

Indian Economy: The fall of IL & FS (Infrastructure Leasing and Financial Services)

GS Paper 3: Indian Economy and issues related to growth and development.



IL and FS is an Indian infrastructure and development company. Its projects includes some of the largest infrastructure projects in India including India's longest tunnel, Chenani Nashri tunnel. It operates through more than 250 subsidiaries including IL & FS Investment managers, IL & FS financial services and IL & FS Transportation networks India Limited (ITNL). IL&FS has several

Infrastructure Leasing & Financial Services Limited (IL&FS) is an Indian infrastructure development and finance company. IL&FS was formed in 1987 as an "RBI registered Core Investment Company".

projects in different sectors including Transportation, Area Development, e-Governance, Health Initiatives, Cluster Development, Finance, Power, Ports, Water and Waste Water, Urban Infrastructure, Environment, Education, and Tourism.

Relevance of IL and FS

Incorporated in 1987, the company was initially promoted by the Central Bank of India, HDFC and Unit Trust of India (UTI) with the objective of promoting infrastructure projects in the country. IL&FS calls itself as an expert from "concept to execution" and over the years, its focus has steadily shifted from project sponsorship to that of project advisory and project facilitator for development and implementation of projects. The firm has a demonstrated track record of generating resources by inducting strategic partners or through sale of assets to external investors.

CRUX OF THE ISSUE

IL and FS defaulted on a few payments and failed to service its Commercial papers (CPs) on due date which means the company has run out of cash or is facing a liquidity crunch. The company piled up too much debt to be paid back in the short term while revenues were skewed towards the longer term.

The issues faced by IL and FS

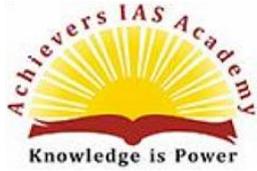
- ✚ The first signs of trouble emerged in June when IL&FS defaulted on inter-corporate deposits and commercial papers (borrowings) worth about Rs 450 crore.
- ✚ After the first default, a note issued in July by ICRA ratings agency said four of its subsidiary IL&FS Transportation Networks' (ILTN) project special-purpose vehicles reported irregularities in debt servicing. A fifth project had to dip into its debt service reserve to pay good on dues.
- ✚ In August, ICRA downgraded the long-term rating on Rs 4,475 crore worth of debt securities from AAA to AA+ taking into account the "company's elevated debt levels due to the funding commitments towards Group ventures".
- ✚ On September 4, IL&FS yet again defaulted on a short-term loan of Rs 1,000 crore from SIDBI (Small Industries Development Bank of India), while a subsidiary has also defaulted on Rs 500 crore due to the development financial institution, which reportedly forced SIDBI to ask its chief general manager in charge of the risk management department to resign.
- ✚ IL&FS' net debt to earnings before interest, tax, depreciation and amortisation, a measure of a company's ability to pay debt through its operating income, was hovering around a ratio of 11 at the end of March 2018.
- ✚ By the middle of September, IL&FS and IL&FS Financial Services had a combined 270 billion rupees of debt rated as junk by CARE Ratings and a further six group companies had suffered downgrades with a negative outlook on another 120 billion rupees of borrowings.

CAUSES OF THE COLLAPSE

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| Poor corporate governance & inadequate regulation for monitoring the firm. |
| Its complex corporate structure, like having more than 100 subsidiaries made problems hidden. |
| Lack of transparency and disclosure even from the part of credit rating agencies were deceiving. |
| Taking up projects to please political parties rather than based on economic analysis. |
| Infrastructure projects are difficult to assess in terms of risks & returns as it is long term. |

The effects of fall of IL and FS

On Friday, IL&FS said it was unable to service its obligation towards a letter of credit to IDBI Bank Ltd. This has raised concerns about the possibility of further defaults hitting mutual funds with exposure to IL&FS and its group companies. Twelve asset management companies through 32 funds held an aggregate 22.83 billion rupees in debt securities of



ACHIEVERS IAS ACADEMY

IL&FS and its subsidiaries at the end of August, according to analysts at Morningstar. Some of them have already marked down those investments as bond prices crashed, according to fund management sources. Investors are also worried about redemption pressure spilling over to other shadow bank lenders.

Questions

1. Discuss how IL and FS collapsed mainly owing to failed corporate governance. What changes should we envisage in the regulatory mechanisms of such systematically important firms? Suggest a way ahead to prevent future collapses of financial structures.
2. Bailout is an option to save sinking ships like IL and FS. Comment.