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Emerging Study on Corporate Debt Restructuring (CDR) with reference to Vardhaman Poly-Tex Company in 'Oswal' Textile Group

***Dr. Srinivasa Rao Kasisomayajula**

***Principal/Professor, Vijaya P.G.College, Dept of Business Management, Munaganoor, Hayathnagar, Hyderabad**

Introduction:

Corporate Debt Restructuring (CDR) or simply restructuring of loans and advances, with all its pros and cons, is an effective financial tool, especially during the times of crisis are in smoothening the adverse effects of economic downturns on the borrowers of credit as well as their lenders. The world economy has completed five years since the sub-prime crisis in the USA in mid-2007, which gave way to the full-fledged global financial crisis of 2008 and the global recession of 2009, the fourth such recession since World War II. The present crisis and the global recession of 2009, like the previous three global recessions of 1975, 1982 and 1991 and the great depression of the 1930s, have necessitated the banks all over the world to deleverage as also to restructure a large number of their household and corporate debt. But, any kind of restructuring has to be accompanied by prudence on the part of the lenders and financial discipline on the part of the borrowers. Absence of these conditions results in dead weight loss to the society in general. This study focus on conducting business ethically likewise challenging the status quo and delivering value beyond expectations require innovation in products and services. However, ethics help in preventing misuse. These facts can be seen in the genesis of the global financial crisis. It was not the innovative financial products but the lack of ethics in their design and sale which led to the crisis. CDR was also a beautiful innovation to protect the values of both the corporates under distress and the credit portfolio of their lenders. However, due to the extraordinary rise in the number and volume of advances being restructured under the scheme in recent times, it has come under media scanner, and engaged the attention of the financial market players, the borrowers, the regulators and the policy makers. However, it appears that the provisions of the CDR mechanism have not been used very ethically and judiciously, giving rise to the unprecedented increase in cases under CDR. Viability criteria, a critical element in any restructuring and its assessment brings into picture a number of professionals apart from the essential counterparties to a loan agreement, play a very important role in assessing the viability of restructuring proposals. Due to constraints of time and skills as also because of statutory requirements, lenders have to rely on the due-diligence done and certificates given by such professionals. However, such decisions are prone to Type I and Type II errors of statistics, i.e. an unscrupulous borrower with an unviable account may avail the benefit of restructuring and at the same time, a bonafide borrower with a viable account may be denied the opportunity to resurrect his account. Therefore, ethics and professionalism of individuals in such positions go a long way in ensuring that such errors do not occur.

Need for the Study:

- Restructuring is a societal convention to attempt to assist anyone in distress. Similarly, restructuring is a tool to lend a hand of assistance to borrowers who are temporarily in distress, in particular, where the distress is caused by circumstances beyond the control of the borrower. Thus, debt restructuring may be required under certain circumstances viz. a general downturn in the economy which results in the deterioration in the financial health of borrowers. It may also be warranted in case of emergence of legal or other issues that cause delays, particularly in cases of project implementation. External developments, such as global factors may also result in widespread impact on the financial health of borrowers and may necessitate use of restructuring as a tool to help the borrower tide over difficult circumstances.
- The need for such a specialised institutional mechanism arose in the background of difficulties faced by banks while restructuring their large exposures involving more than one lender, under consortium banking arrangement. While it was easier for banks to negotiate the terms of restructuring of their own exposure with their customers, they found it difficult to co-ordinate their negotiation and monitoring efforts where restructuring involved multiple lenders. Therefore, a need was felt to devise a system where restructuring of large corporate exposures from multiple banks under consortium banking arrangements could be carried out. The Reserve Bank was seized of the matter and it put in place the scheme of CDR in August 2001 based on the mechanism prevalent in countries like the U.K., Thailand, Korea, Malaysia, etc. These guidelines were finalised after extensive discussion between Government of India, Reserve Bank, Banks and FIs.

Objectives:

1. To elaborate on what constitutes debt restructuring and the genesis of restructuring in the country.
2. To discuss why restructuring is important and also what is the role of regulators in debt restructuring.
3. The reasons why this is so, going on to talk about why the Reserve Bank is concerned

in this regard.

4. To measure the performance of the selected company based on their financial indicators
5. Finally, the way forward if restructuring is to continue as an instrument for ensuring the well being of lenders, borrowers and the society at large.

Limitations:

The objective of CDR is to ensure a timely and transparent mechanism for restructuring of the debts of viable corporate entities affected by internal and external factors, outside the purview of BIFR, DRT or other legal proceedings. The legal basis for the mechanism is provided by the Inter-Creditor Agreement (ICA). All participants in the CDR mechanism must enter the ICA with necessary enforcement and penal clauses. The scheme applies to accounts having consortium accounts with outstanding exposure of Rs.10 crores and above. The CDR system is applicable to standard and sub-standard accounts with potential cases of NPAs getting a priority. Packages given to borrowers are modified time & again. The main Drawback of CDR is reaching of consensus amongst the creditors delays the process.

Theoretical Frame Work:

Corporate Debt Restructuring: *"Any change in the Terms and Conditions of the loan or credit, especially in respect of its servicing, is called restructuring of loan / debt. Corporate debt restructuring is a specialized institutional mechanism for restructuring large exposures involving more than one lender under consortium banking arrangements"*

