Banks on project finance

Why in news?

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In the Banking Roundtable held last week, bankers made it clear that they are hesitant to go big on project financing.

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What is project finance?

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Project finance is the financing of long-term infrastructure, industrial projects and public services, in which project debt and equity used to finance the project, are paid back from the cash flow generated by the project.

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Why are the banks hesitant in public financing?

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- Bankers are clear that very few banks would go big on project financing until the government created the ecosystem for the resolution of issues.
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- Due to the past experience in the recent years, bankers will now provide project finance only if they see a chance to recover their investment quickly in case things go wrong.
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- The gross non-performing assets (NPAs) of the banking sector stood at Rs 6.3 lakh crore in the June quarter, and restructuring is on in barely a fraction of these cases. This seriously limits their lending capacity.
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- Schemes such as strategic debt restructuring (SDR) and sustainable structuring of stressed assets (S4A) have not met with much success. Under these schemes, banks have not been able to\n
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  - agree with promoters on valuation,
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    - convert their debt into equity or
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    - find managers or new buyers to run the businesses.
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- It is not just bankers who are hesitant to fund large-scale projects; even promoters who have learnt their lesson the hard way will want all the safeguards in place before indulging in future projects.
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What is the way ahead?

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- The Insolvency and Bankruptcy Code (IBC), 2016, is expected to address some of these concerns.
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- There is no shortage of demand for funds, which will only increase as the economy grows. However, bankers want tighter contracts so that borrowers understand that the money has to be repaid and that they cannot lead lavish lifestyles at the expense of banks.
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- The future of financing projects should be governed by **take-or-pay contracts** and if things do not work out, the funds are to be returned.
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- There are enough honest promoters out there who may have set up projects in good faith but are unable to get them going because of changes in the external environment or regulations or public protests. Therefore a more structured approach should be in place where access to natural resources, land, approvals and backward-forward linkages are in place before funds are committed.
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