

# Rainbow turns out to be a mirage

The conclusion to the two-part series says that there are no easy answers to the NPA problem faced by Indian banks

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A solution for the NPA problem for PSU banks has proved elusive so far. The authorities have been in denial mode for long and the problem's depth and extent have been revealed only recently.

The efforts of RBI have not borne fruit: The 5/25 scheme which permitted extension of loan amortization period up to 25 years with interest reset every 5 years did not work as the higher interest burden due to tenor extension required additional borrowing which worsened the initial problem.

The sale of NPAs to Asset Reconstruction Companies (ARC) has so far been very low due to two main reasons: banks have been reluctant to sell NPA at a price reflecting their realisable economic value; and, banks received only 15% of the NPA sales consideration in cash, while the rest was given by way of security receipts (SR) which meant that the seller bank continued to be exposed to the risk of short recovery of the loan from the borrower.

The Strategic Debt Restructuring scheme (SDR), unveiled in June, 2015, involved banks taking over companies by converting debt into equity, replacing the promoters and thereafter selling their equity holdings to new investors. However, as of December, 2016, only two such cases of sale had materialised.

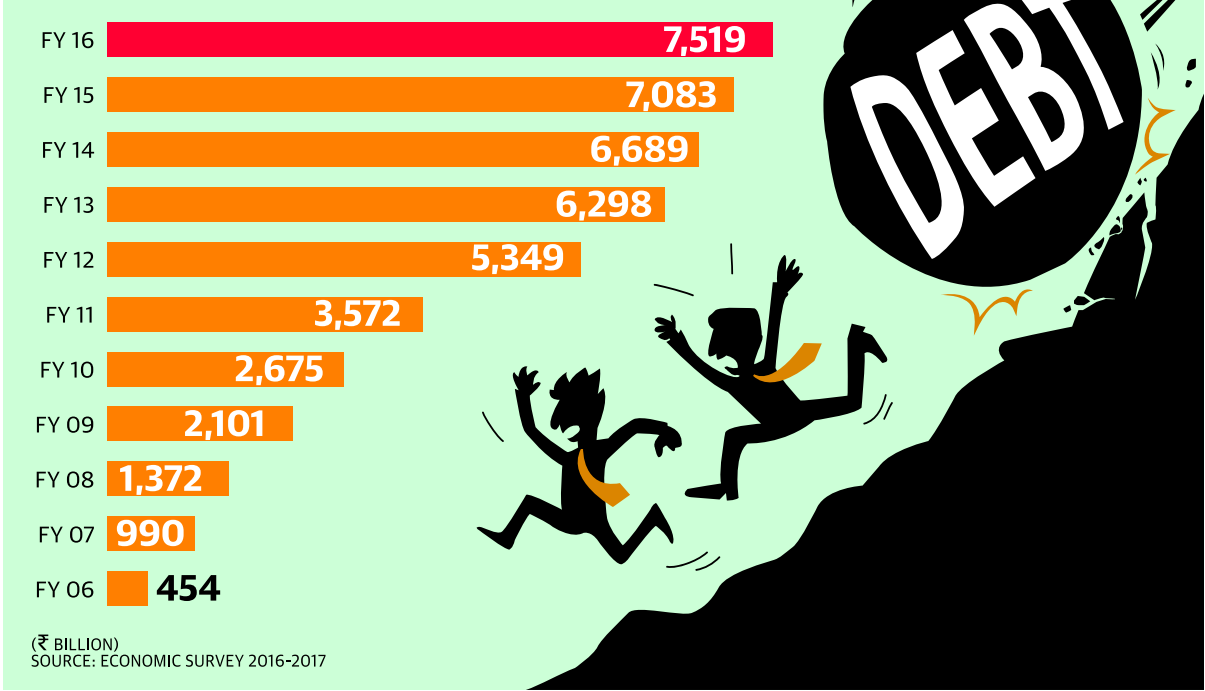
The Scheme for Sustainable Structuring of Stressed Assets (S4A) was introduced in June, 2016, whereby the outstanding bank loan is required to be bifurcated into sustainable and unsustainable portions, enabling the borrower company to be revived and making it possible for the sustainable portion to be repaid.