Restructuring refers to several related processes such as recognizing and allocating financial losses, restructuring the financial claims of financial institutions and corporations, and restructuring the operations of financial institutions and corporations, recognition or resolution involves the allocation of existing losses and associated redistribution of wealth and control. Here Losses means differences between financial institutions' and corporations' market value of assets and nominal values of liabilities. It can be allocated to shareholders by dilution, to depositors and external creditors by reduction (of the present value) of their claims, to employees and suppliers by payment of lower wages and prices, and to the government that is, the public at large through higher taxes, expenditure cuts, or inflation. Financial restructuring for corporations can take many forms such as rescheduling (extension of maturities), lower interest rates, debt for equity swaps, debt forgiveness, indexing of interest payments to earnings, and so on. The main aims of financial restructuring are separating and treating appropriately viable and nonviable firms and creating the right incentives for operational restructuring. **Operational restructuring:** Operational restructuring is an on-going process, includes improvements in efficiency and management, reductions in staff and wages, sales of assets, enhanced marketing efforts, and so on, with the expectation of higher profitability and cash flow. Restructuring of loans and advances is not a new phenomenon in India and terms such as rescheduling / renegotiation / rehabilitation / restructuring have been used interchangeably by the Reserve Bank of India (RBI) and banks since long. Reserve Bank's prudential guidelines on restructuring of advances have evolved over a period of time from simple instructions to reschedule the loans of people affected by natural calamities in the late 1970s to comprehensive guidelines on restructuring of loans to large corporates under consortium/multiple banking arrangement. The guidelines gradually evolved in tune with the changing dynamics of the financial and real markets by taking into account the international best practices, recommendations of various committees and feedback from the stakeholders. CDR is a specialised institutional arrangement for restructuring of large credit exposures of multiple banks to corporate. Activities related to expansion or construction of a firm's operations in its assets or financial or ownership structure are referred to as corporate restructuring. Profitable growth constitutes one of the prime objectives of most of the business firms. It can be achieved 'internally' either through the process of introducing new products or by expanding the capacity of existing products. Alternatively, the growth process can be facilitated 'externally' by acquisitions of existing business firms. This acquisition may be in the form of mergers, acquisitions, amalgamations, takeovers, absorption, consolidation, and so on.

Financial Restructuring: Financial restructuring is carried out internally in the firm with the consent of its various stakeholders. This form of corporate restructuring is relatively easier to put to ground. This is a suitable ode of restructuring of corporate firms that have incurred accumulated sizable losses over a number of years. As a sequel, the share capital of such firms, in many cases, gets substantially lost; in fact, in some cases accumulated losses over the years may be more than share capital, causing negative net worth. Given such a dismal sate of financial affairs, a vast majority of such firms are likely to have a dubious potential for liquidation. This restructuring is one such a measure for the revival of only those firms that hold prospects for better financial performance in the years to come. To achieve the desired objective, such firms restart with a fresh balance sheet, which does not contain past accumulated losses and fictitious assets and shows share capital at its real worth. Financial restructuring is achieved by formulating an appropriate restructuring scheme involving a number of legal formalities. It is normal for equity shareholders to make the maximum sacrifice, followed by preference shares and debenture holders / lenders and creditors, respectively. The sacrifice is in terms of waiver of a part of the sum payable to various liability-holders. The sacrifice may be also being in terms of acceptance of new securities with a lower coupon rate, with a view to reduce the future financial burden on the firm. The arrangement may also take the form of conversion of debt into equity; sometimes, creditors, apart from reducing their claim, may also agree to convert their dues into securities to avert pressure of payment. As a result of all these measure the firm may have better liquidity to work. Thus, financial restructuring implies a significant change in the financial / capital structure of firms, leading to a change in the payment of fixed financial charges and change in the pattern of ownership and control. Financial restructuring aims at reducing the debt / payment burden of the firm. The aggregate sum resulting from the reduction / waiver in the claims from various liability-holders and profit accruing from the appreciation of assets such as land and buildings is then utilized to write off accumulated losses and fictitious assets and create provision for bad and doubtful debts and downward revaluation of certain assets, say, plant and machinery, if they are overstated.

Regulatory Frame work:

The role of the regulator in restructuring of accounts explores some myths which are commonly accepted about restructuring in the country. *First*, it is a prevalent misconception among the industry and borrowers that restructuring can be carried out only in cases of standard accounts. The Reserve Bank has clarified time and again that even the accounts classified as substandard and doubtful can be restructured, if found viable. However, the asset classification benefit of retention of standard account classification after restructuring, although it being an event of impairment, is a regulatory forbearance. Such regulatory forbearance is available on certain conditions laid down by the Reserve Bank's guidelines. But accounts can always be restructured outside the regulatory forbearance, if found viable. Even the accounts which are compulsorily downgraded on restructuring due to absence of regulatory forbearance can be upgraded after satisfactory performance during the specified period. Industry, borrowers as well as banks approach the Reserve Bank for granting them the permission to restructure their accounts on account of some hardship. As the RBI guidelines on restructuring are comprehensive and applicable to all borrowers and they already provide some regulatory forbearance, such requests imply a request for further relaxations in guidelines. Such frequent tweaking with regulatory guidelines is not an ideal practice and therefore, the Reserve Bank generally does not agree to such requests. At times an impression is created that such refusals imply these accounts cannot be restructured. However, the fact remains that restructuring of viable accounts is always in the domain of the banks and it is the duty of the banks to nurture a viable account even in the absence of asset classification benefit. Having presented some of these common misconceptions about the regulatory approach to restructuring; the regulator's interest in restructuring emerges from the close linkages between restructured accounts and non-performing advances (NPAs). If the terms and conditions of loans, especially in relation to repayment are not adhered to, especially for a specified period of time, account is classified as an NPA. If accounts are restructured, then too, the terms and conditions of the loans are not fulfilled. But such accounts are not always classified as NPAs.

From an operational perspective, there can be two types of restructured accounts: the *first types* of accounts are those which are restructured and classified as NPAs; the *second type* is those which are restructured but asset classification is retained as standard. In the first case, regulatory concerns are few and limited to the issue of upgrading the account to the standard category. In general, a NPA account, can be upgraded when the terms and conditions of the loan are fulfilled by the borrower. In the case of restructured accounts, however, the original terms and conditions are changed. Hence, the issue of the conditions under which the account can be considered as standard or upgraded to the standard category become pertinent. Regulatory guidelines attempt to lay down the broad parameters under which restructured accounts can be treated as standard. The second type of restructured accounts, however, attract greater regulatory attention, due to the associated moral hazard problems – that of the potential of an account being restructured, at times repeatedly, to avoid classification as an NPA. This type gives rise to the need for regulatory and/or prudential guidance. Hence, the role of the regulator in case of restructuring of accounts arises with regard to the issue of prudential guidelines for determining the asset classification of account at the time of restructuring and the time frame for up gradation of restructured NPA accounts. The regulator also comes into the picture for the purpose of granting regulatory forbearance with respect to asset classification under exceptional circumstances. The amendment to the debt recovery legislation will, among others, allow multi-state co-operative banks to assign their bad loans to asset reconstruction companies (ARCs), proving a win-win for banks as well as the companies. Currently, these co-operative banks are not allowed to sell bad loans to ARCs. This will open the opportunity for ARCs to tap the sector which has so far not been targeted for debt recovery. ARCs buy bad loans from banks and financial institutions at a discounted rate and recover the dues from the borrower. The amendments also allow banks to acquire immovable properties from the borrower so that they can sell them at a later date. Sometimes there are no buyers for a property or there is cartelisation from bidders, who deliberately quote a lower price thus undervaluing it. The amendment will ensure that banks do not get into the situation of distress sale and get the right pricing for the assets on sale. The amendment states that banks will be heard to Debt Recovery Tribunals (DRTs) before granting any stay on recovery of loans from borrowers. This will ensure that the law is not misused by borrowers to delay the settlements and payment of dues. Also the amendment allows ARCs to convert a part of the debt into equity. This could be a win-win situation for the borrower as well as the ARC. The borrower stands to gain because his outstanding liability decreases to the extent of equity conversion and the ARC can exit the company when it has made good of the liability. Further, the ARC will also get some amount of management control in the borrowing company so as to aid in the turnaround of the stressed company.

