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RIPPLE EFFECT OF THE IL&FS CRISIS

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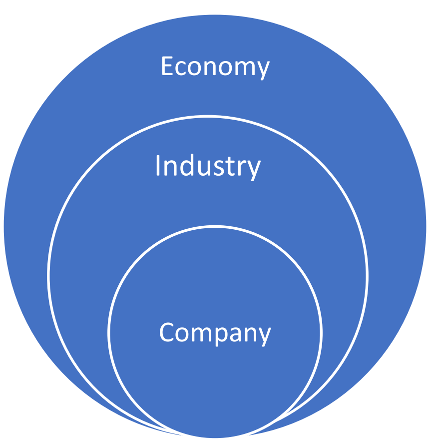
Abstract

Non-Banking Financial Companies (NBFC) are those financial institutions which cater to the demand of those customers whom banks think as sub-prime. In India these companies referred to as NBFC are currently very vulnerable and it is a concern for both RBI as well as the government. The major reason for the concern is the 2019 crisis in the NBFC sector. The crisis which ended in late 2019 was not an overnight event. The worsening of the conditions of NBFCs started in the mid-2018 and gradually deteriorated. The whole crisis timeline can be divided in 2 parts. The first part being the period in which the uncovering of the situation happens and the second part is the actions taken against the defaulters and measures to revive the sector. In this paper we have done an event study of the announcements made during the first period which showed the uncovering of crisis. The major announcements which took place in that period were considered and how those announcement affected the stock price of the related companies. The reason for doing this study was to assess the ripple effect of an announcement of one company on the company, industry and economy as a whole.

INTRODUCTION



In India, Financial Inclusion has always been on the agenda of any political party's government. NBFCs plays a very vital role in fulfilling this agenda. NBFCs reach out to those segments which are niche and lucrative but where the bigger and conventional commercial banks (CBs) do not provide their services.

In this paper we are going to talk about the crisis happened in 2018 in the NBFC sector. The significance of this crisis is that it made one of the largest NBFC namely IL&FS group fell down. The effects of which were quite strong at that time and is still existing. The crisis proved to be a serious concern in the operational efficiency of the NBFCs in India. The crisis was mainly caused by the maturity mismatch of its assets and liabilities. Maturity mismatch occurs when the time duration for which loan is given out and the time duration for which the deposit is accepted does not match.

Even though this crisis happened in one company in particular but it had impacted not only the sector but the economy as well because banks are believed to be the reflection of the economy. So here the paper has tried to find out the ripple effect of the crisis. Ripple effect studied here starts from the particular company then the industry and lastly the economy as whole.

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Here event study is used as a method for finding out this ripple effect. The study has considered the happenings or announcements related to companies facing the crisis. The first part of the crisis is considered here which is showing how the condition of crisis was uncovered by making various announcement by the concerned entities mainly rating agencies and government. So the effect of these announcements made regarding the particular arms of IL&FS on the stock price of that arm is measured by calculating the abnormal gain/loss for the particular period after the announcement. Also for the same period the percentage change in the indices of the industry and the economy is used to show whether there is a ripple effect of the announcement or not.

Review of Literature

Manda & Rani, 2019 (Crisis in the Indian NBFC sector) covers the impact of IL&FS crisis on the financial sector of India. It explained how banks can use this crisis as an opportunity to improve their asset quality by increasing loans to small businesses which has lower probability to convert into NPAs. It further talks about the change in the regulations by various regulatory bodies of India such as RBI, NHB and SEBI. The major findings of the paper are that regulators have made a timely intervention in changing the regulations but these regulatory changes is going to give short term pains to the sector players and may provide more consolidation in an already consolidated sector.

Roy et al., 2018 talks about the financial and legal framework for regulating shadow banking in US, Europe and in India with reference to RBI and SEBI. It also analyzes the impact of IL&FS crisis. It defined Non-Banking Financial Companies on the basis of 3 approaches – Based on Activity, Entity and Instrument. It took 5 factors while summarizing the basic regulatory requirements – Registration, Minimum Net Owned Funds, Public Deposits, Restrictions and Credit Ratings. It concludes that IL&FS crisis has made people skeptical about the watertight regulatory system in India. However establishment of NCLT has given people assurance that NCLT will act as a true backbone for the Indian economy to protect from any 2008 like crisis.

