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KINGFISHER AIRLINES LTD. & FIRESTAR INTERNATIONAL PVT. LTD. SCAMS (WILFUL DEFAULT AND FRAUD CASES)

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ABSTRACT

The growth of the banking sector acts as an impetus for the economic progress of any country as they are interrelated. Although in India, regulators try to monitor the banking sector in a conservative fashion, not allowing too many risks to seep in but still the sector is exposed to its own set of challenges. The concurrent need is to find solutions to such problems. Non-Performing Assets (NPAs) remain one such burning issue. The objective of this study is to understand the underlying mechanism that paves way for high-profile NPAs. Ultimately, the result represented the decline in NPAs levels from 2018 to 2019. But the percentage of wilful defaults in gross NPAs is increasing and fraud cases are furthermore, on the rise. Hence grasping the gravity of the issue, this paper examines the trends of gross NPA, wilful defaults and frauds. To unravel the fundamental problem, we have analyzed the two massive cases of Kingfisher Airlines Ltd. and Firestar International Pvt Ltd. We have discussed how these scams took place with the core focus of lapses from the bank's side. We have analyzed those key failures to recognize the bank's point of view thereon. Besides this, we tried to find out the mistakes that can again cause banks to be hit by such massive scams. Some valuable recommendations are equally drawn in the preceding section of the paper.

Keywords: *NPA, Kingfisher Airlines Pvt. Ltd., Firestar International Pvt. Ltd., Willful Default, Fraud.*

Introduction

When we talk about the problems of the Indian banking sector, the existence of Non-performing Assets (NPAs) acts like the elephant in the room. It is a problem that has been haunting the economy for more than two decades. In terms of the Reserve Bank of India (RBI)'s, an asset becomes non-performing when it ceases to generate income for the bank. The increasing non-performing assets (NPAs) of banks affect the financial stability of a country, profitability of banks, quality of bank assets and pose a severe level of stress on banks' balance sheets. There are several factors like industrial recession, sluggish economic growth, ineffective recovery system of banks, complex judicial procedures, wilful defaults, frauds, etc. contributing to the increase in NPAs.

But in this paper, we are only focusing on wilful defaults and frauds. Though the gross NPA as a percentage of gross advances observed a decline from 2018 to 2019 as a result of the Government's 4Rs strategy stated by Finance minister Nirmala Sitharaman. But the contribution of wilful defaults has increased up to 60% in the last five years (2014-2019). A borrower (individual or company) is considered a wilful defaulter when it does not repay the loan or debt taken even when the borrower is perfectly able to pay off the obligations or it diverts borrowed funds for other purposes or disposes off the asset provided by him to secure the loan without the knowledge of the bank.

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Fraud is intentional, dishonest behaviour by a person, deliberate concealment of material fact with the motive of gaining an advantage over another or deceiving for personal benefits. The amount involved in fraud is also increasing and indicates the extent of tremendous loss to which the public has been put and shaken their confidence in the financial system. The Kingfisher Airlines Ltd. (2016) And Firestar International Pvt Ltd. (2018) cases are one of the most significant wilful defaults and fraud cases in banks' history.

Background of Study

- **Kingfisher Airlines (KFA) Ltd. Case**

The analysis of the KFA Case provides learnings for all the stakeholders including the government, the structure of law and the banking system. Interestingly this story started way back in 2005. Vijay Mallya, who was the owner of KFA made it the second-largest airline and captured 25% of the domestic travelers' market in India. Mallya was extremely ambitious and wanted to operate overseas routes in less time and hence decided to acquire some international airlines. In 2007, KFA bought bleeding Air Deccan. They renamed Air Deccan as Kingfisher Red and provided the same facilities as KFA at modest costs. This led to a decline in KFA's market share and hence, they decided to increase Kingfisher Red's fare but this reduced the market for Kingfisher Red ultimately leading to higher debts. 2008 onwards, KFA started incurring losses. The reason stated was the plunge Mallya took into businesses that required more funds to sustain itself than they were generating. He kept diverting the landed loan amount. KFA obtained loans from 17 banks, and the majority were PSUs. Some private banks like ICICI and HDFC recovered loans by selling the United Breweries (UB) Ltd's securities in the market. In 2010, KFA turned into an NPA for banks.

