A STUDY ON THE IMPACT OF INSOLVENCY AND BANKRUPTCY CODE, 2016 ON INDIAN COMMERCIAL BANKS- A PRE AND POST EVENT ANALYSIS

Esther Tensingh (Department of Management Studies, CHRIST (Deemed to be University))

Dr. Suresha B. (Associate Professor, Department of Management Studies, CHRIST (Deemed to be University))

Abstract

The Indian banking sector has seen various changes over the last decade. An increase in the non-performing assets (NPA) was a major reason for worry for the government of India. Increased rate of recovery in India and high percentage of NPA led to issues between Banks, organization and individuals (lenders and borrowers). The introduction of insolvency code by the government of India in 2016 was aimed to bring down NPA and increase the recovery time. This paper attempts to study the impact of the IBC on the banks on India over the last 6 years. A comparative analysis was performed between private and public banks. The article in divided into 2 parts, the first studies the Advances and NPA while the later explains the impact of NPA on the profitability ratios. This study has used secondary data and analysed 21 public and 21 private banks using correlation and regression. The results show a significant impact of the introduction of IBC on the recovery rate, profitability and the NPA. This paper has addressed changes in policies for improvement of the code.

***Key words**: IBC, NPA, profitability ratios, recovery rate, private banks, public banks, insolvency and bankruptcy code, non-performing assets, Advances, regression*

I. Introduction

The Indian economy today has emerged as one of the fasted growing economy and is expected to be among the top three economies in the next decade due to its strong democracy and ties with neighbouring nation. The Indian economy is a mixture of all types of economies popularly known as a mixed economy. It is known to be the world's seventh largest in terms of nominal GDP. As on 2018, Indian ranks 122 in per capita GDP with $7783. In the post liberalization era, India managed to achieve an annual growth of 6-7% of GDP. The financial system plays a major role in the development of a country's economy as in aids in the wealth creation by linking a resident's savings to investments. The financial system of a country enables the movement of funds from households to companies and helps in the growth of both businesses and households. The structure of the Indian financial system can be divided into organized financial system and unorganized financial system. The banks are regulated by the RBI by keeping in check the CRR, SLR, Repo rate etc. This ensure that the banks function properly and they always have a provision of funds in case of emergency. The RBI regulates the banks and handles any kinds of problem that arises. The increase in the NPA over the decade led the RBI to introduce the insolvency and bankruptcy code and took prompt corrective actions to reduce recovery time. The law was introduced as an effort to merge the large number of laws pertaining to insolvency and bankruptcy. This was an important step taken towards the growth and stability of the banking sector in India. Although similar laws already in existence in other countries, India's introduction to IBCC put it into the race of growth with the other major countries such as US, UK and Germany. This paper aims to bring out the changes the banks have seen over the last 3 years after the introduction of IBC and a pre and post event analysis.

II. Motivation of Study

The banking industry of any country plays a key role in the growth and stability of its economy. India being a developing country continues to see changes every day. In the last decade banks in India failed to reduce NPA levels despite the large number of laws introduced for insolvency and bankruptcy separately. After the introduction of the Insolvency and Bankruptcy code in 2016 which combined all these laws as one, there was a relief for both borrowers and the lenders due to promise of reduction of recovery time. It has been two years since the code was passed and the right time to analyse its effects. Thus, this study drives its motivation from the curiosity of the people to know what kind of impact this law has had on the banking sector of India in the last two years and the need to improve the quality of the code that has been enforced.

