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Bank balance sheet recovery

Asset quality is improving, but risks remain

Asset quality in the banking system continues to improve. As the latest Report on Trend and Progress of Banking in India, by the Reserve Bank of India (RBI), showed, the gross non-performing assets (GNPAs) ratio in scheduled commercial banks declined from 8.2 per cent in March 2020 to 7.3 per cent in March 2021. According to the RBI's estimates, the ratio is expected to have declined to 6.9 per cent by end-September 2021. The financial results declared by banks for the December 2021 quarter suggest that the banking sector balance sheet continues to improve. As a report in this newspaper showed on Wednesday, 28 listed banks reported a year-on-year increase in net profit of 64.1 per cent. Profits went up by 21.5 per cent sequentially.

The sharp jump in profits is largely on account of a fall in provisions and contingencies. GNPAs for these banks declined by 3.5 per cent sequentially. Net interest income, meanwhile, improved by about 10 per cent year-on-year. Continued improvement in the banking sector should help boost confidence as it reduces growth and financial stability risks. With the ongoing deleveraging in the corporate sector, India would be well-positioned to invest as the economy recovers. The government is also pushing up capital expenditure in the hope that it will crowd in private investment over time. However, this might take some time as capacity utilisation is still low and the medium-term outlook remains uncertain.

Although credit growth has improved from a very low base, it is being led by the retail segment. Also, as highlighted by the RBI, credit is not flowing to lower-rated firms. At a broader level, although the banking balance sheet is improving, risks remain. For instance, as the support extended to borrowers is withdrawn, provisioning may have to be increased. Profitability may be hit in the coming quarters because of increasing market interest rates. The value of bond holdings by banks may suffer. Also, it's worth highlighting that a large part of the clean-up in the banking system has happened because of write-offs. This should certainly not be the preferred way as it would require consistent capital infusion. The government, for instance, has infused about ₹3.5 trillion into public sector banks (PSBs) since 2014.

As asset quality gets better, bank managements must focus on improving lending standards. This is critical, particularly in PSBs, to avoid recurrence of asset quality problems as and when investment revives. Further, the government must strengthen the system for the Insolvency and Bankruptcy Code with the objective of resolving stressed assets in the given time frame. As reported in these pages, compared to the requirement of about 360 members, the National Company Law Tribunal has 63 members. The government must provide the required human resources to the tribunal and facilitate a quick resolution of cases. This will not only help banks but make capital more efficient, in general, and push growth. The government has also set up an alternative mechanism through an asset reconstruction company to resolve stressed assets. However, it remains to be seen how effectively it addresses the issue. As things stand today, the IBC is the best way to resolve bad loans. Thus, the framework must be strengthened.

Defending a global brand

Hyundai flap has lessons for other MNCs

It is not often that a social media post by a provincial car distributor leads to a conversation between two foreign ministers —but that is just what has happened following a message on social media from a Pakistani vendor of Hyundai cars that expressed support for Kashmiri separatists. Following a firestorm on Indian social media, the South Korean foreign minister spoke to his Indian counterpart to express his regrets. Whether social media posts of this sort should eventually be raised to the level of external affairs ministries is one question. But the other question is how transnational companies, like Hyundai, can effectively manage their operations at a time of increasing geopolitical tension. Hyundai India issued a statement dissociating itself from the post by the Hyundai distributor in Pakistan. This did not noticeably calm tensions, nor was it likely to. It is true that Hyundai's sales in India are unlikely to suffer any lasting damage. But the fact remains that a build-up of such incidents is not good for a brand's image and shifts companies into fire-fighting mode. Multinationals which face significant domestic competition —like a South Korean carmaker in India — will find themselves particularly disadvantaged in that they will fear some offended potential customers will switch to locally-made alternatives.

