CAFRAL
CENTRE FOR ADVANCED FINANCIAL RESEARCH AND LEARNING
Promoted by Reserve Bank of India

CAFRAL Newsletter
August 2020 – October 2020

Highlights of Learning Programs

CAFRAL Web-Conference for Chief Human Resources Officers (CHROs) and Chief Learning Officers (CLOs) of Banks and Financial Institutions: August 08, 2020, Online CISCO WebEx - Web-Conference

The program sought to engage with the Chief Human Resources Officers (CHROs) and Chief Learning Officers (CLOs) of the banks on challenges and opportunities thrown up by the Covid-19 outbreak for HR and Learning. Prof. Indira Parekh, Former Dean IIM Ahmedabad and Founder President, Flame University spoke on the leadership issues while Mr. Subir Das, HR consultant and former adviser, McKinsey & Co. discussed the competency mapping and development focusing on Post COVID situations. There was also a discussion amongst the CHROs and CLOs regarding the opportunities and challenges of WFH, emerging training needs due to COVID and more importantly how CAFRAL can help bridge the training gap in this regard. The participants appreciated the timely selection of the topic for the web conference and also the effectiveness of the speakers.

Program on Digital Lending: Technologies, Processes and Regulations, August 17-18, 2020, Online CISCO WebEx - Virtual Learning Program

The program provided the participants with a snapshot of the Digital Lending (DL) ecosystem and the policy and practical aspects of business models, risks, regulations and technologies surrounding DL. Coverage included P2P lending, digital lending for MSMEs and home loans, digital valuation of mortgages, regulatory concerns in DL, etc. Speakers for the program included policy makers, practitioners (from bank, NBFC & lending platform) and an international service provider for valuation. The program was well appreciated for the range of topics covered.

Program for Non-Executive Directors on the Boards of Banks and Financial Institutions, August 31, 2020 - September 01, 2020, Online CISCO WebEx - Virtual Learning Program

Programs for NEDs aim to improve the effectiveness of the directors on boards of banks by focusing on some of the contemporary issues that may be of interest to board members and few process related issues of board functioning. In this program, the focus was on the outlook for NPAs and capital in the COVID scenario, strategy and financing of MSMEs, assessment of financial crime risk, cyber security management, the emerging board role and structure in India, adherence to secretarial standards, compliance with listing requirements and the issue of related party transactions. Speakers included those with board experience, banking sector experts and analysts and professionals dealing with board processes and compliance requirements.

CAFRAL Virtual Learning Program on Agro-MSME Lending: September 24-25, 2020, Online CISCO WebEx - Virtual Learning Program

Agro-MSMEs, which operate in the intersection of Agriculture and MSME sectors, can be powerful vehicles of growth in the post-pandemic environment. The CAFRAL VLP sought to build a business case for lending profitably to the Agro-MSMEs as they hold a promise for the development of the rural economy in a sustainable and impactful manner. The program covered policy developments and innovation in the Agro-MSME sector with inputs on lending to FPOs, Agri-value chain financing, Climate Smart financing, Wellness Agriculture, the technical aspects of agri-MSME financing, etc.

CAFRAL Virtual Learning Program on Detection, Investigation and Prevention of Financial Fraud & Crime, September 28-29, 2020, Online CISCO WebEx - Virtual Learning Program

The program covered regulatory and supervisory developments in relation to fraud and financial crime and explored the emerging trends in fraud risk management, more particularly the use of Early Warning Systems (EWS) and sought to enhance the fraud prevention capacity based on substantive outcomes of investigations and forensic audits. Subject experts from RBI, Central Bureau of Investigations, banks and specialist firms engaged in financial crime provided valuable inputs based on their knowledge and experience.

Webinar on Work from Home (WFH) and Management of Operational Risks Amid and Post Covid 19: Issues, Lessons and Way Forward, October 09, 2020, Live Webinar

The webinar, in partnership with PRMIA, discussed the new ways of functioning and the emerging good practices in the operational risk area, particularly relating to WFH. The Webinar explored practical insights and perspectives relating to WFH, especially from the risk perspective from a range of institutions and speakers. There program had wide participation from banks, NBFCs, FIs, academia, professionals & interested persons.

