

**A CORPORATE PERSPECTIVE ON THE RELEVANT ISSUES OF THE
WORKING GROUP (WG) REPORT TO REVIEW RESTRUCTURING
GUIDELINES**

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at the

ROUND TABLE HELD BY CAFRAL

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OBJECTIVE, UNDERLYING PRINCIPLE AND COVERAGE OF THE PRESENTATION

- ❖ To present the corporate sector's perspectives in an objective manner
- ❖ The ultimate goal in corporate finance is the same for the banks and the borrowing companies
- ❖ Views, submissions and suggestions on the following aspects
 - Overview of restructuring and the current environment
 - Viability issues
 - Promoters' contribution
 - Personal guarantee of promoters
 - Recompense
 - Conclusion

BACKGROUND

- ❖ Growth in NPAs and CDR references are manifestations of the impact of global recession and the sickness, illiquidity and lack of growth in the economy and the corporate sector.
- ❖ Government and the Central Bank are seriously addressing these issues and the constitution of the WG is an appropriate step.
- ❖ WG has addressed the various issues comprehensively
- ❖ There is, however, a substantial focus on ‘moral hazard’ and ‘regulatory forbearance’, said to be arising out of the existing restructuring guidelines.
- ❖ This needs a careful reflection on some points

OVERVIEW OF RESTRUCTURING AND THE CURRENT ENVIRONMENT (CONTD.)

POINTERS FROM HISTORICAL DATA

- ❖ CDR cell's published data as on 31-3-2012 and 30-6-2012 shows that the ratio of approved and rejected cases by CDR is around 80:20 in terms of number and 87:13 in terms of aggregate debt.
- ❖ A recent research report reveals that the aggregate debt of companies which have exited CDR is Rs.52000 Crs, out of which Rs.43000 Crs (83%) relates to successful exits and Rs.9000 Crs (17%) to unsuccessful exits.
- ❖ This points out that the referred cases were found to be largely viable and that the packages have been implemented successfully to a large extent.
- ❖ CDR system has completed a decade, has been the guiding force in the harmonization of all restructuring guidelines and has high acceptance.

OVERVIEW OF RESTRUCTURING AND THE CURRENT ENVIRONMENT (CONTD.)

CURRENT ENVIRONMENT AND THE NEED OF THE HOUR

- ❖ While bankers are facing difficult times, entrepreneurs are also facing multiple challenges - systemic and specific, and external and endogenous.
- ❖ A large number of entrepreneurs are well meaning, want to do things the right way, have chosen risks of business over comfortable jobs and their efforts result in building national assets.
- ❖ Today, new projects are not coming up, existing projects are stalled, capacity expansions are not taking place, equity environment is not favourable and debt has become very costly.
- ❖ Entrepreneurs need institutional support now more than ever.

VIEWS AND SUGGESTIONS ON VIABILITY

BENCHMARKS

- ❖ Recommendation 7 introduces specific benchmarks for viability, which is welcome
- ❖ However, qualifying in all parameters simultaneously may be difficult. This may cause varying perceptions and views in different banks.
- ❖ CDR-EG should be empowered to allow deserving deviations so as to ensure commonality, instead of leaving it to individual banks, which will delay implementation of packages.

VIEWS AND SUGGESTIONS ON VIABILITY

CONVERSION ISSUES

- ❖ Recommendation 17 seeks to minimize investments in equity / preference shares in restructuring cases.
- ❖ Banks have already been quite selective and restrictive in such investments.
- ❖ In today's unfavourable environment for equity, capping equity and preference capital investments together at 10% of the restructured debt can be seriously detrimental to the potentially viable companies.

VIEWS AND SUGGESTIONS ON VIABILITY (CONTD)

CONVERSION ISSUES (CONTD)

- ❖ Recommendation 18, which proposes confining conversion of debt into equity only to listed companies calls for a review, especially in the current adverse market environment for IPOs.
- ❖ In fact, banks seem to have had problems with investments made in some listed companies at high prices. Investments in unlisted companies can be made at par and can give excellent upsides; a timeline can be fixed for the company to go public.
- ❖ Overall, there seems to be no reason to change the existing guidelines on investments in equity / preference shares in restructuring. In fact, there is a case for relaxing them.
- ❖ Basically, banks, being long term players should be allowed to see equity investments in restructuring cases as an opportunity to get market oriented returns on their exposures rather than treating it as a burden for them.

VIEWS AND SUGGESTIONS ON VIABILITY (CONTD.)

TIME SPANS FOR VIABILITY AND REPAYMENT

- ❖ Recommendation 8 to reduce the time spans for achieving viability seems unrealistic in the present economic conditions, and should not be implemented in a hurry.
- ❖ Further, restrictions on the repayment period, such as 10 years for non-infra companies, are based on a benchmark set up many years ago and need review in the light of mega projects of today.
- ❖ Industry conditions differ from one another and a ‘One size fits all’ prescription for time spans may be counter productive.
- ❖ In the circumstances, repayment period for both infra and non-infra companies need not be artificially capped but should be fixed based on a realistic DSCR. The existing and proposed time spans may be used as an indicative range.

TIME SPAN FOR EXTENSION OF DATE OF COMMENCEMENT OF COMMERCIAL OPERATIONS (DCCO)

- ❖ Recommendation 3 of retaining the longer extension periods for DCCO in respect of infra companies is welcome.
- ❖ It is, however, disappointing that the WG, after detailed deliberations and noting that non-infra projects are highly disadvantaged (para 6.55) chose not to make any recommendations (para 6.56).
- ❖ Non-infra projects, representing the core and manufacturing sectors are equally important. They also have large outlays, face legal and environmental issues, and are susceptible to natural calamities. The present environment is hardly conducive for timely completion of projects.
- ❖ Hence, extension may be considered in their case also by addressing the recommendation 3 further with the observations made in paras 6.54 to 6.56.
- ❖ The enabling provisions in the infra projects' guidelines, which allow an additional one year extension for DCCO 'for other reasons', can be extended to non-infra projects also.
- ❖ Clear and realistic instructions will also eliminate premature declarations of DCCO. Otherwise, attempts to meet deadlines technically will dilute real time commercial operations.

