
# NBFC Crisis – Case study on IL&FS

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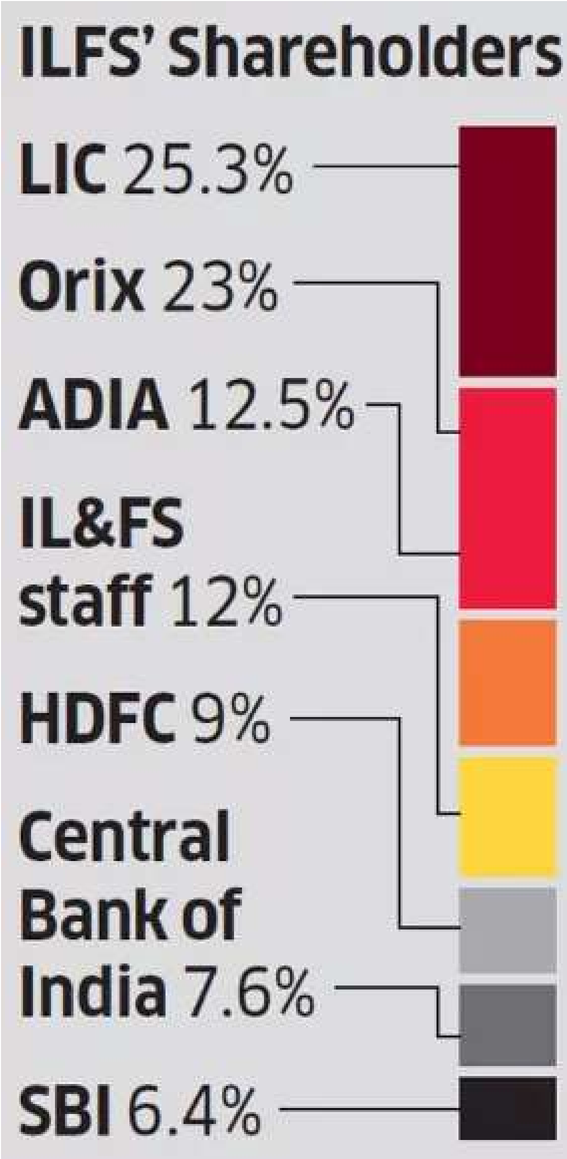
## Background

In 1987 IL&FS was formed by three financial institutions, Central Bank of India, Housing Development Finance Corporation (HDFC) and Unit Trust of India (UTI), to provide loans for major infrastructure projects. After few years two big international institutions, namely Mitsubishi (through Orix corporation Japan) and the Abu Dhabi Investment authority bought the shares of IL&FS. Subsequently, Life **Insurance Corporation India, Orix and ADIA** became its largest shareholders, a pattern that continues to this day.

