Co-lending: Another bonanza for private capital*

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In early December, the State Bank of India (SBI), which dominates the country's banking sector announced that it had entered into a partnership with Adani Capital, a private sector non-bank finance company (NBFC). The aim was to engage in "co-lending" to farmers to help them buy tractors and farm implements, and in the process increase efficiency in farm operations and raise productivity in farming.

The announcement surprised many and angered quite a few. That response was partly influenced by the perception that the Adani group, being close to the current government, was receiving favourable treat ment in multiple are, that facilitated its rapid climb to corporate dominance. The deal with SBI was seen to be another instance where a public sector financial behemoth was being leveraged to promote the interests of that private group.

As a group Adani is now without doubt a large business house, but Adani Capital is a pygmy when compared with SBI. The latter operates through more than 22,000 branches across the country and provides customers access to more than 64,000 automated teller machines (ATMs) and close to more than 70,000 business correspondents (BCs). These BCs can be upgraded to minor branches if opportunities to increase lending to farmers warrant that. Such actions can achieve far more than the 60-odd branches of Adani Capital can contribute. In terms of assets, SBI can boast of Rs. 48 lakh crore as compared with Adani Capital's Rs.13,000 crore.

SBI's claim, however, is that the partnership will help it "expand customer base as well as connect with the underserved farming segment of the country and further contribute towards growth of India's farm economy." And the chief executive of Adani Capital claims that the company's "aim is to make economical credit available to the micro-entrepreneurs of India", by targeting unbanked and underserved farmers. Such claims do not convince. SBI holds around 1.4 crore farmers credit accounts with outstanding credit of close to Rs. 200,000 crore. Adani Capital has a small customer base of around 28,000 with an outstanding loan book of Rs. 1,300 crore. There is no way Adani Capital can make a difference to SBI's rural credit exposure, let alone contribute significantly to raising farm productivity by disbursing credit.

While the Adani group's record has brought the SBI-Adani Capital agreement into the spotlight, the latter is part of a more general scheme to promote partnerships between banks—primarily large public sector banks—and much smaller private NBFCs formulated by the Reserve Bank of India. Initially launched in September 2018 in the form of a public-private partnership scheme in the financial space to "co-originate" loans for the priority sector, this was converted into a "co-lending" arrangement in November 2020 "to provide greater operational flexibility to the lending institutions". Following this, such agreements have been signed by banks other than SBI, such as that between Punjab National Bank, Central Bank of India and IIFL Home Finance, Bank of India and MAS Financial Services, Bank of Baroda and U GRO Capital and Union Bank of India and Capri Global Capital. The last of these hopes to "enhance last-mile finance and drive financial inclusion to MSMEs by offering secured loans between Rs 10 lakh to Rs 100 lakh". SBI too has said that it is looking to increase the number of co-lending agreements with NBFCs in a range of 'priority' areas.

Despite this balance of advantage, the co-lending scheme is loaded in favour of Adani Capital. While the NBFC would be the “single point of interface for the customers and shall enter into a loan agreement with the borrower”, subject to the terms agreed between the colenders, it would have to outlay only a minimum of 20 per cent of the loan amount, with the SBI providing the rest. That is, the NBFC chooses the borrower and finalises the loan, but carries just 20 per cent of the risk. Thus, the NBFC can spread its own capital across a much larger number of loans, reducing its own overall exposure to risk much more than the 20 per cent share in each loan ensures.

Moreover, the interest rate charged and returns earned by banks and the NBFC is expected to be different in these financial partnerships for a number of reasons. First, the benchmark interest rate based on which the final lending rate is fixed is set lower for bank than for the NBFC. An example provided in the RBI circular detailing the 2018 loan co-origination scheme, which was a precursor to the co-lending scheme, placed these at 8 per cent for the bank and 9 per cent for the NBFC. Second, the spread envisaged is lower for the bank than for the NBFC (2 and 3 per cent in the circular). Based on these rates, a weighted average interest rate is calculated, which is significantly lower than the rate being charged by the NBFC on its share of the loan, since funds from the bank constitute the dominant share of the loan. Thus in the example provided in the circular, the interest rate being charged by the NBFC is 12 per cent, but the interest rate paid by the borrower on the loan is only 10.4 per cent.

The Reserve Bank of India, in a note to its computation makes clear that the example is only illustrative and not mandatory. The actual difference in rates charged by the bank and the NBFC would be based on negotiation, and given the structure of the scheme is likely to be tilted hugely in favour of the NBFC. The guidelines on the co-lending arrangement from the RBI specify that “the ultimate borrower may be charged an all-inclusive interest rate as may be agreed upon by both the lenders conforming to the extant guidelines applicable to both.” The lower interest rate on loans to which the NBFC is exposed, resulting from the co-lending arrangement, would not only allow it to cover a larger set of potential borrowers, but shut out competition from public sector banks that would also carry a large share of the risk.

Such schemes facilitate the back door entry of business groups into banking. Having been banished from the banking space by nationalisation, big business houses have been looking to re-enter the sector in a policy environment that has consistently pushed liberalisation. But, even though the RBI has accepted in principle that corporate houses should be allowed to apply for banking licences, it has not granted them in practice. Uncertainty over the consequences have held back the central bank. And a reticence to accept stringent conditions that would “ring-fence” the banking activities of corporates once they gain entry have discouraged the latter. This explains the effort at back-door entry. There have been other examples, such as the use of say the Payments Bank route to enter the periphery of the banking space and then seek a tie up with a big public bank to enlarge footprint. Thus Mukesh Ambani’s Reliance group, permitted by liberalised rules to set up Jio Payments Bank, forged a tie up with SBI, with the latter acquiring a 30 per cent shareholding in the payments bank. This too was surprising since Payments Banks are meant to independently supplement the activities of normal commercial banks to advance financial inclusion of underbanked segments. But by forging an alliance, Jio Bank was clearly attempting to exploit SBI’s national presence and image to enhance its own credibility. In that case too, SBI’s claim that it would benefit from Reliance’s telecommunications network to enhance its digital presence was not convincing.

From the point of view of the private sector, especially the business houses, these developments are of significance. Prior to nationalisation, the presence of private capital in banking meant that private players had a role in influencing the allocation of national savings deposited in the commercial banking system. There was enough evidence that this control over national savings was used to serve the interests of the corporate sector, at the expense of provision of credit to sectors like agriculture and small and medium scale industries. Nationalisation shifted control of national savings out of private hands to those of the government, which did result in greater credit provision and better distribution of that credit across sectors and segments of the population. But it also eroded the financial power that banking presence provided the corporate sector.

In the first wave of liberalisation, India’s private sector did contemplate recovering its control over national savings. But, three decades after the first Narasimham committee made a case for returning control to the private sector, movement in that direction remains limited for reasons cited earlier. Policy reversal has proved difficult and private players have failed to outcompete public banks. While the project of privatising public banks is still on the anvil, a less risky and more lucrative option seems to be to share control as junior partner with the public sector and serve as its “implementing arm” in specific areas. The ‘co-lending’ scheme seems geared to do that, providing room for private profit with a small capital outlay and without much risk. As is the case with all public-private partnerships under capitalism, the public sector will bear the risk while the private sector will share the rewards generated largely by the investment of public capital. The claim that those rewards are for the unique services rendered by private capital is nothing but an effort at whitewashing a surplus transfer from the state to the private sector.

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