Restructuring Conundrums
- A case of IDBI Bank Ltd.

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About the Indian Banking Sector Scenario

The Indian banking sector has seen tremendous growth since 1992. The sector has witnessed the emergence of private sector and new generation banks. These banks continue to co-exist with PSBs (Public Sector Banks) to offer quality services to the common public through a mix of conventional and modern banking methods. Thanks to the Government's policy on financial inclusion and inclusive growth combined with impetus to digitization, the number of banking outlets in rural villages have doubled during the period of study (refer Exhibit I). The Indian banking sector is plagued by a major issue, i.e, NPA (Non-Performing Assets). A bulk of the bad loans are not cases of outright frauds. The Economic Survey of 2016-17 states that bad loan problem is mostly the result of factors extraneous to management.

Factors such as global financial crisis, delay in land and environmental clearances for projects, near collapse of steel prices, fall in spot rate of power and adverse course judgements on 2G spectrum and coal block allocation have all contributed to the bad loan problems. The banking sector has provided more loans to non-food sector than to agriculture and others. Under the non-food sector, exposure of banks is more towards infrastructure segments such as steel, power, telecom etc. The NPA (Gross and Net) and slippage ratios of the Indian banking sector have increased during 2013-2017 (Refer Exhibit IV). The RBI (Reserve Bank of India) has been taking proactive measures to tamper the burgeoning problem.

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One of the measures is establishment of ARCs (Asset Reconstruction Companies). ARCs were set up to enable faster recovery of loans without the intervention of the court. The ARCs purchase the non-performing assets from the banks and the purchase consideration is settled partly by cash and the remaining in the form of security receipts. Once the amount is recovered, the security receipts are redeemed by the ARCs. The book value of assets acquired by ARCs and security receipts issued are shown in Exhibit II. The ARCs have not been successful in the process as it is marred by regulatory constraints, lack of consensus on the right price of bad loans and capital constraints. With the introduction of IBC(Insolvency and Bankruptcy Code), the recovery process is expected to smoothen, which will in turn aid the ARCs in attracting capital for their business.

About IDBI Bank- Issues and Concerns

Industrial Development Bank, a developmental financial institution was set up in 1964 as wholly owned subsidiary of RBI. In 1976, the government replaced RBI as its owner and the mandate given to RBI was to finance, promote and develop industry in the country as a lead agency. IDBI went public in 1995 to raise funds for expansion of business. Post public issue in 1995, the Government's holding was trimmed to 75%. The Institution struggled to manage its assets and liabilities.Due to heightened mismatch between assets and liabilities for reasons viz., regular intervention of various stakeholders in the functioning, lack of governance and prudential norms in managing the assetslead to the decision of transforming the development financial institution into a Universal Bank. An Act in 2003 gave it the status of a company and it became a Scheduled Bank. To complete the process of transformation, its own banking arm was set up in 1994.According to the Act,the bank can carry on banking business in addition to the business which may be carried on and transacted by the development bank. In other words, a Universal Bank was established. As a Universal Bank, IDBI Bank, besides its core banking and project finance domain, has an established presence in associated financial sector businesses like Capital Market, Investment Banking and Mutual Fund Business. In the long run, the bank has been unable to establish itself as either a private bank or a development bank. In 2005, the Government decided to merge the developmental financial institution with the IDBI bank hoping that a synergy effect would prevail. IDBI bank, however, could not reinvent itself. In the process, it killed a fine private bank, its own offspring.

The bank's financials have not been encouraging over the years. The bank had posted net loss for two consecutive years (2016 & 2017, refer Exhibit II). The stressed assets have piled upto ₹ 60000 crs. The net bad loans of ₹ 28665 crs are far more than the current net worth of the bank. The gross NPA(%) and net NPA (%) have seen an increasing trend over the years and surpassed the average NPA level of the Indian Banking Sector (refer Exhibit III). Net Interest Margin(NIM), a key indicator of a bank's efficiency has shrunk over the years and is the lowest among all banks. It was expected that the net interest margin will improve with regular redemption of bulk deposits and the rise in low cost current and savings account. The most alarming aspect of the dwindling financials is the CAR(Capital Adequacy Ratio), a tool which measures the contribution of bank's own funds in the risk weighted assets. The CAR has also come down and is the lowest when compared to average CAR in the banking sector.

Red flags have been raised by analysts and pundits on the falling CAR of IDBI Bank over the years. (Refer Exhibit IV).

On the positive side, the bank has started to dispose off non-core assets and this is expected to bring down the gross bad assets in the coming years. The bank has also redeemed ₹ 5000 crores of additional bonds which has saved around ₹ 530 crores of interest annually. Improving quality of assets and widening of net interest margin are expected to culminate in improved efficiency of the bank.

