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CORPORATE DEBT RESTRUCTURING: CONCEPT, ASSESSMENT AND EMERGING ISSUES

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ABSTRACT

Corporate Debt Restructuring (CDR) has been used by the companies while facing ugly finances and the bankers willing to consider a flexible mechanism such as CDR, as the banks /financial institutions have to reduce their Non Performing Assets (NPA) .Based on the recommendations of the Working Group on CDR Reserve Bank of India (RBI) has appealed to the corporate to be exercising caution and financial discipline and the bankers to be prudent and vigilant while granting the CDR to the borrowing companies based on their prevailing financial situation. This research paper assumes topical significance now. The research paper is structured as follows: Firstly, it attempts to study the concept of CDR from the borrowing company's context as well as from the lending bankers view. The Second part would present statistics on NPA and analysis. The Third part would examine the impact of CDR to the banking system and the economy and the emerging issues and perspectives would be posed in the Conclusion.

Keywords: Corporate Debt Restructuring, Non Performing Assets Restructured Standard Advances, Reserve Bank of India, Banking System

Corporate Debt Restructuring (CDR)

CDR is an effective financial tool to provide a flexible mechanism to the corporate management to get back to the top line growth oriented performance ,cutting overheads / other unnecessary expenses consolidating their operations and streamlining their balance sheets, cash flows and finances . CDR would also include heavy dose of financial discipline to be followed by the internal operations, improve cash positions in the short term as well as the short term along a structured path of recovery. As part of corporate restructuring, it might extend into spinning off new divisions and even diversifying into related /unrelated businesses as the emerging circumstances require. It would also expect the company to take up strategic acquisitions to raise the business sophistication or alter its business mix. Alternatively, it may entail heavy use of leverage and even share repurchase/buy back mechanisms, raise EPS and discourage hostile tender offers.

From the Bankers point of view, it should be attempting to help the borrower with a financial arrangement ,who is facing distress temporarily ,to tide over and become financial viable and restoring their finances . CDR is a specialized institutional mechanism for restructuring large exposures involving more than one lender under consortium/multiple banking arrangements. Stijn Claessens of the World Bank has defined 'restructuring 'refers to the several related processes -recognizing and allocating financial losses ,restructuring the claims of financial institutions and corporations and restructuring the operations of financial institutions and corporations. Losses, i.e. differences between financial institutions and corporations ' market value of assets and nominal value of liabilities can be allocated to shareholders by dilution ,to depositors and external creditors by reduction (of the present value) of their claims ,to the employees and their suppliers by payment of lower wages and prices ,to the government ,i.e. public at large ,through higher taxes and expenditure cuts or inflation. Financial restructuring for corporations can take many forms: rescheduling (extension of maturities), lower interest rates, debt for equity swaps, debt forgiveness, indexing of interest payments to earnings and so on. The main aims of financial restructuring are separating and treating appropriately viable and non viable firms and creating right incentives for operational restructuring. Operational restructuring, an on-going process, includes improvements in efficiency and management, reductions in staff and wages, sales of assets (e.g., reduction in subsidiaries), enhanced marketing efforts, and so on, with the expectation of higher profitability and cash flow. "

While appreciating the multifaceted dimension of the above definition and application, one should admit that restructuring of corporate loans and advances is not a new phenomenon and the terms such as restructuring/renegotiation/rehabilitation/rescheduling have been used interchangeably by RBI and the lending institutions since 1970s, when industrial sickness was formally accepted as an economic and industrial financing phenomenon in Indian economy. The RBI guidelines on bank loans restructuring have evolved over a period of time since late 1970s, when natural calamities affected the various sectors of the economy and the need for developing comprehensive guidelines for restructuring of corporate loans by the consortium of banks /financial institutions was felt. These guidelines have been modified and refined with the changing dynamics of financial and real markets, by considering the international best practices (notably U.K. Thailand, Korea, Malaysia) and recommendations of various committees and feedback from the stakeholders. The objective of CDR framework was to ensure a timely and transparent mechanism of restructuring of loans for viable entities facing problems outside the purview of BIFR, DRT, and other legal proceedings including SICA.Viablity of the account was considered more vital for restructuring with malfeasance /fraud and cases of willful default being barred from the CDR framework. These guidelines also adopted the existing asset classification as per the NPA guidelines (March 2001).When companies are hit by extraneous circumstances that affect their performance and hence their ability to service bank loans, restructuring of the debt is done in terms of tenure, swaps, interest rates etc. This would enable the company to recover and the bank does not treat the loan as an NPA. Structured CDR ensures transparency in procedure and limits arbitrariness. The current CDR framework has also considered the subsequent recommendations of Shri Vepa Kamesam Committee (March 2005) and Smt.S.Gopinath (November 2005).

