PEOPLE: International Journal of Social Sciences
ISSN 2454-5899

Appa Rao & Jessica, 2017

Volume 3 Issue 1, pp. 516 - 522

Date of Publication: 21st March, 2017

DOI-https://dx.doi.org/10.20319/pijss.2017.s31.516522

This paper can be cited as: Rao, K., A., & Jessica, V., M. (2017). Corporate Financial Distress – Corporate Debt Restructuring Mechanism in India. PEOPLE: International Journal of Social Sciences, 3(1), 516-522.

CORPORATE FINANCIAL DISTRESS – CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA

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Abstract

After Recession, corporate was not doing well. There is a situation where the company's cash flow is not enough to pay financial obligation is called Corporate Financial Distress. External and internal factors of an environment are causes for corporate financial distress. The main objective of this paper is to know the causes for financial distress. This study finds that Delay in obtaining permissions, Short term funds used for long term purpose, Slowdown in Economy and Investments are diverted into other projects most important factors for the financial distress of companies. In this situation, Corporate Debt Restructuring Mechanism is a platform for corporate to stop winding up and come out from financial distress. This study finds that 97 out of 530 companies exited successfully come out from CDR Mechanism.

Keywords

Financial Distress, CDR, Corporate, Turnaround

1. Introduction

One of the main features of Business is Risk. This is unavoidable. In continue of business, there are two stages which are either Profits or Losses. Those two stages are resulted by External factors and internal factors of the business environment. If those factors are influencing in positive way business will turn to profits or if it is negative turn to losses.

Sometimes companies face difficulties to pay financial obligations. There is a situation where the company's cash flow is not enough to pay financial obligation is called Corporate Financial Distress. In the financial distress, Situation Company should look into where the actual problem is. The Company should Rearrange/Rebuild the financial structure of business.

Corporate Debt Restructuring Mechanism (CDR) is a platform for corporate to come out from financial distress and to stop winding up. Not only corporate it protects all other stakeholders of the companies especially Banks and Financial Institutions (Lenders).To secure lenders money and other stakeholders CDR Mechanism emerged in India.

1.1 Corporate Debt Restructuring Mechanism in India

CDR Mechanism was started on 23 August 2001 with detailed guidelines were issued by Reserve Bank of India for implementation by financial institutions and Banks.

The Corporate Debt Restructuring (CDR) Mechanism is a voluntary non-statutory system based on Debtor – Creditor agreement (DCA) and Inter – Creditor agreement (ICA) and the principle of approvals by super majority of 75% creditors(by value)which makes it binding on the remaining 25% to fall in in line with the majority decisions. The covers only multiple banking accounts syndication/ consortium accounts where all banks and institutions together have an outstanding aggregate exposure of Rs.100 million and above**.**

1.2 Objectives of Corporate Debt Restructuring Mechanism (CDR)

1. To ensure a timely and transparent mechanism for restructuring of corporate debts of viable entities facing problems for the benefit of all concerned.

2. To aim at preserving viable corporate those are affected by certain internal and external factors.

3. To minimize the losses to the creditors and other stakeholders through an orderly and coordinated restructuring program.

2. Literature Review

(Kasisomayajula) suggested that restructuring mechanism is a tool to support companies which are financially distressed due to external factors.

(Malik, 2013) said that industrial sickness is an organic process caused by several factors including some even beyond the control of industrial enterprises but mismanagement considered to be the general and all functional areas like finance, production, marketing, personnel and technological

(Halpern, Kieschnick, & Rotenberg, 2009) Analyzed 42 firms which are engaged in a Highly Levered Transactions firm during the year 1985-1990.and they found that Debt composition is a more influencing factor for the financial distress of companies, these firms which are using public debt more likely to face financial distress

(Acharya, Bharath, & Srinivasan, 2007) has investigated on defaulted firms in U.S over the period 1982-1999 regarding creditors of defaulted firms recover the significantly lower amount of distress. They found that these recoveries are not only due to the economic downturn but also financial constraints due to fire-sale.

(Padilla & Requejo, 2000) Shows that debt restructuring process will trigger operational actions to make the firm more “focused’. It enables creditors to impose their views on the firm's future prospects and the result of a shift of control right and residual claims from shareholders to creditors which are value increasing and reduce the future distress.

(Hotchkiss, 1995) reported that if creditors involve the matters of financially distressed firms, it does create value.

(Gilson, John, & Lang, 1990) examined the determinants of 169 firms choice between formal bankruptcy and out-of-court restructuring and found that about 80 firms successfully restructured their debt throughout -of –court renegotiations and these firms have more intangible assets ,a larger percentage of debt owed to bankers and fewer lenders .financial distress is more likely to be resolved through private renegotiations when both relatively less debt owed to trade creditors and more is owned by bank lenders.

3. Need for the study

In 2012, More than 100 companies were referred to CDR Mechanism which was the highest since the forum was launched in 2001. It was kept on increasing up to 655 as on 30th September 2016.These all companies are financially distressed due to internal and external factors of the environment. If, no mechanism support to these companies all the stakeholders especially Banks and Financial Institutions will be in trouble. The other way Banks Non-performing assets will increase and the economy will be a slowdown. So there is a need to find reasons for financial distress and the performance of CDR Mechanism.

4. Objectives of the study

1. To know most influencing factors for the financial distress of companies which are restructured through corporate Debt Restructuring Mechanism in India.

2. To see any difference in opinion of three groups like Bankers, companies, and professionals who are participants in the process of corporate Debt Restructuring Mechanism in India regarding reasons for financial distress.