CDR – Structure

The CDR Standing Forum, the top tier of the CDR Mechanism in India, is a representative general body of all Financial Institutions and Banks participating in CDR system. The Forum comprises Chief Executives of All-India Financial institutions and Scheduled Banks and excludes Regional Rural Banks, co-operative banks, and Non-Banking Finance Companies. The CDR Core Group is carved out of the CDR Standing Forum to assist the Forum in convening the meetings and taking decisions relating to policy, on behalf of the Forum. The Core Group consists of Chief Executives of IDBI, SBI, ICICI Bank, BOB, BOI, PNB, Indian Banks Association (IBA) and Deputy Chairman of IBA representing foreign banks in India. The individual cases of corporate debt restructuring are decided by the CDR Empowered Group (EG), which is the second tier of the structure of CDR Mechanism in India. The EG in respect of individual cases comprises Executive Director (ED) level representatives of Industrial Development Bank of India Ltd., ICICI Bank Ltd., State Bank of India as standing members, in addition to ED level representatives of financial institutions (FIs) and banks which have an exposure to the concerned company.

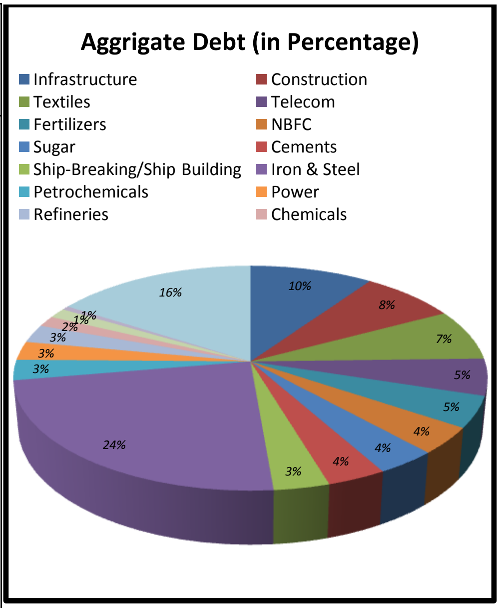
CDR – Cell: The CDR Cell, the third tier of the CDR Mechanism in India, is mandated to assist the CDR Standing Forum and the CDR Empowered Group (EG) in all their functions. All references for corporate debt restructuring by lenders/borrowers are made to the CDR Cell. It is the responsibility of the lead institution/major stakeholder to the corporate to work out a preliminary restructuring plan in consultation with other stakeholders and submit to CDR Cell. The EG decides on the acceptable viability benchmark levels on the following illustrative parameters, which are applied on a case-to-case basis, depending on the merits of each case: Debt Service Coverage Ratio, Break-even Point (Operating & Cash), Return on Capital Employed, Internal Rate of Return, Cost of Capital, Loan Life Ratio, Extent of Sacrifice. Corporate Debt Restructuring (CDR) CELL Progress Report as on September, 2012 presented in Table 1 and its industry wise classification in Table 2.

Table 1: Overall Status including cases withdrawn / Exited (Rs. Crores)

Total References Received		Cases Rejected / Closed		Cases under finalization of Restructuring packages		Total Cases Approved	
No. of Cases	Aggregate Debt	No. of Cases	Aggregate Debt	No. of Cases	Aggregate Debt	No. of Cases	Aggregate Debt
466	245928	75	27416	64	31118	327	187394

Table 2: Industry-wise Classification of Approved Cases (Rs. Crores)

Sl. No	Industry	No. of Companies	Aggregate Debt	Debt in %
1.	Infrastructure	15	18154	9.69
2.	Construction	5	14182	7.57
3.	Textiles	62	13715	7.32
4.	Telecom	10	9886	5.28
5.	Fertilizers	8	8455	4.51
6.	NBFC	7	7247	3.87
7.	Sugar	26	6733	3.59
8.	Cements	11	6595	3.52
9.	Ship-Breaking/Ship Building	3	6213	3.32
10.	Iron & Steel	39	44343	23.66
11.	Petrochemicals	3	5493	2.93
12.	Power	11	5006	2.67
13.	Refineries	1	4874	2.60
14.	Chemicals	15	2898	1.55
15.	Paper/Packaging	20	2699	1.44
16.	Engineering	10	1039	0.55
17.	*Others	81	29862	15.93
	TOTAL	327	187394	100.00



*Others includes Jewellery, Liquor, edible oil, Pharmaceuticals, Electrical, Storage Media, Metals (Non-ferrous Metals), Computer (Hardware/soft), Cables, Ceramic Tiles, Auto Components, Automobiles, Food & Food Processing, Glass, Retail, Wood Products, Agri, Plastic, Hotels, Rubber, Forgings, Hospital & Healthcare etc.

