A Comparative Study of Restructured Advances of Public Sector Banks and Private Banks

Sarika Gupta*
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Abstract

When the company cannot meet with its financial obligations or paying the debts when they are due, the company can be considered to lead to a debt trap situation and accordingly the company may face insolvency. Thus, to avoid insolvency problems the restructuring of advances require. Financial restructuring is offered to all sectors and industries i.e. manufacturing sector, service sector, infrastructure sector, trading activities and it also includes micro, small, medium and large industries including proprietary concern, partnership firms, cooperative societies, private and public limited companies and public sector undertakings. There are various tools available for financial restructuring but some of them are massively used during past years and Corporate Debt Restructuring is one of them. The study is mainly focused on the data available with CDR cell, BIFR, RBI and published news related to area of study. The study covers only cases of CDR process.

Keywords: *Financial Restructuring, Corporate Debt Restructuring (CDR), Reserve Bank of India (RBI), Banking System.*

Scope of Corporate Debt Restructuring in Financial Restructuring:

Introduction: Financial Restructuring is a process geared to avoid the liquidation of the Company. It involves agreement by third parties to satisfy creditor's claims under certain terms and conditions. Financial restructuring may also be carried out by concluding an agreement with all creditors of the Company under which creditors will be paid on somewhat different terms than those initially accepted by the Company when credit and loans were extended. This form of financial restructuring enables the Company to continue its operations and minimize creditor's losses and getting more time for repayment of debt.

Companies use debt restructuring to avoid default on existing debt or to take advantage of a lower interest rate. A company will often issue call bonds to allow them to readily restructure debt in the future. The existing debt is called and then replaced with new debt at a lower interest rate.

Companies can also restructure their debt by altering the terms and provisions of existing debt.

The major causes behind implementing various financial restructuring methods are structural transformation and have also faced numerous problems during their implementation, expansion, diversification or sustainability of the project. They also faced severe financial crunch at certain point of time. This necessitated study of some empirical consequences. In the above backdrop, this study was undertaken to find out scope of CDR in financial restructuring. Hence an attempt has been made to examine the utility of corporate debt restructuring from various tools of the financial restructuring in India.

The period before 1991 was known as pre-reforms period wherein the Indian economy was mainly governed through industrial licenses and controls, monitored interest rates as well as dominant role played by public sector companies, Government corporations and very few business houses, facing very less competition. Considering the nascent stage of economic development, the system could have been considered as better for the said period but it had made its own impact such as uneconomic and uncompetitive production systems leading to the higher cost of production and inefficiency. From 1980 onwards, deregulation policy was initiated, the government relaxed entry barrier and slowly and gradually removed certain restricted clauses in the MRTP Act, allowed expansion of capacities, reduced import restrictions as well as encouraged modernization of industries. The high production growth was witnessed during 1980 1990 but again the growth could not be sustained after the 1990s due to various external factors such as sharp increase in the world oil prices, sharp devaluation of Indian rupees and opening up of the economy by adopting various economic reforms during June 1991 which resulted in sudden exposure of Indian industry to the outside world.

Rodrik and Subramanian (2004) distinguished between pro-business orientation of the 1980s and the pro-market orientation of the 1990s. According to them, the former focused on rising of the profitability of the established

*Assistant Professor, P.M.B. Guajarati Commerce College, Indore
** Research Scholar

companies by removing price control, reduction in corporate taxes and easy restrictions on capacities for established enterprises which all took place in 1980s drawn to favor incumbents and procedures. On the other hand, pro-market reforms focused on removing impediments for the functioning of the markets, allowing increased competition, both in domestic and foreign front. The pro-market reforms have mainly affected the business environment of the Manufacturing sectors and it had hardly added anything to the aggregate economic performance. Due to these reforms, numbers of industrial companies have started performing from good to bad and bad to worse. As per the World Bank data, during 1985, there were 1,60,000 sick units in India of which only 60 closed during that year These sick units are performing at the cost of entire economy under the guise of public interest by means of various concessions and subsidies in all the forms. Up to 1990, Indian economy and industries were not affected by the global market due to the closed economy policy followed by the government. As soon as the reforms in the form of liberalization and globalization policy were adopted, the industries have started feeling sudden jolts from the outside world. Lot of uneconomic and unviable companies had to close down their shutters as they could not face global competition with the reduction in the import duty rates as well as improvement in the infrastructure facilities resulting in reduced transportation cost made various global products cheaper than the countries own product and accordingly the Indian industries had to either make them competitive or to wind up their businesses.