3. To analyze the success of corporate Debt Restructuring Mechanism in India.

5. Hypotheses

Research Hypothesis H1: There is a significance difference in opinion of three groups like Bankers, companies, and professionals who are participants in the process of corporate Debt restructuring mechanism regarding financial distress reasons of companies.

6. Research Methodology

Nature of study: This study is Descriptive and analytical in nature.

Sample: This study is done by collecting total sample 81 (from 52 Bank Officials, 16 Financial Managers/CFO & 13 Charted Accounts) who are participants in restructuring process through corporate Debt Restructuring Mechanism in India.

Tools: Questionnaire is used to find the reasons for the financial distress of companies.

Methods: Descriptive statistics Mean, Median and Mode & Z-statistics and MANOVA are used.

7. Analyses of Data

Table 1: *Descriptive statistics and Z-score*

Factors of Financial Distress	Mean	Median	Mode	St.dev	z score	Rank
Delay in obtaining permissions	3.925	4	4	0.707554	1.30732	1
Short term funds are used for long term purpose	4.1	4	5	1.013828	1.084996	2
slowdown in economy	3.9125	4	4	0.844847	1.080078	3
investments are diverted to other projects	4.0125	4	4	1.049337	0.964895	4
Delay in commencement of operations	3.9	4	4	0.935922	0.961619	5
Changes in Government policies	3.7875	4	4	0.909775	0.865599	6
Less than expected sales	3.7375	4	4	0.882226	0.835954	7
Excessive Borrowings	3.675	4	4	1.04063	0.648645	8
Higer cost of prodution	3.5625	4	4	0.939213	0.598906	9
Lack of adequate control	3.4875	4	4	1.006231	0.484481	10
Investments in associates and subsidaries are much more than Networth	3.5375	4	4	1.146748	0.468717	11
Lack of Market research	3.4875	4	4	1.102285	0.442263	12
Increase in interest rates	3.3875	3.5	4	0.934484	0.414668	13
Lack of timely diversification	3.375	4	4	0.932874	0.401984	14
Lack of critical tie ups	3.325	3	4	0.96489	0.336826	15
Tough competition in the market	3.35	3	4	1.044576	0.335064	16
Lack of focus on implementation of projects	3.3625	4	4	1.105152	0.328009	17
Lack of planning for Technology Upgradation	3.275	3	4	0.92743	0.296518	18
Application of funds for unauthorised purpose	3.35	4	4	1.202318	0.291104	19
Changes in value of rupee	3.275	3	3	1.005995	0.273361	20
Lack of effective collection machinery	3.2375	3	4	0.903492	0.262869	21
Unviable business Strategy	3.2375	3	4	1.070239	0.221913	22
Inaccessbility of finance for working capital	3.15	3	4	1.137397	0.13188	23
Choice of wrong project	3.1375	3	4	1.166448	0.117879	24
Inaccessibilityof finance for starting project	3	3	4	1.074172	0	25

Interpretation: By using Z-score test Delay in obtaining permissions, Short term funds used for long term purpose, Slowdown in Economy *and* Investments are diverted into other projects *most important factors for the financial distress of companies which are restructured through corporate debt restructuring mechanism (CDR) India.*

Research Hypothesis H1: There is a significance difference in opinion of three groups like Bankers, companies, and professionals who are participants in the process of corporate Debt restructuring mechanism regarding financial distress reasons of companies.

Table 2: *MANOVA Test Multivariate Tests*

Effect		Value	F	Hypothesis df	Error df	Sig.
Intercept	Pillai's Trace	.974	77.907[b]	25.000	52.000	.000
	Wilks' Lambda	.026	77.907[b]	25.000	52.000	.000
	Hotelling's Trace	37.455	77.907[b]	25.000	52.000	.000
	Roy's Largest Root	37.455	77.907[b]	25.000	52.000	.000
Profession	Pillai's Trace	.829	1.502	50.000	106.000	.041
	Wilks' Lambda	.319	1.600[b]	50.000	104.000	.023
	Hotelling's Trace	1.664	1.697	50.000	102.000	.012
	Roy's Largest Root	1.307	2.771[c]	25.000	53.000	.001

a. Design: Intercept + Profession

b. Exact statistic

c. The statistic is an upper bound on F that yields a lower bound on the significance level.

Interpretation

The following is the MANOVA using the Wilk's Lambda test. We can see from the table that we have a "Sig." value of 0.023, which means $p < .05$. Therefore, we can conclude that there is a significant effect of Profession on the set of variables which are cause for financial distress.

Table 3: *Overall status of corporate Debt restructuring mechanism*
As on 30 September 2016

	No.of Cases	**Aggregate Debt (Rs in crores)**
Total references received by CDR cell	655	474002
Total cases Approved	530	403004
Cases exited successfully	97	70660

(Source: (paradyne, 2017))

Interpretation

After implementation of CDR package 97 out of 530 companies which are restructured through corporate debt restructuring mechanism in India have come out successfully from CDR cell. Still, they are expecting more companies will turn around from financial distress.

8. Conclusion

Corporate financial Distress is a situation where the company's cash flows are not enough to pay the financial obligation. This study found that the most influencing factors which cause financial distress are Delay in obtaining permissions, Short term funds used for long term purpose, Slowdown in Economy *and* Investments are diverted into other projects and least important factors are Unviable business strategy, Inaccessibility to finance for working capital, Choice of wrong project and Inaccessibility to finance for starting the project. To support to turn around companies from financial distress CDR Mechanism has given the opportunity to these companies. And also found that in the CDR Cell 97 out of 530 companies have come out from financial distress successfully.

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