In a growing sign of companies facing difficulties in meeting their financial obligations, the number of corporate debt restructuring cases in India has crossed the century-mark since the beginning of 2012. A total of 101 cases were referred for Corporate Debt Restructuring (CDR) as of September 30, involving a collective debt amount of close to Rs. 64,000 crore, according to data available with the CDR cell of bankers. RBI had helped set up the CDR system in 2001 to help corporates facing financial difficulties done to "factors beyond their control and due to certain internal reasons." Besides helping the corporates manage their huge debts, it also seeks to safeguard the interest of banks and financial institutions through restructuring of certain debt cases. High interest costs along with overall sluggishness in the domestic and global economies have made it difficult for companies to meet their debt obligations – resulting in a spurt in CDR cases. According to the latest data available with the CDR cell, 466 cases involving a total debt of Rs. 2.46 lakh crore were referred to it since inception. Of this, 101 cases involving about Rs.64,000 crore have been referred in 2012 it self. Besides, 51 cases have been approved for restructuring of debt amount totally nearly Rs. 45000 crore in 2012 as on September 30. In the first two quarters of the current fiscal 2012-13, 74 debt cases were referred for restructuring debts totalling about Rs.40,000 crore. This is higher than the referred CDR cases for an entire financial year ever. In the previous fiscal 2011-12, 87 cases (then a record) with an aggregate debt of about Rs. 68,000 crore (over $ 12 billion) were referred for corporate debt restructuring. The amount of such distressed debt had grown nearly three-fold from Rs.23, 000 crore in 2010-11, while the number of cases also grew sharply by 78 per cent. According to the CDR data, 50 cases involving an aggregate debt amount of Rs.40, 000 crore were approved during 2011-12. In comparison, 27 cases with Rs. 7000 crore were approved for CDR exercise in 2010-11. During the fiscal ended March 31, 2010, a total of 31 CDR cases were approved for debt of Rs. 18,000 crore. Experts say that the rising number of CDR cases does not augur well for the banking sector as also for corporates. With reference to Table-1, out of the 466 cases referred to the CDR cell so far, 75 cases involving Rs. 27,400 crore have been rejected by bankers, while 64 cases (totalling over Rs.31,000 crore) are under finalisation of restructuring packages. A total of 327 cases have been approved since the start of the CDR mechanism as on September 30, 2012 for a total amount of Rs. 1.88 lakh crore.

CDR – Monitoring:

The success of CDR Mechanism depends essentially on close monitoring of each and every package approved by the CDR Empowered Group (EG). The monitoring mechanism comprises, Monitoring Institution (referring institution); Monitoring Committee; and External agencies of repute to complement monitoring efforts and also to carry out concurrent audit, special audit/valuation etc.The Monitoring Institution is required to monitor all aspects of implementation of the package and furnish a consolidated report on the status of sanction and implementation of the approved package to CDR Cell every month, in the prescribed format.

CDR – Guidelines:

- Banks may restructure the accounts classified under 'standard', 'sub- standard' and 'doubtful' categories
- Banks cannot reschedule / restructure / renegotiate borrower accounts with retrospective effect
- No account will be taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them, which may be applied on a case-by-case basis, depending on merits of each case
- The parameters may include for review is Return on Capital Employed, Debt Service Coverage Ratio, Gap between the Internal Rate of Return and Cost of Funds
- Amount of provision required in lieu of the diminution in the fair value of the restructured advance
- Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects / activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns / action

Fair Account Value *(according to* RBI Cir: DBOD.No.BP.BC.9 /21.04.048/2012-13 July 2, 2012)

- Reduction in the rate of interest and / or reschedule of the repayment of principal amount, as part of the restructuring, will result in diminution in the fair value of the advance
- It is, therefore, necessary for banks to measure such diminution in the fair value of the advance and make provisions for it by debit to Profit & Loss Account
- For this purpose, the erosion in the fair value of the advance should be computed as the difference between the fair value of the loan before and after restructuring
- Fair value of the loan before restructuring will be computed as the present value of cash flows representing the interest at the existing rate charged on the advance before restructuring and the principal, discounted at a rate equal to the bank's BPLR or base rate

CDR – Solutions

Term loans: Rescheduling of Principle Repayment including Holiday / balloon repayment, Funding of Interest, Reduction of Interest Rate, Sanction of Demand loan.

Working Capital: Converting into WCTL**,** Fresh sanction of WC**,** Funding of Interest**,** Reduction of Interest**,** Converting shortage of DP into WCTL

Non-Fund: Converting into WCTL / DPG**,** Commission funding, Extension of Facility

Others: Sale of Assets, Sacrificing, One time settlement

Trends in Restructuring:

As mentioned at the outset, CDR has come under the attention because of the extraordinary rise in the number and volume of advances being restructured under the scheme in recent times. The guidelines on restructuring have generally been used to the advantage of both the borrowers and the banks in situations of economic downturns and temporary cash flow problems. However, due to extraordinary rise in the cases referred to and restructured under CDR mechanism during the current and previous fiscal years, questions are being raised as to whether this indicates a general downturn or gross misuse of the CDR Mechanism by banks and corporate borrowers. Slowdown in the country amidst overall global slowdown is generally being cited as the reason for the recent increase in restructured accounts. In fact, an analysis of the data and trends in restructured accounts, especially standard restructured accounts, seem to suggest differently. The reason for choosing the data on standard restructured accounts is that possibilities of unviable accounts getting restructured is greater when some kind of regulatory forbearance is available on asset quality and provisioning. The increase in resorting to restructuring can be partially attributed to excessive leveraging by some borrowers during boom period. An analysis of the trends in leverage of the larger borrowers in the country during the first decade of this century certainly seems to suggest this. Again, there are deficiencies in the manner in which project appraisal is conducted especially with regard to cash flow analysis and determination of the date of completion of projects. When commercial operations are delayed, a host of factors including the uncertainties surrounding the project are cited as the reason. But, when there are uncertainties, these have to be accounted for during the appraisal of the project and a proper cushion needs to be built to take care of these uncertainties. Instead, the effort is to appraise a project keeping in view an aggressive repayment schedule resulting in a very short term focus of borrowers, banks and financial analysts who appraise the project. This short term focus, in many cases, is the reason for the need for successive restructuring. Let us look at some of statistical trends in restructured advances in the last few years. From the data available with RBI ***(Table 3)***, it is observed that between March 2009 and March 2012, while total gross advances of the banking system grew at a compound annual growth rate of less than 20%, restructured standard advances grew by over 40 per cent. Resultantly, the proportion of Restructured Standard Advances to Gross Total Advances increased from 3.45 % in March 2011 to 4.68% in March 2012. A further analysis of data suggests distinct trends in restructured accounts in public sector banks and in private sector and foreign banks. Restructured accounts have growth at a compound annual growth rate of 47.86 per cent in public sector banks as against a growth rate of credit of 19.57 per cent. The corresponding figures for private sector and foreign banks are 8.12 per cent (restructured advances) and19.88 per cent (credit growth) and (-) 25.48 per cent (restructured advances) and 10.96 per cent (credit growth) respectively. Further, as on March 2012, the ratio of Restructured Standard Advances to Total Gross Advances is highest for PSBs at 5.73 per cent, while the ratio is significantly lower for private and foreign banks at 1.61 per cent and 0.22 per cent, respectively ***(Tables 4)***. A further granular breakup of the data on restructuring over the last few years indicates that the ratio of restructured accounts to gross advances is the highest for the Industries sector at 8.24 per cent (with medium and large industries sector being at 9.34 per cent). The ratio for agriculture stood at 1.45 per cent, while that for services stood at 3.99 per cent (with micro and small services being 0.94 per cent). While the ratio stood at 2.24 per cent for priority sector advances, it stood at 5.83 per cent for non-priority sector loans.

