GUEST COLUMN

GAURAV GUPTA

Retail lending industry must settle conflict of interest

Non-banking financial companies (NBFCs) must follow fair, respectful and empathetic practices when ensuring last-mile credit availability, said Finance Minister Nirmala Sitharaman recently. Speaking at the NBFC Symposium 2025 in New Delhi, she encouraged companies to increase their market share to 50 per cent from 25 per cent, but equally directed them to ensure that loans to customers weren't "pushed". While her comments were motivating to NBFCs, a moot point remains: How do you ensure loans aren't pushed when frontline field teams at lending institutions are primarily driven by incentives linked to disbursements?

The compensation of frontline bank and NBFC employees (typically comprising majority of total staff) is structured as a certain amount of fixed income and disbursement-linked incentives, which are often paid on a monthly or quarterly basis. Maximising income or incentives is a frontline employee's primary objective and they largely focus on disbursals. That potentially makes them give scant regard for repayment of loans by borrowers.

Ironically, lending is the only business where sale or disbursement doesn't result in a profit. Profit is earned when the last few equated monthly instalments are received. So, while remuneration of senior management in banks and NBFCs is regulated and often linked to performance or profitability of the lender, the majority of the team is focused on disbursement. That results in a clear misalignment between employee and overall objectives.

FRONTLINE EMPLOYEES OF LENDING INSTITUTIONS GET FINANCIAL INCENTIVES FOR DISBURSEMENTS, ENCOURAGING THEM TO PUSH LOANS TO CUSTOMERS WHO MAY NOT BE AWARE OF THE RISKS

As we look to drive financial inclusion, we must remember that several first-time borrowers may not be well-informed about the implications of their decisions. With frontline teams incentivised to maximise disbursements, quite often, customers may be encouraged to borrow well beyond their repayment capacity. New companies, frontline employees and heightened competition to earn incentive are some factors that have perhaps contributed to the overleveraging of borrowers — a fact we are all coming to terms with presently.

As frontline employees go about pushing loans and maximising their incentives, they are aided by the valuation ecosystem in mortgage-backed lending. With little or no accountability in processes, very often the same property is valued differently to meet the disbursement requirements of frontline teams. For example: Valuer X may give two different valuations to two different frontline employees and there isn't any basis to validate the same. There isn't any way in which the valuer can be made accountable.

How can we build a better and more transparent ecosystem to benefit the customer, lender and overall economy?

■ To start with, it is important that all employees are aligned with the objectives of the lender. Every employee must strive to work towards profitability enhancement. Incentives must, therefore, be linked to profits to ensure that employees stick to sound lending practices and aren't only focused on disbursements.

■ The process of valuing collateral is something that needs to be standardised as far as possible. One way of doing this could be by setting up a central repository where property valuations are uploaded and stored on a common platform that is accessible to all regulated entities, much like a credit bureau. Such a central repository would enable lenders to verify valuations and discourage valuers from providing different assessments for the same property, depending on who hires them.

■ And finally, we must all play our part in customer education and awareness. The requirement of a key-facts statement being issued to the borrower is a good initiative that brings transparency. The customer must be educated to make an informed and responsible choice, understand the importance and implications of timely servicing or default.

The Finance Minister's call to banks and NBFCs to work together in advancing financial inclusion and achieving the vision of a Viksit Bharat is both timely and encouraging. Addressing a few of these key issues mentioned will go a long way in creating an environment that benefits both borrowers as well as lending institutions.

The writer is founder-MD & CEO, Tyger Capital

PHOTO: SHUTTERSTOCK

It's time to get started, put money in deals

Bank financing of M&As will be like any other business and only needs guardrails, report **Raghu Mohan, Ishita Ayan Dutt** and **Abhijit Lele**

Last fortnight, State Bank of India (SBI) Chairman C S Setty lifted the veil on a subject long spoken of in corporate corridors: Why can't our banks finance mergers and acquisitions (M&As)? Change is in the air: Indian Banks' Association (of which Setty is the chairman) is to "make a formal request" to Mint Road to make way for it. Thus far the exclusive turf of foreign banks even though its funding remains offshore — as in, it's not on these entities rupee-book (and a few select shadow banks) — a most lucrative segment in the investment banking suite, M&As, will be homeward-bound.

Business Standard reached out to Setty for his views on the guardrails which need to be in place before Indian banks foray into this business; the revisions or changes in regulations which would be in order; and the treatment of capital markets exposure defined as one of the "sensitive sectors" by the Reserve Bank of India (RBI), the others being commodities and realty. Setty did not respond but his predecessor at SBI, D K Khara, explained why the oft-trotted reasons for disallowing M&A financing may not hold anymore.