Indian economy has witnessed lot of cyclical changes during last 19 years due to liberalization, privatization and globalization (LPG). Following liberalization in 1991, India has made great efforts to foster industrialization with an aim of promoting economic development. Lot of pro market reforms have taken place including focus on removing impediments for the functioning of the market. It has allowed increase in competition both from international and domestic market. The changes in the pro market reforms affect the business environment of the manufacturing sector. Because of the globalization as well as integration of Indian economy with the world economy, new challenges have been thrown open for the corporate sector and they were amenable to the external economic environment. More premature financial problems have been witnessed in the Indian corporate sector. It was imperative for the Government to have effective mechanism in place to deal with the corporate financial problems.

Literature Review: Finance is the life blood of business. A unit may be unviable because of a major lubricant i.e., finance. There are various mechanisms available to a firm for revival. Financial Restructuring is a favored mechanism for firms in red. Does corporate debt restructuring is useful tool for financial restructuring and it help in improving the financial performance of a firm? An attempt has been made in this Chapter to undertake extensive literature review in this area both in National and International context.

Christopher and Neill Marshal (1992) conducted a study on Corporate Restructuring in the Financial Services Industry and contended that large firms transmit the dynamics of contemporary restructuring and in turn, establish a symbolic relationship with places. The paper concludes that closer market integration results in divergent organizational forms, with district geographical expressions.

Bowman and Harbir Singh (1993) in his study on Corporate Restructuring, they have concluded that Financial restructuring, when accompanied with investment in key strategic activities, can be effective for the firm.

Gibbs (1993) in his study stated that there occurs three types of corporate restructuring transactions: 1. Financial restructuring including recapitalizations, stock repurchases, and changes in capital structure, 2. Portfolio restructuring involving divestment and acquisitions and refocusing on core business, resulting in change of the diversity of business in the corporate portfolio; and 3. Operational restructuring including retrenchment, reorganization, and changes in business level strategies. These three types of restructuring are not mutually exclusive; and in fact, frequently occur together. The findings of the study support agency conflicts as a partial explanation of corporate restructuring and confirm the importance of outside directors, stock-based management compensation, and an active, well-functioning market for corporate control in preventing and correcting agency problems.

Djankov and Colln Xu (2000) made comparative study of the growth and financing patterns of East Asian Corporations in the years before the crisis with those in other countries. The conclusion was drawn that the East Asian financial crisis showed that risks arising from the corporate sector typically occurred because of institutional weaknesses, including weak property rights, poor bankruptcy and accounting procedures, lack of transparency, and weak or perverse incentives.

O. N. Singh (2004) in his article of business line defines the main objects of CDR as: revival of units by increasing their production within a time-frame and, if necessary, by changing the management with government support. The CDR mechanism has not proved effective in redressing loan delinquency by big borrowers; it has, in fact,

enhanced the losses.

Stevan T. Kargman in his research on Project Finance Restructurings and Corporate Debt Restructurings in the Emerging Markets: A Comparative Overview state In many emerging market jurisdictions, the local insolvency law may not provide lenders with a special priority if they provide ongoing financing to an insolvent debtor, and in out-of-court restructurings there may be a reluctance among lenders to provide such funding absent special arrangements among the debtor's major creditors which may be difficult to arrange.