NEED FOR FLEXIBLE APPROACH BASED ON MERITS

- ❖ Recommendation 16 suggests increase in the minimum promoters' contribution from the present 15% of the banks' sacrifice, to the same or 2% of the restructured debt, whichever is higher.
- ❖ In normal circumstances, promoters can be asked to contribute a share of the incremental finance.
- ❖ However, if the promoter is unable to contribute for genuine reasons and the project is viable, restructuring should not be denied. The following considerations may be employed in determining a relaxation on merits.
 - Has the promoter made genuine efforts and shown competence to run the company / implement the project; the promoter's non-monetary contributions, such as obtaining and keeping in tact all approvals and sustaining the morale and involvement of the stakeholders including employees, can also be considered.
 - Has the promoter diverted funds outside the business or unproductively?
 - Has the promoter already brought in sufficient funds earlier to an acceptable level?

PROMOTERS' CONTRIBUTION (CONTD)

NEED FOR FLEXIBLE APPROACH BASED ON MERITS (CONTD)

- Has the promoter made sacrifices already, such as infusion of funds which other shareholders have failed to bring in?
- Has the promoter enabled or facilitated the raising of any interim finance or any deferment of the company's obligations through guarantee / letter of comfort / negotiations / goodwill?
- It would be difficult to visualize cash resources being available with the promoter at a crunch time. If a loan has to be given either to the promoter personally or to the parent / holding / group company to enable any of them to contribute in the restructuring package, will this be in the interests of such an entity in terms of its servicing capacity? Will it amount to the adage 'two bad decisions cannot make a good one'?
- Overall, a flexible approach depending on the conduct and track record of the promoters in terms of the above factors would be ideal.

PERSONAL GUARANTEE OF PROMOTERS

REVIEW OF REVISED RECOMMENDATIONS

- ❖ Recommendation 22 of WG proposes reversal of the existing provisions of CDR which have a good rationale for excluding this requirement, if the restructuring is caused by external factors pertaining to the industry and the economy. WG suggests its stipulation in all cases irrespective of reasons. The following aspects have to be considered in this matter.
 - The stipulation of personal guarantee, even if the restructuring is caused by factors beyond the promoters' control, negates the principles of corporate entity and discourages entrepreneurship.
 - The 'skin in the game' (of the promoter) argument seems to treat a personal guarantee as a moral obligation. It is actually a legal obligation, and would be disproportionate to both the means of the promoter and the promoter's share in the equity of the company. The matter has to be examined from the legal and fairness of practices angles.

PERSONAL GUARANTEE OF PROMOTERS (CONTD)

REVIEW OF REVISED RECOMMENDATIONS (CONTD)

- Quite often, the promoter is a company and the decision to invest in the company to be restructured would have been taken by the former's shareholders, after being approved by its board and lenders. It would be unfair to ask an individual to bear this onerous responsibility.
- Typically, pledge of the promoters' shares is obtained by the lenders of the restructured company. This should suffice for the control over the promoter.
- Recommendation 23 that corporate guarantee should not be a substitute for the promoters' personal guarantee also does not merit approval by the RBI for the above reasons.

❖ In summary, the existing guidelines may be continued.

- ❖ Recommendation 20 on recompense starts with the ways of facilitating CDR exits by the borrowers. However, by prescribing a minimum of 75% to be paid, the flexibility is severely constrained. The real issue in this matter is not the percentage of recompense but the inequity in calculation as observed by the following:
 - In the past, banks have changed the formula for calculating recompense unilaterally, contrary to the debtor: creditor agreement.
 - The PLRs of the public sector and private sector banks used to vary significantly and the average PLR would be highly skewed if one of the top 4 financing banks has a very high PLR. The benchmark should be changed to base rate uniformly or linked to a market accepted benchmark, such as the 10 year Government securities (G-secs) rate.
- ❖ If a company meets all its CDR obligations promptly, it would be on par with a top rated company in terms of its repayment performance. However, recompense would cause it to pay an interest rate applicable to a stressed asset throughout the loan period. It would be equitable if companies working under financial strain are incentivized for prompt payment by reducing the recompense on the above lines.

IMPLICATIONS OF CDR FOR THE CORPORATES

- ❖ CDR's greatest help to the companies has been in evolving and implementing a package within a reasonable time, which individual negotiations could never have achieved.
- ❖ It also requires enormous efforts on the part of the company to adhere to the repayment programme and meet other challenges, as times are not always good and there is very little margin for error.
- ❖ Once a company starts doing well, CDR becomes quite an impediment for any operational flexibility or future plans. Hence, companies would like to exit CDR.

CONCLUSION (CONTD)

IMPLICATIONS OF CDR FOR THE CORPORATES (CONTD)

- ❖ The banking system can make this easier and also churn their restructuring portfolios, by being flexible within reasonable limits.
- ❖ A restructuring is normally done only once in the history of a company. Hence, it should not be a half hearted measure, which is neither good for the company nor for the banks.
- ❖ The future of CDR, based on a healthy combination of entries and exits, would strongly depend on the foundations of mutual faith and commonality of purpose among the banking system and the assisted companies.

THANK YOU