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India Gallops

Insolvency and bankruptcy code

The Government of India is consistently introducing reforms for sustainable growth. It is interesting to look at the figures, which is self speaking. India today is a 2.4 trillion dollar economy and is the 5th largest economy in absolute terms. In 2007, it was a 1 trillion dollar economy. By 2016, it added 1 trillion dollar to itself. It took us 9 years. But look at this-in last 18 months, we added 0.4 trillion and we are going from strength to strength. We could become a 5 trillion economy in next 5 years and when that happens India will be the 3rd largest economy in the world.

In October, 2016 total deposits touched Rs.100 lakh crores in India. In 2011, the figure was Rs.50 lakh crores; In 1995-It was just Rs.5 lakh crores. These figures are not anecdotal in nature. In last 20 years, inspite of all upheaval and turbulence, we have emerged as mature and consistent players. From T+20 we have gone to T+2. Equity markets have played and will keep on playing a large role. Credit market and equity market moving hand in hand will take our economy to newer heights.

India nationalized the Banks about 45 years ago; the primary reason of which was democratization of credit. Lot has been done and it is surely a constant process. Further, through bond markets, credit can be made available to entrepreneurs, SME's etc. The sector is lying quite starved of credit. Current credit to GDP is only 65%. Credit as a % to the economy should also grow.

The credit cost/borrowing cost matters a lot to everyone and more so to the SME sector. This sector is very closely looking at GST. Earlier they were able to manage through their own ecosystem but now it will not be the same anymore. Most of the businesses needs money quickly. Even if banks takes time, NBFC is slated to come to their rescue. The funds are not getting released from there also. Informal lenders are absent after demonetization. The market is minutely studying as to how GST will span out. Demand has been an issue. It is a function of liquidity. In case the rates are hotting up, credit demand may not pick up. The growth will pick up from the third quarter it seems with stable macros and amidst all, firmness in commodity prices. Corporate India is very mindful and is looking at their balance sheets very cautiously.

REITS will make an impact. That is the source of funding. The 5/25 program of RBI has also contributed. Banks are going to do the weightlifting of credit. The big chunk is still banks. Banks borrow short and lend long. The household balance sheet is also at a good shape. Global growth is encouraging. Question that looms large, is currency appreciation worrisome? It is going to make landed imports cheaper but ofcourse making the exports earn less.

Infra spending should boost growth. Lot of funds has been committed by the Government. Affordable housing can be one big catalyst. Logistics could be another sector which after GST is being watched closely. It can also see a big boost. Affordable housing goes hand in hand with home loans. Credit growth in real estate & Indian bond market will bring a magical change to the economy. In this direction, the Government of India has enacted the Insolvency & Bankruptcy Code, 2016 which is already proving to be a game changer and is instrumental is unlocking the stuck capital into the economy.

India is a constant work-in-progress and it is aptly mentioned that such a road is always under

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construction. Spectacular growth is happening in India. All eyes are glued towards India and it has now become irresistible, like probably never before, in the recent memory.

Would like to delve on the importance of having a whole-some insolvency and bankruptcy policy of the Country. It was looming large in the minds of the successive governments. An efficient bankruptcy law which would be instrumental in bringing in timely, swift and quick time bound intervention, either for restructuring in cases where there is still steam left in it or take it to liquidation without letting it remain in a vegetative state for a long time.

The law mentions the giving of moratorium to the Company which is walking through the process of the Insolvency Resolution. This moratorium acts like a calm period because the law gives the Company an immunity from all kinds of legal tussles and even the existing legal cases are not to be pursued by the institutor. In this calm period, the expectation from the administrator (in india, they are known as insolvency professionals) is to keep on carrying the business of the Company as a going concern and to be the facilitator to place a resolution plan which bridges the current gap of payments and receipts and also shows the road map for the Company to keep running by shedding the flab and having re-worked itself with realistic facts and figures.

The current gap in such cases is huge. The raw material and resources needed to build that bridge is not available in the market, for the simple fact that the Company does not have the matching net worth and it has, with efflux of time and/or various entrepreneurial and external challenges, has further eroded the value of its existing assets also, be it tangible or intangible.

