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MANY MORE BANKS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

India has no balance of payments problem. Nor is it constrained any longer by endemic shortages of food, fuel and other essential raw materials. Even government finances are on the mend, with the goods and services tax regime stabilising and the worst of the COVID lockdown-induced revenue shortfalls over. But there is one unresolved crisis — of a broken banking system — that can hold back economic growth. Public sector banks (PSBs), in the last five years, have seen their share in total advances and deposits fall from 74-76 per cent to 60-65 per cent. But these are still far too high and also worrying, given the accumulation of bad loans, both past and prospective. The Centre cannot keep recapitalising PSBs. While there are well-run private sector banks, they cannot pick up the slack from the vastly reduced lending capacity of PSBs.

The solution is simple: India today needs more banks. It is in this context that the recommendation by a Reserve Bank of India (RBI)-appointed internal working group to allow non-banking financial companies (NBFC) with asset size of Rs 50,000 crore or more to convert to banks, is welcome. Such NBFCs could include those controlled by large corporate houses, subject to their having a minimum of 10 years of successful operations and the promoters being “fit and proper”. If the panel’s suggestions are accepted, many NBFCs — like Bajaj Finserv, Aditya Birla Capital, L&T Finance, M&M Financial Services and Cholamandalam Investment & Finance — would qualify. Their lending books are already bigger than many banks. The integrity and reputation of the promoters in these cases, too, isn’t under question. If becoming banks gives them greater access to low-cost public deposits and thereby enables more lending, that is good for the economy’s growing credit requirement.

Converting established NBFCs into banks is different from permitting large corporate/industrial houses in general to set up banks. The RBI panel has rightly adopted a cautious approach in this regard. Banking as a business involves deploying others’ money. India’s past history is replete with instances of business houses using banks as captive fund pools for financing other group entities and related parties. Licences should, hence, be issued selectively and preference given to those with a proven track record in running NBFCs as independent, arm’s-length businesses. Banking regulations should ensure adequate safeguards against “connected lending”, though one mustn’t forget that recent scams have been more about PSBs and so-called professional-promoted entities (Yes Bank and Global Trust Bank). The need for better supervision mechanisms is as urgent as the need for more banks, small and big.

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