Take the adequacy (or lack) of safeguards. Stockbrokers have margin calls but banks are more regulated and follow stringent risk management and capital adequacy norms. Banks will anyway subject M&A proposals to credit underwriting norms, align with compliance standards and adhere to exposure limits. As for concerns relating to concentration (monopolistic) emanating from M&As, you have the Competition Commission of India. The point being made is hygiene measures and sundry modalities will unfold; we are after all, just getting started.

'Lost opportunity'

As to why M&A financing should be allowed, Khara's case is first, "it's prudent to give a product that Indian companies want rather than pushing loans which may not meet their requirements." Second, given foreign banks are already in the game via their international networks, "our banks are losing out on this opportunity." And third, for us to become developed, "such funding within India and for select international transactions (to acquire companies with technology, say in the defence sector) should be allowed". As Hitendra Dave, chief executive officer (CEO) of HSBC India, put it: "We want Indian companies to be at the forefront of international M&A activity and having banks to back their ambition is the need of the hour." That said, "this is an area which requires specialists and specialisation and banks which want to enter this activity will need to build the required expertise."

Why did bank financing of M&As become a no-go area? The 1991 securities blowout is usually seen as a trigger for RBI's clampdown but there's nothing in its circulars which specifically frowns upon it. Senior bankers surmise its roots are in the thinking that it's "unproductive" in nature. The logic driving it, they say, is as follows. When Firm A acquires Firm B, there's no incremental addition to productive capacity in the economy even though it holds true for the merged entity — you have merely financed the purchase of shares. Indian promoters were also covertly against such financing lest they become victims of hostile takeovers. As an aside, given that the issue of hostile takeovers is sure to crop up in the ongoing debate on M&A financing, it would be worthwhile to define the term "hostile" — to the promoter/s or shareholders' interest.

There are other fault-lines on the regulatory front. Banks can't get into M&A financing but non-banking financial companies (NBFCs) can. This even as NBFCs source credit from banks. It amounts to banks financing M&As, a step removed — buffered by another set of regulated entities or REs' (read NBFCs) equity capital. Or inter-connected lending by RBI's REs. This can lead to a situation where an acquiring firm floats bonds which are subscribed to (partly or fully) by NBFC/s (funded by banks), the proceeds of which finance an acquisition. Banks cannot cavort likewise — be it by giving loans (even if it is a general-purpose line without end-use restrictions) or by subscription to bonds. With newer sources of funding emerging (even for M&As) — alternate investment funds and family offices — it gets to be even more opaque and complicated.

BANKS FACE REGULATORY HURDLES AND HISTORICAL CONCERNS OVER M&A FINANCING, BUT EXPERTS ARGUE IT'S VITAL FOR INDIAN COMPANIES TO COMPETE GLOBALLY

Now let's take stock of banks' exposure to sensitive sectors. According to RBI's 'Report on Trend and Progress of Banking in India (2023-24)', this stood at 22.1 per cent of total loans and advances at ₹2,098,358 trillion (marginally higher than the 21.7 per cent a year ago). But during this period, the share of capital market exposure soared to 31.3 per cent to ₹243,321 crore (up from 20.2 per cent). The central bank cites a "merger" as the reason for the increase to the sensitive sectors in general (a reference to the HDFC Ltd and HDFC Bank transaction) but this still does not explain the jump in banks' capital market exposures. Again, it's not clear whether these numbers take into account bank funding to NBFCs that finds its way to the sensitive sectors.

"Financing M&As is not very different from any other lending risk that depends on a company's future cash flows," says Sunil Sanghai, founder and CEO of NovaaOne Capital. He is the chair of the Federation of Indian Chambers of Commerce and Industry's National Committee on Capital Markets and believes that "in the case of M&As, it is linked to cash flows of the new entity created through the transaction. Denying this option to local banks and companies puts them at a disadvantage." Seshagiri Rao, JSW Group's chief financial officer, mirrors Sanghai: "Banks can fund acquisitions in infrastructure projects and even take up to 50 per cent equity, but in non-infrastructure deals, this is barred due to concerns around capital market exposure." Even as he concedes "banks should not have too much capital market exposure — guardrails are necessary. But a blanket ban shuts off a crucial source of funding, making M&As more expensive for Indian companies."

Time to move ahead

And did you know of this? The RBI permits banks to finance investments and acquisitions by Indian companies in their offshore joint ventures or subsidiaries though not from their local books but from banks' offshore offices. This has other ramifications: any mess in these transactions and its impact on offshore offices — be it branches or representative offices — has a bearing on the Indian parent bank. Be as it may, "Having opened this window, it can be considered for onshore deals also," points out Ameya Khandge, partner at Trilegal (and national head of the banking and finance practice groups). As for guardrails, he notes that the RBI could, as a start, limit these deals to tangible real-sector assets; not to intangibles or valuations that go beyond asset value to aspects like non-compete fee, etc; and mandate strict concentration and sectoral exposure limits. "Plus, use a combination of both cash-flow-based lending and real asset collateral and allow it only for non-hostile deals and in cases under the Insolvency and Bankruptcy Code (IBC, 2016) where there is consensus on what is to be done".