Gilson (2010) in his article on A comprehensive discussion of restructuring possibilities The author presents a number of restructuring case studies of companies operating in the US. The cases are divided into three modules: financially distressed firms that restructure their debt contracts, cases where equity contracts were restructured, firms that restructured their employee contracts to control labor costs. Information garnered from the first module is used in this article

Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India (august 2012) in his speech elucidate CDR, has come under the attention because of the extraordinary rise in the number and volume of advances being restructured under the scheme in recent times. The guidelines on restructuring have generally been used to the advantage of both the borrowers and the banks in situations of economic downturns and temporary cash flow problems. However, due to extraordinary rise in the cases referred to and restructured under CDR mechanism during the current and previous fiscal years, questions are being raised as to whether this indicates a general downturn or gross misuse of the CDR Mechanism by banks and corporate borrowers.

The literature review reveals that there is an acute need for studying various type of restructuring methods including Corporate Debt Restructuring, which is showing an increasing trend over the years not much research undertaken as far as the financial restructuring in the Indian context is concerned. Again, with the changes in the overall economic policy, business environment and legal system, a sea change in the financial sickness as well as revival measures adopted by promoters, financial institutions, banks, Reserve Bank of India and the Government of India has been observed. There are very few empirical studies on the impact of financial restructuring on corporate performance. Empirical research is needed to find scope of CDR in financial restructuring. Moreover, financial restructuring is effective in which types of firms i.e. large, medium or small size firms. This study attempts to fill these gaps identified through literature review.

Scope of the Study: Financial restructuring is offered to all sectors and industries i.e. manufacturing sector, service sector, infrastructure sector, trading activities and it also includes micro, small, medium and large industries including proprietary concern, partnership firms, cooperative societies, private and public limited companies and public sector undertakings. It is not feasible to have data of micro and small industries because of non-availability of adequate published information. Moreover, most of them are in the unorganized sector, which makes it difficult to get financial and audited data of such firms. Infrastructure sector has been identified as a thrust area only during last decade and most of the firms under this category are either new firms or do not have adequate tenure wherein restructuring was required or has yielded result. On the other hand, service sector and trading activities do not have adequate asset base and in most of the cases, the banks/ financial institutions as well as promoters would like to take recourse of liquidation/ insolvency/winding up process instead of restructuring.

In light of this, the study is mainly focused on the data available with CDR cell, BIFR, RBI and published news related to area of study. The study covers only corporate who have emerged from either BIFR proceedings or CDR process.

Causes Leading to Financial Restructuring: When the company cannot meet with its financial obligations or paying the debts when they are due, the company can be considered to lead to a debt trap situation and accordingly the company may face insolvency. Thus, to avoid insolvency problems the financial restructuring is required. The following are the main reasons leading the company to debt trap situation:

- Financial: Short term funds utilized for long term purpose and there is a cash flow mis-match, Diversion of Funds, Wrong Financial Planning with higher leverage either at conceptual stage or during expansion or diversification, loose control on Receivables or Unnecessary piling up of Hugh Inventory, etc.
- Market Driven: Not recognizing the need for change in the market or the products of the company may become obsolete or redundant resulted in poor demand and there is no scope for the company to change the product line/product mix resulted into debt trap situation.
- Wrong Product/Market: Single customer or few customers to whom the company is catering to and because of change in their product mix or because of insolvency of the customer, huge bad debt occur resulted in the debt trap of the company.

- Managerial: Management failure which includes acquiring adequate skills or lack of information system leading mismanagement and liquidity crunch situation.
- Technological: Obsolete technology or Hugh Investments in Assets with rapid continuous change in the technology.
- External Factors such as sudden opening up of economy and cut-throat competition from the foreign players or de-valuation of currency when industry depends on heavy imports or de-valuation of foreign currency when unit depends upon exports of the said country only.
- Over Expansion of the Capacity or Untimely diversification.
- Effect of international market and sudden volatility in the prices leads to insolvency.
- Other factors such as workers' strike/lockout, death of key promoter/key technical/managerial person resulted in loss of interest by the management, environmental factors or accident in the factory premises, statutory permissions, etc. which may lead to closure of the plant.

