Research Journal of Management Sciences E-ISSN 2319–1171
Vol. **5(7),** 12-14 July **(2016)** *Res. J. Management Sci.*

Mini Review Paper

Rising Non-Performing Assets in India – An Outcome of Willful Default or a Genuine Business Failure?

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Available online at: www.isca.in, www.isca.me
Received 10th June 2016, revised 4th July 2016, accepted 5th July 2016

Abstract

In India, all the Public Sector Banks put together have registered a net loss of Rs. 18,000 Croes during the financial year 2015-2016 in spite of registering a whooping "Operating Profit" of Rs. 1.40 lacs Crores due to the provisioning for bad loans. There have been cases where the borrowers are genuine and have really suffered losses due to economic slowdown and on account of the default by their debtors. However, there are some corporate and individual borrowers who have resorted to the malpractice of siphoning of the money. Such, borrowers are allegedly doing it willfully, hence, called willful defaulters. In the cases where assets of the borrowers were over-valued and loans were granted in excess of the market value of their assets must be dealt with seriously.

Keywords: Willful Defaulters, Non Performing Assets, Crony Capitalism, Public Sector Banks.

Introduction

On account of the economic downturn and the RBI's guidelines of provisioning for weak assets, the Public Sector Banks in India have registered huge net losses during the financial year 2015-2016. Although, all Public Sector Banks put together have registered a huge "Operating Profit" of Rs. 1.40 lacs Crores during the financial year 2015-2016, but due to provisioning for bad loans, they have suffered "Net Losses" to the tune of Rs. 18,000 crores.

Meaning of Willful Defaulters

There have been many cases where the borrowers, either companies or individuals are genuine and have really suffered losses due to economic slowdown or on account of the default by their debtors. However, there are some borrowers who have resorted to the malpractice and siphoned off the borrowed money. Hence, in spite of having the capability, they are not repaying the loans. Such, borrowers are allegedly doing it willfully, hence, called willful defaulters[1]. According to the RBI, borrower shall be deemed to be a willful defaulter in any of the following cases: i. When there is a default in repayment along with a deliberate intention of non-payment of loan in spite of having the capacity to repay the loan. ii. When the funds are diverted for other purposes and not utilized for the purpose the loan was availed for. iii. When the money is siphoned off and not utilized for the purpose it was availed for. Moreover, there are no or insufficient assets to justify the usage of funds. iv. When the assets really bought by using the borrowed money but were later sold off without the permission of the lender. iv. When the guarantees furnished by the borrowers are not honoured when they are invoked by the lender, the borrower is termed as willful defaulter.

Repercussions of the Willful Default

Banks and Non-banking Finance Institutions are required to submit the list of willful defaulters at the end of every quarter to the CIBIL (Credit Information Bureau India Ltd). Along with the list, banks also submit the name of the present and previous (at times even independent and nominee) Directors with a view to put other institutions and banks on guard against such defaulters. Once a borrower is classified as willful defaulter, no additional loan facility is possible from any institution or bank. He is also not allowed to float any new company for the next five years from the date of being declared a willful defaulter. Such a labeling is followed by legal process and even a criminal proceedings if necessary against the borrowers or guarantors. Banks are empowered to change the management of the willfully defaulting company. Keeping in mind the repercussions, no company would like to have such a bad tag.

Remedies available against Willful Defaulters

Presently, there is no specific law for legal action against the willful defaulters. RBI, has however, defined the term and has also explained the process to be followed by the banks in case of willful default by their borrowers. Lending banks, therefore, initiate action against these willful defaulters under SARFAESI Act.

The Parliamentary Standing Committee on Finance presented its report on 24th February, 2016 and recommended that each bank must announce the name of "willful defaulters". Moreover, it also suggested that relevant laws and regulations should be amended to enable lending banks to make the names public. It will work as a deterrent for other willful defaulters. Today, the willful defaulters owe Public Sector Banks a total of around Rs. 65,000 crores, which is about 21% of the total NPAs.

