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10.1 SUGGESTION FOR IMPROVEMENT OF CDR SCHEME

The Reserve Bank of India proposes to widen the scope of Corporate Debt Restructuring (CDR) and make it more efficient. Under the changes proposed today by the RBI to the existing guidelines, the Corporate Debt Restructuring scheme will be extended to corporate on whom banks and financial institutions have an outstanding exposure of Rs 10 crore as against Rs 20 crore currently. This could bring a larger number of sick units under the ambit of CDR. A corporate coming under the scheme would require the support of 60 per cent of creditors by number in addition to the support of 75 per cent of creditors by value.

This is being done with a view to make the decision-making process more equitable, the Reserve Bank of India said.

This is expected to give smaller lenders a say in the debt restructuring exercise. Until now, larger lenders have been enjoying greater influence in such exercises. To improve the efficiency of the Corporate Debt Restructuring scheme, it is proposed to link the restoration of asset classification prevailing on the date of reference to Corporate Debt Restructuring cell to implementation of package within three months from the date of approval of the package. This explained a banker, means that if a CDR scheme is not implemented within three months of its
date of approval, the advantages of classification of the assets would not be available to the borrower.

The RBI has also proposed one-time settlement as a part of the CDR scheme to make the exit option more flexible. This has fetched a positive response from bankers.

A Special Group under the Chairmanship of Smt. S. Gopinath, Deputy Governor, Reserve Bank of India has undertaken a review of the Scheme recently and suggested certain changes / improvements in the existing Scheme for enhancing its scope and to make it more efficient. Based on the recommendations made by the Special Group amendments proposed to the guidelines on Corporate Debt Restructuring are furnished in the 3. The major modifications proposed in the existing Corporate Debt Restructuring Scheme relate to

> Extension of scheme to corporate entities on whom banks and institutions have an outstanding exposure of Rs.10 crore or more.

> Requirement of support of 60% of creditors by number in addition to the support of 75% of creditors by value with a view to make the decision making process more equitable.

> Linking the restoration of asset classification prevailing on the date of reference to Corporate Debt Restructuring Cell to implementation of package within three months from the date of approval of the package.
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- Restricting the regulatory concession in asset classification and provisioning requirement to the first restructuring where the package also has to meet certain norms relating to turnaround period and minimum sacrifice and funds infusion by promoters.

- Convergence in the methodology for computation of economic sacrifice among Banks and Financial Institutions.

- Regulatory treatment of non-SLR instruments acquired while funding interest or in lieu of outstanding principal and valuation of such instruments.

- Limiting RBI's role to providing broad guidelines for the Corporate Debt Restructuring System.

- Enhancing balance sheet disclosures.

- Pro-rata sharing of additional finance requirement.

- Including OTS as a part of the CDR Scheme to make the exit option more flexible and.

- Discretion to the core group in dealing with willful defaulters in certain cases.

To make the CDR system effective there is a "standstill clause", the 'standstill' agreement is binding for 90 days, or 180
days by both sides. Under this clause, both the debtor and creditor(s) shall agree to a legally binding 'standstill' whereby both the parties commit themselves not to taking recourse to any other legal action during the 'standstill' period, this would be necessary for enabling the CDR System to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. This is applicable for civil action.

10.2  

SUGGESTION FOR IMPROVEMENT IN CONTROLS FOR REDUCING NPA's

Subsequent to the Asian currency crisis which severely crippled the financial system in most Asian countries, the magnitude of NPAs in Asian financial institutions was brought to light. Driven by the need to proactively tackle the soaring NPA levels the respective Governments embarked upon a program of substantial reform.

This involved setting up processes for early identification and resolution of NPAs. The table below provides a proposed cross country comparison of approaches used for NPA resolution.

<table>
<thead>
<tr>
<th>Country</th>
<th>AMCs</th>
<th>Debt Restructuring Mechanism</th>
<th>Key Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>Centralised Agency – Danaharta</td>
<td>Corporate Debt Restructuring Committee (CDRC)</td>
<td>NPAs not sold to third parties but restricted. Good, focused</td>
</tr>
<tr>
<td>Country</td>
<td>Agency Description</td>
<td>Resolution Approach</td>
<td></td>
</tr>
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<td>-------------</td>
<td>------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>Centralised Agency - KAMCO, now supplemented by Individual bank based NPA resolution.</td>
<td>Quick resolution of NPAs due to aggressive NPA disposal and restructuring.</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>Centralised Indonesian Debt Restructuring Agency (IBRS)</td>
<td>Manu NPAs restructured but issues like no transparency in restructuring process, poor bankruptcy laws, government intervention and questionable court decisions</td>
<td></td>
</tr>
</tbody>
</table>
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<table>
<thead>
<tr>
<th>Thailand</th>
<th>Centralised Agencies - Financial Sector Restructuring Authority (FSRA), Asset Management Corporation Now supplemented by Individual Bank based resolution.</th>
<th>Corporate Debt Restructuring Agency (CDRAC)</th>
<th>have meant little progress to NPA sale to third party.</th>
</tr>
</thead>
</table>

