N. SUNDARESHA SUBRAMANIAN

WITH A FOREWORD BY DR M. S. SAHOO

THE DIRTY DOZEN

INDIA'S TWELVE BIGGEST CORPORATE DEFAULTERS

Foreword

The Dirty Dozen is an iconic 1967 American war film, adapted from E. M. Nathanson's gripping 1965 novel by the same title. Noted for its enthralling narrative, both novel and film brim with suspense, drama and pulse-pounding action. The plot, in both, centres around a military mission that trains a dozen hardened convicts into highly skilled commandos. This book, titled *The Dirty Dozen*, although unrelated to the works mentioned above, draws parallels with its cinematic counterpart, embarking on an economic mission to rejuvenate twelve beleaguered companies fighting for survival. With a narrative as gripping as its namesake film and novel, this book by N. Sundaresha Subramanian promises to enthral readers with its tale of failure and redemption amidst corporate chaos. My professional journey allowed me a glimpse of the run-up to the 'Dirty Dozen' and their life and our economy thereafter.

Kongo Gumi Co. Ltd., a Japanese firm revered for its temple construction expertise, ran for a record 1,429 years. On failing to repay its debts, the company filed for bankruptcy in 2006, underscoring the destructive powers of this double-edged leverage. For while on one hand, bankruptcy can increase returns, allowing debtors to grow faster than they would otherwise, on the other, it can equally aggravate losses, especially during economic downturns. The latter can lead to severe consequences such as insolvency and asset forfeiture.

In the best of times, it is difficult for an astute business entity to figure out its optimal leverage. Companies may be tempted to overleverage if the economy is booming, and debt is easily available. The situation gets exacerbated when the creditor, having no effective means to recover the debt, is obligated to extend a fresh round to avert the borrower from defaulting – a vicious cycle. A poignant caricature by Ravikanth succinctly captures this heady cocktail where a debtor jests with a banker: 'Your lending rates are okay! But the high NPA numbers, wow, that's what attracted me to your bank!'[1]

In early 2016, the inevitable happened. The Indian economy suffered from the 'twin balance sheet syndrome' (TBS). The balance sheets of both firms and banks were under severe stress, with half of the firms reporting an interest coverage ratio (a measure of how well a firm can pay the interest due on outstanding debt) of less than one, implying little room to service their debt obligations. Meanwhile, with non-performing assets (NPAs) exceeding 9 per cent by mid-2016, the profitability of banks was critically impacted and constrained fresh lending. The problem continued to aggravate. NPAs kept growing, while credit and investment kept falling. An effective insolvency law, one that could settle NPAs and improve credit availability by enabling swift and cost-effective resolution of stressed assets, became a necessity. Thus emerged the Insolvency and Bankruptcy Code (IBC) in May 2016, as an urgent response to the TBS.

A real sector company typically funds its operations through equity and debt. Ideally, this equity and debt should be safeguarded by their stakeholders – the shareholders and creditors, respectively. Sadly, this was not the case. The shareholders retained control over the company even after exhausting its equity. Failure to repay debt did not have any consequence on them, thereby incentivizing excessive leverage. With the introduction of the IBC, power now lay with the creditors, enabling them to take charge of debt-laden companies. While any stakeholder could initiate insolvency proceedings as soon as equity became depleted, the code placed financial creditors (FCs) in the driving seat, considering their commercial wisdom, allowing them to decide the company's fate. The IBC empowered these stakeholders to close an insolvency proceeding, decide to liquidate the company at any time or rescue it.

Armed with this unprecedented authority, the FCs could now orchestrate the rescue of distressed companies through a comprehensive resolution plan. With the IBC in place, they could: (a) scour the global market for the most viable resolution plan, in a significant departure from previous mechanisms that prevented existing promoters from resorting to them; (b) take and/or cause a haircut of any amount to any or all stakeholders as may be required for rescuing the company; and (c) undertake resolution plans that may entail any measure(s) – a change of management, technology, or product portfolio; acquisition or disposal of assets, businesses or undertakings; restructuring of organization, business model, ownership or balance sheet; strategies of turnaround, buyout, merger, amalgamation, acquisition or takeover, etc.[2]

Having said that, some companies were beyond repair and had to be closed. The IBC provided a structured framework for the closure of such companies.

There was an unprecedented urgency to implement the IBC in the face of the festering TBS. The Insolvency and

Bankruptcy Board of India (IBBI), which oversees insolvency matters, was created on 1 October 2016. It was tasked with enforcing the corporate insolvency resolution provisions in the code, starting from 1 December 2016. The IBBI set up the necessary ecosystem to handle insolvency, which included the creation of professional roles and agencies focused on insolvency. Additionally, they designed the guidelines that activated the mechanism for resolving corporate insolvency from the expected date. This fresh system has brought about a sea change in how insolvencies are managed in India, delivering on both efficiency and transparency.

