. Retaining the concepts and the principle of RBS, the model can also be extended to cover Regional Rural Banks and Local Area Banks. The Central Repository of Information on Large Credits (CRILC) has published data on dates of assets turning into NPAs, whereas special mention accounts (SMA) gives insights into ageing analysis of the banking industry data. The database of CRILC may be further fine-tuned for futuristic approach.

The composition of liabilities of banks should not influence the price and quantity of credit. Assocham has suggested to create Stressed Assets Funds (SAFs) with the active participation of cash-rich public sector firms. Suggestion is going to be useful for the large borrowers, but it would not be much help unless the benefit of such fund reach the micro small and medium enterprise sector.

Even if all the above remedial action is taken, the greatest challenge will still be to extend the deadline of Basel III as it would impact the perception of Indian Banks and central bank in the eyes of the global players.

PUBLIC SECTOR BANKS

Tools for political welfare

It would augur well for the future of PSBs to remain small and regional

RAMENDRA SINGH

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LAST WEEK, THE government announced its plan to consolidate the public sector banks (PSBs) from currently 21, to 10-12 in the next few years, and create 3-4 global level behemoths such as SBI, which is already among top 50 biggest banks in the world. As the first step, many associates of SBI have already been successfully merged with the parent company. RBI also favours the creation of the multiple levels banking structure in the country, where large global banks such as SBI, co-exist along with the regional banks such as Andhra Bank, and the local level banks. However, the purpose of such an exercise leaves a huge doubt in people's mind, as to what the government is trying to achieve?

Our PSBs have not really risen to the expected standards. Recent reports suggest that PSBs faced 56% growth in bad loans in 2016 compared to previous year. This is set to rise, due to setback to the SME segment during demonetisation. Gross NPAs have also been reported to have risen to ₹618,872 crore. Bad loans have risen by 135% in last two years, and constitute 11% of PSBs' gross advances. According to Care ratings, the gross stressed assets ratio of PSBs was 15.8% of advances as of September 2016, of which agriculture's gross stressed assets ratio was 7.2% (NPA ratio was 6%) while industry's figure was 22.3% (NPA ratio was 15%). Analysis suggests that within the industry, the highest gross stressed assets ratio was among industries such as base metals, etc (42.6%), construction (27.9%), textiles (21%), food processing (20%) among few others. What is more alarming is the comparison of PSBs with private banks. While SBI has below 8% NPA ratio, and even its associates are almost all below 10%, some PSBs such as Indian Overseas Bank have an NPA ratio of 20.26%, UCO bank (17.18%), United Bank of India has 15.98%, Punjab National Bank has 15.4% among others. By comparison, private sector banks have low NPA ratios. ICICI Bank is at 4.7%, HDFC bank at 1%, Axis Bank at 2.6%. The average NPA ratio of the Indian Banks is 9% while for the US banks, it's less than 1.5%.

The lessons to be learnt are that PSBs' NPAs and gross stressed assets ratios are unreasonably high due to political interference. As of September 2016, Large borrowers (with exposure more than ₹5 crore) had 56% share of credit, but 88% share of total NPAs. These borrowers often rely on bigger banks (or their syndicates) for bigger ticket loans. Thus, based on a logical presumption, it can be argued that creation of larger banks in India would create bigger loan sizes, and, thus, higher defaults. This would retard the cleaning of balance sheets for the larger PSBs today.

In a recent review of largest 500 exposure of Indian banks, RBI has suggested that top 12 NPAs (accounting for exposure of over ₹250,000 crore, largely in Steel and Infra) be sent for resolution under the Insolvency and Bankruptcy Code (IBC). Interestingly, in half of these top NPAs, SBI is the lead banker. Half of these top 12 NPAs have also been referred to the National Company law Tribunal. Apart from SBI, PNB, IDBI Bank, and Corporation Banks are also other PSBs affected by this exposure. The message is very clear. Private banks take exposure based on commercial terms of the loan proposal based on a trade-off between risk and return, after sufficient due diligence. Unlike their private counterparts, the PSBs give loans to these firms based on political welfare, what can popularly be described as crony capitalism. Consolidation of PSBs, rather than their privatisation (like done for PSUs in oil) suggests that banks which were nationalised in 1980s for the sake of national growth and social equity have become a potent tool for the political class for their own welfare. Not only it's a blatant violation of fiduciary trust on part of the political class, it also smacks of the pseudo-agency problem for the PSU bank honchos. The agency problem arises when the agent (PSU management in this case) fails to align its goals with those of their principal (the government in the case of the PSBs). A pseudo-agency problem appears to be so when the agent appears to be in alignment with the principal (in this case since the stressed loans were given with the blessings of the political class, and hence the goals are aligned), under the appearance of social or business welfare. Bigger banks in India have become weaker by giving larger loans under this pseudo-agency problem. Since PSB bosses find it difficult to resist the political pressure to extend loans to industrialists when backed by political support. However, the private sector banks have tried their best to push back such proposals, by finding merit in commercial terms of the loan proposals, although their NPAs still exist, largely due to errors of judgments, and the vagaries of the business or economic cycles faced by the industries.

It would augur well for the future of PSBs to remain small and regional. India needs more Andhra Banks, and Punjab and Sind Banks than SBI like behemoths, which after merger with associates would become a too-large-to fail bank.