The Role of Asset Reconstruction Companies in Recovering NPAs in India

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Abstract:

Asset Reconstruction Companies (ARCs) established under SARFAESI Act 2002, has been proved as one of the most effective curative management strategies in resolving the problem of Non-Performing Assets (NPAs) in Indian Banking Sector. The paper discussed the recovery mechanism of NPAs followed by ARCs and the problems faced by ARCs in India. As ARCs is more capable in resolving the problems of NPAs but the total net worth of all the existing ARCs is not enough to acquire all the stressed assets of Indian banks, there is a huge growth prospects not only for existing ARCs but also for new upcoming ARCs in future. The correlation between the profits of ARCIL and Gross NPAs of banks is depicting a clear picture in this context. Many analysts consider profits earned by ARCs as Money from Junk. Moreover, the paper also highlights the how the New Bankruptcy Code 2014 will bring more opportunities for ARCs

Key Words : NPAs, SARFAESI Act, Asset Reconstruction Companies (ARC), ARCIL, New Bankruptcy Code 2014

Introduction:

Indian Banking System has been facing a major problem i.e. rising of Non-Performing Assets (NPAs) in both public and private sectors banks. The level of NPAs acts as a mirror which reflects the performance of banks. A high level of NPAs suggests high possibility of large number of credit defaults. This increasing number of credit defaults affects not only the profitability position but also the net worth of the banks. It also creates an ill effect on the goodwill of the banks and restricts the cash flow of the banks due to provisioning of fund made against these NPAs. "High level of NPAs can be serious drag on overall performance of economy due to diversion of its management and financial resources towards recovery of NPAs. Greater the resources needed by banks to reserve for losses, lesser is the amount of capital they can leverage."

Thisproblem of NPA has become a national issue as it hinders the pathof the growth of the nation. Many internal checks and controllingschemes have been introduced by RBI to reduce the level of NPAs.The RBI has also made many efforts in checking few negligent practices of bankers like account of poor project evaluation, extensive project delays, poor monitoring, faulty evaluation of mortgaged assets, etc. Such efforts were proved helpful to reducethe chances of occurring NPA to a certain extent.

For the purpose of controlling NPAs in Indian Banks, the Government of India, the RBI and many banks have collectively formulated and implemented various types of strategies to manage these NPAs. These strategies include One Time Settlement Schemes, Debt Recovery Tribunals, Asset Reconstruction Companies (ARCs), Corporate Debt Restructuring, BIFR for Sick Units, following early warning signals, etc. Among these strategies the ARCs established under the SARFAESI Act, are the most effective tool in recovering the NPAs. As the debt recovery ratio of ARCs is higher as compared to the other recovery channels, the RBI has given green signal to three more ARCs on 3rd August, 2015.

The problem of NPA in Indian banks is getting bigger and bigger. An upward trend during the post global crisis, can be seen with the increase of amount of Gross NPA from Rs. 38,968 crores in 2007 to Rs. 1,48,257 crores in 2015. As the problem of NPA in Indian banks is growing, there is a huge possibility of growth of ARCs in India. Moreover, the implementation of New Insolvency and Bankruptcy Code 2014 is a welcome move towards improving the credit environment and enhancing the creditor–debtor relationship.

This step may be an additional advantage to the ARCs for recovering NPAs. This study is an attempt to analyse the future prospects of ARCs in India by determining the existence and degree of correlation between the amount of increasing NPAs and the growth of Reconstruction companies, the various problems faced by ARCs and the impact of New Bankruptcy Code on the functioning of ARCs in India.

Objectives of the Study

- To study the various problems faced by Asset Reconstruction Companies in India.
- To determine the correlation between the growth rate of NPA in Indian Banks and profitability growth rate of ARCs in India.
- To analyse the impact of New Insolvency and Bankruptcy Code 2014 on the growth prospects of ARCs.

Research Methodology

It is an analytical study based on secondary data retrieved from different reliable sources. ARCIL has been selected from 16 ARCs in India, as it is the oldest ARC with the highest amount of Net Worth. The period taken into consideration for the study is from 2009 to 2015. For testing the hypothesis, Karl Pearson's Coefficient of Correlation (r) has been used. By this tool the degree of correlation between the growth of NPA in Indian Banks and profitability growth of ARCIL has been ascertained. After determining the value of Karl Pearson's Coefficient of Correlation (r), Student-t Test has been used to determine the existence of significant correlation between the growth of NPA in Indian Banks and profitability growth of ARCIL.

Significance of the Study

The study is based on the growth prospects of ARCs in India. ARCs have been proved as the most effective tool in recovering NPAs as compared to other recovery tools like Debt Recovery Tribunals and Lok Adalats.

Hence this paper could provide a proper understanding regarding the need of more ARCs in India. The paper also discussed about the various problems faced by the ARCs and therefore the policy makers may take necessary measures to overcome the problems of ARCs in order to strengthen the position of ARCs. As the study also depicts the impact of New Bankruptcy Code 2014 on the growth prospects of ARCs and Indian Banking Sector, it can also familiarize the many industrialists, bankers and scholars regarding the new norms and provisions followed at the time of insolvency.

NPA Recovery Mechanism by ARCs

The loan amount taken by a client by providing mortgaged asset, will be converted into NPA if the borrower fails to repay it and it is due for 90 days or more. Now the bank has the option either to recover the loan itself or sale that NPA to an ARC. ARC will raise the necessary funds through a subscription instrument floated by the trust. This instrument is known as Security Receipt (SR) and this will be issued to qualified institutional buyers.

As per many economists, the ARCs have been proven as the most effective recovery channel for NPAs. A sharp rise in sale of stressed assets to ARCs during FY2014 has been reported. With a view to clear up NPAs, Indian banks resorted to sale of such assets to ARCs at a mutually agreed price. According to RBI estimates, Indian banks sold stressed loans worth $2.8 billion during FY2014 as against $0.2 billion during FY2013. In the first quarter of FY2015, banks sold more than $2.5 billion to ARCs prior to change in ARC investment guidelines by RBI.

Insolvency Code 2016 and ARCs

The bankruptcy process within the New Insolvency Code is all about how best can creditors recover their claims on firm that has gone bankrupt.

- The New code is more effective with the primary objective to create a new institutional framework, consisting of Insolvency and Bankruptcy Board, Insolvency Professional Agencies, Insolvency Professionals, Information Utilities and Adjudicating authorities.
- It facilitates time bound insolvency resolution process and liquidation with faster debt recovery mechanism i.e. within 180 days which can be extended by 90 days only.
- It seeks to improve the handling of conflicts between creditors and debtors, avoid destruction of value, distinguish malfeasance vis-à-vis business failure and clearly allocate losses in macroeconomic downturns.

Findings and Suggestions

The government as well as RBI should take initiative to encourage new entrants to make investments into the business of asset reconstruction of banks to reduce and control these NPAs. On the other hand, sound and successful businesses in this sector could also contribute more towards the activities of Corporate Social Responsibilities (CSR), which would be beneficial for the society as well. The best example in this area is ARCIL that performed numerous CSR activities during 2015-16. It should also be noted that the banks should

make appropriate valuation of assets of mortgaged assets so that the ARCs could recover sufficient amount from such assets. These measures would bring more opportunities for all ARCs in India.

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