Once the Company goes into the lurch for varied reasons and if the situation is left unchecked, unattended or not properly addressed, this gap becomes bigger and bigger and on one side the loan starts ballooning and on the other side the sources of funds starts to further dry up. It is a vicious circle. The Company gets into a situation of default and one deadline miss and then another and a pile up just happens. To get rid of one of these situations, the Company gets into taking another loan to pay off the earlier one, which is dearer and stringent. This princely loan then becomes a liability which has entered the existing vicious cycle and this also doesnot meet the expectations of timely pay offs. The business has its own needs of capital and in distress situations, to remain afloat, this need increases invariably. Unfortunately, when the business needs capital the most at a competitive price, that is the time when it become most expensive for them and also becomes scarce.

Let us come to a situation where with the first default, which if considered to be the first wake-up call, the Company is able to ring the bell and seek a healthy intervention of its lenders to help it come out of distress. If the liquidity position is bad, the lenders come together and with the help of a anchor person, takes very informed decisions and either considers it necessary to infuse fresh lease of life into the Company or decides to liquidate the Company on its persistent failure, if any.

Either ways, the whole idea is to keep the entrepreneurial stint intact, to recognize and distinguish bona-fide failures from mala fide intentions to make it fail, to keep the economy going by not de-locating the various stakeholders enjoined in that ecosystem and to make sure that there are not perpetual degradation of the assets of the Company leading to lesser and lesser realization from those assets.

Therefore, one of the fundamental objective of keeping it extremely water tight in terms of time schedules is 'asset value maximisation'. With each passing day, under distress situations, the value keeps on depleting and decaying. Secondly, in the calm period (moratorium), it gives opportunities to both the sides to very objectively think about restructuring the Company, its business, its management, if the need be and through re-negotiations try and find out a path which will lead to revival of its business and to bring it on track. A new priority of meeting its obligations is made and the Company continues its business.

To make sure that all of it is binding on all the parties, the Honourable National Company Law Tribunal adjudicates and gives validity to the renegotiated proposals and on the failure of restructuring process, the NCLT quickens the insolvency proceedings.

I was going through this article 'What not to say to the bereaved', which is an excerpt from the book, namely, Option B: Facing Adversity, Building Resilience, and Finding Joy, co-authored by Facebook COO Sheryl Sandberg, whose husband died suddenly while exercising in 2015, who talks about why it's important not to make death the elephant in the room.

She mentions, 'After the bereavement, at first going back to work provided a bit of a sense of normalcy. But I quickly discovered that it wasn't business as usual. I have long encouraged people to bring their whole selves to work, but now my 'whole self' was just so freaking sad.'

She shares, 'As people saw me stumble at work, some of them tried to help by reducing pressure. When I messed up or was unable to contribute, they waved it off, saying, 'How could you keep anything straight with all you're going through?'

She recollects and says, 'In the past, I'd said similar things to colleagues who were struggling, but when people said it to me, I discovered that this expression of sympathy actually diminished by self-confidence. What helped was hearing, 'Really? I thought youmade a good point in that meeting and helped us make a better decision.' Bless you.Empathy was nice, but encouragement was better.'

When I was reading this, my mind wandered to what we do with failing or failed businesses. The white elephant that it becomes in the room and with the account getting declared as an NPA and with all the noise that surrounds it, most of the interactions which occurs then, is cold, distant and stilted. The connections starts slipping away. The treatment is like that of leprosy at times. The various schemes of the Government made available to business for its revival and giving it a chance to bounce back is commendable, be it the SDR, CDR, 5/25 scheme, JLF and now the Insolvency & Bankruptcy Code, 2016. The new Code has been designed in a manner which doesnot make failure as the white elephant in the room. It may be called as the new 'normal'. And if it is the new normal, there have been ways and means prescribed to quickly extrapolate the available and involve the various stakeholders to come out with a conscious call, which is real and doable. The encouragement that comes with the realization that failure is not a sin and that even after failures, I can rise, is enough to give the mind a booster dose of stability.

Yes, like in today's world, it has become very important to make a distinction between fake news and real news, similarly, it is equally important to understand the difference between failing businesses and businesses which are meant to fail.

When we talk of fake news, we always have undermined the menace and gradually have realized that, inter-alia, technological tools have to be increasingly used to call out on hoaxers and traditional media have to be pepped up and increased spending needs to be done on investigative journalism. The existing institutions also needs to be further strengthened and that the response time to fake news have to be faster by using the same technology that troublemakers use to peddle fake news, otherwise very soon it will be difficult to identify the counterfeit from the genuine and the loss will be for everyone.