The Central Government has been playing an active role in restructuring process of banks. Usually, the government announces a bailout package and infuses funds to ailing Public Sector Banks(PSBs). The Government on ayear by year basis identifies beneficiary banks for allocation of funds as a bailout package. In an unprecedented move, the government is contemplating on a proposal of directing the largest Insurance company, namely LIC (Life Insurance Corporation) of India to infuse ₹ 15000 crores into IDBI Bank. This would mean that LIC will pick up a stake of 51% in the ailing bank. This is subject to consent from Insurance Regulatory Authority of India (IRDAI). The current norms do not permit an insurance company to have more than 15% in a single bank.This capital infusion though is only temporary and LIC is expected to reduce its stake to around 15% in a stipulated time frame. According to analysts, this deal will help the bank to come out of the stressed scenario (Net NPAs). This, along with the expected government infusion, will provide good returns in the future. The CAR is expected to increase to 15% if the deal is through. The capital infusion is also expected to meet the Basel III norms.

High pitched debates are already on as to whether this deal is going to benefit the insurer and the bank in the short run, the first impression being that the bank is benefitting more than the insurer. The arrest of senior officials of the bank in the erstwhile 'Kingfisher Airlines' has only exposed poor governance norms and interference from various quarters of the government in running the bank. In hindsight, key to successful turnaround of the bank is to run it professionally with an independent board and minimum interference of the government (LIC as a proxy for the government) and this is an issue to ponder upon. Ideally, Singapore can be looked upon as an example. DBS bank was set up by the Singapore Government as a developmental bank and is run by a board. The government has nothing to with it except of earning handsome returns on its investment.

Will the stakeholders of the insurer and the bank benefit from this deal despite the red flags raised citing the poor financial health of the bank? It is only a matter of time before we get to know. After all, LIC's capital infusion into the bank is just 0.5% of its ₹ 23000 trillion worth of total assets under its management.

To summarise, the conundrums relating to restructuring of IDBI Bank are the following-

a. Should the bank accept the capital infusion proposal of LIC, strengthen the internal governance norms to improve capital adequacy standards?

b. Should IDBI bank strengthen the internal governance norms, transfer the bulging NPAs to Asset Reconstruction Companies (ARCs), divest from non-core/ banking activities and utilise the funds to improve capital adequacy standards?

c. Should the bank be acquired by /merged with financially healthier bank(s) and play second fiddle in running the banking operations?

d. Should the bank refer its assets (in case of corporate debt) to IBC to turnaround the non-performing assets and improve the capital adequacy standards?

Exhibit I

A glance at key statistics of Indian banking sector

Particulars	2016-17	2015-16	2014-15	2013-14	2012-13
Total Deposits	111139	100927	94338	85332	74297
Total Borrowings	12807	14488	11499	11013	10104
Loans and Advances	81162	78965	73882	67352	58798
Investments	36522	33278	29776	28833	26131
No. of ATMs	208354	198952	189279	161750	114014
No.of Banking outlets in villages	598093	586307	553713	383804	268454

***particulars in bold are amount in billions**

(Source-www.rbi.org)

Exhibit II

Book Value of Assets acquired by ARCs and Issue of Security Receipts

Financial Year	Book Value of Assets ([1] in crs)	Security Receipts ([1] in crs)
2012-13	8000	2200
2013-14	28000	14800
2014-15	40000	21000
2015-16	19700	9800
2016-17	35000	17000
2017-18	40000	19500

(Source- Business Line, dated 01/07/18)