CAFRAL Virtual Learning Program for Chief Financial Officers : Traditional and Evolving Role, October 22-23, 2020, Online CISCO WebEx - Virtual Learning Program

The program covered the traditional functions and the evolving role of CFOs. While some sessions dealt with the traditional but intricate technical issues such as those relating to audit, taxation and legal & regulatory compliance, the others explored more nuanced, complex and multidisciplinary aspects of CFO function surrounding balance sheet optimisation, application of advance technologies in the matters of financial controls, preparation of financial statements, risk appetite statements, etc. Shri T V Mohandas Pai, Chairman, Manipal Global Education, was the keynote speaker.

Highlights of Research Activities

Research Highlights

In two short policy papers, Dr. Udupa, Research Director, CAFRAL and coauthors look at the determinants of COVID-related fiscal stimulus across countries and the effects of different COVID-scenarios on India's FY21 fiscal deficit. In the first paper, the authors look at the fiscal stimulus given by over 70 countries and evaluate the determinants of such stimulus. They find that the size of the stimulus is determined by countries' sovereign credit ratings. Better rated countries are likely to give larger stimulus and do so much earlier compared to lower rated countries. COVID-related variables such as number of cases and deaths were significant but were less relevant than the credit rating. The second paper evaluates different fiscal deficit outcomes under different economic scenarios. The authors recommended a 2.2-4.8% of GDP additional stimulus based on an international benchmark. Under the larger stimulus of 4.8% of GDP and the worst-case scenario of 10% fall in GDP, they estimate FY21 fiscal deficit to hit close to 8.5% of GDP.

CAFRAL Live Lecture Series on Advanced International Trade by Dr. Asha Sundaram, Senior Lecturer and Deputy Head, Department of Economics, University of Auckland , August 17-20, 2020, Online CISCO WebEx - Live Lectures

CAFRAL conducted a live online lecture series on Advanced International Trade between August 17-20, 2020. The lectures were delivered by Dr. Asha Sundaram, Senior Lecturer and Deputy Head, Department of Economics, University of Auckland. The lectures covered determinants of international trade flows, trade and welfare, and issues related to free trade agreements. The lectures combined international trade theory and empirical evidence to give a broad view of the important issues in this field.

The recordings of the lectures are available on CAFRAL's website.

Highlights of Research Seminars and Brown Bag

Unearthing Zombies by Dr. Nirupama Kulkarni, Research Director, CAFRAL on October 23, 2020

Paper Abstract

"Zombie" borrowers, which are insolvent firms sustained by continued extension of credit by complicit banks, can prevent the efficient allocation of resources. We use supervisory data on the universe of large bank-borrower relationships in India to examine two key reforms aimed at tackling zombie lending: an overhaul of the bankruptcy law, and a subsequent regulation that removed lender discretion in recognizing bad loans. We show that the latter reform is more effective in forcing banks to recognize zombie loans as non-performing. While the effect of the bankruptcy law is muted in weakly capitalized and government-owned banks, the regulation is able to nullify the influence of capital but not ownership. Post-reform, credit reallocates to young and healthy borrowers. Zombie borrowers then cut investment, whereas healthy borrowers expand it. Overall, our results suggest that regulatory action toward zombies might be necessary in weakly capitalized banking systems, but governance frictions can limit the efficacy of even the strongest regulation.

Import Competition, Formal Sector Employment, and Contract Labor: Evidence from India by Dr. Vidhya Soundararajan, IIM Bangalore on October 21, 2020

Paper Abstract

The debate on the effects of import competition on sectoral composition of employment remains unsettled. Using the case of the Indian manufacturing sector and exploiting plausibly exogenous variation from Chinese imports, we provide the first causal evidence that higher import competition: (i) increases the probability of a worker being employed in the formal sector; and (ii) reallocates employment from informal to formal sector thereby increasing the share of the formal sector employment. This increase in formal sector employment is mainly driven by an increase in contract labor, for whom wages are lower than regular workers, and firing costs are absent. The aggregate effects are entirely driven by firms in the top 50% of the productivity distribution. In contrast to the formal firms, informal sector firms shrink and drop workers as a result of the competition. While prior evidence indicates that formalization is driven by export market opportunities, to the best of our knowledge, this is the first study to show that formal sector employment can also increase as a result of import competition. Our results are robust to IV estimates and controlling for a host of other potential trade and industry level channels.

