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## Column: Bad bank vs SUUTI

Government not even ready to sell SUUTI shares, where's the question of replacing bad promoters?

By: [Sunil Jain](#) | Published: January 27, 2016 12:08 AM



Given how cleaning up of bad loans at public sector banks is so critical to the future growth of lending, the arguments for and against a 'bad bank'—a specialist bank that buys bad loans from banks and hawks them off later, possibly at a discount—are once again gathering steam. The arguments on both sides are well known, and from what he has said publicly, [RBI Governor Raghuram Rajan](#) appears to be against the idea. The logic is a simple one: if PSU banks are going to be allowed to park their dodgy loans with a bad bank, they will lose the urgency to chase the recovery of bad/dodgy loans in the future.

On the other hand, a bad bank implies an urgency when it comes to fixing bad loans—by taking over companies and actively looking for investors to sell them to—that is critical. Indeed, if bad loans are allowed to linger instead of being fixed through a quick surgical strike, chances are they will get even more toxic with the passage of time since the interest burden will keep piling up. In other words, take a big hit once and for all, and then move on.

There are, also, other critical issues of capital that mean the bad bank will find it difficult to take off. If the bad bank is to take over bad/dodgy loans in any reasonable quantity, it needs to be adequately capitalised—the government is barely able to provide

enough capital to PSU banks to allow them to grow fast, how is it going to be able to capitalise the bad bank; remember how SBI's rating got affected because of the government's ability to pump capital into it a few years ago? Also, to the extent PSU banks have to write off loans—depending on the haircut they take while selling loans—they will also have to be capitalised; though the money they get from selling the loan to the bad bank will help reduce this. In other words, the government's ability to fund a bad bank is also a serious question mark over the scheme.

There is, however, an even more fundamental reason for why a bad bank won't work in the Indian context, and that is lack of public trust in government functioning, whether that is justified or not is a different matter. If a bad bank has to take over a loan involving promoter A and bank B, it will require both to take a haircut, and how big this will be—will it be a mundan, to use Rajan's expression for how defaulting promoters just wanted banks to take a huge haircut—will differ in each case. Even if you assume the promoters are willing to roll over and allow their companies to be taken over—the continuing Vijay Mallya saga shows you just how simplistic this view is—if the bad bank asks promoter A to take a 40% haircut as compared to a 50% haircut for promoter C, you can be sure this will be raked up by the Opposition and by the CAG/ CVC/ CBI—after which, someone like [Prashant Bhushan](#) will file a public interest litigation on the crony capitalism involved. And then there will be the issue at what price the company is sold to promoter D for—right now, the way the law is structured for public sector units, it is the L1 tender approach that needs to be followed; there are, of course, exceptions and ways around this, but they tend to get very long and tedious.

In which case, the government needs to sit down with Opposition parties and CBI/ CVC/ CAG to figure out how this dilemma is to be resolved. Having a very professional board running the bad bank—though the ownership will be that of the government—is one option to show the government is not trying to influence decision-making, but it is not clear how long this can sustain with the political class and even the courts increasingly looking in favour of CAG audits wherever public money is involved, even if through a PPP model.

A good example to cite here is that of SUUTI, or the company created to hold the erstwhile UTI's shareholding in Axis Bank, L&T and ITC. None of these are PSUs, so

logically speaking, there should be no delay at all in the government selling its stake in these firms—this is not acceptable in even the case of PSUs, yet the fear of unions has been a reason behind delays in both disinvestment and privatisation. Yet, successive finance ministers have not sold the government stake in SUUTI for one reason or another. In the past, these reasons have varied from wanting a strategic stake in a company that can one day be making warships (this means the government will actually have to buy more L&T shares since its holdings are way below even 26%!) to how—in the case of ITC—it didn't want to destabilise a well-performing management; managements don't get destabilised by share sales, but this was the logic given by a former heavyweight finance minister.

If the government is that wary of unsettling existing management, imagine how it will react when the bad bank seeks to remove, virtually by the scruff of their necks, a whole host of errant promoters? Many of the promoters are those that have funded political parties, including the [BJP](#), in the past and may indeed be still doing so—how is the political system react when its financiers are being so badly treated; make no mistake, if a bad bank is to be created, it will have to be ruthless in the manner in which it deals with defaulters who manage to stay rich while their companies find it difficult to service their debts.