In addition to the above, some of the more recent and aggressive steps to resolve NPAs have been taken by Taiwan. Taiwanese financial institutions have been encouraged to merge (though with limited success) and form bank based AMCs
through the recent introduction of Financial Holding Company Act and Financial Institution Mergers Act. Alongside the Ministry of Finance has followed a carrot and stick policy of specifying the required NPA ratios for banks (5% by end 2003), while also providing flexibility in modes of NPA asset resolution and a conducive regulatory and tax environment. Deferred loss write-off provisions have been instituted to provide breathing space for lenders to absorb NPA write-offs. While it is too early to comment on the success of the NPA resolution process in Taiwan, the early signs are encouraging.

Most Asian countries adopted “Out of Court” restructuring mechanisms to minimize court intervention and speed up restructuring of potentially viable entities. However, this process has yielded mixed results. In Korea for example, while most corporate entities entered into workout arrangements this often did not lead to far reaching restructuring of these entities. While debt restructuring was generally implemented quickly, delays were witnessed in asset reduction programs and improvement in operating performance was slower and lower than expected. In Thailand similarly, majority of restructuring arrangements have typically involved extension of grace periods or concessional arrangements and it is widely held that genuine restructuring has not taken place.

Internationally, restructuring of NPAs often involves significant operational restructuring in addition to financial restructuring.
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The operational restructuring measures typically include the following areas:

- Revenue enhancement
- Cost reduction
- Process improvement
- Working Capital Management
- Sales of redundant / surplus assets

In some cases, operational restructuring involves making additional investment to finance profitable projects.

Typically, lenders set up a working group including their representatives as well as those of the borrowers. Usually, an independent consultant / financial advisor are engaged to advice on possible operational restructuring measures. The working group adopts a brainstorming approach to identify possible improvement areas, which could include, inter alia:

Cost rationalization, e.g., through rationalization of workforce, closure of unviable units, product line rationalization, centralization of cash and accounting control, outsourcing, process automation, etc.

Improvement in sales though reorganization of sales force compensation packages, investment in new products, development of new markets, customer loyalty program.
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Working capital management by negotiating deferrals with suppliers, identifying alternative sources of supply, tightening of recovery processes from debtors.

Identification of surplus / redundant assets could include identification of non-core business, surplus machinery and equipment, non core patents and trademarks.

Identification of profitable areas of operation and redoubling of efforts in those areas, backed up with additional funding if necessary.

For each of the improvement measures identified, the following analysis is carried out:

- Savings / effect on EBIT and EBIDTA
- Effects on cash flow.
- Related cost (e.g. one time cost of a VRS).

As seen from the Asian experience, in general, NPA resolution has been most successful when

- Flexibility in modes of asset resolution (restructuring, third party sales) has been provided to lenders.

- Conducive and transparent regulatory and tax environment, particularly pertaining to deferred loss write offs, Foreign Direct Investment and bankruptcy / foreclosure processes has been put in place.
Performance targets set for banks to get them to resolve NPAs by a certain deadline.

The objective of the Corporate Debt Restructuring (CDR) framework is to ensure timely and transparent mechanism for restructuring the corporate debt of viable entities facing problems, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned.

The sick enterprises will become technologically and economically viable and start production, and will start profit. Ultimately the banks and financial institutions’ NPAs will substantially be reduced and Banks will become healthier. More job opportunity will be created GDP will be increased and the thus there will be Country’s Economics Growth and National Goal will be achieved.

The Banks & Financial institutions should ensure that CDR is not used as deferment of NPAs in the books, there should be physical reduction of NPAs.

At present CDR is being misused for reduction of NPAs, this is not the intention of the policy – in following cases CDR should not be considered.

i) In cases there is inherent non feasibility of the project.
ii) In cases, there is no demand of end product.
iii) In cases where the management reputation is not good.
TO MAKE THE CDR MORE EFFECTIVE

i) The promoters must bring the Share of Funds before the banks and institutions being their share.

ii) The product should be changed if there is no demand for it; for example if there is no demand for Scooters then it should be changed to motorbike or composite textile changed to yarn.

iii) The management is changed and Concurrent Auditors from the Institution be appointed to monitor the account.

However this suggestion should be implemented in spirit for which they speak & not for convenience. If these suggestions are applied effectively then CDR shall be a boon for the growing economy.