Household Responses to COVID-19 in India by Dr. Arpit Gupta from New York University on October 16, 2020

Paper Abstract

Not available

Bank Concentration, Sub-optimal lending and Industry Structure by Rahul Singh Chauhan, Research Associate, CAFRAL on October 7, 2020

Paper Abstract

We show that bank-concentration at the US county-level increases industrial concentration. By exploiting discrepancies in the enforcement of bank-merger regulatory reviews, we formulate a fuzzy regression discontinuity design, with the dominant bank's county-market share as an instrument for deposit concentration. Our baseline results provide evidence that deposit concentration increases industrial concentration measured by county-level labour Herfindahl-Hirschman Index (HHI), as well as dampens the entry and exit rate of non-financial firms at the county-level. We further explore heterogeneity in our results with respect to external financial dependence, the 2008 recession and regulatory forbearance. We explore whether concentration engenders incentives to lend sub-optimally in order to protect incumbents. We find that the mean banking market concentration is positively correlated with non-performing assets and loan restructuring at the bank-level.

Lights out? COVID-19 containment policies and economic output by Dr. Sonalika Sinha, SRU, RBI, on September 23, 2020

Paper Abstract

This paper estimates the impact of the COVID-19 pandemic in India on aggregate economic activity as measured by night-time lights, with a focus on differential containment policies implemented after a uniform, nationwide lockdown. Using this variation in a differences-in-differences empirical framework, we estimate the cost of COVID-19 vulnerability and the simultaneous containment strategy at the district level. We find that night-time light intensity, a high-frequency proxy for economic activity, declined by 7.2% (0.035 standard deviations) for district zones with greatest vulnerabilities and restrictions and by 1.3% (0.008 standard deviations) for district zones with intermediate vulnerabilities and restrictions, as compared to district zones with least vulnerabilities and restrictions. The magnitude of the night-time light reduction was greater in May 2020, compared to June. We find that the Red and Orange zone districts in more developed areas (more urbanized, with more deposits, formal employment and population density) experienced relatively lower nightlight intensity in the unlock period, suggesting a sharper decline in economic output in those districts. Examining heterogeneity by mean district age reveals younger districts experienced lower economic costs, consistent with younger populations adapting better. Our findings show the extensive economic costs of COVID-19 pandemic on districts in India.

Regulatory Limits to Risk Management by Dr. Ishita Sen, Harvard University on September 11, 2020

Paper Abstract

Considerable research focuses on the aggregate impact of debt financing. We show that equity is empirically more important for firm growth than generally understood. An extra dollar of equity issuance is associated with an extra $0.93 of real assets, whereas an extra dollar of debt issuance is associated with an extra $0.14 of real assets. Firms issue equity first, then increase real assets, and finally issue debt while repurchasing equity. We explain this sequence using a model in which debt is tax preferred relative to equity but is subject to limited commitment. In the model, firms initially issue equity to finance investments. After they obtain assets that can be pledged to lenders, firms substitute debt for equity to benefit from interest tax deductions. We estimate the model and use it to evaluate the efect of several government policies on corporate growth through their impact on the sources of financing.

Financing Corporate Growth by Dr. Ali Sananti, American University on August 24, 2020

Paper Abstract

Considerable research focuses on the aggregate impact of debt financing. We show that equity is empirically more important for firm growth than generally understood. An extra dollar of equity issuance is associated with an extra $0.93 of real assets, whereas an extra dollar of debt issuance is associated with an extra $0.14 of real assets. Firms issue equity first, then increase real assets, and finally issue debt while repurchasing equity. We explain this sequence using a model in which debt is tax preferred relative to equity but is subject to limited commitment. In the model, firms initially issue equity to finance investments. After they obtain assets that can be pledged to lenders, firms substitute debt for equity to benefit from interest tax deductions. We estimate the model and use it to evaluate the efect of several government policies on corporate growth through their impact on the sources of financing.