The Kingfisher’s debt was reconstructed for the very first time in November 2010 by the banks. The consortium of lenders led by the State Bank of India (SBI) converted Rs 1,400 Cr loan but the shares were overestimated while valuation.

Apart from that, KFA was provided with the period of nine years along with a two-year moratorium at lower rates of interest with issuance of fresh loans as well. The reason that is quoted behind such generosity of banks traces to Rajya Sabha’s membership and political connections which helped Mallya to pull all this through. The immediate liability of Mallya came down to nothing as almost all of the KFA’s debt was restructured. Despite a tainted credit history, IDBI Bank extended loans to KFA.

In the year 2011, troubles in paradise started to reappear on the account of rising fuel costs but this was just one excuse to save the face. This ultimately resulted in the inability of KFA to pay dues to the oil companies and salaries of the employees. The onset of 2012 emerged as more turbulence for KFA and it was finally, declared as a Non-Performing Asset (NPA) by its largest creditor – State Bank of India (SBI). This resulted in KFA becoming grounded in October 2012 as it was unable to remunerate its employees leading to cancellation of its license by the Directorate General of Civil Aviation in December 2012.

Out of the total debt of Rs 9,000 crores, Mallya agreed to repay the principal amount of the loan (Rs 6,000 crores) with the interest amount being waived off but the lenders objected to that. Hence, he moved to Britain leaving India. He has been included in the "Wanted list of India" for wilful default & currently he is in Britain.

- **Firetsar International Pvt Ltd. Case**

In 2018, another Nirav Modi Firestar International Pvt Ltd. Scam made to the headlines. Beginning in 2011, it got exposed in 2018. In 2011, Mr. Modi was in need of funds for importing pearls and diamonds and Punjab National Bank (PNB) helped him out by providing buyer’s credit. It refers to nothing but simply a loan which is taken from a foreign bank where the guarantee to pay is assumed by PNB. This allowed Mr. Modi to avail funds putting banks at risk. These LOUs by PNB allowed him to score credit from foreign branches of other banks like Axis Bank or Allahabad Bank (Hong Kong Branches). Next, the funds were credited into the Nostro account of PNB's branch. Using these funds, Mr. Modi was able to import pearls and diamonds. What should have happened is Modi should have exported these imported jewels and made payments against the LOUs to the lenders but rather he diverted the funds to other purposes. The bank token devices of fake or dummy companies that were being used by Mr. Modi to transfer funds were also found by Enforcement Directorate (ED). The payment of older LOUs was being done by generating the new ones from other banks. This process carried on till 2008. Nirav Modi pulled his first fake guarantee from PNB on Mar 10, 2011, and continued to get 1212 more such guarantees for the coming 6 years. In this way, the wheel of fraud was kept running. Mr.

Gokul Nath Shetty, who had been operating at the foreign exchange department of the PNB branch was also involved as he used SWIFT to transfer money in Mumbai since 31 March 2010 conveniently ignoring Core Banking System. There was no linkage of SWIFT to the CORE Banking System (Bandyopadhyay, 2018) and ideally, if the SWIFT was unlinked to CBS, they should have manually kept a manual record which was also not done. From the side of workers, one worker employed two or at a time three officers' passwords, which is strictly warned against by RBI as it puts SWIFT transactions to risk.

The lid of this sham opened when a new manager at PNB asked for collateral security from Modi's people for issuing an LOU but the bone of contention was that till now all the LOUs were issued without collateral. The bank officials told the new manager that this had never happened at PNB and Mr. Modi had been availing this benefit for a long time. The officer was triggered sensing that something was not right and went ahead with the scrutiny, eventually realizing that PNB has become the victim of a fraud. A complaint was filed against Mr. Modi & Mr. Mehul Choksi, Mr. Gokul Nath Shetty and other bank employees for amount involved of Rs 280 crore. Although it was stated by PNB that all reports were duly sent to top management and they were unaware of the fraud. This was a situation which could have been detected by banks with a little bit of effort and due diligence.