III. Review of Literature

The Indian banks face many challenges and prospects due to factors such as transparency, growth of risk such as NPA, global economy, ethical issues and customer retention. Goyal and Joshi (2012**).** It is also suggested that Indian banks need to come up with better and innovative products to compete with the growing technological world**.** A study that discussed effect of factors such as NPA and P/E on the Indian banks suggested that that NPA in few banks such as Punjab national bank showed a fall in NPA till 2012. PSBs didn't show the same results and the then government in 2013 ensured that they reduced the lending rate and cleared stalled projects which in turn led to the rising of NPAs. (Kajar and Trivedi (2014). Different insolvency laws that existed in India before the introduction of Insolvency and bankruptcy code in 2016. There existed 10 different laws in 2015 before all of them were combined and amended to form a single law (Adukia,2015). A in depth study of the recent IBC concluded that the code currently encourages liquidation at the price of financial restructuring. It was also suggested that the code doesn't provide enough representation to the stakeholders. (Pandey ,2016). NPA was seen to have an impact in the profitability of the banks which can further lead to the reduction of the banking efficiency (Dhara.K ,2017). A study done on the challenges and problems related to the IBC 2016 suggested that the code's idea was to not only reduce NPA but to increase FDI and improving India's rank in the Ease of Doing Business Index (Goel ,2017). But the code, however, is over ambitious trying to combine more than 11 laws regarding bankruptcy and aiming to cause major amendments in short time Venkat. P (2016-2017**),** in his research pointed out that the IBC was a welcomed change in the bankruptcy process in India since it took more than 4 years to resolve a case before IBC was introduced. He believes that if this code is implemented properly, it would help lenders, borrowers, regulators and the government. In his paper, Venkat suggests that IBC will significantly increase the transparency in the Indian system. He finally says that the IBC will start showing its affects after a year or two in 2018 when the recovery rate will start decreasing

IV. Research Gap

Research in the banking industry has always been a priority for the country and hence many researchers have done a study on the different regulations introduced by the government to help the problem. The Insolvency and bankruptcy code 2016 are a relatively new code and something that has never been seen India. Thus, not a lot of research has been done of its impact on the banking sector. After careful study of the literature, a few gaps have been found. The IBC has had a cascading effect, that is, many variables have been affected but this study considers only two and more can be further studied. Very little impact has been seen in the last two years and thus a full impact hasn't been studied and can be studied after a few more years.

V. Need for The Study

A study comparing the time before IBC was implemented and after implementation can help us understand the changes that the banking sector has seen in the last 1-2 years. There is a need to study the impact of IBC on the banking sector to check if the IBC has only been implemented to help the financial institutions or has it been a source of relief for others as well. It is important to study this to check how it provides a specialized resolution mechanism to deal with bankruptcy situations in banks, insurance firms and financial sector entities. Insolvency codes worldwide have taken time to stabilize. With the right implementation process, it can have a positive impact on the economy.

VI. Methodology

Objective of The Study

1. To study the impact of introduction of IBC on Indian banking sector- both long term and short term.
2. To study the trends of NPA in commercial banks of India
3. To study the pre-IBC era with respect to NPA
4. To study the post IBC era with respect to NPA

The type of research conducted is quantitative and the population chosen for the study are the Indian commercial banks both private and public. The period of study is 6 years (3 years before IBC and 2 years after IBC). The type of data used for this research is secondary data collected from relevant websites such RBI, economic survey articles and journals. The sample used are 21 PSBs and 21 PVBs. The results were analysed using tools such as correlation and regression models. The statistical tools used to perform the analysis was SPSS and excel sheet

Hypothesis

Model 1:

1 H0: There is no impact of Advances on the NPA of private sector banks

H1: There is an impact of advances on the NPA of the private sector banks

2 H0: There is no impact of Advances on the NPA of public sector banks

H1: There is an impact of advances on the NPA of the public sector banks

Model 2:

3 H0: There is no impact of NPA on the profitability ratios of public sector banks

H1: There is an impact of NPA on the profitability ratios of public sector banks

4 H0: There is no impact of NPA on the profitability ratios of private sector banks

H1: There is an impact of NPA on the profitability ratios of private sector banks

VII. Empirical Results and Discussion

Model 1

PVBS		B	Std.error	Beta	t	Sig.
	CONSTANT	3604.298	536.087		-6.723	.001
	ADVNACES	.461	.033	.987	13.985	.000
PSBs						
	CONSTANT	- 80884.480	28160.186		-2.872	.035
	ADVNACES	2.176	.599	.852	3.633	.015

TABLE 1: COEFFECIENTS – ADVANCES AND NPA

It can be observed that the significance level for private banks is 0.000 which is lesser than 0.05. Hence the null hypothesis is rejected and H1 is accepted. When It comes to the public sector banks the significance is seen to be 0.15 which is greater than 0.05, thus we can accept the null hypothesis for public sector banks.

