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NPA RESOLUTION THROUGH LIQUIDATION?

LIQUIDATION AS A RESOLUTION TO NPA CRISIS WOULD BE DISASTROUS FOR THE ECONOMY, SOCIETY AND THE BANKING SYSTEM

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Today, the Indian industry is reeling under a severe debt trap. The long list of companies that are caught in the debt trap and are being referred to the National Company Law Tribunal (NCLT) under the Insolvency and Bankruptcy Code (IB Code), 2016 for Corporate Insolvency Resolution Process (CIRP) suggest that the cause for this huge debt is not only attributable to the individual companies but it is a mix of various external factors that have led to such debt crisis. The situation is complex and cannot be solved through the 'one size fits all' approach or through a cosmetic surgery. The cause of the bad loan needs to be ascertained to arrive at the solution that needs to be administered.

The reasons for the NPA crisis are a mix of various factors ranging from economic factors to companies overleveraging themselves with an obsession of growth and profit, and absence of a timely resolution in the banking system, resulting in the debts ballooning to an out of proportion limit today. The continued sluggishness in domestic growth for around a decade and slow recovery in the global economy have resulted in many projections going wrong.

Of course, like elsewhere, there are black sheep here as well but they can be identified through existing mechanism of forensic audits/wilful defaulters etc and needs to be tackled separately. But the entire industry should not be treated in the same manner.

While everyone acknowledges and are in agreement with the reasons for the debt crisis, we have failed to find a practical solution to the problem. Perhaps we are targeting at the wrong end towards mitigating the crisis. Though IB Code is a pragmatic process, however in our delivery mechanism, we are still following the same mistakes committed during the CDR regime.

The current ballooning NPA crisis could have been tackled long ago during 2012/2013, when a surge in the number of cases being referred to the CDR cell was noticed. However, instead of tackling it pragmatically when it first appeared, we preferred procrastination.

Over the last three to five years, we tried to manage NPA provisioning with an eye on banks' balance sheets instead of resolving the same through revival.

IB Code was introduced to find a commercially viable solution to the NPA crisis which could not be solved by various previous schemes like SDR, S4A, 5:25, etc. It promised to be a practical approach to arrive at a resolution of the corporate debt in the best interest of all the stakeholders. IB Code had superseded all the debt resolution mechanisms and was expected to correct the various shortcomings in the previous approaches.

However, IB Code in practice continues to harbour the ills of the previous processes. Lending is a commercial decision of the banks on which they earn interest and the borrower uses for investment for future returns.

Unfortunately, IB Code in its current form supports the decision of lenders to lend but punishes the decision of the borrowers to borrow when the loan turns bad due to reasons beyond the control of both.

The prime issue lies in our approach to solve the crisis. In all resolution mechanisms we start with the amount of debt and then try to negotiate on the wish lists for arriving at the minimum haircut and accordingly the sustainable debt without due consideration on its viability. The approach in IB Code should have been different. It should have started with two basic questions:

>> Is the company viable?
>> What is the sustainable debt based on independent study?

A company is considered to be viable if it can earn profit on its own strength. A Techno Economic Viability (TEV) study can bring out the quantum of income the company can have on a sustained basis.

Lenders have the right to demand their money while the borrowers are bound to pay the amount borrowed. However, that should not result into any mental block in the quantum of loan to be assigned as sustainable debt to arrive at the resolution. This should be purely based on the independent studies done dispassionately. The unsustainable portion can always be made up by assigning equity, zero coupon bonds, etc to the lenders. **As the company revives, the lenders can benefit from the upside of the equity. But in the tug of war between sustainable and unsustainable debt, the company may slip into liquidation where no one gains resulting into huge socio-economic collateral damage.**