Everything was arranged for the banks to take advantage of the IBC – like taking a horse to water. Unfortunately, like the proverbial horse, they refused to drink. Despite being the top victims of unpaid loans and possessing full control over the IBC proceedings, banks were reluctant to wield this power. In the first two quarters, 166 companies were admitted to the IBC process. About a quarter of them were initiated by FCs. The reluctance of banks to initiate IBC proceedings against defaulting companies, particularly those with substantial defaults, remains a conundrum.

A case was made to find solutions outside the IBC. The government's economic think tank echoed this in the Economic Survey for 2016–17:

> The problem is that the new bankruptcy system is not yet fully in place, and even when it is, the new procedures (and participants) will need to be tested first on smaller cases. Some considerable time will consequently elapse before the system will be ready to handle the large, complex cases.

It suggested an alternative:

> 'One possible strategy would be to create a "Public Sector Asset Rehabilitation Agency" (PARA), charged with working out the largest and most complex cases.'[3]

As banks waited for an alternative to the IBC, the IBBI found itself in an uneasy spot after expeditiously establishing the insolvency framework. The government, too, having invested a lot in the IBC, was wary about considering alternatives, believing the IBC to be suited for all cases, regardless of their size. Leaving aside its efficacy, the creation and implementation of the proposed PARA would take a few years. Faced with pressing growth imperatives, the government opted to push for IBC usage by enacting the Banking Regulation (Amendment) Ordinance, 2017, on 4 May 2017. This ordinance empowered the Reserve Bank of India to direct banks to use the IBC, ensuring timely resolution of default cases.

In June 2017, the RBI first told banks to start insolvency proceedings under the IBC. These proceedings, involving twelve accounts with significant Non-Performing Assets (NPAs) – around 25 per cent of the banking system's total NPAs – came to be widely known as the 'Dirty Dozen'. This phrase was popularized by Sanjeev Sanyal, the Senior Economic Adviser at the finance ministry at that time. This galvanized the FCs, who had been watching from the sidelines until then, to use the code for the resolution of their stressed assets. By the last quarter of 2023, over 60 per cent of insolvency proceedings were initiated by FCs, underscoring both their newfound assertiveness and the government's steadfast commitment to insolvency reform.

And so commenced the arduous odyssey. Shortly thereafter, on 23 November, the Swachhata Drive found its way to the IBC through section 29A, which prohibited unclean hands from taking over a company through a resolution plan. This brought about a shift in debtor–creditor relationships, leading to ownership changes in many large companies that were furiously contested up to the Supreme Court. As the dust settled, a remarkable transformation unfolded. Some of the 'Big Twelve' managed to recover convincingly, others had to be liquidated and a few are still in the middle of the process. By September 2023, the banks' NPAs had gone down to 3.2 per cent, from a peak of 11 per cent in September 2018. The banks reported a net profit of ₹2,63,214 crore in the financial year 2022–23, compared to a loss of ₹32,438 crore in 2017–18. Meanwhile, companies also improved their functioning, resulting in strong balance sheets, sensible borrowing levels, and an interest coverage ratio over 3.5. This shift from stress due to unpaid loans to having twin balance sheet benefits marked a significant turn of events.

A recent IIMA* study finds that post resolution, the companies have witnessed substantial improvements. Their turnover increased by 76 per cent, profitability ratios converged with benchmarks, and market capitalization tripled over three years. Corporate governance, too, witnessed improvement, as demonstrated by the decrease in transactions between related parties after the implementation of the IBC. In the first three years of the IBC, India's global ranking in resolving insolvency parameters jumped from the 136th place to the 52nd. The clear risk of losing their company caused debtors to take active steps to avoid the IBC process. This is evident from the fact that

* Indian Institute of Management Ahmedabad

insolvency applications for initiation of the IBC process against 27,514 companies, with an aggregate default of ₹9.74 trillion, were withdrawn before admission, reinforcing the maxim that the best use of the IBC is not using it at all.

The Dirty Dozen isn't merely a chronicle of corporate downfall and revival; it serves as a beacon of hope and inspiration amidst adversity. These narratives work as poignant reminders that even in the bleakest of circumstances, there exists a flicker of possibility waiting to be seized. May the cautionary tales contained within these pages ignite a flame of inspiration, encouraging companies to not only embrace change but also to navigate challenges with resilience and fortitude. Within the crucible of adversity lies the opportunity for growth and transformation, ultimately enabling companies to emerge stronger and more resilient than ever before.

Dr M. S. Sahoo
Former Distinguished Professor, National Law University Delhi &
Former Chairperson, Insolvency and Bankruptcy Board of India

February 2024