Trends in Corporate Loans Restructuring

CDR has come under the scanner because of the significant increase in the number and volume of advances being restructured by the banks under the Scheme in the recent years as presented in the Table 1 below:

Table 1.

Particulars		**Mar.2009**	**Mar.2010**	**Mar.2011**	**Mar.2012**
Gross Advances	Gross advances (Cr.)	27,53,365	32,27,287	39,82,954	46,55,271
Restructured Standard Advances (RSA)	RSA (Cr.)	75,304	1,36,426	1,37,602	2,18,608
Restructured to Gross Advances	Ratio (%)	2.73	4.23	3.45	4.68

Source: RBI Monthly Bulletin, September 2012

The Guidelines of CDR have been used by the banks with a way to secure advantages both to the corporate borrowers and the banks under the circumstances of economic downturn and temporary cash flow problems. However, due to the extraordinary rise in the cases referred to and restructured under the scheme, serious attention has been drawn as to whether this indicates a general downturn or gross misuse of CDR mechanism by the corporate borrowers and the lending institutions. The reason for choosing the data on RSA as given above is to probe the possibilities of unviable accounts being restructured along with providing more time for the companies to improve their finances and move on the path of recovery. The rise in resorting to restructuring can be partially attributed to excessive leveraging by some borrowers during the boom period. It is observed that between March 2009 and March 2012, while total gross advances of the banking system grew at a compound annual growth rate of less than 20 %, RSA grew by more than 40 %. As a result, the proportion of RSA to Gross Total Advances grew from 3.45 % in March 2011 to 4.68 % in March 2012. A further detailed examination of RSA to various sectors is presented in the Tables 2 & 3 below:

Table 2.

Trends in Restructuring across Sectors – Growth Rates (per cent)

Particulars	2009-10		2010-11		2011-12	
Segments	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances
Agriculture	25.74	64.91	15.65	11.16	15.09	20.74
Industries	24.14	93.87	26.96	(-) 0.23	19.52	64.70
Industries – Micro and Small	13.06	52.79	12.84	(-) 3.61	20.32	(-) 17.51
Industries – Med and Large	26.79	99.21	29.96	0.11	19.38	72.59
Services	29.02	79.91	31.99	35.67	20.74	134.34
Services – Micro and Small	53.87	49.44	42.19	1.50	14.74	1.02
Services – Med and Large	22.03	89.36	28.37	44.04	23.10	157.35
Others	1.08	49.37	16.78	(-) 14.80	11.20	(-) 16.04
Total	17.21	81.17	23.41	0.86	16.88	58.48

Source: RBI Monthly Bulletin, September 2012

Table 3.

Ratio of Restructured Standard Advances to Gross Advances (per cent) across Sectors

Particulars	March 2009	March 2010	March 2011	March 2012
Agriculture	1.10	1.44	1.38	1.45
Industries	4.87	7.60	5.98	8.24
Micro and Small	2.91	3.93	3.36	2.30
Medium & Large	5.34	8.39	6.46	9.34
Services	1.43	2.00	2.05	3.99
Micro and Small	1.54	1.50	1.07	0.94
Medium and Large	1.40	2.17	2.44	5.10
Others	1.78	2.62	1.91	1.45
Total	**2.73**	**4.23**	**3.45**	**4.68**

Source: RBI Monthly Bulletin, September 2012

The analysis as given in the above table indicates that ratio of RSA to Gross advances is the highest for the Industries sector at 8.24 % (with medium and large industries being at 9.34 %). The ratio for Agriculture stood at 1.45 %, while that for Services stood at 3.99 % (with Micro & Small services being at 0.94 %).The data clearly indicates restructuring is resorted to liberally in the industrial sector (particularly large industries) ,while the borrowing for agriculture and small industries have lower RSA. The above trends reinforce that the banks have been more liberal to Industries sector than Agriculture and Small industries which are the priority sector!

Impact of CDR on the Banking System

Ideally, the granting of CDR decision and sanctioning reliefs to the borrower company is a bilateral decision between the banks and borrower companies. As the prevailing finances of the borrower indicate operational deficiencies and sickness, the banker's decision on CDR and related reliefs to the borrower are valid. From the Banker's point of view, as long as the assistance provided to such borrowers had become substandard/ NPA, granting CDR is nurturing the company to become viable and recover its profitability. Further, if the terms and conditions of loan, especially in relationship to repayment is not adhered to after a specified period of time, the account is classified as NPA. If accounts are restructured, then too, the terms and conditions are not fulfilled. But such accounts are not classified as NPA. From an operational perspective, there can be two types of restructured accounts: the first those accounts which are restructured and classified as NPAs; the second type are those which are restructured, but the asset classification is retained as standard. In general, a NPA account can be upgraded when the terms and conditions of the loan are fulfilled by the borrower. In the case of RSA, the original terms and conditions of assistance are changed.