> **BANKS ARE NOT EXPECTED TO CLOSE THE ECONOMY. INDIA IS NOT CLOSING AND NEEDS ITS INDUSTRIES FOR ITS PEOPLE. WASHING OFF ITS HAND FROM THE STRESSED ASSETS AT PALTRY LIQUIDATION VALUE IS IN EFFECT DESTRUCTION OF ASSETS. SUCH AN APPROACH OF BANKS WOULD RESULT IN HUGE JOB LOSSES AND UNEMPLOYMENT WOULD RISE MULTIFOLD. LIQUIDATION OF COMPANIES AT SCRAP VALUE BY THE BANKS, EVEN IF THE COMPANIES ARE IN PRODUCTION, MAKING PROFIT, PROVIDING EMPLOYMENT TO A FEW THOUSAND PEOPLE, CONTRIBUTING TO THE GOVERNMENT EXCHEQUER BY MAKING ALL TAX AND STATUTORY PAYMENTS ON TIME, WOULD BE DETRIMENTAL TO THE INDUSTRIAL SCENARIO AND SOCIO-ECONOMIC LANDSCAPE OF THE COUNTRY**

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The IB Code has vested enormous power on the secured creditors. The secured creditors through the committee of creditors (CoC) have been empowered to finalise the plan for revival of the company. This has been rightly done because it is the debt whose resolution is being done and the secured creditors are the best people to decide on the contours of doing so. However, with the rights, there should also be accountability on the CoC to ensure resolution.

Despite CIRP being a judicial process, banks loath to take any decision on the resolution plans of the companies in insolvency. **Banks are afraid of enquiry by vigilance agencies of their decision on resolution plan and hence prefer procrastination, thus wasting valuable time.** There is no scope of inaction or indecisiveness under IB Code 2016. Indecisiveness or inaction in this time-bound process would only result into liquidation of productive assets along with its huge social and economic costs.

Banks are still in the wish list syndrome even under IB Code. They prefer to push companies in liquidation rather than taking a commercial decision of resolution even if the NAV of the resolution plan is much higher than the liquidation value. Banks feel that they would be questioned on haircuts in resolution plan, while no questions would be asked to them in liquidation irrespective of how paltry the value that liquidation might fetch. Lenders are not interested in pursuing a resolution plan even if it does not require any fresh exposure and is based on internal accruals. Such obsession to liquidate productive assets ignoring the multiple times of higher NPV in resolution, defeats the basic idea of Corporate Insolvency Resolution Process. IB Code was not meant for liquidation of stressed assets but to revive viable assets.

There is a need to make bankers accountable for their action in the process of CIRP. If any company is forced into liquidation due to indecisiveness of bankers or due to their commercially wrong decision, where NPV of resolution is multiple times the liquidation value, then they should be held accountable. Banks need to be questioned for such commercially wrong decisions which go against their interests only because some bankers wish to save themselves from future questioning. It calls for a change in the system.

The bankers should be protected from harassment on commercial decisions of haircut in NCLT driven IB Code while they should also be pulled up for any loss to the banking system and to the productive assets due to their indecision. The Corporate Insolvency Resolution Process can never succeed without active and prudent participation of bankers.

Banks are not expected to close the economy. India is not closing and needs its industries for its people. Washing off its hand from the stressed assets at paltry liquidation value is in effect destruction of assets. Such an approach of banks would result in huge job losses and unemployment would rise multifold. Liquidation of companies at scrap value by the banks, even if the companies are in production, making profit, providing employment to a few thousand people, contributing to the government exchequer by making all tax and statutory payments on time, would be detrimental to the industrial scenario and socio-economic landscape of the country.

We are today at an opportune time to have the industrial development zoom forward because of various initiatives to propel growth taken by the government under the dynamic leadership of Narendra Modi, Prime Minister of India.However, the current approach in CIRP under IB Code 2016 raises serious concern and would certainly be a major damper that can derail the potential growth momentum, causing huge social distress. Government needs to provide proper guidelines and protection to the banks as they tackle the stressed assets.

There is need for an urgent intervention by the government before some valuable companies are condemned to the gallows. This would deal a serious blow to 'Make in India' and 'Start up India' killing the entrepreneurial spirit in the country.

CDR AS A RESOLUTION MECHANISM FAILED BECAUSE...

>> Restructuring was often done just to delay the classification of an account as NPA rather than making efforts to make it viable
>> The interest of banks was in maintaining the account as standard instead of ensuring revival and sustainable operations
>> There was no effort on the part of the banks to identify the reasons for sickness and to address them
>> The effect of downturn in external environment was often ignored
>> Banks were under a wish list syndrome in suggesting models that would be acceptable to their sanctioning authority with an eye on provisioning and NPA management, without considering viability