Model 2

PVBS		B	Std.error	Beta	t	Sig.
	CONSTANT	1.768	.056		31.295	1.768
	NPA	-9.293E-5	.000	-.952	-6.917	-0.006
PSBs						
	CONSTANT	.375	.705		.531	.618
	NPA	-3.059E-5	.000	-.428	-1.059	.338

TABLE 2: COEFFECIENTS – ROA AND NPA

DEPENDENT VARIABLE: ROA

It can be observed that the significance level for private banks is -0.006 which is lesser than 0.05. Hence the null hypothesis is rejected and H1 is accepted. When It comes to the public sector banks the significance is seen to be 0.338 which is greater than 0.05, thus we can accept the null hypothesis for public sector banks.

PVBS		B	Std.error	Beta	t	Sig.
	CONSTANT	17.386	.582		29.856	.000
	NPA	-.001	.000	-.961	-7.814	.001
PSBs						
	CONSTANT	13.989	3.625		3.859	.012
	NPA	-.001	.000	-.898	-4.555	.006

TABLE 3: COEFFECIENTS – ROE AND NPA

DEPENDENT VARIABLE: ROE

It can be observed that the significance level for private banks is 0.001 which is lesser than 0.05. Hence the null hypothesis is rejected and H1 is accepted. When It comes to the public sector banks the significance is seen to be 0.006 which is lesser than 0.05, thus we can reject the null hypothesis for public sector banks.

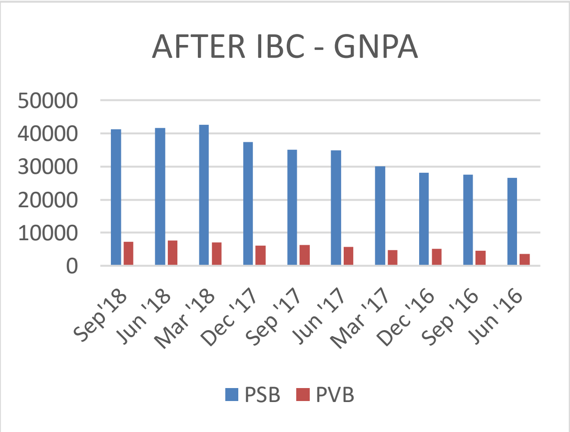
PVBS		B	Std.error	Beta	T	Sig.
	CONSTANT	4.131	.103		40.232	.000
	NPA	-9.694E-5	.000	-.871	-3.970	.011
PSBs						
	CONSTANT	2.902	.119		24.491	2.902
	NPA	-1.657E-5	.000	-.836	-3.411	-0.0111

TABLE 4: COEFFECIENTS – NIM AND NPA

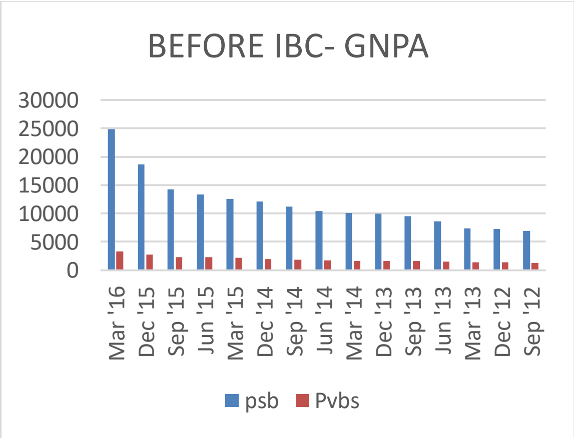
DEPENDENT VARIABLE: NIM

It can be observed that the significance level for private banks is 0.011 which is lesser than 0.05. Hence the null hypothesis is rejected and H1 is accepted. When It comes to the public sector banks the significance is seen to be -0.0111 which is lesse than 0.05, thus we can reject the null hypothesis for public sector banks.

