Concerns with Infra Project Plans

What is the issue?

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In recent times domestic banks are ill-suited to meet the lending needs of medium- to long-gestation projects.

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What are the issues with performance of banks?

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- Both PSU and Private sector banks has short-term deposit base which leads to an asset-liability mismatch.
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- Apart from that domestic banks also have displayed poor skills in assessing the viability and likely cash flows of industrial projects.
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- It is concerned that banks' risk-aversion will hurt Government's ambitious infrastructure-building plans.
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- India is already an island of high interest rates in the global context and this puts domestic industry at a big competitive disadvantage.
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What are the concerns with government measures?

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- Union government is planning to step in bond markets to fund Infrastructure projects.
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- SEBI has proposed to direct large companies to source a quarter of their credit needs from the bond markets.
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- While there's certainly a need to develop a vibrant market alternative for funding projects, achieving this through a diktat is a bad idea.

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- Businesses try to lower their cost of capital by juggling between bank loans, external commercial borrowings and bond issues, depending on which route is the cheapest.
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- Forcing companies to compulsorily source a fourth of their loan needs from the market will introduce rigidity into their financing plans, and hamper their ability to cut capital costs.
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- Domestic bond market is already overcrowded with issuers, thanks to frequent borrowings by both the Central and State governments.
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- Forcing corporates to jostle with sovereign borrowers for their capital can only escalate their borrowing costs.
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- Overall, it is the lack of demand and secondary market liquidity for long-dated bonds that present the biggest impediment to the markets meeting the long-term credit needs of industry.
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What measures needs to be taken?

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- Nudging institutions such as foreign funds, domestic pension funds, EPFO, insurance companies and mutual funds to participate more actively in long-dated bonds is one way to prop up demand.
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- Regulators recently allowed domestic pension funds and the EPFO to venture below AA-rated bonds to bump up yields.
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- But this is a long-drawn process that requires these institutions to develop better credit appraisal systems.
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- The most practical solution is to allow entities managing infrastructure projects to directly issue long-dated bonds to high net worth investors or vehicles managed on their behalf.
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- The success of tax-free bond and infrastructure bond offers tells us that this is the most expedient solution to reducing banks’ burden on industrial financing.
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Source: Business Line

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