Similarly, in the world of business, it is equally important that genuineness is sieved well. The Insolvency & Bankruptcy Code, 2016 gives that power to the creditors who have lent the hard earned money of the countrymen to the businesses to further grow and generate wealth, which in turn keeps the different components of the economy running. If the creditors now undermines not only that business but may be, have recognized the true face of the intention behind it, have been given the power to punish the counterfeit by taking it to liquidation, straight away. After all, these funds are the ones which could have been used for public health, housing, poverty reduction and other worthy purposes, but got chosen for borrowings and if the business has no remnants, the lenders should realize whatever it can, without further deterioration in its value due to efflux of time. A question that craves for an answer is, 'Does these businesses also not get a last chance?'! leave this to be answered by the stakeholders themselves. The decisions will no more be taken by the debtors but this process under the new Code, shifts the balance of power to the creditors. The creditors take charge and if in their wisdom supported by facts and figures, it is important to give a last chance by the mechanism of a resolution plan which could also mean getting in a new promoter, it can be done.

Let us read this interesting case. I have picked it up from an article written in the newspapers, about the National Carrier,'Air India'. Air India's losses over decades have entailed countless write-offs and injections of fresh government equity. The previous Government decided in 2012 to pump in a whopping Rs.30,000crores to revive a sick giant that never recovers despite swallowing gargantuan doses of cash. At a time when airlines across the world are minting money because of low fuel prices, Air India lost Rs.3587 crores in 2015-2016 even while Indigo made Rs.1987 crores. A body which is profusely bleeding from all sides, with a debt size of Rs.46,000crores which is larger than the entire government outlay for MNREGA.

In its present form, Air India is too sick to privatise. The government and banks will have to write off a large chunk of its debt, something called a 'haircut' in financial parlance. Such haircuts are the standard procedure for reviving enterprises that have a future, provided past debt is written off. Air India has a large fleet, is a member of the star alliance and has slots at international airports, all of which have substantial value. The Government must disinvest and for that it must recast Air India financially to make it auctionable at a decent price.

This is just a case which explains even the working of several companies which is straddled with big size loans and have lost their hopes of revival with present balance sheet size and needs restructuring.

While reading through Warren Buffet's investment principles, an interesting write-up caught my attention and those days, I was going through the draft of the regulations being framed under IBC and it struck chord with me. Let me share with you. He mentioned that towards the end of August of 2005, one of the most dangerous tropical storms in history began brewing. As the tropical storm cut across the tip of Florida and entered the Gulf, it immediately began to swell. In less than 24 hours, the storm doubled in size. And as it grew into a full-blown hurricane, the weather experts gave it a name: Hurricane Katrina.

By the time the storm hit the southeastern coast of Louisiana, Hurricane Katrina was nearly 120 miles wide. A storm of Katrina's size is expected to cause flooding and damage, but coastal cities and neighborhoods use a variety of flood walls and levees to prevent total catastrophe. These walls are built along rivers and waterways and act as a barrier to hold back usually high waters and prevent flooding.

Shortly after Hurricane Katrina made landfall, it became clear that the levees of New Orleans might not be able to hold back the rising waters. Minutes later, the levees began to fail, and the entire districts became submerged in more than 10 feet of water.

The great mistake of Hurricane Katrina was that the levees and flood walls were not built with a proper "margin of safety." The engineers miscalculated the strength of the soil the walls were built upon. As a result, the walls buckled and the surging waters poured over the top, eroding the soft soil and magnifying the problem.

The term, margin of safety, is an engineering concept used to describe the ability of a system to withstand loads that are greater than expected. Of course, maintaining a proper margin of safety is crucial not only in construction and engineering, but also in many areas of daily life and businesses.

The point that I am driving home from this is, 'Are our businesses really pinpointing their risks in material terms and also implementing the mitigation plans for the same. Are they creating a margin of safety, which is bigger and larger than the leeves which is strong enough to endure the pressures?'. The idea is to protect the businesses from unforeseen problems and challenges by building a buffer between what it expects to happen and what could happen.Ofcourse, it is needless to mention that risks are an integral part of businesses and if there is no risk, there is no reward.

The Code cannot be the answer to all the problems. Definitely, it is working and it has put the defaulters on tenterhooks. The Government's intention of giving the creditors the safety net for their lent money and boost the bond market of the economy, thereby having more circulation of money is surely going to succeed. The money will therefore become less dearer and entrepreneurial skills will find more takers in the market place.

The world cannot ever become picture perfect but surely can become a pleasing experience in terms of doing clean business. ▪