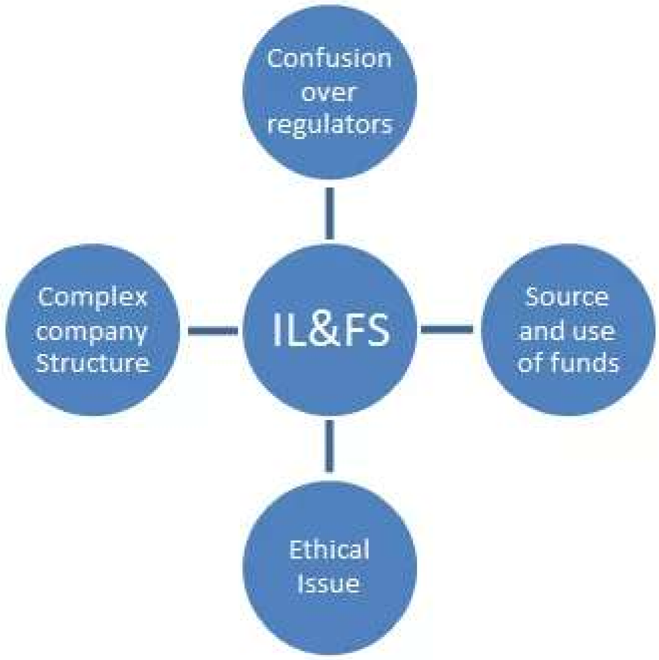



Infrastructure Lending and Financial Services (IL&FS) has more than 250 subsidiaries. IL&FS has financed some of the largest infrastructural projects in India – for e.g. Chennai-Nashri tunnel (longest road tunnel in India) & is considered as a pioneer in PPP projects. IL&FS was envisioned to provide long term big infrastructure loans which the banks were reluctant to provide.

From July to September 2018, two subsidiaries of IL&FS's reported having trouble paying back loans and inter corporate deposits to other banks and lenders, resulting in the RBI requesting its major share holders to rescue it. Recently, Government of India has taken control of IL&FS's, after it failed to pay off debt payments. Since this move by the government there has been an increase in volatility in the stock markets. A new board was constituted as the earlier board was deemed to have failed to discharge its duties. The new board consists of Kotak Mahindra Bank managing director **Uday Kotak**, former IAS officer & Tech Mahindra head Vineet Nayyar, former Sebi chief G N Bajpai, former ICICI Bank chairman G C Chaturvedi, former IAS officers Malini Shankar and Nand Kishore.

IL&FS has been recognized as systematically important institution due to the size of Infrastructure projects it funds. If IL&FS fails then there will be repercussions in various fields like agriculture, education, health, sanitation etc.

# Reasons for failure of IL&FS




**Lack of regulators**

- **Rating Agencies –** The rating agencies gave IL&FS an AAA rating and this encouraged investment in the company but now they have changed the rating of IL&FS as junk.
- **Shareholders** – Major shareholders failed to monitor the company that they invested in.
- **Board of Directors** – All the senior officers have resigned from their posts.
- **RBI** – RBI is considering itself a regulator today but it could have monitored the situation before the crises unfolded.
- **Government of India** –It never properly assigned any regulator.

**Source and use of funds**

- Increase in interest rates of short term borrowings.
- Loans skewed in the long term – Most debts that IL&FS had to pay off were short term while the loans it had granted were majorly long term.
- Lacking transparency in financial position and too many loans to own subsidiaries.
- No clear distinctions between public & private projects.

**Complex company Structure**

- **Too many subsidiaries** – with more than 250 subsidiaries, the auditing and monitoring of the company is difficult for any auditing firm or regulator.

**Ethical Issue**

- **Crony capitalism** – there have been known cases where things were hidden deliberately & unviable projects were sanctioned to please the ruling parties.

# Effects of IL&FS crises

1. Loss of confidence of investors.
    1. Many mutual funds have invested in its Bonds, Certificate of Deposits. The default and further fear of default is contagious to all financial markets which resulted in loss of money for many investors during last few months.
2. Government decision to pump more funds to meet with crises can result in widen of fiscal deficit which has adverse repercussion on inflation, exchange rate, growth etc.
3. It can lead to diversion of funds which were meant for social sector programs.
4. It leads to increased litigation in National Company Law Board (NCLB) as shareholders decided not to allow further defaults by IL&FS

# Solutions

1. Simplifying the complex structure of IL&FS.
2. Making stringent laws to deal with lack of transparency in both companies structure and finances as well as rating agencies
3. Minimizing red-tapism, reducing paper work to avoid stalling of projects.
4. Board of directors should be held accountable for such major defaults and should be brought under regular audit mechanism.
5. Auditing should be done by independent third party auditors appointed by the government in consultation with RBI and major share holders. This will ensure greater transparency in auditing of financial records.
6. Bringing IL&FS properly under the ambit of SEBI or RBI.
7. Fast tracking land acquisition and environment clearances.
8. The government can look at disinvestment of deteriorating assets rather than bailing them out from the tax payers money

As it is rightly said “A stitch in time saves nine”. It is important that the government takes corrective action before it is too late to handle similar incidents.

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