Objectives

To analyze the trends of gross NPA, wilful defaults and frauds.

- To analyze the case studies of Kingfisher Airlines Ltd. and Firestar International Ltd.
- To find the major reasons that lead to wilful defaults and frauds and bring the key failures to light that lead to such scams.
- To state the possible reasons which can lead to further such scams.
- To give suggestions based on banks' point of view, secondary research and after analyzing the cases that can help banks to increase their efficiency and hence safeguard themselves from such future scams.

Review of Literature

Now, let's discuss some research studies which have acted as an underlying base for building up this paper. This part of the research paper discusses the issues already explored by existing studies and the results that have been highlighted by them which related to NPA. The literature review is of utmost importance while conducting any research study as it explains the necessity of the current research initiatives.

In India, primarily the literature discusses the trends and causes of NPAs across years of various banks. But as the contribution of the wilful defaults and frauds to NPAs is increasing, it becomes necessary to devote appropriate attention to the causes behind these, as well, as both are continuously showing the inefficiency of banks in lending. Few works of

literature available on these topics are as follows:

The study conducted by **Jaydev M and Padma N (2017)** talks about wilful defaulters related to Indian Banks which revealed that a large number of wilful defaulters emerge in the economy because of the weak governance structures to step on law and flout certain rules and regulations and these funds are usually borrowed from government-owned banks so that the entire risk factor can be shifted to government and ultimately, the entire public.

Lakshmi Karthik, Arvind Shrivastava, M. Subramanyam have put together a study of the suit filed against the wilful defaulters of India, for the period 2002-2016 and tried to analyse them critically. PNB SCAM: Shining Diamond Trader Took Away PNB's Shine (2012) by Love Jit Kaur questions the management, operations and internal audit procedures at PNB that allowed the fraud amount to magnify and persist undetected for more than 5 years. The paper calls for a review and restructuring of internal processes at Public Sector Banks (PSBs) and developing mechanisms that can aid in recognizing threats of such scams at early levels rather than allow them to grow and magnify. Apart from this, the study also talks about how such scams have a dire impact on the economy as a whole putting the entire financial structure to risk because of the inter-relatedness.

Frauds in the Indian Banking Industry by **Charan Singh (2016)** uses secondary data to talk about issues such as banking frauds and mounting credit card debt. He has adopted a case study-based and interview-based approach taking in the loop the people connected with the financial system. The study also comments upon the efficiency and credibility of third-party players like auditors and credit-rating agencies.

A Khanna (2009) tries to probe the reasons behind bank fraud and preventive and corrective actions that can be taken to counter them. It also takes on bank employees and their involvement in such high-profile scam cases. The study emphasizes preventive training of employees and setting up mechanisms for internal control and eradication of practices that lead to such financial misconduct. The author Batra S. (2003) provided a comparative analysis of the existence of NPAs in the Asian Markets highlighting the higher levels of NPAs in India. It is also brought to notice that how banking structures revolve too much around recovery procedures rather than trying to nib NPAs in the bud by acting with due diligence while making the loans essentially stating that Prevention is better than cure. It is true that NPAs cannot be eliminated – they are a consequence of risk-taking which is one of the jobs of the lenders but the degree, amount and concentration of NPAs have to be kept under control.

- **Banking Frauds in India:** Case Studies of Nirav Modi and Vijay Mallya case by Dr Anil Dogra moves along similar lines but also adds the angle of corruption to the study which is stated to be like cancer in modern times. Just as timely detection of the disease is helpful, same goes for Non-Performing Assets (NPAs) in the economy. The detection of fraud and corruption has become a burning issue for discussion. He describes it as a universal phenomenon spread across the entire globe. The study also talks about preventive and corrective measures that can be taken to curb corruption.