### S4A a non-starter

This is also a non-starter, with only three cases cleared so far. While there is excitement and expectations surrounding the Insolvency and Bankruptcy Code, 2016, it is well-nigh impossible that resolution of even the large-sized NPAs can be brought about within a reasonable period of time under the mechanism contained in this

## Debt of top 10 stressed corporate groups

If public sector banks are to cleanse their balance sheet within a year of (the proposed) PARA coming into existence, their aggregate credit loss of about ₹4 trillion will have to be funded upfront. Who will do this?



The insolvency path would lead to a 'fire sale' in a growing economy

statute. The judicial authority for this purpose – the National Company Law Tribunal (NCLT) – currently clears 6,620 cases a year and it has a backlog of 24,900 cases.

Further, both resolution and bankruptcy will cause significant loss to banks. But the boards and senior management of PSU banks have all the incentive to prefer a much higher loss through resolution or bankruptcy *vis-a-vis* a commercially driven write-off decision. The insolvency route would lead to a "fire sale" of assets in a growing economy – a paradox of sorts. This is a sad reality that lies at the core of resolving the NPA problem.

**A para-banking solution?** Like all grand ideas, the proposition to set up a Public Sector Asset Rehabilitation Agency (PARA) *a la* what China did in the past catches attention.

The details are sketchy, untenable, and even confus-

ing, though. By way of illustration, if PARA were to operate professionally and not on political principles, it will be required to buy NPAs at prices that will involve deep writedowns by banks.

How is it conceivable that PSU banks that are reluctant to agree on debt workout involving writeoffs will be enthusiastic in doing so while selling NPAs to PARA?

More importantly, if the PSU banks are to cleanse their balance sheet within a year of PARA coming into existence, their aggregate credit loss of around ₹4 trillion will have to be funded upfront. Who will do this?

The accompanying table illustrates the debt of top ten stressed corporate groups aggregating ₹7.5 trillion, which needs to be written down to spur their revival. It is beyond the ability of the government to do this even over three years.

The idea that a slice of RBI's capital can be used for funding PARA (or loss of PSU banks?) is almost irresponsible.

If RBI parts with a portion of its holding of government securities, the resultant loss will have to be absorbed either by its current income

or through a drawdown of its usable equity (equity that can be freely used to meet any kind of loss) which, in RBI's case, is almost identical with its internal reserves.

The RBI took a policy decision in 1997 to achieve and maintain a ratio of internal reserves to assets at 12% to ensure adequate risk capital for its balance sheet. The ratio increased steadily thereafter, exceeding 12% in 2009-10 and remaining close to 12% in the following year. It fell subsequently and now it is at 7.5%. Needless to say, the last three years have witnessed a sharp drop in the usable equity of RBI. By all indications, RBI is undercapitalised right now.

Asking RBI to deplete its usable equity further will worsen its financial position, thereby undermining its ability to pursue policies independently.

### Amendment to BR Act

From an operational perspective, the amendment has two new elements: (i) Direct power for the government (to be exercised through RBI) asking banks to initiate insolvency proceedings against specific delinquent borrowers. (ii) RBI to

constitute oversight authorities/committees for providing 'advice' to banks in taking decisions on debt resolution.

Seemingly, both the elements are intended to take care of the unwillingness or lethargy of PSU banks in dealing with corporate stressed assets.

What is interesting here is that the initiative/approval of the 'state' is sought to be introduced where the boards of PSU banks should be able to take decisions themselves based on commercial considerations alone.

This bears the hallmark of a 'rent-seeking' economy. An unintended consequence here will be that PSU banks will henceforth be reluctant to initiate any insolvency proceedings on their own.