Modus Operandi adopted by Willful Defaulters

Going by the above definition or meaning of "Willful Defaulters", the list of such borrowers is getting bigger and bigger with every passing month in the recent past. The modus operandi allegedly adopted by these borrowers to siphon off borrowed money in various sectors is as under:

In manufacturing Sector, the borrower avails of a loan either from a Public Sector or a Private Sector bank for setting up a manufacturing unit. In connivance with the bankers the project cost is over-valued to the tune of 2 to 3 times of the actual cost. Plant is in fact erected and commissioned too. The EMIs are also paid for initial period of one to two years with ulterior motives of extracting more money from the banks towards working capital. In the meanwhile, around half of the borrowed money is siphoned off by resorting to the tactics of overbilling by the suppliers and other means. It becomes possible as the project cost from the very beginning is exaggerated with the help of a few unscrupulous bankers. When all scopes of availing anymore funding from the bank are exhausted, the real motive of the borrowers starts surfacing. They stop paying Banks' EMIs regularly making excuses of shortage of funds. They are even not scared of being tagged or classified as NPAs because their actual purpose of availing the loan is already served and handing over the keys of their plant or manufacturing unit to the banks remains the matter of time.

In Import-export Sector, the money borrowed from the banks is used to import raw material from some foreign country and the finished goods are usually exported to a company located in the tax havens - especially UAE. The modus operandi allegedly adopted in this sector is to float or open a shell company in Dubai which functions as a wholesaler or a middleman between the seller and the third party buyers. Borrower company supplies finished goods to this shell company which allegedly defaults in payment. Hence, this borrower registers "Business Losses" in his books of accounts in India due to non-payment by his Agent(s) in Dubai. Consequently, the borrower either flee the country or raises his hands up from repaying to the bank(s).

In Service Sector, money is borrowed from Public or Private Sector bank(s) in India then services of a company (usually a shell company) located outside India are availed of. The service provider (borrower's own shell company) is then allegedly asked to raise the bill which is usually two to three times of the actual cost of the services rendered. The money, thus borrowed from Indian Banks, is siphoned off and sent out of India through SWIFT transfers to the Service provider's account.

Banks are equally to be blamed

Today bankers are running helter-skelter for a cover and approaching the government to persuade the CVC and CBI not to initiate any inquiry against them as they took a collective decision to extend the loan. But it is difficult to comprehend as to why they are so scared of CVC or the CBI if they have not done anything wrong[2]. They should rather appreciate the move and cooperate with the agencies in bringing the truth out. In fact, the wrong decisions of a few unscrupulous Bankers, have created such a big mess, that almost all public sector banks have registered a net loss during the financial year 2015-16. Even if they took a collective decision, they cannot run away from their responsibilities. Collective decisions, warrants for a "Collective responsibility" and in turn "Collective prosecution".

An outcome of Crony Capitalism

The recent deep surgery (scrutiny) of the bad loans by RBI has exposed the prevalent crony capitalism in India. It has literally robbed PSBs of thousands of crores[3]. Crony Capitalism is a term used for the Economies where the survival and / or success of a business depends upon the nexus between government officials and the business people[4]. It is not new in this country but has picked up the pace for the last three decades as evident from the fact that how this ugly picture started surfacing on the Business Canvas of India, especially from 1980s. These new Industrial Houses not only survived and shot up at a supersonic speed but also manage to leave behind the traditional and well established industrial houses of the country – courtesy "Crony Capitalism". This very exposure by the RBI has not gone down well with some vested interests in the banking sector and industries and that is the reason why they are lobbying against the RBI Governor as well as the investigation by the CVC or CBI. Luigi Zingales, a former colleagues of Mr. Raghuram Rajan from Chicago University recently made a statement that "Rajan attacked for fight against crony capitalism"[5].

Conclusion

In some cases, the borrowers may have been facing a genuine problem of scarcity of funds due to economic slowdown and also on account of the default by their debtors. But wherever the things have gone terribly wrong and borrowers are either absconding or have managed to flee the country after defaulting in payment. There is, therefore, an urgent need for an independent enquiry by the CVC or neutral agency like CBI to ascertain the real cause of the rising bad loans. In the cases where assets of the borrowers were over-valued and loans were granted in excess of the market value of their assets must be dealt with seriously. There is also a need to check if these bankers have amassed assets beyond their known sources of income. It will not only help in getting to the root of the problem but will also act as a deterrent for the erring bankers in future. It will not be out of place to mention here that the borrowers who are absconding or have fled the country should be extradited and dealt with strictly without any further delay.

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