

# RECOVERING NON-PERFORMING ASSETS

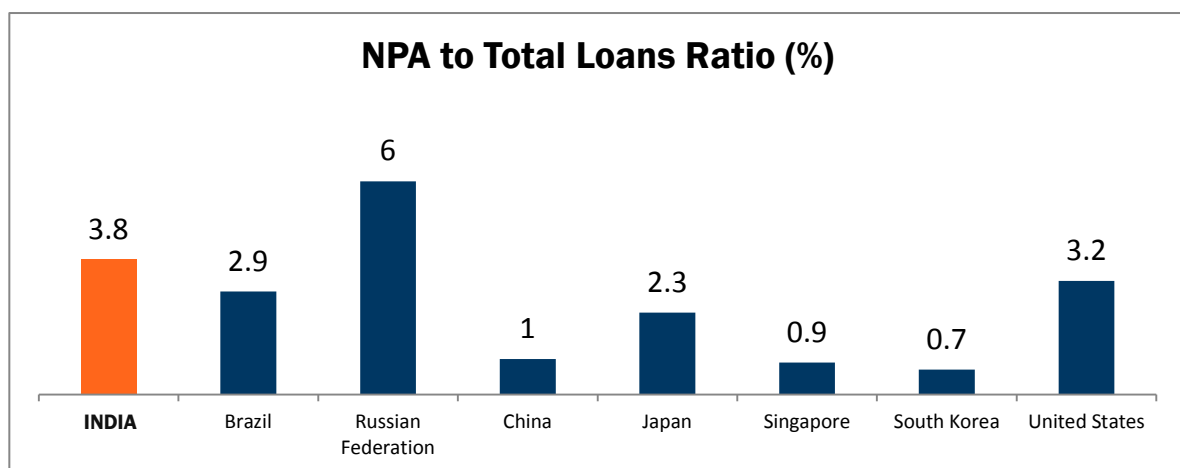
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A large multinational bank recently approached FTI Consulting's Global Risk and Investigations Practice (GRIP) to seek assistance in the recovery of a sizeable unsecured loan that it had provided to its borrower, a listed Indian company. At the time of disbursement, the company had been performing quite well and was among India's fastest growing corporates. However, over time, the company defaulted on its loan repayment and saw its stock price plummet, having made no payments to the bank against either the interest or principal amount.

Through the course of our investigation, which sought to ascertain the underlying reasons leading to the current predicament facing our client and to provide information which could assist with negotiations in the recovery of the loan, it became apparent that the borrower had been involved in arranging bribes for state government contracts in India while certain principals of the company were also found to be heavily politically exposed. Furthermore, our team was able to obtain credible intelligence to reflect how certain individuals in the company, along with rogue traders, had manipulated the share price of the company to artificially inflate its net worth.

The above case in point, as experienced by our client, is forming part of a worrying growing trend in India: the rise of the non-performing asset (NPA).

India has been witnessing a substantial increase in NPAs in recent years, which has placed the banking system, and in turn, the Indian economy, under significant strain. Between 2009 and 2013, India saw its NPA to total loan ratio grow from 2.2% to 3.8%.<sup>1</sup> As the chart below shows, India has surpassed the ratio of most developed economies, including those in Asia. This ratio does not appear to be slowing either, with experts suggesting that by the end of 2014, it will have reached 5% — much higher than most developed economies.



<sup>1</sup> World Bank, "Bank Nonperforming Loans to Gross Loans," <http://data.worldbank.org/indicator/FB.AST.NPER.ZS>

## About FTI Consulting

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## Factors Afflicting NPAs

NPAs often go unnoticed in the financial system during times of economic growth, and therefore only come to the fore when the tide turns for the worse. From 2002 to 2008, India's stock market performance was positive, boosting confidence and leading companies to borrow funds for expansion. Unsurprisingly, the financial sector extended more credit to support this growth, which eventually became unsustainable. However, the rise in credit growth was not followed by proportionate economic growth, but increased lending and the easy availability of credit resulted in prices rising even further. Further, the global financial meltdown in 2008 witnessed central banks providing credit in an attempt to inject liquidity into the system, causing further increases to asset prices in countries like India. In order to curb inflation, the central banks, such as the Reserve Bank of India, raised interest rates. Therefore, borrowers' abilities to make repayments were severely hampered at a time when their disposable income and value of their assets was diminished.

The growth in bad loans stemming from India's private banking sector has largely been impacted by external factors such as slowing economic growth. As noted above, however, the country's banks have also had to deal with an array of internal factors which included, but were not limited to, poor credit appraisal procedures, inadequate monitoring, lending under political pressure as well as high exposure to government lending schemes. Similarly, willful default by borrowers has also contributed to the worsening asset quality of India's banking sector.

## Getting to the Crux

Although not all NPAs are a result of a slowing economy or corrupt influences, financial institutions must consider the durability of the business model such as financial viability and technical capabilities, as well as promoters' credentials to include industry reputation, amongst other factors, before lending money. Undertaking a proactive stance in the manner of due diligence into potential borrowers will assist financial institutions in their selection process and will go some way to curtailing the likelihood of a loan becoming an NPA, as well as reducing wasted time, expense and reputational damage, in the longer term.

While a proactive approach is desirable, this may not always be feasible. In instances where the recovery of an NPA is required, a reactive approach is needed whereby understanding the underlying reasons as to why a loan repayment has defaulted, particularly in the context of an NPA, alongside an assessment of the current operational and financial conditions of the company and its promoters can be crucial for clients. These are elements that are often overlooked by banks' internal asset recovery teams who explore various NPA recovery options such as debt recovery tribunals, asset reconstruction companies, litigation or settlement with borrowers. Uncovering factors that have led to a default through business intelligence gathering and the identification of assets can bring about greater leverage for those seeking to use pressure point tactics at the negotiating table.

### Business intelligence for informed decision making

- Economic/operational challenges
- Intent to defraud/siphoning of funds/financial wrongdoings
- Identifying strengths, weaknesses and potential vulnerabilities
- Political connections

### Asset Searching to ascertain whereabouts of assets

- Shareholdings and other business interests
- Movable (yachts, private jets, etc.) and immovable property
- Other income, art collections, antiques and other prized possessions

### Negotiating a better deal

- Use of identified weaknesses and vulnerabilities to negotiate a favourable settlement

Should you require any advice, please contact us to further discuss how FTI Consulting can help.



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