Comparative Analysis



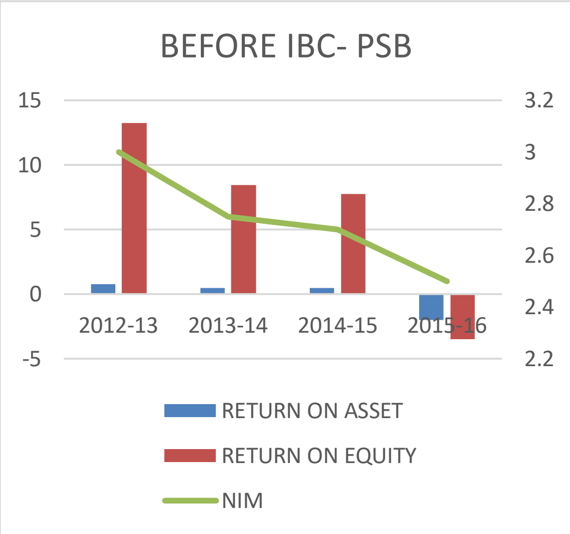
GRAPH 1: GNPA AFTER IBC

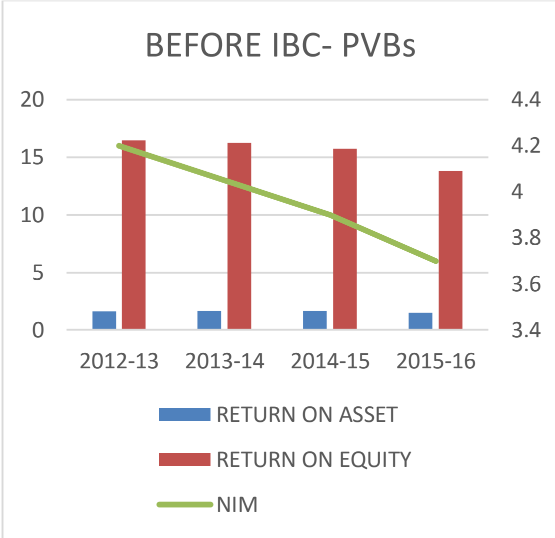


GRAPH 2: GNPA BEFORE IBC

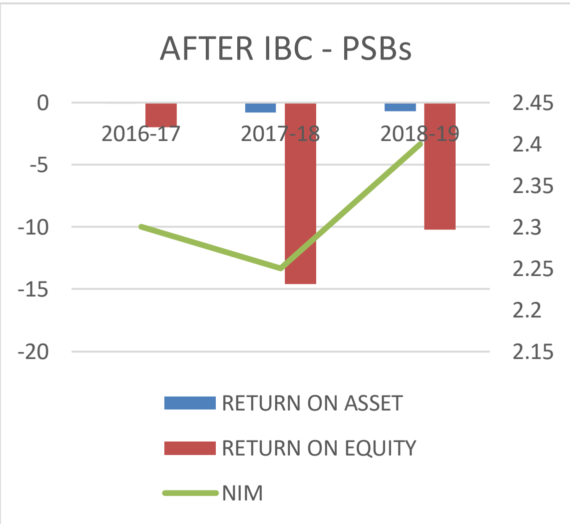
From the graph above, it can be seen that before the introduction of IBC, there was a steep and a continuous increase in the levels of the GNPA which wasnt a good sign for the Indian economy. After the advent of IBC in May 2016, GNPAs continued to increase without showing an affect and surged in March 2018. This was essentially due to higher provision requirement after resolution of stressed assets.