Exhibit II

Balance Sheet of IDBI Bank ——————————— in Rs. Cr. ———————————-

	Mar 17	Mar 16	Mar 15	Mar 14	Mar 13
	12 mths	12 mths	12 mths	12 mths	12 mths
EQUITIES AND LIABILITIES					
SHAREHOLDER'S FUNDS					
Equity Share Capital	2,058.82	2,058.82	1,603.96	1,603.94	1,332.75
Total Share Capital	**2,058.82**	**2,058.82**	**1,603.96**	**1,603.94**	**1,332.75**
Revaluation Reserve	5,417.75	5,607.83	1,662.85	1,712.84	1,762.78
Reserves and Surplus	15,087.09	20,055.15	21,050.11	20,322.08	18,139.73
Total Reserves and Surplus	20,504.83	25,662.97	22,712.96	22,034.92	19,902.51
Employees Stock Options	0.00	0.00	0.19	0.45	0.77
Total ShareHolders Funds	**22,563.65**	**27,721.79**	**24,317.10**	**23,639.30**	**21,236.02**
Deposits	268,538.10	265,719.83	259,835.97	235,773.63	227,116.47
Borrowings	56,363.98	69,573.94	61,832.98	60,146.29	65,808.87
Other Liabilities and Provisions	14,302.18	11,356.57	10,044.51	9,437.40	8,607.14
Total Capital and Liabilities	**361,767.90**	**374,372.13**	**356,030.57**	**328,996.63**	**322,768.51**
ASSETS					
Cash and Balances with Reserve Bank of India	13,346.92	13,822.91	13,035.77	12,711.11	10,543.95
Balances with Banks Money at Call and Short Notice	19,337.16	2,757.63	1,489.99	4,106.80	7,380.57
Investments	92,934.41	98,999.43	120,963.21	103,773.50	98,800.93
Advances	190,825.93	215,893.45	208,376.87	197,686.00	196,306.45
Fixed Assets	7,348.78	7,447.32	3,060.50	2,983.21	2,925.29
Other Assets	37,974.70	35,451.39	9,104.24	7,736.01	6,811.32
Total Assets	**361,767.90**	**374,372.13**	**356,030.57**	**328,996.63**	**322,768.51**

Exhibit III

Profit & Loss account of IDBI Bank ———————— in Rs. Cr. ————————-

	Mar 17	Mar 16	Mar 15	Mar 14	Mar 13
	12 mths	12 mths	12 mths	12 mths	12 mths
INCOME					
Interest / Discount on Advances / Bills	19,310.33	20,772.25	20,829.77	20,257.32	19,549.29
Income from Investments	6,574.71	5,941.08	7,209.80	6,074.72	5,335.15
Interest on Balance with RBI and Other Inter-Bank funds	456.85	47.07	69.35	103.34	156.12
Others	1,449.48	1,282.70	45.07	162.13	23.75
Total Interest Earned	**27,791.37**	**28,043.10**	**28,153.99**	**26,597.51**	**25,064.30**
Other Income	3,967.60	3,410.36	4,007.63	2,978.75	3,219.51
Total Income	**31,758.97**	**31,453.46**	**32,161.62**	**29,576.27**	**28,283.81**
EXPENDITURE					
Interest Expended	22,039.71	21,953.81	22,406.10	20,576.04	19,691.19
Payments to and Provisions for Employees	2,203.59	1,674.05	1,926.36	1,491.61	1,538.50
Depreciation	358.94	214.18	136.95	113.17	124.12
Operating Expenses (excludes Employee Cost & Depreciation)	2,578.28	2,241.36	1,964.11	1,714.06	1,471.75
Total Operating Expenses	**5,140.81**	**4,129.58**	**4,027.42**	**3,318.84**	**3,134.36**
Provision Towards Income Tax	203.93	4.25	1,045.60	1,169.45	1,518.51
Provision Towards Deferred Tax	-3,663.81	-1,310.20	-631.65	-549.72	-778.82
Other Provisions and Contingencies	13,196.47	10,340.82	4,440.77	3,940.26	2,836.48
Total Provisions and Contingencies	**9,736.59**	**9,034.87**	**4,854.72**	**4,559.99**	**3,576.17**
Total Expenditure	**36,917.11**	**35,118.26**	**31,288.24**	**28,454.87**	**26,401.72**
Net Profit / Loss for The Year	**-5,158.14**	**-3,664.80**	**873.39**	**1,121.40**	**1,882.**

(Source-www.moneycontrol.com)

Exhibit IV

Key Parameters- IDBI Bank (IDBIB) Vs Indian Banking Sector (IBS)

Particulars	2016-17		2015-16		2014-15		2013-14		2012-13	
	IDBIB	IBS	IDBIB	IBS	IDBIB	IBS	IDBIB	IBS	IDBIB	IBS
NIM *	-18.56%	2.50%	-13.06%	2.60%	3.10%	2.60%	4.21%	2.70%	7.50%	2.60%
RoA*	-1.42%	0.40%	-0.97%	0.40%	.24%	0.80%	.34%	0.80%	.58%	1%
RoE*	-30.08%	4.20%	-16.57%	3.60%	3.85%	10.40%	5.1%	10.70%	9.66%	13.80%
Gross NPA Ratio	21%	9.30%	11%	7.50%	6%	4.30%	5%	3.80%	3%	3.20%
Net NPA Ratio	13%	5.30%	7%	4.40%	3%	2.40%	2%	2.10%	2%	1.70%
CAR	11%	13.60%	12%	13.30%	12%	13.00%	12%	13.00%	13%	13.90%

(source-www.rbi.org) & (www.moneycontrol.com)