Table 3: Trends in Restructuring (Rs. Crore)

Year	G.A.	Trend %	RSA	Trend %	Ratio (RSA/GA)	Trend %
March 2009	27,53,365	100%	75,304	100%	2.73**%**	100%
March 2010	32,27,287	117%	1,36,426	181%	4.23**%**	154%
March 2011	39,82,954	144%	1,37,602	182%	3.45**%**	126%
March 2012	46,55,271	169%	2,18,068	289%	4.68**%**	171%
Average	54,755.25	132.5%	41,851	188%	0.04%	137.75%

Table 4: Trends in Restructuring across Sectors - Growth Rates in %

Segments	2009-10			2010-11			2011-12		
	G.A.	RSA	Ratio	G.A.	RSA	Ratio	G.A.	RSA	Ratio
All Banks	17.21	81.17	4.23%	23.41	0.86	3.45%	16.88	58.48	4.68%
Public Sector Banks	19.81	96.59	4.97%	22.98	3.86	4.20%	16.02	58.33	5.73%
Private Sector Banks	12.80	5.60	2.05%	26.60	-28.48	1.16%	20.65	67.35	1.61%
Foreign Banks	-1.38	-25.06	0.55%	19.06	-27.56	0.34%	16.35	-23.76	0.22%
Agriculture	25.74	64.91	1.44%	15.65	11.16	1.38%	15.09	20.74	1.45%
Industries	24.14	93.87	7.60%	26.96	-0.23	5.98%	19.52	64.70	8.24%
Micro & Small	13.06	52.79	3.93%	12.84	-3.61	3.36%	20.32	-17.51	2.30%
Med and Large	26.79	99.21	8.39%	29.96	0.11	6.46%	19.38	72.59	9.34%
Services	29.02	79.91	2.00%	31.99	35.67	2.05%	20.74	134.34	3.99%
Micro and Small	53.87	49.44	1.50%	42.19	1.50	1.07%	14.74	1.02	0.94%
Med and Large	22.03	89.36	2.17%	28.37	44.04	2.44%	23.10	157.35	5.10%
Others	1.08	49.37	2.62%	16.78	-14.80	1.91%	11.20	-16.04	1.45%
Total	17.21	81.17	4.23%	23.41	0.86	3.45%	16.88	58.48	4.68%

Source: The Economic Times: Sep, 9, 2012; GA: Gross Advances RSA: Restructured

Standard Advances

The data clearly highlights the fact that restructuring is resorted to liberally in case of industrial sector (particularly large industries), while smaller borrower accounts such as agriculture and micro and small enterprises see less of restructuring. The above trends clearly underscore the reasons for the regulatory discomfort with the manner in which the extant restructuring guidelines and the associated regulatory forbearance are being used. While clearly there is cause for concern given the pace and quantum of restructuring over the last few years, the concerns are aggravated by the fact that the restructuring is neither being permitted in a transparent and objective manner by banks nor is it being resorted to in a non-discriminatory manner. It is clearly observed that public sector banks share a disproportionate burden of such accounts. If the reason for the recent increase in restructured accounts is indeed the economic downturn, then it should have been reflected across all bank groups and not just public sector banks. The trends are arguably a reflection of the fact that public sector banks have not been as judicious in the use of restructuring as a credit management tool as the private sector and foreign banks. Recently announced Q1 results for 2012-13 also indicate that private sector banks have managed their credit portfolio in a better way than the PSBs. The data on restructuring also throws up an important question as to whether the small and marginal borrowers are discriminated against by the banks for restructuring of their accounts, even if found viable. Again, if the economic downturn were the sole reason for the increase in restructured accounts of late, then the downturn should logically have affected the weaker segments of the economy more, leading to a higher share of restructured accounts in the SME and priority sectors, which is not the case. The data on restructuring, on the contrary, seems to suggest that, when it comes to restructuring, our banks have a substantial bias towards more privileged borrowers' vis-à-vis small borrowers. It seems to suggest that restructuring of accounts is being resorted to avoid classification of accounts as NPA.

Misusing of CDR Mechanism:

This analysis brings to the issue of misuse/abuse of CDR Mechanism by banks as well as corporates. It may note that even the best of intentions gets defeated when a system is not used judiciously. The CDR Mechanism was devised as there was a need for an institutional mechanism to support the large, viable accounts facing temporary problems as also to preserve the values of large exposures of banks. As previously stated, restructuring has been a prominent central banking tool in the times of crisis across most jurisdictions despite its moral hazard aspects. It is also accompanied by the regulatory forbearance on asset classification, provisioning and capital adequacy in order to provide the banks and corporate the much needed leeway to rejuvenate their productive assets during times of crisis. Regulatory forbearance on asset classification in India, however, has become a standing feature irrespective of the presence or absence of a financial crisis/economic downturn. Rather, it has been observed lately that even at the slightest sign of slowing down of the economy or any particular sector of the economy, banks as well as corporates start demanding even further relaxations in the regulatory forbearance on restructuring. It may be recalled here that CDR Mechanism has been given some special dispensation regarding asset classification on repeated restructuring which is not available to non-CDR restructuring. In view of the foregoing observations, I am compelled to infer that, perhaps, the availability of standing regulatory forbearance to CDR Mechanism has prompted banks to avoid using other means of credit management judiciously, i.e., proper due-diligence before sanctioning a credit facility, regular and proper monitoring of accounts after disbursal and taking prompt corrective action on the first signs of weakness in the accounts. While establishing viability of the account before restructuring the same is a mandatory condition, it seems that proper due-diligence is not carried out on this front in a number of cases. In order to ensure the highest levels of integrity and diligence, the Reserve Bank's guidelines on CDR Mechanism have delegated the authority to evolve policies and guidelines on corporate debt restructuring to CDR Standing Forum, consisting of Chairman level representation from banks; and the authority to approve individual cases of corporate debt restructuring to CDR Empowered Group, consisting of ED level representation from banks. Despite these safeguards, it appears that, in the recent past, many unviable accounts were restructured by establishing viability only with some kind of financial engineering. Our guidelines on CDR Mechanism have evolved in the context of international experience. Most of the countries have based their framework for corporate debt restructuring on the UK's London Approach, wherein, under the leadership of the Bank of England, UK banks developed a set of informal guidelines on a collective process for voluntary workouts to restructure debts of corporates in distress, while maximizing their value as going concerns. They also took into account the international federation of insolvency practitioners (INSOL International)'s 'Statement of Principles for a Global Approach to Multi-Creditor Workouts'. An informal out of court system like CDR Mechanism is always a preferable way for loan resolution, if used prudently and ethically. In this regard, I would like to quote from the 'World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems' which states that "A country's financial sector should promote the development of a code of conduct or an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure, especially in markets where enterprise insolvency has reached systemic levels. An informal process is far more likely to be sustained where there are adequate creditor remedy and insolvency laws. The informal process may produce a formal rescue, which should be able to quickly process a packaged plan produced by the informal process.

The formal process may work better if it enables creditors and debtors to use informal techniques." However, issues of moral hazard are also likely to emerge from such informal out of court systems. Internationally, corporate debt restructurings can also be viewed in the continuum between an excessive creditor oriented approach and an excessive debtor oriented approach. An excessive debtor oriented approach gives rise to the aspect of *moral hazard* as it may encourage the debtor to take excessive risks in the knowledge that the burden of any losses will fall disproportionally on creditors. RBI's CDR guidelines attempt to strike a balance between these two approaches by requiring both the debtors and creditors to make sacrifices and by requiring the promoters to increase their stake in the form of guarantee or equity. However, these norms have been circumvented to some extent. While the debtors and creditors avail the benefits of asset classification, provisioning and capital adequacy on restructuring, they have tried to avoid the painful sacrifices in terms of provisioning on diminution in fair value and promoters' sacrifice. Such circumvention of norms not only camouflages the weakness of credit portfolio of banks but also weaken their defence against expected losses. The inherent credit weaknesses of such accounts are further aggravated due to lower stake of the promoters in the restructured business. Taken together, both these aspects decrease the efficiency of the financial system and increase its vulnerability to external shocks.

Company Profile:

Oswal Group is a biggest textile production organization in India. Vardhaman Poly-Tex is one of the listed public limited company in this group and incorporated on 1980. The units are located in five places. The directors' board consists of 5 members. The promoters and all the directors are well experienced in this line of business. The management is competent enough to handle the affairs of the company. The installed capacity is 1,78,704 Spindles for Cotton Yarn Spinning, 11,648 spindles for Worsted Spinning and 15 tons per day for Dying capacity as on 31st March 2012. The company is having very good Technology, Marketing channels and also having efficient skilled workers. The company line of activity is engaged in manufacturing of cotton yarn, acrylic yarn, woollen yarn is worsted spindles, garments and blended yarn. This Company credit risk rating is Moderate based on ABS as at March 31st, 2011. The company External "D" rank Rating has given by ICRA in May 2012 in Term Loans Rs.112Crores, WCTL Rs.98Crores, and FBWC limits Rs.144 Crores, NFB Limits Rs.30Crores. All the loans are overdue and Substandard, Over dues in term Loan Rs. 7.00 Crores, Over dues in WCTL Rs. 1.71 Crores, Working Capital Over dues Rs. 16.02 Crores, Outstanding interest liability is Rs. 66.85 Crores, Shortage of Drawing power Rs. 64.75 Crores, FCCB – Unsecured and Overdue Rs. 43.24 Crores.

Table-5 Company Share Capital and its holding percentage from 2010 to 2012 In crores

Category	As on 31-3-2011		As on 31-3-2012		As on 30-6-2012	
	Amount	Holding %	Amount	Holding %	Amount	Holding %
Promoters & Directors	7.20	44.36%	7.33	45.14%	7.33	45.14%
Financial Institutions/Foreign Institutional Investors / Banks	0.15	0.95%	0.01	0.03%	0.01	0.03%
Corporate Bodies	3.99	24.54%	4.95	30.49%	4.88	30.05%
Public & Others	4.90	30.15%	3.95	24.34%	4.02	24.78%
Total	**16.24**	**100.00%**	**16.24**	**100.00%**	**16.24**	**100.00%**

Source: Company Annual Reports

Circumstances Leading to Reference to CDR for restructuring and progress:

1. Cost of raw material consumed as a percentage of sales has increased from 69% in FY 2010-11 to 84% in first half of 2011-12. Company suffered a net loss of Rs.61.96 Crores for 1st 9 months of FY 2011-12 mainly due to high inventory costs' resulting from Cotton was procured at all-time high prices in the season between October-March 2010-11. Domestic and global cotton & yarn prices fell from record highs since March 2011 due to the Government policy on cotton and cotton yarn exports towards the end of 2010 influenced both the cotton and yarn price creating an artificial scarcity of the produce both the cotton and yarn price creating an artificial scarcity of the produce both within and in the global market. Government had put restrictions on cotton yarn exports towards

the end of 2010, resulting in Indian players losing their market to other yarn producing nations across the globe during this period. When ban on exports was removed in March 2011, there were huge quantities to be exported with lower demand. Global recessionary trends, there was further slow-down in demand in both domestic and export markets. Anticipation of a spurt in global cotton production further put downward pressure on both cotton and yarn prices.