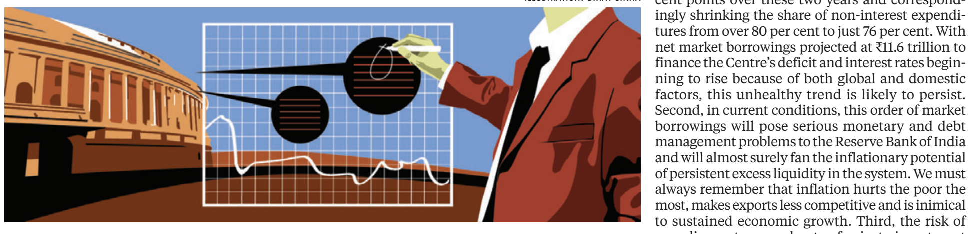
Certainly, companies must carefully manage their brand names and their presence on social media in different geographies. There is no reason why the "Hyundai" name should have been used by a distributor in Pakistan rather than by the national office of the carmaker in that country, which would presumably have had a much more careful approach. It is also true that many transnational companies do not have clear social media policies warning their employees to take into account the effect of their posts on other markets. After all, the global public square is much smaller than it was. Posts made by Pakistani accounts are visible in India and vice versa. Companies that have a presence in multiple countries with outstanding geopolitical issues between them must be especially careful. Tighter control over the ecosystem that is associated with a brand is essential to preserve that brand's integrity and marketability.

In the end, there will be costs to companies from kowtowing too much to such voices, as well. Indian social media may be dominated by hyper-nationalist narratives, but social media in the People's Republic of China — carefully controlled by the government — is even more nationalist. And it is certainly many times more lucrative than the Indian market, and thus losing it is a risk that few companies are willing to take. Brands and multinationals over the past years have grown to understand and fear the response of Weibo and other mainland social media networks to products and advertising campaigns. But this sensitivity is itself causing a backlash. Companies that bend over too far — such as the film studio that removed a Taiwanese flag from a flight jacket in the *Top Gun* sequel —may find themselves the subject of harsh scrutiny in their home markets in the West. For now, it may be possible to seek to stay above the fray, as Hyundai should essentially have managed in this particular controversy. Yet that may not always be possible in the future

Budget 2022: Some musings

The worrisome issue of fiscal consolidation remains a major concern

ILLUSTRATION: BINAY SINHA



A week after the Union Budget, pretty much every worthwhile comment (and many not so worthwhile ones!) has been made in all forms of media. However, as a regular columnist, one feels obliged to declare one's hand. So here goes.

First, it is important to recognise that the finance minister (FM) and her team were charged with making a Budget in an extremely challenging economic situation. The economy had been hammered by the Covid pandemic and the strong initial lockdown in spring 2020, and although the output recovery since then had been quite good, it had been buffeted by the second and third waves of April-June 2021 (Delta) and December-January of 2021/22 (Omicron), respectively. Furthermore, substantial scarring damage persisted in the form of record fiscal deficits and unprecedented debt-GDP ratios, high unemployment and underemployment (especially in the numerically dominant informal sector), stagnant aggregate consumption levels, stalled private investment and an uncertain global economic environment. Aside from the strength of the formal sector output recovery, the rebound in exports and imports was a redeeming feature.

A PIECE OF MY MIND

SHANKAR ACHARYA

Against this background, I had hoped for a significant fiscal consolidation (perhaps close to a per cent of GDP), the continuation of FM's refreshingly commendable commitment to transparency and proper accounting of budget numbers, continuation of various special programmes to help the most badly hit sections of society (including informal sector workers and micro, small and medium enterprises), a significant, sustainable effort to raise the Centre's gross tax ratio (stuck at 10-11 per cent of GDP for many years) through possible new taxes on the very rich (such as on capital gains, inheritance and wealth) as the only durable solution to our record deficit/debt problems, and significant trade policy reforms to consolidate and strengthen the rebound in foreign trade, especially in our long-stagnating merchandise exports.

As usual, some of my hopes were met and others belied. The Budget does promise a modest fiscal consolidation of 0.5 per cent of GDP, down to 6.4 per cent from the Revised Estimate (RE) of 6.9 per cent. Nirmala Sitharaman's commitment to transparency in presenting the budget numbers has continued, including in the detailed presentation of the cleaning up of the Customs tariff schedule in the explanatory memorandum to the Finance Bill, although one misses the summary table of changes in effective Customs duty rates appended to each of her three previous Budget speeches. So has her commendable penchant for conservative fiscal projections of revenue and expenditure. The special programmes to assist the pandemic-afflicted sections of the population have also been broadly maintained.

