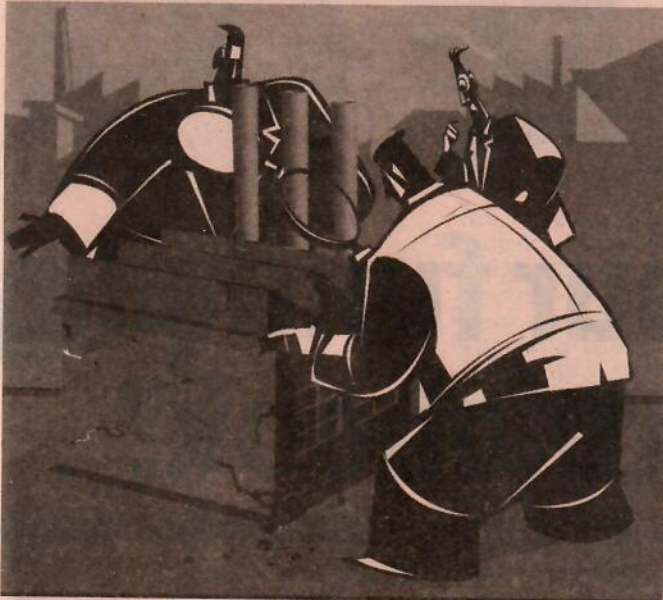


ILLUSTRATION BY AJAY MOHANTY



FIRMS UNDER CREDIT STRESS IN FY15 & FY16

Private non-financial companies

Number
8,275

Total borrowing

₹30.04 trillion

₹16.28 trillion

Bank borrowing

Of these, firms with ICR < 1.5 in both years

Number
3,296

Total borrowing

₹16.9 trillion

₹9.5 trillion

Bank borrowing

Prioritise pushing large firms via IBC

The need of the hour is to focus on the IBC pipeline, increase the quantity of assets flowing through it, and reduce the time taken

India has begun on resolving the corporate balance sheet, and four big firms have completed the process. The data for 2015-16 shows that there were 3,296 large private non-financial firms under a fair amount of credit stress. These added up to bank borrowing of ₹9.5 trillion and total borrowing of ₹16.9 trillion. Lenders, the RBI, the Ministry of Corporate Affairs (MCA) and the Insolvency and Bankruptcy Board of India (IBBI) need to move vigorously in order to put this chapter to a close.

There is a lot of criticism of the extent to which the IBC (Insolvency and Bankruptcy Code) process is allegedly pushing good firms into liquidation, or resulting in low realisations for creditors. From the viewpoint of the economy, however, it is a pure gain when a distressed firm is resolved. The firm (as a going concern) or its assets (through liquidation) go into new hands, who get back to a healthy balance sheet. This yields prosperity and employment.

As an example, Bhushan Steel has a capacity of about 5 million tonnes per annum. Under financial stress, it was producing about 3 million tonnes per annum. Post-IBC, capacity utilisation will surge in a few months. This is a gain of 2 million tonnes of steel produced per year. This augments GDP and jobs. This is a pure gain. Even if the creditors got a poor deal, there is

no question that this economic growth is obtained.

What is the magnitude of distressed debt in the country? We examine the private non-financial firms in the CMIE database. There are 8,275 large firms which are observed in both 2014-15 and 2015-16. These add up to ₹30.04 trillion of borrowing and ₹16.28 trillion of bank borrowing. We have focused on private firms, as bank lending to firms like Air India or Food Corporation of India is probably going to receive some preferential access to taxpayer resources.

The interest cover ratio (ICR) shows the level of stress in a company in merely meeting interest payments. A good way to identify stressed companies is to look for ICR values of below 1.5 in 2014-15 and in 2015-16. We find 3,296 private non-financial firms that are under financial stress. This list has ₹9.5 trillion in bank borrowing and ₹16.9 trillion in borrowing. A disproportionate amount of borrowing was in these stressed firms: While they are only 40 per cent by number, they make up 55-60 per cent by their share in borrowing.

What is the magnitude of bank lending to firms in the economy? We estimate this as bank lending excluding agriculture and excluding individuals. In 2015-16, this was ₹48 trillion. Therefore, the 8,275 firms that we see contain about a third of the over-

all lending by banks.

In the set of 8,275 firms, we are seeing ₹9.5 trillion in stressed bank debt. Does this mean that the overall stressed bank debt is about ₹28 trillion? We suspect this is not the case. Bank debt to public sector firms perhaps has some recourse to taxpayer resources. It is also likely that the large firms in sectors with the greatest difficulties (metals and infrastructure) are disproportionately in the sample. The remaining firms which are not seen by CMIE are likely to not have comparable levels of stress.

This evidence gives us a hint of the scale at which the bankruptcy process is required to work in India. The first 40 big firms have begun their journey in the IBC process, and of these four have finished it. This needs to scale up greatly. The need of the hour is to focus on the IBC pipeline, to increase the quantity of assets flowing through it, and to reduce the time taken.

Not all stressed firms will show up at the IBC. If the IBC works well, it enhances the bargaining power of lenders, and many settlements will be negotiated. These settlements should also get many private non-financial firms back into a state of health. If we push through about 1,000 of these CMIE-observed firms through the IBC process, perhaps the remainder will work out through private negotiations. We then face the question: How many years will it take to process 1,000 of these firms? What can we do to reduce the delay? There are four areas of work.

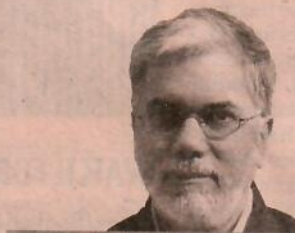
The drafting of the IBC amendment, which excluded promoters, has kicked off private detectives all over the country looking for ways to knock out a business rival in the IBC process on the grounds of family connections and defaults. This law needs to be amended to preserve the spirit of excluding promoters, but reducing the delays.

Bank regulation should force large markdowns at the first default so that banks have the incentive to vigorously carry cases through the IBC. If regulations require a 100 per cent markdown, banks have the incentive to use the IBC even if the recovery rate is just 10 per cent. If, on the other hand, regulations require a mere 50 per cent markdown, then banks have an incentive to drag their feet once it is clear that the recovery rate will be below 50 per cent. No amount of policy work on the IBC will yield rapid outcomes if the creditors lack hunger. Technically sound banking regulation is a key requirement.

There are concerns about the working of the National Company Law Tribunal and the National Company Law Appellate Tribunal. A significant backlog has started developing here. The traditional Indian approach has consisted in responding to a case backlog by adding judges. The productivity of judges can, however, be greatly increased through process improvement, with a separation between the judicial and administrative functions. We need to undertake business process engineering of courts. The MCA needs work towards a combination of more judges and higher output per judge.

The MCA and IBBI need to build a case management system where a web page is shown to the public at the first filing associated with any company. All events and documents about each case should be updated daily on this website. The MCA and IBBI could then obtain research evidence on the sources of delay, and solve the problems.

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SNAKES & LADDERS

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