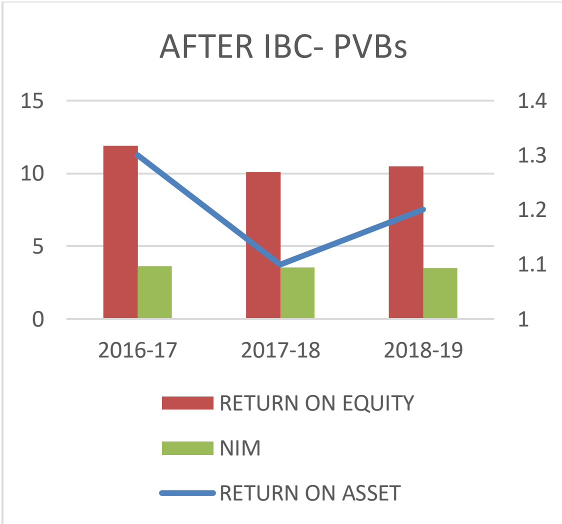
Profitability Ratios





GRAPH 3 : PROFITBAILITY BEFORE IBC (PSB) GRAPH 4 : PROFITABILITY BEFORE IBC(PVB)

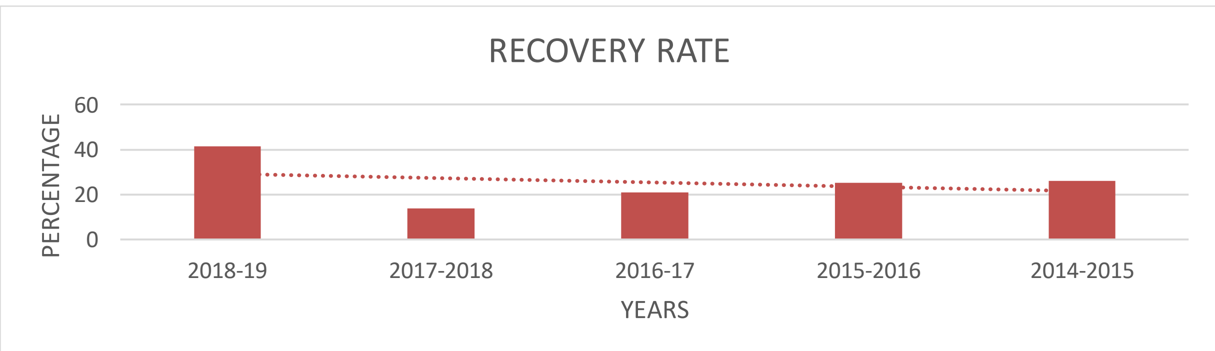




GRAPH 5: PROFITBAILITY AFTER IBC (PSB) GRAPH 6 : PROFITABILITY AFTER IBC(PVB)

The profitability ratio has shown a constant fall in the years before IBC was introduced and have shown a gradual increase in the years following IBC.

Recovery Rate



GRAPH 11: RECOVERY RATE IN PERCENTAGE

From the graph, it can be seen that there is a positive trend in the recovery rate of the amount involved in NPAs.

VIII. Summary of Findings

From the above regression results, it can be concluded that providing advances to borrowers has had a significant impact on the NPAs. Two models were considered in this study. The results of Model 1 showed that the Advances being given to borrowers has a significant impact on increase in NPAs in private. However, PSBs have not shown a significant impact due to government policies. Model 2 showed that NPA have significantly affected the profitability ratios. There is a negative correlation between NPA and the profitability ratios which indicates that reduction in NPAs will cause an increase in the profitability ratios. PSBs however did not show as much impact as the private sector banks.