Need for Restructuring: Number of times a question arises that why sick units should be restructured and makes it financially viable. Following are the main reasons for making sick units viable:

- Unless sick units are restructured and make it viable, the assets of the industry remain idle which can cause a great loss to the country.
- A running unit can provide employment to the workers and others. It achieves the social goal of providing employment opportunities to the people at large.
- A running industry can contribute to the exchequer of the Government by way of tax/duties and thus it will definitely help in contributing increase in government revenue.
- When there is a global crisis, as witnessed during 2008, it is the responsibility of the State to provide proper restructuring to all the industries in general so as to give impetus to the economy & take country out of the grip of the recessionary trend. To provide restructuring to certain essential product manufacturing companies so that overall industrial growth can be maintained at bench mark level.
- To provide restructuring for better utilization of overall resources of the country.
- To unlock NPA accounts of the bank or not allowing standard accounts to slip to sub-standard accounts or doubtful category, restructuring is always welcome measure to reduce overall NPA of the banking system.
- To bail out the genuine promoters/genuine industries out of difficulty.
- In case of large industry, where numbers of other industries/ancillaries are dependent on the said large unit, it is desirable to restructure the account of the large unit for not impacting other ancillary industries.

Methods of Financial Restructuring: Financial restructuring includes:

- Re-phasement of the Loan
- Re-schedulement of the Loan
- Re-structuring of the Loan
- Infusion of funds by promoters/Strategic Promoters
- Additional funds to be provided by Banks & FIs at concessional rate of Interest
- Conversion of Part of the Loan in to Equity Capital or Preference Share Capital
- Conversion of Working Capital in to Working Capital Term Loan
- Converting Interest due in to Interest Funded Term Loan Amalgamation of Sick Unit with Healthy Unit
- Sale of Excess/Non-Used Assets of Sick Industry
- Change of Management
- De-merger of Undertaking of the Sick Industry and raise funds for the resultant Company
- One Time Settlement with the Banks/Unsecured Creditors/Statutory Creditors and Workers by infusion of funds by Promoters/ Strategic Investors
- Capital Restructuring by Reduction of Capital and Infusion of Additional Funds by Promoters/ Investors Reduction or Waiver of Interest/Principal by Banks and Financial Institutions
- Raising of Additional Funds for the Company by mortgaging additional assets of promoters or Pledge of Shares of Promoters
- Partial Sale of Assets/Conversion of Loan in to Equity/Waiver of Interest and Principal/ Commencement of Job-work of idle capacity
- Providing Subsidy by Government and Priority in Government Tender
- Providing Additional Loan and Recovery of Old and New Loan through cut back system, etc.

The financial restructuring is achieved either by taking any one of above measure or more than one measures simultaneously.

Legal Basis of Financial Restructing in India: Laws which shall prevent insolvency in the country and resulting into financial restructuring are classified as under:

- Companies Act, 1956 (Section 391 to 396)
- Companies Act, 1956 (Section 425 to 560 deals with winding up)
- Companies Amendment Act 2002
- Companies Bill, 2008
- Sick Industrial Companies (Special Provision) Act, (SICA) 1985
- Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDBFI Act) (Debt Recovery Tribunal)
- Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002 (Securitization Act)
- State Financial Corporation Act,1951

Quasi or Non judicial Basis of Financial Restructuring in India:

- Corporate Debt restructuring Mechanism scheme
- RBI guidelines to banks for re-schedulement/ restructuring of debt
- Banks' internal guidelines
- Lok Adalats

Above classification reveals that there are various laws applicable in the case of financial restructuring, but legal procedure have there drawbacks also for example lengthiness, time consuming, strict rules and regulations etc. so that These types of laws are not very preferable by the borrowers who are facing financial difficulties and facing esteem need of funds , they prefer to use any mechanism which are out of preview of laws and regulation and easy going also, this requirement are fulfilled by government after a long discussion with RBI, Financial Institutions, Banks etc. and introduced Corporate Debt Restructuring mechanism in the year 2001, with the main object to help corporate who are facing financial difficulties out of the preview of BIFR.

Objectives:

1. To determine restructured advances of Public Sector Banks in recessionary period.
2. To determine restructured advances of Private Sector Banks in recessionary period.
3. To analyze trends in restructuring of advances of Public Sector Banks during the period of recession.
4. To analyze trends in restructuring of advances of Private Sector Banks during the period of recession.
5. To make compression in advances restructured of public sector banks and private banks.