Praveen S Kambar (2019) points to privatization of banks and states this is not a foolproof solution to the problems of the banking industry. He talks about the idea of establishing a bad bank and the challenges associated with it. A case study on the erosion of Kingfisher Airlines by Panigrahi, Antra Sinha, Anshul Garg, and Astha Mehta stresses the unchecked ambition of the owner – Mr. Vijay Mallya where he provided services to the customer delight but the inability to manage funds that went into the provision of such services led to the downfall of KFA which allowed the company to make a mark in customer's mid but the financial management got messed up in the process. The study also talks about the financial conditions at UB Holdings. He has tried to explain the business model of KFA and shed some light on the role that the lenders (the banks) have played while extending credit and during attempts of recovery.

Research Methodology

To realize the stated objectives, the research has been drawn by analyzing both primary and secondary data. The primary information is obtained through self-administered questionnaire, observation and discussion with both public and private sector banks. The secondary data have been extracted from journals, articles and research papers.

Data Sources

Secondary Data

- RBI reports, research reports, and published articles. These secondary sources are part of separate chapters in this report.
- Statistical data have been collected from RBI websites and earlier published research papers.

Primary data

Primary data comprises of a questionnaire, designed to fulfill the above-stated objectives.

Tools of Analysis

To achieve the stated objectives, the scams have been analysed making use of both the primary and secondary. The questionnaire has been designed on the following points: -

- Key failure points that we have found in the scams.
- Reasons which are stated under wilful default & fraud.
- Perception of bankers on the reasons & key failure points.

Sampling Frame

The sample size of the comprehensive study includes around 67 in charge Officers from various responsible departments working in separate banks of SBI, PNB, Punjab Sindh Bank, Canara, etc. The questionnaire was purposely divided into distinct segments like credit extension, IT and recovery and redressal.

Analysis and Findings

The analysis is based on the primary and secondary data collected. We have tried to evaluate key failure points in Kingfisher Airlines Ltd. and Firestar International Ltd. We have also tried comparing them with the current practices of lending in banks.

The **secondary data study** is drawn from the analysis of cases. The lapses observed in the scams from the bank's side are given below.

The key failure points which we found in **KFA** are as follows:

- **Inappropriate Collateral Collection:** Bank of India (BOI) gave loans on accepting current assets as security. SBI kept trademarks and goodwill of Kingfisher as collateral wherein 2009 the value was 4000 Cr. which dropped to 6 cr.
- **Overestimation of Shares while Debt Restructuring:** The lenders gravely overestimated the value of shares of KFAs while converting Rs 1,400 cr loan by valuing shares of KFA at Rs. 64.49 which were trading at only Rs.39.90 all-time high of Rs.48.
- **Special Benefits due to Political Connections like Stretched Repayment Period of Loans:** The bankers provided leeway to KFA in terms of extending the repayment period that too at lower interest rates ignoring the interests of the lenders.
- **Lack of Interbank Communication:** Industrial Development Bank of India (IDBI) extended the loan to KFA despite turning into an NPA.
- **Inefficient Monitoring of End-use of Funds:** Mallaya was diverting the funds from banks and banks were completely unaware of the fact. They failed to maintain track of money.

The key failure points in **Firestar International Ltd.** are as follow:

- **No Rotation of Employees:** Mr Gokul Nath continued to work at foreign branch for about seven years flouting RBI guidelines.
- **Interbank Communication was Unmaintained:** Communication channels between the overseas banks like Allahabad Bank and Axis Bank with PNB were tampered and ineffective.
- **Inefficient Monitoring of End-use of Funds:** LOUs were issued to customers with no sanctioned limits. The follow-up on these LOUs was not done after the expiry of prescribing of 90 days (Source: India Today). Briefly, LOUs were misused by the issue of new LOUs to provide for the mature ones, or they were repeatedly extended.
- **Auditing Failure:** Auditors were not able to detect the problems at the beginning which created problems for future.
- **Inappropriate Collection of Collateral:** When Mr. Modi's people demanded LOUs from PNB, the new PNB office asked for the collateral which was looked down upon by everyone. PNB had been providing LOUs to Mor. Modi without any collateral. This pushed the new officer to delve deeper into the issue.
- **Unauthorized Sharing of user IDs and Maker-Verifier- Approver Chain not followed in issuing LOUs:**. In 2016 advisory, the RBI had warned that unauthorized sharing of user IDs and passwords might present SWIFT transactions at risk (which was happening in Firestar). A Letter of Undertaking (LOU) is nothing but a bank guarantee which helps a bank's customer to raise debt from another Indian bank's foreign branch putting the guarantor bank at risk. It helps in availing short-term credit for business transactions. Generally, collateral is demanded for providing such a facility which was missing in this case. The LOUs are issued after undergoing a maker-verifier approver chain but it was not followed in case of Firestar.
- **Lack of Integration of SWIFT with CBS:** SWIFT refers to a network that allows secure transmission of information among financial institutions which is enabled through a standardized system of codes. SWIFT messages go through a three-tier verification system that is to create, check and authorize which includes three individuals involved in a bank - a maker, a checker and a verifier and a fourth not from the bank, who remains the person who receives the communication and sends a confirmation to secure space and no one has access to this room (RAMKIPKF S&S LLP). Generally, CBS and swift are both entered on one interface. PNB didn't possess the mechanism. If they didn't possess this technology, they should have accepted to maintain records in sync and manually preserve them but they didn't implement this either. Therefore, bank employees at varying levels are complicit in the fraud or completely negligent.

BASIS	AGREED	DISAGREED
Wilful Default & Fraud are one of the significant reasons of NPA and requires urgent attention	53.7%	46.3%
Herd behaviour in lending	29.8%	70.2%
Bad corporate governance in banks	44.7%	55.3%
Political intervention in lending	41.7%	58.3%
Inappropriate technology usage contributes to wilful defaults.	14.9%	85.1%
Inefficient auditing by auditors	38.8%	61.2%
Acceptance of inadequate collateral or sanctioning of security free a loan.	41.7%	58.3%
Inadequate due diligence	62.6%	37.4%
Ineffective monitoring of end use of funds	65.6%	34.4%
Bad internal risk management facilitates frauds.	53.7%	46.3%
Intense competition affects on lending	31.3%	68.7%
Top-level management involvement in massive frauds	80.5%	19.5%

The above **percentage table** is prepared as per the primary data collected from banks. Further, the explanation of some points mentioned in the table and answers provided by bankers to some subjective questions are as follows:

- According to analysis, it is discovered that **53.7%** of bankers agreed with the statement that wilful defaults and frauds stand the significant contributor to NPA. Where frauds and wilful defaults need grave attention as it is not only the result of customer-specific actions but also the outcome of operational deficiency and defective credit appraisal.
- The key reasons for fraud as stated by **60%** of financiers are inadequate due diligence by the credit team, inappropriate collateral management and ineffective training of employees. Other **40%** of bankers presented customer-specific actions and improper monitoring of end-use of funds as primary reason for fraud and wilful defaults.
- **58.3%** of bankers stated they assigned more importance to the risk profile of the borrower, and collateral is collected accordingly. While the rest **41.7%** agreed that in some cases collateral-free loans have been sanctioned which later leads to wilful defaults and frauds.
- **62.6%** of bankers agreed there was inefficient due diligence by bank employees while lending. They defend their answer by stating that possible reason for this inefficiency could be frequent transfers of bank employees and inadequate knowledge of diverse fields
- In Kingfisher Airlines Ltd. Case, lack of inter-bank communication exaggerates the problem as multiple banks provide a large number of loans to KFA. For this, they argued it is incorrect, as multiple bank arrangements are followed by banks. In this case, the reason conceivably could be operational deficiency and lack of due diligence.
- IDBI extended advances to KFA, despite their other loans, which had already turned into NPAs. For this **70.2%** of bankers stated that it could be due to Vijay Malaya's established political connections. Other **29.8%** stated it could be because of herd behavior that prevailed across the banks.