However, there are no new taxes on the super-rich or any other significant tax-raising measures, apparently in consonance with prime ministerial guidance. Nor are there any marked reductions in our heightened protective Customs duty structure, which militates against sustained growth of exports and successful global value chain participation. On the other hand, there is a major expansion of capital expenditure, especially on basic infrastructure, which should impart significant multiplier demands for materials and labour and help strengthen the economy's medium-term growth potential.

Let me revert to the worrisome issue of fiscal consolidation. This Budget has been framed against the background of persistence, over three years, of record high fiscal deficits with the combined (Centre plus states) deficit over 13 per cent of GDP in 2020/21, about 11 per cent in 2021/22 and projected at over 10 per cent in 2022/23, and record government debt ratios around 85-90 per cent of GDP. The adverse consequences are beginning to manifest. First, interest payments of the Centre have jumped by nearly 40 per cent between 2020/21 and 2022/23, raising their share in total expenditure by a record 4.4 per cent points over these two years and correspondingly shrinking the share of non-interest expenditures from over 80 per cent to just 76 per cent. With net market borrowings projected at ₹11.6 trillion to finance the Centre's deficit and interest rates beginning to rise because of both global and domestic factors, this unhealthy trend is likely to persist. Second, in current conditions, this order of market borrowings will pose serious monetary and debt management problems to the Reserve Bank of India and will almost surely fan the inflationary potential of persistent excess liquidity in the system. We must always remember that inflation hurts the poor the most, makes exports less competitive and is inimical to sustained economic growth. Third, the risk of crowding out green shoots of private investment revival is not a chimera.

However, there may be a silver lining. Just possibly, the FM's welcome conservatism in estimating revenues and expenditures may have exaggerated the deficit-debt challenges a little. First, based on published trends up through December 2021, the REs for revenues may be underestimates and those for expenditures may be overestimates, thus possibly yielding a sizable government cash balance by end March, which could significantly reduce the scale of market borrowings in 2022/23. Second, the Budget's projection of nominal GDP growth of 11 per cent in 2022/23 sits awkwardly with the Economic Survey's expectation of 8-8.5 per cent real growth, as it would imply a GDP deflator increase of only 3 per cent or less, very different from the 8.4 per cent estimated by the National Statistical Office in its Advanced Estimates of National Income for 2021/22. Bearing in mind the "low base effects" because of Delta and Omicron in the several months of 2021/22, real GDP growth in 2022/23 could be around 7 per cent or so. Furthermore, the GDP deflator is likely to be in the 6-7 per cent range. Together, this suggests that nominal GDP growth in 2022/23 could well be around 13-14 per cent. Assuming a reasonable tax revenue elasticity of unity, net taxes of the Centre could then be around ₹0.7 trillion higher than estimated. Allowing for some under-budgeting of expenditures for subsidies and MNREGA and over-budgeting of capital expenditures, it is possible that, other things equal, deficits and market borrowing requirements might be ₹0.5 trillion less. Adding a couple of trillion rupees of possible underestimated cash balances, noted above, we might well see market borrowings ₹2-3 trillion less than projected.

All this would certainly help. But let us remember that Budget Estimates are just that, and they can go awry for all sorts of reasons, including unforeseen domestic or international shocks. The basic moral of the story is simple: Macroeconomic management is usually a lot more comfortable with lower fiscal deficits. The sooner we get there, the better for the economy.

The writer is Honorary Professor at ICRIER and former Chief Economic Adviser to the Government of India. Views are personal

The limits of compassionate capital

Consider two news items in the first three days of this week. The first was that loss-making renewable energy company Suzlon Energy has asked the state-owned Power Finance Corporation for a ₹4,200 crore bailout. The other was that the fossil fuel giant BP reported its highest profit in eight years.

The contrast between Suzlon's crisis and BP's good fortunes are telling. One has seen losses swell from cumulative operational problems — soaring raw material costs, a glut of projects and tariff pressures on wind power. BP, on the other hand, is riding on buoyant oil and gas prices spurred by a geopolitical crisis in the Ukraine.