As for the government, will there be clear and transparent guidelines as regards which of the defaulters to proceed against?

There is every possibility that debt resolution will henceforth follow a political process.

The same logic applies to oversight authorities/committees. It goes against the very grain of corporate governance because the boards of banks will have to heed

their 'advice'. And, who in India does not know that a king's 'advice' is actually an 'order'?

All in all, the amendment is unlikely to make any significant dent on the NPA situation, except at the margin perhaps.

### No magic solution

There is no magic solution. Nor is there any possibility of finding a solution within the extant political-bureaucratic paradigm that seeks to keep the PSU banks within a 'command and control' framework.

A genuinely fresh 'out-of-the-box' approach is needed. We propose a framework with six elements:

One, U.S. style stress tests should be introduced to determine the capital shortage in respect of each PSU bank; two, the government should devise and declare a policy for capital infusion based on objective performance criteria; three, mergers and acquisitions of PSU banks by the private sector and foreign banks to be allowed, as there are too many PSU banks; four, banks should give priority to those loan restructuring where institutional investors are willing to provide equity for business turnaround.

Such restructuring can be an eclectic combination of all the schemes launched so far, the guiding principle being loss-sharing: the promoters should shed their equity in favour of banks at realistic valuation to the extent the latter are reducing debt.

The incentives of all concerned in a debt resolution aimed at a business turnaround, namely the promoter, the bank and the new investor will be aligned through a combination of debt writedown, reduction in promoter's stake and infusion of fresh equity at realistic valuation; five, boards of banks should have full freedom to decide on restructuring; and six, vigilance action to be taken if, and only if, there is clear evidence of malfeasance as distinct from *post facto* detection of decision error.

(Sivaprakasam Sivakumar is MD, Argonaut Global Capital LLC, U.S., and Himadri Bhattacharya is Senior Advisor, RiskController Global)

### GUEST COLUMN

## Before sunlight turns shadowy

K.E. RAGHUNATHAN

The per unit price of solar power in India has dropped from ₹15 to ₹2.44 in 5 years. In fact, it has fallen from ₹4.50 within one year. Has the technology improved so much in the solar sector to facilitate this fall? Has solar become commercially viable and attractive for everyone? Have government incentives enabled this price fall? How much further will prices fall in the next five years? Is this sustainable?

If this sector is in profitable growth mode, why have giants like Sun Edison, Solar World, Sungevity Beamreach, Climate Energy and Mark Group filed for bankruptcy in the past year? Also, Yingli Green Energy, a former world leader in solar panel volume, recorded a loss of \$267.1 million in the fourth quarter of 2016 on \$294 million in revenue.

So, all is not hunky dory with the industry.

### Viability questions

The per unit price is the price that state utilities pay the developer for power supplied.

For unit cost of ₹2.44 to be viable, it would mean an average year RoI and functioning of the plant for 20 years. The project cost needs to be under ₹3 crore per MW, excluding land and connectivity. Also assumed is that all power generated gets consumed by state-run generation and distribution companies (Gedcos) and all dues get paid in 30 days.

Is it possible to run such projects profitably? The quality of material used becomes suspect. Interest costs alone can be substantial.

A 60 GW solar capacity, the Centre's 2022 goal for ground-mounted projects, would need 3 lakh acres and ₹2,50,000 crore in investment. The assumptions are: the average cost per MW would be ₹3.5 crore; and generation of 240 million units a day into the grid.

Assuming average tariff of ₹4.50, it would mean a daily payout of ₹100 crore by a Gedco. Is this feasible, given their financial ill health?

If a state becomes power surplus, it must export solar

power generated to other states. Such sale cannot occur at a price lower than the ₹4.50 per unit at which the state has bought the power. If other states can buy power at rates now lower than ₹4.50, the selling state is left with no buyers. Also, who will account for transmission losses and distribution costs? If there is viability gap funding, and if the projected power is not generated after a few years, then the subsidy is wasted.