- **41.7%** of bankers agreed political pressure is involved in sanctioning some massive loans and it is more in public sector banks. They significantly said that political pressures are generated at the top level which further passes on to a more ordinary level. This is evident in the Vijay Mallya case being a member of parliament, he exploited his political connections to get multiple loans.
- It was found the banks are completely dependent on the credit rating agencies' reports in granting loans. A few like SBI and PNB possess their internal rating mechanisms and contain their parameters for ratings. In such cases, banks are suggested to accord more importance to their internal ratings. Many times credit rating agencies' reports are manipulated or drawn on the basis which doesn't suit every bank's risk management levels.
- **85.1%** of bankers do not find lack of technological upgradation as significant reason behind the fraud. They said there were alternatives available to this. Hence, this nullifies the justification provided by PNB, that the non-integration of SWIFT with CBS was one of the primary reasons that leads to such massive scams.
- PNB stated that all reports were duly sent to top management in Nirav Modi case. Then how is it possible that upper level was not aware of the situation. To this, 80.5% bankers stated that it wasn't possible that such a massive fraud can take place without the involvement of top management and the other 19.5% stated it could represent a case of misrepresentations/ omissions in reports.
- In case of KFA, herd behavior of banks is observed as multiple banks lend multiple loans without any due diligence and exclusively relying on the actions of other banks. To this, all banks stated they evaluated the portfolios of the investors. Advances are granted only when the portfolios are found viable.
- In KFA and Firestar International Pvt. Ltd. Scam, the auditors were held responsible as they have not performed their work properly. To this **38.8%** of bankers stated audit failure is solely the result of examiners' negligence. The other **61.2%** of bankers said, maybe the auditors were provided incomplete records for examination. But they should have asked for the necessary documents.
- In both cases of Firestar International Pvt Ltd. and KFA, the compromise settlement was refused by banks. To this, banks stated compromise settlements are refused in criminal cases. Considerably, they added that recuperation of default amounts included long legal impediments and procedures which delay the loan recovery.

Suggestions

In this chapter, as per the analysis drawn, we have tried suggesting possible measures which can prevent banks to safeguard themselves from more isolated scams.

Prevention is better than cure. Nurturing this idea, the banks can consider the below-given suggestions.

- Improving the quality of due diligence performed while the extension of credit by banks and continued supervision can be of considerable help in reducing the number of such scams. Although, extremely proficient employees have been appointed for credit appraisal even then its quality is not up to what is required. While analyzing the secondary data and significant cases, it has been revealed that the existing credit assessment system is deficient.
- After providing the advance, there should be a proper observation of funds lent. Banks may conduct frequent visits, check periodical reports, etc. for this purpose. Our specific recommendation for banks is to do surprise inspections. This will provide an extremely realistic picture and authentic records. They should obtain a proper and systematic review of the project for which the loan has been arranged.
- From our analysis, we got to know that political pressure is involved in lending some massive loans. So extra autonomy should be allowed to banks to accommodate more efficient, effective and independent credit extension and monitoring mechanism. This will aid them to lower risks of political pressure and improve the efficiency of management and operations.
- Avoid collateral-free practice in providing the loan as observed in scams as well as per the preceding analysis. This collateral independent practice is extremely risky, and banks should follow rules and regulations as framed by RBI. Competition in banking industry is fine, but that should not land the bank in a situation where it's hard to recover.

- Lack of due diligence represents a significant problem in the discussed cases. This activity is compulsorily required to be performed by the banks before granting loans. No defending point given by bankers justifies lack of due diligence.
- As per the analysis, it is noted that multiple lending was observed and the reason being was lack of exchange of information about the borrowers. Hence, we suggest that coordination should be maintained between the banks to prevent such wilful defaults and frauds.
- Legal Procedures have to be stricter and more stringent and independent of political networks. Hence, it is recommended that more autonomy should be given to banks as this will result in a faster recovery process.

Limitations

- Because of the coronavirus pandemic, the results of the study are primarily drawn on basis of secondary information and very few on the principles of primary data.
- The analysis is conducted from 2011 to 2019. It has been tried to include the possible updates related to the topic. But there could be a few regulatory provisions enacted after the concerned period can be one influential factor.
- Existing bias of respondents while answering the questions might have affected the quality of data to some extent, despite all precautionary measures being taken.

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