Suzlon was a poster boy of the early trend of investing on ESG, or Environmental, Social and Governance, metrics. Its failure highlights the risks associated with ESG investing, which has gained momentum after the Paris agreement on climate change, which committed countries to greenhouse gas reduction targets.

SWOT

KANIKA DATTA

This wind turbine maker with debt of ₹6,640 crore had attracted interest from blue-chip private equity players such as IDFC PE, Olympus and Asia Climate Partners and even a white knight investor in Sun Pharma's Dilip Shanghvi. Now, with a step-down subsidiary in the US having filed for bankruptcy, it is asking for a government bailout.

ESG investing can be seen as a continuum of a global investment philosophy that gained traction after the great accounting frauds of the early 21st century — Enron, WorldCom, Freddie Mac, AIG *et al*. Occurring about a decade after capitalism's grand victory over communism in the Cold War, these scandals were an embarrassingly public reminder of the seamier side of free enterprise.

At Davos and other global talk shops, earnest discussions focused on ways to "save" capitalism, and the twin notions of "compassionate capital" and "impact investing" emerged. These concepts posited that capitalism should not be a force of profit only but a source of good ("impact") too. Bill Gates was an early proponent of this concept. Inevitably, vast amounts of compassionate capital sloshed into global markets spawning impact investment funds focused on healthcare, infrastructure and education in poor countries.

These new-age capitalists acquired a confirmatory theory from management guru C K Prahalad, a much-awarded professor of the University of Michigan. He wrote *The Fortune at the Bottom of the Pyramid* that made the argument for helping the poor and making profits. The book became all the rage, though careful observers pointed out that in several case studies, the "helping the poor" part seemed to be an afterthought to the "making profit" part. Others felt uneasy at the thought of making money by selling soap and salt to the poor.

Strangely, the 2008 financial crisis did not prompt a rethink, though the implosion was caused by high finance chasing bottom-of-the-pyramid consumers with dodgy home loans. The crisis revealed the old risk of accounting and accountability. That applied to impact investing too. These investments poured into countries with weak or non-existent laws and institutional governance mechanisms and rampant corruption. How to determine whether, say, a hospital for the poor or a power utility was delivering bang for the compassionate buck?

The answers were hazy, at best, which opened the doors for a world-class fraudster such as Arif Naqvi, the Pakistani founder of Abraaj Capital. This investing impresario's compelling story of deploying capital to eradicate global poverty fooled Bill Gates, Edgar Bronfman, John Kerry, Prince Charles, Klaus Schwab, Bank of America, McKinsey, KPMG, Hamilton Lane, the World Bank and the US, British and French governments. Abraaj, now in liquidation, extracted capital from top-of-the-line global investors for projects in India, Pakistan, Nigeria, Ghana, Turkey and so on, by spinning a fantasy that they wanted to hear.

It took about 13 years for someone to figure out that the profits Mr Naqvi promised weren't forthcoming. In fact, Mr Naqvi, the toast of the Davos crowd, operated a global Ponzi scheme, extracting money from one investor to finance a high-roller lifestyle for himself and senior executives, shifting money from one fund to another whenever payments came due (all deliciously chronicled in *The Key Man* by two *Wall Street Journal* reporters.

This is not to say that ESG Funds are incipient fraudsters — far from it. But the fact that ESG investing is impact investment bolstered by a climate change agenda should raise the level of caution. In May last year, the US Securities and Exchange Commission released an unprecedented ESG-focused risk alert pointing to inadequate disclosure, misleading claims and insufficient knowledge of ESG investment analysis. That's one problem. The other is the variable national policies, especially in emerging markets, that make investments difficult to measure. In India, for instance, the long-standing problems of regulated energy pricing add layers of complexity to the RE business. Equally, high fossil fuel-using companies are known to make token investments in RE power or corporate social responsibility projects to attract ESG money. In short, the more opaque the metric, the higher the risk.

