

Rs. 4.5 lakh Cr. lending opportunity for NBFCs and private sector banks

**Mid-Corporates and MSMEs scouring for new lenders post PCA in PSBs;
PSBs need to be strengthened to sustain economic momentum**

Indian economy has shown strong signs of recovery subsequent to the impact of demonetisation and GST implementation. The key to acceleration in the growth momentum is availability of adequate credit, especially to mid-corporates and MSMEs. Acuite Ratings' study indicates that mid-corporates and MSMEs will need to mobilise around Rs. 6 lakh Cr. of additional debt over the next two years to meet their increased working capital and capital expenditure requirements. However, the erstwhile lending engine to this segment, public sector banks (PSBs), have limited ability to meet such requirements given the prompt corrective action (PCA) status of a majority, priority given on stressed asset recoveries and their weak capital position. In the opinion of Acuite, non-banking financial companies (NBFCs) and private sector banks have a significant opportunity to scale up their business by Rs. 4.5 lakh Cr. in the mid corporate and MSME space over the next 2 years. However, this may still not be enough to meet the increasing credit demand and therefore, Acuite believes there is a need to revive fresh lending by PSBs to these segments within a specific policy framework.

The advances growth of PSBs are likely to remain modest in 2018-19 and 2019-20 given the continuing challenges in asset quality, provisioning requirements and capitalisation. As on date, 11 PSBs have already been placed under PCA, resulting in deceleration in their loan book growth. For these 11 banks, overall loan book has de-grown by around 3.3% in 2017-18 on the back of a de-growth of 3.6% in the previous year, primarily due to slowdown in lending to MSMEs and mid-corporates. While more strictures are being placed on existing PSBs under PCA, few more large PSBs may be placed under PCA shortly. This may result in no net increase in PSBs' lending to the mid-corporate and SME segments over the next two years, as the growth in lending by PSBs outside the PCA framework will be offset by the de-growth in lending by the PSBs under PCA.

Says Sankar Chakraborti, CEO, Acuite Ratings "We believe that such slowdown in lending by PSBs will lead to a huge opportunity build-up of nearly Rs 4.5 lakh Cr. for other lenders, especially NBFCs and private sector banks (including small finance banks) over 2018-2020." NBFCs have already witnessed a growth of 24% in their AUMs over the last 2 years, reflecting the emerging opportunity. While large and established NBFCs are expected to continue their growth trajectory driven by the opportunity in the retail and MSME space, there will also be strong growth prospects

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for wholesale focused NBFCs including the new entrants, to grow their lending book. Most of them are strongly capitalised and many have also raised capital from the equity markets in recent times. **Hence, adds Mr. Chakraborti “NBFCs’ lending to mid-corporate and SME segment is expected to grow at a compound annual growth rate (CAGR) of 25% over the next two years.”** Private sector banks are also expected to tap this business opportunity selectively and are likely to lend only to borrowers which meet their risk profile requirements.

As NBFCs and private sector banks grab this opportunity, mid-corporates and MSMEs will be able to meet a substantial part of their funding requirements over the medium term with an increase of 100-150 basis points in their cost of funds. **Nevertheless, says Suman Chowdhury, President, Acuite Ratings, “A sizeable funding demand of around Rs. 1.0-1.5 lakh Cr. may remain unmet. Therefore, PSBs need to be revitalised and permitted a lending window to mid-corporates and MSMEs to ensure economy’s growth momentum is not impacted.”** A suitable policy framework can be put in place for PSBs under PCA framework to take additional exposures up to a certain limit per borrower, subject to their lending track record in mid-corporate and MSMEs. PSBs need to be incentivised to build their skill sets in MSME lending given their reach in specific clusters and geographies. This will not only enable them to support the funding needs of the economy but also better identify the sector specific or geography specific risks and price it appropriately in their lending rates. This will also result in better granularity in the banks’ lending portfolio and thus reduce portfolio concentration, which has been historically driven by large corporate exposures. The rationale for reviving such lending by PSBs is further reinforced by the fact that SME segment has historically witnessed better asset quality as compared to the large corporate segment.

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