The move will also help give a fillip to capacity expansion by India Inc through the inorganic route, especially when IBC cases are involved. Again strangely, Indian banks actively finance the acquisition of targets through the corporate insolvency resolution process (CIRP) under the IBC. This is because, in an acquisition under CIRP, bank financing is not utilised for funding acquisition of shares but for repaying existing lenders of the target company.

In the context of the move to fine-tune the IBC (and bank funding of M&As), it is also worthwhile to take on board former RBI governor Shaktikanta Das' observation on group insolvency. Speaking on 'Resolution of stressed assets and IBC - Future Road Map', organised by the Centre for Advanced Financial Research and Learning, Mumbai, 11 January 2024) he noted that while the insolvency mechanism has been graduating towards a zone of stability through various concerted measures, one visible impediment seems to be the absence of a clear framework for group insolvency. "...in the absence of a specified framework, the group insolvency mechanism has been so far evolving under the guidance of the courts. Perhaps the time has come for laying down appropriate principles in this regard through legislative changes."

We are just getting started on the road to bank M&A financing. The RBI already has a number of prudential lending frameworks in place that can be tweaked to address some of these risks. As for misgivings, "indicatively, single/group borrower exposure caps could be set at lower threshold of Tier-I capital, higher risk weights could apply for M&A loans, robust end-use norms to avoid fund diversion, separate disclosure norms for such loans for increased transparency, among others," says Rohan Lakhaiyar, partner (financial services-risk), Grant Thornton Bharat. "While guardrails may provide prudential limits to the banks, nothing can replace banks' independent due diligence processes and risk management practices for funding M&A deals,' he adds.

M&A financing by banks is like any other business; and unlike too.

Disclosure: Entities controlled by the Kotak family have a significant holding in Business Standard Pvt Ltd.

Top M&A deal-makers, 2024

Rank	Advisor	Market share (%)	Deal value ($ mn)	Deal count
1	EY	11.7	12,229	65
2	Kotak Mahindra Bank	10.6	11,080	13
3	Deloitte Touche Tohmatsu	6.9	7,250	24
4	Moelis & Co	6.6	6,897	7
5	Barclays	6.5	6,787	5
6	Morgan Stanley	6.2	6,449	7
7	PwC	5.2	5,483	25
8	NovaaOne Capital	4.9	5,086	2
9	BNP Paribas	4.0	4,223	2
10	Citi	3.7	3,878	3

And in 2025 (YTD)

Rank	Advisor	Market share (%)	Deal value ($ mn)	Deal count
1	Citi	11.4	7,977	7
2	EY	10.4	7,231	34
3	Morgan Stanley	7.8	5,412	8
4	Goldman Sachs	7.5	5,261	6
5	JPMorgan	7.4	5,171	5
6	PwC	5.4	3,786	17
7	Barclays	5.3	3,725	3
8	Jefferies	5.3	3,690	7
9	Kotak Mahindra Bank	4.2	2,947	9
10	Deloitte Touche Tohmatsu	3.6	2,494	35

Source: Bloomberg

"WE WILL MAKE A FORMAL REQUEST FROM THE IBA (TO THE RBI) TO ALLOW BANKS TO FINANCE M&As"

C S SETTY
Chairman, State Bank of India (SBI)

"IT'S PRUDENT TO GIVE A PRODUCT THAT COMPANIES WANT RATHER THAN PUSHING LOANS WHICH MAY NOT MEET THEIR NEEDS"

D K KHARA
Former SBI Chairman

"BANKS FUND ACQUISITIONS IN INFRASTRUCTURE PROJECTS BUT NOT IN NON-INFRA DEALS"

SESHAGIRI RAO
CFO, JSW Group

"WE WANT INDIAN COMPANIES TO BE AT THE FOREFRONT OF INTERNATIONAL M&A ACTIVITY"

HITENDRA DAVE
CEO, HSBC India

"FINANCING M&As IS LIKE ANY OTHER LENDING RISK THAT DEPENDS ON A COMPANY'S CASH FLOWS"

SUNIL SANGHAI
Founder & CEO, NovaaOne Capital

"LIMIT DEALS TO TANGIBLE REAL-SECTOR ASSETS; NOT TO INTANGIBLES AND SET STRICT EXPOSURE LIMITS"

AMEYA KHANDGE
Partner, Trilegal

"EXPOSURE CAPS COULD BE SET AT LOWER THRESHOLD, AND HIGHER RISK WEIGHTING COULD APPLY FOR SUCH LOANS"

ROHAN LAKHAIYAR
Partner (financial services, risk), Grant Thornton Bharat