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RESCUING IL&FS

Relevant for: Indian Economy | Topic: Investment Models: PPP, SEZ, EPZ and others

The **Centre's move to supersede** the Board of Directors of the troubled Infrastructure Leasing & Financial Services (IL&FS) has come not a day too soon. By explicitly stating its intent to "ensure that needed liquidity is arranged for IL&FS from the financial system", the Centre has sent out an unambiguous message to the markets that it will not allow the company to fail. In fact, a lot of the turbulence witnessed in the debt and stock markets last week could have been avoided had the government acted earlier. Any rescue plan for the beleaguered company obviously had to begin with replacing the existing management that was responsible for mismanaging its affairs. The annual general meeting of shareholders of IL&FS on September 29 had approved a rights issue of 4,500 crore and a debenture issue of 15,000 crore. But which lender or shareholder would commit to extending support to the company when it was defaulting regularly and the same set of people responsible for the mismanagement continued to be in charge? Against this backdrop, a change in management and the appointment of experienced people — such as Uday Kotak, who has rich experience in the finance sector; G.C. Chaturvedi, former bureaucrat and non-executive chairman of ICICI Bank; and G.N. Bajpai, former chairman of the Securities and Exchange Board of India and the Life Insurance Corporation — should lend confidence to lenders and investors.

The company is listed as "systemically important" by the Reserve Bank of India, and with over 1,15,000 crore of assets and 91,000 crore of debt, it is too big to fail. The interlinkages between IL&FS and other financial sector entities such as banks, mutual funds and infrastructure players are too strong and the company would have taken them all down with it if it were allowed to fail. At this point, the problem appears to be one of liquidity and not solvency — it is a classic case of over-leveraging, and an asset-liability mismatch caused by funding projects of 20-25 years payback period with relatively short-term funds of 8-10 years. There is a felt need here for long-term finance sources for infrastructure projects. The LIC and some insurance companies are the only domestic sources and they too do not lend beyond 10 to 12 years. The Centre and the RBI should look at ways to deepen the debt markets where infrastructure players can borrow long-term. It also needs to be analysed how a company listed as "systemically important" managed to fly under the radar with misgovernance. The debt pile-up due to over-leveraging did not happen overnight. How did the RBI, as the regulator, miss the goings-on? Are the shareholders, which are well-known institutions, guilty of misplaced faith in the management, or were they negligent? Finding answers to these questions is as important as rescuing IL&FS.

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