From the above data and graphs, it can be clearly seen that NPAs were growing at a fast rate due to the improper laws and the longer time period required to recover the assets before the introduction of IBC and prompt corrective action taken by the government. Before the introduction of IBC, NPA increased from Rs 6900 Cr in 2012 to 25000 Cr in 2016. This implied a need for the insolvency and bankruptcy code passed in May 2016. Profitability of the banks measured using ratios such as ROA, ROE, and NIM showed the same negative trend as the NPAs

The years following the introduction of IBC, Banks PSB took a hard hit in the last quarter of 2017-2018. PSBs reported a loss of Rs 62000 Cr and increase in the NPA of around Rs 1.2 Lk Cr. This was due to the higher requirement of provisions for the stressed asset. In the Fy 2018-19, the initiatives taken by the government led to the change in trend in the NPAs. Public sector banks were the first to show a change in trend. In the last quarters, GNPAs decreased from Rs 42500 Cr to Rs 41000 Cr which was a ray of light and the start to a better economy. IBC resulted in bad loans of PSBs declining by over Rs 23000 Cr from Rs 9.62 lk Cr in March 2018.

The profitability ratios also showed a slight increase of about 0.1% between 2016-2018.

IX. Conclusion and Suggestions

This study mainly focused on the impact of the insolvency and bankruptcy code of 2016 on the banking industry of India especially the public and the private sector banks. Its objectives included the effects on the banks pre and post era of IBC.

It can be concluded that the introduction of IBC initially led to a shock in the industry and caused a opposite impact than what it was aimed for. But the last financial year has seen a change in trend due to the introduction of IBC. Also due to this the long-term effects are expected to show the much-awaited results of the reduction of NPA levels in both public and private sector banks and increase in the profitability of the banks. Hence IBC has had a positive impact and will continue to have it on the banking sector of Indian and in turn the Indian Economy. Also, during the study, a few points of problem were identified. These are that the rivals can purchase companies for a very small amount and in the absence of a healthy competition, it can be a point of depression for the economy. Haircuts are still big, and banks need money to cover these. Also, there is no guarantee that banks will have no build up for bad loans as there is no mechanism in place to prevent it. A change in the policies to address these issues can make a huge difference and can improve the quality of the code.

BIBLIOGRAPHY

Bhasin, D. M. (2017). Unmasking Rising NPAs: Can the Indian Banking Sector Overcome this Phase? *International Journal of Management and Social Sciences Research (IJMSSR)*, 20.

Chakraborty, S. A. (2017). Effect of NPA on Banks Profitability. *International Journal of Engineering Technology, Management and Applied Sciences*, 10.

Dey, S. (2018). Recovery Mechanisms of Non-Performing Assets in Indian Commercial Banks: An Empirical Study. *NSOU-OPEN JOURNAL*, 8.

Dr.K.SreeLatha Reddy, M. N. (2018). A Comprehensive Study of NPAs of Scheduled Commercial Banks. *IOSR Journal of Business and Management (IOSR-JBM)*, 8.

Goel, S. (2017). The Insolvency and Bankruptcy Code,2016: Problems & Challenges. *Imperial Journal of Interdisciplinary Research (IJIR)*, 8.

India, R. B. (2018). *December 2018 FInancial stability report.* RBI.

Mainrai, G. (2017). Digital banking: The game changer. *The Journal of Indian Institute of banking and finance*, 10.

Nakul Sharma, R. V. (2017). The insolvency and Bankruptcy code,2016: Insolvency professional Agency. *International jounral of Law*, 5.

P, V. (2017). New Bankruptcy Code and its Futuristic Impact. *The jounral of indian institute of banking and finance*, 9.

Pandey, A. (2016). The Indian Insolvency and Bankruptcy Bill:Sixty Years in the Making.

RBI. (2018). *Report on trend and progress of Banking In India.*

Samad, A. (2015). Determinants Bank Profitability: Empirical Evidence from Bangladesh. *International Journal of Financial Research*, 7.

Xalxo, J. V. (2017). Overview of the insolvency and bankruptcy code,2016 and the accompanying regulations. *Journal of contemporary issues of law*, 26.

Young, E. a. (2017). *Interpreting the code Corporate Insolvency in India.*

young, E. a. (2018). *Global banking outloook 2018.*