The efficiency of equipment should determine the level of import duty

Imports of China-made solar modules without any duty, irrespective of their efficiency or quality is hurting industry prospects. If the modules fail to generate adequate power after a while and if the firms that supplied the modules with 25 years warranty go bankrupt, what happens to the plant?

### What is needed?

Duties based on efficiency of the material imported would discourage poor quality. On arrival of shipment at an Indian port, a sample module must be submitted to an MNRE-approved testing centre for measurement of efficiency and accordingly customs duty should be levied. Lower the efficiency, higher the duty. This will allow quality imports and promote 'Make in India' – whose incentives can make benefit the solar industry.

The Centre should also publish the actual quantum generated monthly by each solar power plant feeding into the grid, state wise. A minimum generation criteria per MW is to be fixed. Failure to meet this target should result in a penalty.

Power purchase agreements must ensure that failure to generate a certain million units per MW a year for two consecutive years would result in cancellation of the PPA and in the recovery of land.

(The author is MD, Solkar Solar Industry Ltd. and National President, All India Manufacturers' Association)

### EXPLAINER

## Prompt corrective action for banks



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As the financial health of banks had deteriorated over the last three years, the Reserve Bank of India (RBI) has revised the norms for prompt corrective action early last month, and has promptly imposed those norms on a couple of public sector lenders.

### What is PCA?

PCA norms allow the regulator to place certain restrictions such as halting branch expansion and stopping dividend payment. It can even cap a bank's lending limit to one entity or sector. Other corrective action that can be imposed on banks include special audit, restructuring operations and activation of recovery plan. Banks' promoters can be asked to bring in new management, too. The RBI can also supersede the bank's board, under PCA.

The provisions of the revised PCA framework will be effective April 1, 2017 based on the financials of the banks for the year ended March 31, 2017. The framework will be reviewed after three years.

### When is PCA invoked?

The PCA is invoked when certain risk

thresholds are breached. There are three risk thresholds which are based on certain levels of asset quality, profitability, capital and the like. The third such threshold, which is maximum tolerance limit, sets net NPA at over 12% and negative return on assets for four consecutive years.

### What are the types of sanctions?

There are two type of restrictions, mandatory and discretionary. Restrictions on dividend, branch expansion, directors compensation, are mandatory while discretionary restrictions could include curbs on lending and deposit. In the cases of two banks where PCA was invoked after the revised guidelines were issued – IDBI Bank and UCO Bank – only mandatory restrictions were imposed. Both the banks breached risk threshold 2.

### What next?

Some more lenders are expected to come under the corrective action framework as and when their asset quality worsens, putting profitability under pressure. Some public sector banks have breached the net NPA parameter as well as the profitability parameter. These banks are comfortable on the capital parameter, thanks to the government's commitment to ensure the PSU banks are not starved of capital. However, as the government has its own commitment for maintaining fiscal discipline, it remains to be seen how long it can afford to infuse capital in these banks.

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BENGALURU

Google is wooing some of the world's hottest start-ups to sell its cloud computing technology.

These include ventures that send satellites into the space to study the changing earth, firms that convert traditional manufacturing plants into smart factories and start-ups that are simulating entire cities.

Google is offering cloud technology that combines a large amount of storage and computing. It then sells it to customers who may want to enhance or set up new data centres.

Planet Labs, Inc, a start-up which is on a mission to image the entire Earth every day, and make the global change visible, said that it has switched to Google Cloud to host its imagery and do data processing.

"There are a handful of companies that can offer storage and processing, we are really impressed by Google Cloud's core technology," said Will Marshall, co-founder and chief executive of Planet Labs, at Google Cloud Next conference held recently in San Francisco.