2. The industry is still in the process of clearing high cost of finished goods inventory, out of 226 listed textile companies in the country, 83% have shown poor results and 127 companies incurred net loss during the first half of 2011-12.The interest rates have risen by almost 400 basis points over the last 18 months. The high interest cost of almost 8% of revenues has further reduced the bottom-line of the Company.
3. The global market has adversely affected the working/profitability of the textile industry due to the fluctuations of Indian Rupee vis-à-vis US $, steep rise in minimum support price of cotton by Government of India, withdrawal of duty draw back scheme & withdrawal of interest subvention. Sales realizations of yarn exporters have been affected due to recession in USA and Europe. Reduction in global consumers leading to sharp reduction in demand of Textiles also has an impact over the company.

Data Analysis:

Table-6 Financial Indicators for the last 2 years Estimates for the current & projections values

Particulars	2009-10 Audited	2010-11 Audited	2011-12 Audited	Projected for 2012
Capital Reserve & Surplus	12.66 141.72	16.28 159.76	16.28 156.30	34.63 199.77
Less: Intangible Assets / Accumulated Losses	154.38 24.68	176.04 1.29	172.58 79.84	234.4 00
Tangible Net Worth Long Term Loans from Banks / Fin. Institutions	129.70 110.08	174.74 191.66	92.74 199.72	234.40 198.52
Capital Employed	239.78	366.40	292.46	432.92

Unsecured Loans	--	--	--	20.00
Total Long Term Funds	239.78	366.40	292.46	452.92
Total Current Assets (A)	***179.23***	***298.14***	***130.12***	***339.74***
Current Liabilities:				
Bank Borrowings Overdrafts/Cash Credit	238.87	161.26	186.17	144.00
Bills Purchased & Other Current Liabilities	61.5	94.77	168.39	140.42
Total Current Liabilities (B)	***300.37***	***256.03***	***354.56***	***284.42***
Net Working Capital C= (A – B)	-121.14	42.11	-224.44	55.32
Gross Block	437.44	445.55	550.09	586.85
Less Depreciation	181.12	207.91	233.30	238.78
Net Block	256.32	237.64	316.79	348.07
Investment	151.83	137.88	163.25	136.50
Non Current Assets	9.56	40.60	39.25	--
Total Fixed Assets Block (D)	296.57	416.12	519.29	484.57
Total utilization funds in to various assists	175.43	458.23	294.85	768.99
INCOME STATEMENT				
Domestic Sales	365.79	502.15	449.14	436.15
Export Sales	161.89	213.91	285.83	291.88
Total Net Sales	527.68	716.06	734.67	728.03
Other Income	-21.71	13.00	36.02	16.56
Total Income Available	505.97	729.06	770.69	744.59
Less Operating Expenses(Excl. Depreciation)				
Profit/Loss Before Depreciation Interest and Tax	37.62	111.08	-7.31	88.00
Less: Depreciation	28.31	27.32	29.60	30.87
Profit/Loss Before Interest and Tax	9.31	83.76	-36.91	57.13
Less: Interest	40.01	47.92	67.72	51.64
Profit/Loss Before Tax	-30.7	35.84	-107.63	5.49
Less Income Tax	7.68	9.14	26.22	2.96
Profit/Loss After Tax	-22.39	26.70	-81.41	2.53
Capital Employed	239.78	366.40	292.46	432.92

Profit/Loss Percentage on Capital Employed	-9.34%	7.29%	-27.84%	0.58%
Add: Depreciation to Profit/Loss After tax	28.31	27.32	29.60	30.87
Cash Accruals	5.92	54.02	-51.82	33.40
Ratio Analysis				
Current Ratio (Current Assets / Current Liabilities)	0.60	1.16	0.37	1.19
Total Outside Liabilities / Tangible Net Worth	3.16	2.56	5.98	2.15
Debt Equity Ratio (Long Term Debt/Net Worth	1.29	1.62	2.18	1.30
PBDIT to Sales Percentage	7.13%	15.51%	-0.01%	0.12%
Net Profit Before Tax to Net Sales Percent	-5.82%	5.01%	-0.14%	0.01%
Term Debt PBDIT	3.63	2.15	-41.71	2.77
Interest Coverage Ratio (PBDIT/Interest	0.94	2.32	-0.11	1.70
Return on Equity (Profit After Tax / Equity)	-17.26%	15.28%	-87.79%	1.08%
Inventory Turnover Ratio(in Times)	6.76	4.8	28.22	3.74
Debtors Velocity (in days)	30	37	23	43
Creditors Velocity (in days)	10.24	16.67	26.52	9.76
(Inventory + Receivables –Bills Discounted)/Sales	0.23	0.30	0.11	0.39
Cost of Sales to Net Sales	0.90	0.85	1.02	0.90

Source: Company Annual Financial Reports

The above factors have adversely affected the working of the company. The above problems started right from the year 2008-09 and as deteriorated further in the year 2011-12. It has been find out, there have been inappropriate investment decisions made by the company during the past, which have put liquidity strain on the company's operations.

Table-7 Cash Flow Analysis and Funds Flow Analysis (Rs. in Crores)

	Particulars		31-03-2011	31-03-2012
	Cash Flow Analysis			
	Net Cash Flow from Operating Activities		16.34	176.53
	Net Cash flow from Investing Activities		-25.85	-98.49
	Net Cash flow from Financing Activities		20.43	-95.60
	Total Increase / Decrease in cash		10.92	-17.56
	Opening Cash and Bank Balance		11.48	22.39
	Closing Cash and Bank Balance		22.40	4.83
	Funds Flow Analysis	31-03-2010	31-03-2011	31-03-2012
I	Long Term Sources	98.55	210.96	29.00
	Long Term Uses	82.37	47.71	295.55
	Long Term Surplus / Deficit	16.18	163.25	-266.55
II	Short Term Sources	46.88	33.26	266.55
	Short Term Uses	63.06	196.51	0.00
	Short Term Surplus / Deficit	-16.18	-163.25	266.55

Computation of MPBF:

As per the last sanction of working capital in May 2011, the company has been sanctioned limit of Rs.144 Crores for its working capital requirements from different banks. The fund based working capital limits have been assessed at Rs.159.32 crores for the financial year 2012-13.

