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# MANAGING NONPERFORMING ASSETS

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**ABSTRACT**

*Non-performing assets has become a problem for the banking industry in India in particular and world in general. Banks are working with policies and assessment of the borrower and their repayment capacity based on the expected financial performance of the borrower. Borrowers also looking at market conditions, demand supply for their products and financial viability of their ventures. Even after all these evaluations, banks are facing the issue of Nonperforming assets.*

***Purpose:*** *The present case is a real situation faced by a consortium of banks in combined Andhra Pradesh by lending term loans to a company and the situation thereafter. The purpose of the case is to discuss where the things are going wrong between the lender and borrower and who is responsible?*

***Scope:*** *Similar situation might be happening in other states and with other banks and borrowers. This case discussion may be relevant to such situations and find a way to tackle the situation. Such discussions will help in enlightening the lenders and borrowers in future.*

***Conclusion*** *The analysis reveals that failure of the banks to appraise the expansion project in ensuring techno economic viability and post monitoring of the implementation are the causes for the productive activity becoming non performing.*

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***Keywords:*** *NPAs, Term Loans, Defaulters, Substandard Asset.*

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## Introduction

A Bulk Drug and PharmaIntermediates manufacturing company in the state of Andhra Pradesh sanctioned with term loans and Working Capital limits by a consortium of banks, leader of the consortium being a leading public sector bank and two prominent public sector banks as member banks.

The main products of the company were Active Pharma Ingredients and Drug Intermediates.

The company approached the banks for setting up of two manufacturing units at Hyderabad at a total project cost of Rs.9800.00 lakhs. The means of finance envisaged was Rs.3800.00 lakhs as Promoters‘ contribution and Rs.6000.00 lakhs as term loans from the consortium. The project was appraised by Lead Bank technical team and found technically feasible and commercially viable. Accordingly, Banks funded the project.

Both the units were set up as per scheduled implementation plan approved and started commercial production. For the first two years of commercial operations, the company was in stabilisation stage, i.e. overcoming initial teething problems and reaching breakeven level. Company started meeting the commitments of servicing the interest and repayments to term loans.

The main products of the company were in good demand globally.

At this stage, the State government, in order to encourage clusters of industries, encouraged setting up of manufacturing units including Pharma units in identified Special Economic Zones at Visakhapatnam outskirts. The management of the company, attracted by the offers of the State Government decided to go for expansion for manufacture of the products in good demand then.

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Labour Unions did not allow the company to hire labour from outside Visakhapatnam and demanded hiring their people only at specific wages, which was not acceptable proposition for the company.

The company diverted some of sales realisations of the existing units to meet the capital expenditure of the Visakhapatnam unit, which was later found by the Bank's study team.

The company could not bear the debt servicing burden of existing and expanded facilities. The surplus of existing units was not sufficient to service the debt of Visakhapatnam Unit. Consequently, the accounts of the company with all banks were to be classified as NPA.

Interesting thing one should be aware is that whether the bankers are also responsible for such a state of affairs of the company?

On classification of the account as Sub-standard (1st stage of NPA as per RBI guidelines), Bankers took the following steps for recovery as well as to safeguard the assets of the company:

- Joint lenders' meet was held and bankers discussed the possibilities for revival or otherwise.
- Bankers' conducted meetings with the company representatives to discuss and find the reasons for slippage of the accounts and to know the plans of the company for survival/revival.
- Forensic Audit was entrusted by the Bankers to conduct a transaction audit to find the
- utilisation of the finance and diversions.
- Account was reported as Red Flag account on suspicion of diversion and inappropriateutilisation of the funds.
- Account was reported by the Lead Bank to the Central Repository on Information of Large Credit as per RBI guidelines.
- Physical inspection of all the three units were conducted Jointly by the Banks to know the availability of the inventory and other items as declared by the company, to know the statusand condition of their machinery and its safety.
- Insurance of the fixed and movable assets ensured.
- Legal notices were served to the directors, guarantors as there was no satisfactory response from the company for revival /gradual recovery.
- Lenders decided to proceed legally by filing recovery suit against the company and the Guarantors.
- Action under SARFEASI Act was initiated against the collateral property securities bycomplying with the provisions of the Act.
- Company could not come up with any revival /restructuring plans. Most of the technical and qualified Administrative Staff left the company.
- Collateral properties of the guarantor's were disposed off under SARFEASI Act and the amount was adjusted towards recovery of the liabilities of the company with the Bankers as per the pro-rata share of each Bank.
- Company approached for one time settlement of the balance dues requesting the bankersto allow them to dispose off the 3 units on the ground that they would be able to negotiate and get better price from the prospective Buyers.
- Lenders permitted 3 months' time to complete the process and the company started negotiations with prospective buyers.

The matter is in process.

**The Result**

- Promoters with technical experience in relevant field lost the total facility within a span of four years and got their names listed as Defaulters.
- Bankers with lot of persuasion and additional work of legal and recovery effort could manage to recover their dues.
- About 100-120 people lost their direct and indirect employment
- The production facility remained idle resulting in failure to add to the GDP.

**Point to Discuss**

Who is responsible and answerable for the above?

What and where went wrong?

**Teaching Notes**

The failure on the part of the company to assess the future business, sale price and raw material cost while planning for expansion.

Unrealistic and manipulated business projections of the company without being conservative during the initial years of stabilisation.

The failure on the part of the bankers to consider funding of the expansion of the project without envisaging the future probabilities regarding demand for the products, movements in raw material prices, the labour issues realistically and not ensuring the definite sources of the promoters to bring in the required contribution for the project.

Failure of the lending Banks in timely detecting and arresting diversion of existing unit's working capital for creation of fixed facilities for the third unit.

**Lacunae of Appraisal by the Lead Bank**

Bank had laid emphasis on qualifications/experience of promoters in the relevant field, then existing demand for the product and the capacity of executing and running two units at Hyderabad.

Failed to foresee/predict scientifically the future demand and supply, prices of raw materials, assessment of labour related issues at Visakhapatnam and more importantly the source of promoter's contribution for the project at Visakhapatnam.

Could not avert diversion of funds from existing unit.

Here are the lacunae or failure of the management of the company to plan for expansion of the activity without forethought, the reasons being;

- The company was in stabilisation stage and just achieved breakeven of the activity; [not the right time to think of expansion].
- Not assessed realistically about the continuity of the demand for the products.
- Not assessed the balance between the demand for the products and increasing supply
- Failure in predicting or foreseeing the basic raw material prices (started increasing
- consistently when the company was in implementation stage of expansion project).
- Most important factor, i.e., the availability and assessment of technical and non-technical labour and administrative personnel at expanded location. {The labour unions at Visakhapatnam Pharma zone dictated the terms to the company and did not allow engaging the labour at company's feasibility. This had become a real hurdle and the company could not go for commercial production at planned level which caused severe liquidity crisis].

The analysis reveals that failure of the banks to appraise the expansion project in ensuring techno economic viability and post monitoring of the implementation are the causes for the productive activity becoming non performing.

**Conclusion**

The analysis reveals that failure of the banks to appraise the expansion project in ensuring techno economic viability and post monitoring of the implementation are the causes for the productive activity becoming nonperforming.

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