Profiting from purpose

BOOK REVIEW

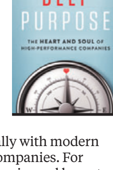
SRIVATSA KRISHNA

Ranjay Gulati is one of the most distinguished professors at Harvard Business School who has done remarkable work on the intersection of leadership, organisational design, and human behaviour. *Deep Purpose* delves deep into architecture of purpose, to examine what sets apart high-performance companies from the rest of the crowd. It is hard to research intangible values such as character, culture, ambition, judgment, and a host of others that we find tough to describe even in an ordinary conversation. This book is a fascinating journey through one such indescribable yet pivotal value: Purpose. All leaders chase obedience to visible and enforceable values, but what about obedience to those that are unseen and the unenforceable yet pivotal? Dr Gulati helps us understand this better through astonishing case studies and insights.

This remarkable book goes into the viscera of purpose, showing how it propels performance and profit and doesn't detract from them. It starts with a few insights from Larry Fink, CEO of BlackRock and one of the world's greatest asset managers, who argues that purpose and profits are two sides of the same coin — unless both sides are deeply cut, the coin is a counterfeit. BlackRock manages not just the money but the trust of people and, as such, typifies deep purpose. The book was probably inspired by Mr Fink's classic letter on profit and purpose. As the book argues, the problem isn't that business leaders have the wrong intentions. It is that they find combining profitability with purpose an overwhelming task because they don't understand the concept and how to go about executing it.

India today has the world's third-largest start-up ecosystem with over 50,000 start-ups and about 2,000 investors chasing them. The eternal question for them is: Should growth come first or a higher calling? Dr Gulati's book would suggest that the latter, not the former, should be at the heart of start-ups, even if that is something with which most venture capitalists might not agree. What would happen if a start-up that had everything going for it, including a higher purpose, finds itself unprofitable, even after splurging investor money to acquire customers while pursuing this higher calling?

The book makes a nuanced distinction between shallow and deep purpose and shows how several prominent companies such as Facebook, Theranos and others practice "purpose washing" mainly to hide behind a veil to disguise their own self-serving motive which is harmful to both individuals and institutions. By going deep into companies as diverse as Lego to Microsoft the book discovers the kernel of purpose and how it goes beyond corporate social responsibility (CSR) or conscious capitalism. Microsoft is today the toast of the world under Satya Nadella's leadership. He helped it rediscover its deep purpose and become a mobile-first and cloud-first company, from being a jaded monopolist selling clunky software, all within the span of less than a decade. He did so by going beyond Maslow's self-actualisation by reimagining a new world where his employees could add value to others and themselves by finding and following their own deep purposes.



Deep Purpose: The Heart & Soul of High Performance Companies
Author: Ranjay Gulati
Publisher: Penguin
Pages: 304
Price: ₹1,799

There is an eternal trade-off especially with modern Internet economy companies. For instance, Google Maps is used by us to do many day-to-day things including finding places, whereas the same Google maps is also used by terrorists to plant bombs. Facebook connects many communities and helps bring people together but has been seen to encourage divisive behaviour between human beings and various groups in society. Above all, there is overwhelming evidence of efforts by foreign actors to subvert US elections, thereby striking at the very heart of democracy via Facebook. So, should Google Maps and Facebook be banned? If not, how can they be regulated by government to make them find their original, authentic deep purpose? The book could do well by guiding political leaders on the kind of regulatory tools they can use to resolve these eternal dilemmas, thereby enabling governments, too, to find their own deep purpose. This is perhaps one of the few things missing in the book.

One of the interesting insights in the book is about how Mahindra & Mahindra tries to find its own deep purpose through one of its executives, Shipra Kumari, who went into the Haryana badlands to help farmers solve the problem of a lack of agricultural labour which in turn prevents them from harvesting their crops in time. Through this programme called "Rise," Anand Mahindra has given deep purpose to an organisation that is producing world-class products for India and the world.

The book also looks at established companies such as Boeing, Johnson and Johnson and shows how they realise the absence of the purpose only after a long period of organisational decay, by which time it is too late to bring them back from the brink.

Deep Purpose is a modern-day timeless classic on how individuals and institutions intersect to produce performance and profit through the alchemy of purpose. Its cases, insights and lessons go a long way, not just by telling us valuable stories but by also nudging the reader towards finding their own deep purpose in life. This is something few others have succeeded in doing.

The reviewer is an IAS officer. Views are personal. @srivatsakrishna