Table – 8 Computation of MPBF

Particulars	Holding Level (in Days)	2012-13	2013-14
Raw Material	90	132.46	141.44
Stores and Spares	45	1.67	1.76
Work in Process (WIP)	5	9.91	10.50
Finished goods	15	29.71	31.47
Sundry Debtors - domestic	20	28.12	30.09
Sundry Debtors - Exports	40	34.55	37.03
Other Current Assets		78.71	78.71
Total Current Assets		315.13	331.00
Sundry Creditors and Others	30	46.17	49.27
Other Current Liabilities & Provisions		63.50	57.78
Total Current Liabilities		109.66	107.05
Working Capital Gap		205.47	223.96
Margins: Domestic Stock	20%	6.95	7.41
Export Stock	10%	13.90	14.81
Domestic Debtors	20%	5.62	6.02
Other Current Assets	25%	19.68	19.68
Margin		46.15	47.92
MPBF		159.32	176.04

Conclusion

Before concluding, to emphasise that resources of the banking sector are precious and limited and they cannot be allowed to be used in an imprudent way. CDR is a necessity especially when economic upturn and downturn are a way of life and part and parcel of business cycles for individual companies. Corporate Debt Restructuring has been in existence for more than a decade in India, and this system has fulfilled its objectives to a large extent. It is a mechanism evolved for preserving the economic values of banks' assets should not be used against its noble objectives. Similarly, regulatory forbearances are discretionary tools which should be used only in the most demanding times. It goes without saying that its future success and failure will depend upon the ethics and integrity of its members and the professionals involved in the restructuring process. The restructuring process is a tool for assisting distressed sections of the economy to tide over difficulties which are temporary in nature and due to circumstances beyond their control. For us to justify that restructuring is for the larger benefit of the economy and the society, it is imperative that it is available to all classes of borrowers and is made available in a timely and non-discriminate manner. This will be possible only if we develop the necessary structures, systems and processes to adhere to the above objectives. A viable time bound action plan for implementing all of this is critical and I hope the finance professionals will play a major role in doing this.

Solutions and Suggestions: The following Restructuring was proposed by the Consortium Bankers:

1. Pricing: Existing Working Capital for Domestic Base Rate + 4.5% p.a., Working Capital Terms loans Base Rate + 5.5% p.a. and Fresh: Base Rate + 6.25% p.a. Term Loans: TUFs Loan – Base Rate +4.25% p.a., Corporate Loan -12% p.a. Fixed. Proposed: Base Rate + 0.5% (floating) with a minimum of 11.00% p.a. to be reviewed annually.
2. Ballooning of outstanding Corporate Loan, Term Loans and fresh WCTL instalments to be repaid in 10 years are as follows: 0.1% in 2011-12, 0.4% in 2012-13, 2.5% in 2013-14, 7% each in 2014-15 & 2015-16, 8% in 2016-17, 12% in 2017-18, 14% in 2018-19, 16% in 2019-20, 18% in 2020-21 and 15% in 2021-22.
3. Carving out the stock deficit in WCTL (Fresh). Reinstatement of need based WC limits of WC-FB: Existing: 144.00 crores, Proposed Total: 159.32 crores and WC-NFB:Existing: 30.00 crores Proposed: 50.00 crores. Fresh Term Loan of Rs.20.00 cores (Our share – Nil) for completing the expansion project of 40,800 spindlage at Nalagarh. The Term Loan to be repaid in 9 years including moratorium of 6 Month from CD
4. Creating of un-serviced Interest and future interest for one year into FITL
5. To pemit to cede pari passu charge on Assets created out of our TL of Rs.8.00 crores presently and permit modification in the TEV Study by our PAG HO: Amount of WCTL to be changed to Rs. 64.72 and allocation of WCTL among banks to be factored as per actual irregularity.Axis Bank share in enhanced WC limits and proportionate allocation of land sale proceeds to WCTL (Old) of Axis Bank to be factored.
6. Sale of Fixed Assets: The company has proposed the sale of approximately 26 acred of land, building, machinery and other assets at Villag Mundian Khurd, Chandigarh road, Dist. Ludhiana. As decided in the Joint Lenders Meting, estimated sale proceeds of Rs. 70.73 Crores is to be utilized towards reduction of outstanding WCTL portion of banks proportionately. (In TEV Study WCTL portion of Axis Bank has not been considered for

reduction from the sale proceeds of the land in view of their stand in not participating in enhancement of WC limit and the resolution of the bankers during the Joint Lenders meeting on 16th August, 2012. However, we have proposed that Axis Bank to participate in the enhancd exposure and sharing of sale proceeds of land)

7. Carving out WCTL: As per the TEV report, overdrawn portion in working capital limits as on cut-off date is to be carved out into a new working Capital Term Loan (WCTL-II)
8. Fresh Funded Interest on Term Loans (FITL):The funding of interest on term loan, corporate loan, WCTL-I, Fresh WCTL and working capital has been considered for the period starting from 1st January 2012 and ending on 31st December 2012.
9. Redemption of FCCB: The outstanding of the FCCBs is recognized at Rs.55.36 crores at an exchange rate of Rs.55/US Dollar for an outstanding amount of $10.07 Mn. The outstanding liability of FCCB is recognized for Rs.43.24 crores as on 31st March, 2012 at an exchange rate of Rs.50.87/US Dollar for an amount of $ 8.5 Millions.
10. ***Waivers:*** Diluted margin as under is considered for the purpose of assessment of limit and calculation of DP: Domestic Stock 20%, Export Stock 10%, Domestic Debtors 20%, and other current assets 25%. DP against TUFS/DEPB and other Government Receivables and Reduction of Creditors only over & above the accepted level for DP calculation purpose
11. ***Sacrifices:*** Rs.51.77 crores Fair value of loan before restructuring is calculate at existing rate of interest and fair value of loan after restructuring is calculated at restructuring rate of interest. The difference of above is discounted at applicable rate of 17%.
12. Fresh Term Loan and repayment schedule thereof: Fresh Term Loan of Rs. 20.00 Crores to meet the cost over run at Nalagarh Project:The project is funded by Term Loan of Rs. 20.00 Crores and Internal Accruals of Rs. 13.00 Crores. The fresh Term Loan shall be from existing Term lenders of the Nalagarh project.

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