Research Methodology:

Hypotheses:

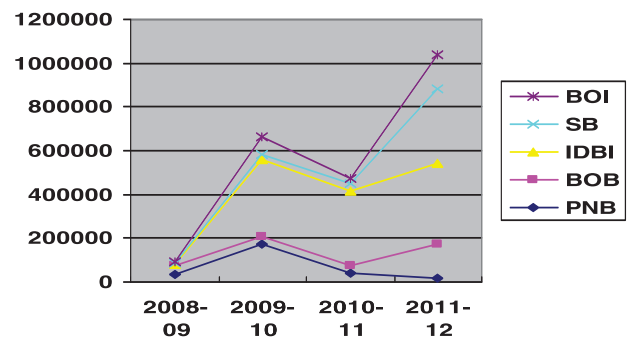
Ho: Restructured advances of public sector banks are not showing any specific trends.

Ho: Restructured advances of private sector banks are not showing any specific trends.

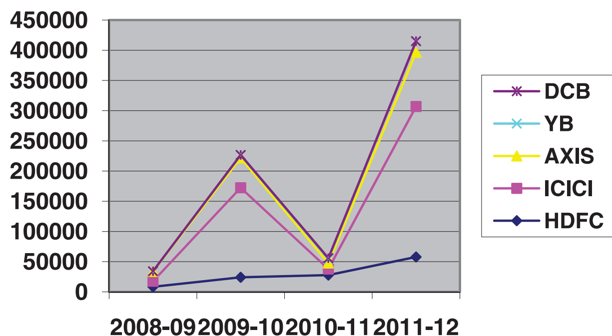
Ho: Restructured advances of public sector banks and private sector banks are not correlated.

Result and Interpretation:

Banks	2008-09	2009-10	2010-11	2011-12
Punjab National Bank (PNB)	35256	170637	41014	200890
Bank of Baroda (BOB)	37759	35576	32025	153400
Industrial Development Bank of India (IDBI)	5608	350969	344839	361170
Syndicate Bank (SB)	8558	26019	32919	34370
Bank of India (BOI)	6797	81979	23869	156460



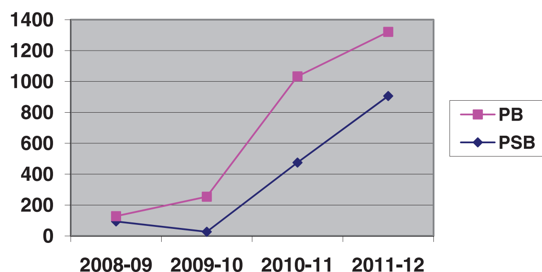
Banks	2008-09	2009-10	2010-11	2011-12
HDFC Bank	8423	24111	27797	57830
ICICI Bank	9122	148268	9937	249090
AXIS Bank	16258	49371	9944	89610
YES Bank	344	4351	6598	18440
Development Credit Bank (DCB)	-	577	1500	40



Correlation

Years	Debt Restructured of PSB's (X)	Debt Restructured of PB's (Y)
2008-09	94	34
2009-10	27	227
2010-11	475	558
2011-12	906	415

Correlation Coefficient of above data: 0.52



Graph of Restructured Advances of PSB & PB

As correlation of PSB and PB is 0.52 it shows the restructured advances of PSB and PB are positively correlated which is also proven by graph. So we reject our third hypothesis because restructured advances of PSB & PB are positively correlated

Conclusion: From the above analysis it is clear that advances restructured by PSB and PB are positively correlated that means there is no difference in trends of restructured advances of PSB & PB. But the correlation between them is only 52% this concludes less degree of correlation between them. With this statement we can explicate that restructured advances of both type of banks are increasing and decreasing in same pattern. We can also say that if economic downturn is only the cause of increasing number of restructured advances of PSB & PB than it must only be increased during the period of recession but they are increased in year 2009-10 than decreased in year 2010-11, than again increased in 2011-12 so we can elucidate that economic downturn is not only responsible for increase in restructured advances there are various other factors which work on it.

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