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Zooming in on India's financial services M&A opportunities

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Non-banking and fintech are among the market segments benefiting from an easing of regulatory constraints.

India's complex, fragmented and fast-evolving financial services market presents a dilemma for potential investors. On the one hand, its huge population — many of whom are unbanked — presents a wonderful growth opportunity. On the other hand, tight restrictions on foreign ownership have, to date, presented significant obstacles.

A recent relaxation in the regulatory regime suggests change may be in the air. In a bid to accelerate financial inclusiveness, in 2016 the Reserve Bank of India (RBI) announced 10 licenses for new 'small finance banks', which offer deposits and lending primarily to small businesses, including farmers. Add to this the 11 licenses granted for the new category of 'payments bank' (which carry out most banking operations but can't offer loans or issue credit cards), and it looks like the government's desire to encourage 'new age' banking is gaining pace. A number of the new payments bank players are telecommunications companies,[1] signalling broaderfinancial inclusion.

It's a similar story in the burgeoning 'non-banking finance company' sector, encompassing financial services businesses that don't hold a banking license and can't take deposits — but can offer loans, credit facilities, retirement planning, and money-market trading.

These companies provide a vital source of finance for the hundreds of millions of Indian citizens that have no credit score and are unable to get consumer, mortgage or vehicle financing from traditional retail banks. An easing in overseas investment requirements has opened the door to up to 100 percent foreign participation in non-banking finance companies, which could lead to interest from cross-border buyers.[2,3]

The real estate market also appears more enticing, thanks in part to the government's "Housing for all by 2022" initiative, which aims to bring affordable housing to the urban poor. Measures like tax incentives on affordable housing projects, and reduced capital gains tax, could encourage private sector participation — and give the mortgage market a much-needed boost. All of which could spell good news for interested buyers.[4] Meanwhile, Indian real estate investment trusts (REITs) are gaining attention among foreign investors due to the removal of dividend distribution tax.[5]

Not surprisingly, fintech is also a rising force in India, most notably in the form of mobile wallets that enable customers to make payments from smartphones. In 2017, Chinese e-commerce giant AliPay extended its stake in PayTM, India's largest mobile payment processor,[6] to 62 percent. Other potential buyers are

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1 *India has a new bank designed specifically for Indians afraid of banks,* Quartz India, 11 July 2017.
2 *India relaxes requirements for foreign investment in non-banking finance companies edit,* Asia Law Profiles, 7 November 2016.
3 *Government allows 100% FDI in 'other financial services' by NBFCs,* The Economic Times, 26 October 2016.
4 *What is Housing for All by 2022 Mission?* Indian.economy.net, 19 February 2017.
5 *Exemption of dividend distribution tax: REITs now a step closer to reality,* The Indian Express, 5 March 2016.
6 *Alibaba to hike stake in Paytm Mall with $177-mn investment,* Business Today, 4 October 2017.

sure to be keeping an eye on this fast-moving space, which also includes robo-advisory companies, peer-to-peer lending and blockchain. And the good news is that foreign acquirers have no limit to their investment in fintech startups.[7]

Openings in mainstream banking

While India's regional banks remain strictly domestic, the surge in non-performing loans (NPLs) presents an alternative route into this sector. State-owned banks account for the lion's share of an estimated US$180b of NPLs, and the clock is ticking towards the 2019 Basel III deadline for meeting stricter capital requirements. The Reserve Bank of India has been empowered to direct insolvency proceedings in the event of default, with the introduction of strong insolvency laws providing banks with a highly effective resolution mechanism. The majority of buyers are likely to be overseas players, such as large international asset reconstruction companies or private equity (PE) houses.[8]

Insurance is another sector to benefit from looser regulations, with the foreign ownership cap increased from 26 percent to 49 percent in 2016 — although all insurance companies must remain "Indian owned and controlled."[9] The bulk of Indian insurers already have a foreign partner, so the best chance for new deals should come from existing overseas players looking to either exit or form relationships with new providers. Nevertheless, the insurance market in India is relatively immature, and we can expect deal activity to rise in the coming years. A further factor driving mergers is the relatively weak position of certain public sector banks, some of whom are planning to exit none-core businesses like insurance.

The Modi regime has been a firm and constant advocate of foreign direct investment. And, with the various changes discussed in this article, India's financial services sector could become a go-to region for M&A.

Six ways to enter the world's second most populous market

Area of investment	Currently available	Foreign investment opportunities
Non-banking finance market	**Yes**	Up to100 percent foreign direct investment
REITs	**Yes**	Exemption from dividend distribution tax
Fintech	**Yes**	No limits
NPLs	**Yes**, significant increase in NPLs expected in 2019	Up to 100 percent foreign direct investment in existing asset reconstruction companies (ARCs: which buy NPLs from banks for resolution. ARCs are licensed entities regulated by the Reserve Bank of India. Foreign investors can also purchase security receipts issued by ARCs.
Insurance	**Yes**, but limited due to market saturation	Foreign ownership cap increased from 26 percent to 49 percent. Companies must remain "Indian owned and controlled."

[7] *RBI's new FDI rules may ease funding norms for Fintech startups,* ET Tech, 24 October 2016.
[8] *India Empowers RBI to Resolve World's Worst Bad Debt Problem,* Bloomberg, 5 May 2017.
[9] *Indian Insurance Sector Welcomes Foreign Investment With Limits on Control,* Skadden, January 2016.

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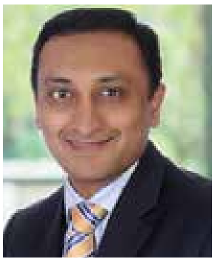

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With 18 years' deal advisory experience, Sanjay has worked on more than 500 transactions involving mergers, acquisitions, disinvestments, cross-border acquisitions, financing by large institutions and private equity investments across various sub-sectors in the financial services industry. He has also been involved with major restructuring initiatives. Sanjay is financial services sector lead for Deal Advisory and also heads the Indian firm's Valuations team.

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