Hence, the issues of the conditions under which the account can be considered as standard or upgraded to the standard category become pertinent. Banking Guidelines lay down the broad parameters under which RSA can be treated as standard. The second type of RSA, however, attracts more regulatory attention from RBI, is the potential of the accounts being restructured, at times, repeatedly, to avoid classification as NPA. The second category poses a moral hazard of a higher degree. Analyses of the trends in leverage of the larger corporate borrowers during the recent years signify the alarm. (Tables 4 &5)

Table 4.

Trends in Restructuring across Bank Groups – Growth Rates in per cent

Particulars	2009-10		2010-11		2011-12	
	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances (*)
All Banks	17.21	81.17	23.41	0.86	16.88	58.48 (42.54)
Public Sector Banks	19.81	96.59	22.98	3.86	16.02	58.33 (47.86)
Private Sector Banks	12.80	5.60	26.60	(-)28.48	20.65	67.35 (8.12)
Foreign Banks	(-)1.38	(-)25.06	19.06	(-)27.56	16.35	(-)23.76 ((-)25.48)

(*) Figures in brackets are the compound annual growth rates between 2009 and 2012

Source: RBI Monthly Bulletin, September 2012

Table 5.

Ratio of Restructured Standard Advances to Gross Advances (per cent) across Bank Groups

Particulars	March 2009	March 2010	March 2011	March 2012
All Banks	2.73	4.23	3.45	4.68
Public Sector Banks	3.03	4.97	4.20	5.73
Private Sector Banks	2.19	2.05	1.16	1.61
Foreign Banks	0.73	0.55	0.34	0.22

Source: RBI Monthly Bulletin, September 2012.

The reasons for the above trend are not hard to find. Deficiencies have been observed in the manner in which the project appraisal is conducted, especially with regard to cash flow analysis and project completion date has been determined. When commercial operations are delayed, a host of factors, including the uncertainties surrounding the project are cited as the reason. Ideally, the proper cushion has to be shown to take care of the uncertainties. Instead, the effort is to appraise a project, keeping in view an aggressive repayment schedule resulting in a very short term focus of the borrowers, banks and financial analysts who appraise the project. The short term focus, indeed the culprit reason, in many cases, for successive restructuring.

An in-depth analysis of the tables 4 & 5 suggest distinct trends in RSA in public sector banks, private sector banks and foreign banks. RSA have grown at a compound annualized growth rate (CAGR) of 47.86 % in public sector banks against a growth rate of credit of 19.57 %. The corresponding figures for private sector banks and foreign banks are 8.12 % (RSA) and 19.88 % (credit growth) and 25.48 % (RSA) and 10.96 % (credit growth) respectively. Further, as on March 2012, the ratio of RSA to Total Gross Advances is highest for PSBs at 5.73 %, while the ratio is substantially lower for private and foreign banks at 1.61 % and 0.22 % respectively. It is also observed that PSBs share a heavy burden of RSA which suggests that PSBs have not been as judicious in the use of restructuring as a credit management tool as the private sector and foreign banks.

The data on RSA also bring our attention as to whether the small and marginal borrowers have been discriminated against by the banks for restructuring of their accounts, even if found viable. Again, if the economic downturn were the sole reason for increase in RSA of late, then the downturn would have affected the weaker segments of the economy, i.e. SME .Our data, on the contrary, seems to suggest that the PSBs have shown more bias to large enterprises with regard to RSA, than SME.

'The Economist' (London) has observed that India's PSBs are sitting on something unpleasant (restructured loans/advances). Our own Indian Economic Daily' The Economic Times' has also commented that the present practices are completely defeating restructuring.

CONCLUDING OBSERVATIONS:

- CDR as an instrument has been used by the banks as well as the borrowers for more than a decade now. The CDR mechanism has been devised as an institutional mechanism to support the large, viable accounts, judiciously and to preserve the values of large exposures of banks.
- RBI Guidelines on CDR have acted as a moral alarm on the banking system to prevent misuse or abuse of the framework of CDR guidelines. Overall, the RBI framework has been a guiding post for the banks over the recent decade of recession and difficulties both for the banks and the borrower industries.
- RBI Committee headed by Shri. Mahapatra has recommended withdrawal of regulatory forbearance on asset classification on restructuring considering the current macroeconomic situation and global situation for a period of two years. This recommendation would provide necessary fillip to the ailing companies.

- Against the scenario of introduction of BASEL III guidelines to the banks in the economy, it is appropriate that the asset classification, provisioning and capital adequacy provide adequate cushion against temporary cash flow problems and related sickness of the borrowers and enable to recover and reach the healthy and profitable status in the specified time period.

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