### Natural disasters

Founded in 2010 by ex-NASA scientists, Planet Labs operates the largest constellation of Earth-imaging satellites. These satellites are collecting a new data set with real-world applications such as tracking natural resources, quantifying agricultural yields and assisting first responders after natural disasters. To image the whole of the Earth every day means preparing for 7 to 10 terabytes of data daily. Google



On cloud nine: Start-ups such as Planet Labs, Improbable and Oden Technologies have got into Google's bandwagon to reap technological benefits.

Cloud now hosts this growing photography repository and the data processing for Planet Labs.

"We have the capacity to image every point on the earth every single day and the sea changes that happen. We see every port, every city, every farm and every forest," said Mr. Marshall.

In February, with help from the Indian Space Research Organisation's (ISRO), the California-based firm successfully launched 88 Dove satellites to orbit.

This is the largest satellite constellation ever to reach orbit. These satellites rode aboard ISRO's workhorse – the polar satellite launch vehicle (PSLV rocket) from

the Satish Dhawan Space Centre in Sriharikota.

Planet Labs has now introduced a tool called 'Planet Explorer Beta' that provides data to individuals, small and medium-sized businesses, developers and researchers around the globe.

### Immersive experience

Google also provides its cloud platform to Improbable, a London-based start-up co-founded by Indian-origin entrepreneur Herman Narula.

It is dedicated to building technology to enable powerful virtual worlds and simulation designed to help solve previously stubborn problems. In gaming and enter-

tainment, this enables the creation of richer and more immersive virtual worlds. For instance, top studios are building their products on Improbable's distributed operating system, SpatialOS. These include top video games like Worlds Adrift, Rebel Horizons and Chronicles of Elyria.

Improbable has now taken a huge leap of simulating entire cities that could impact everything ranging from city planning to healthcare.

At the Google Cloud conference, Mr. Narula said that Improbable has built a complete simulation of an entire British City, in conjunction with a public sector partner.

This includes its telco and transport network, power grid, sewage systems, housing demographics and even the way in which people move around and interact with the city.

"This is the largest simulation of its kind, ever created," said Mr. Narula, chief executive at Improbable. The company intends to foster a community where developers can share code, and build and create new services and businesses.

Mr. Narula said the age of closed systems and trying, in effect, to get developers into committing to a closed ecosystem were over. "We can't succeed unless you succeed and I think Google recognises that," he said.

### Smart factories

Manufacturing is one of the most important sectors of the U.S. economy. The gross output of U.S. manufacturing industries was \$6.2 trillion in 2015, about 36% of U.S. gross domestic product.

But these industries have less access to the new technological advancements in the information technology sector, according to Oden Technologies, a leading industrial Internet of Things venture.

The New York-based firm is betting big on changing this and it runs its entire platform on the Google cloud platform. Using a combination of IoT – a technology where devices communicate with each other intelligently – wireless connectivity, and big data, Oden is helping manufacturers enhance production efficiency.

"We probably wouldn't be comfortable scaling up to thousands and thousands of

factories, tens and thousands of machines, all streaming data, if we didn't know we had the infrastructure of Google to allow us to do that," said Willem Sundblad, founder and chief executive of Oden Technologies.

For example, Google's cloud platform provides the base for obtaining and storing data collated by Oden's wireless devices. It captures and stores about 10 million metrics on each manufacturing line per day. This includes highly granular details, such as melt profile of the materials and measure of power moving to the machines.

Environmental insights like temperature and humidity are also obtained. This way, manufacturers can find if there are weather-related consequences on their manufacturing efficiency.

In March, Mountain View, California-based Google also acquired Kaggle, a community platform for data scientists. The Kaggle community has used machine learning to grade high school essays, diagnose heart failure and increase the discovery significance of the Higgs-Boson, an elementary particle in the Standard Model of particle physics.

Making Google Cloud technology available to its community will allow it to offer access to powerful infrastructure and the capability to store and query large data sets.

"We are going to enable our community to do far more powerful things," said Anthony Goldbloom, chief executive of Kaggle.

(The writer was recently in the U.S. at the invitation of Google)