Kalra, 2016 talks about the evolution of the regulatory framework for the NBFC sector in India. It mentioned four years we having major regulatory changes and the years are 1964 by the Narshimha committee, 1996 – The prudential norms, 2007 – Defining of deposit accepting and non-deposit accepting NBFCs along with separate new prudential norms and in 2014 tightened regulations for NBFCs having high total value of assets and those accepting deposits, the regulations were unified across all such NBFCs. Further the paper analyzed the financial structure and profitability of selected NBFCs from 2006-2015. The findings of the paper are that huge Total Income and Total equity gives sense of confidence for an investor to invest in that NBFC. They also found out that Total Assets of any NBFC is considered as one of the most prominent factor of financial stability measurement.

Perumal & Sateeshkumar, 2013 wrote the paper with objective of documenting the growth and development of the NBFC sector. It also tried to bring to light the perception of the sample customers about the functioning of the NBFCs and also gave some suggestion to tide over crises. It took 40 people from 2 banks and tried to find out the most important parameter amongst Safety of Investment, Risk Elements and the growth prospect, for selection of NBFC. Finally it suggested to setup a Depositor’s Grievances Redressal center for providing quick and effective solutions and suggested to change the regulations for easy liquidation of NBFCs.

Jency S, 2017 wrote the paper with objectives of studying the financial performances of entities such as All Indian financial Institutions (AIFIs), Non-Banking Financial Companies (NBFCs) and Stand-alone Primary Dealers (PDs). It pointed out that there is increase in consolidation in the sector as the number of deposit accepting NBFCs (NBFC D) and Non deposit accepting but Significantly Important NBFCs (NBFC ND SI) are decreasing. It pointed out that there was a continuous growth in credit development because the NBFCs were able to cater to the credit demands of the niche markets. Also according to their study they found out that the profitability of the NBFCs is significantly higher than that of the Commercial Banks (CBs).

Manda & Rani, 2019 (Lessons from the IL&FS Crisis) talked in their paper about the lessons to be learnt from the IL&FS crisis. The paper talked about how crucial was the intervention by the Government through LIC & SBI for providing enough liquidity. The paper further talked about how crisis in one company made life difficult for other NBFCs as this crisis reduced overall access to capital for the sector. This crisis had effected other sectors as well because NBFCs had exposure to Mutual Funds, Pension

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Funds and showed the poor working of the rating agencies. So overall it showed a systematic risk example.

Anant & Anindita, 2020 talked in their paper about the IL&FS Fiasco and the lessons learnt in it. The paper started talking about the modus operandi of the NBFCs in India. The paper then analyzed the causes of the crisis and the impact of the crisis on Auditors, Credit rating agencies and the corporate governance strategies in India. Then it showed the primary data analysis for supporting the theoretical analysis. It finally concluded that better working of the NCLT and NAFRA can help in restricting such crisis in future.

John Binder, 1998 talked in his paper regarding the event study methodology including the modelling of abnormal returns as coefficients in a multivariate regression framework. The paper also talked about the statistical problems in the event study like cross-sectional dependencies and the solutions to these problems.

Data Collection

Firstly the announcements related to the crisis were found out from various sources like news article, rating agency's reports and Government of India websites. Then the companies related to which the announcements were made were listed and the stock prices of those companies were collected from the website of BSE or NSE.

The list of the companies which were related to the crisis are:

- IL&FS Investment Manager
- IL&FS Transportation
- IL&FS Engineering & Construction
- Dewan Housing Finance Company (DHFC).

Along with that the indices used for finding the percentage change in Industry and economy are

- NIFTY Bank and
- NIFTY Financial Services
- NIFTY 50

The time frame of collecting the stock price was according to the announcements made of individual companies.

Methodology

The announcements made regarding the crisis were collected from various news articles, rating agency's reports and Government of India websites. Then the period in which the uncovering of the crisis situation happened was identified. Then the various announcements made during that period were chronologically arranged and the company which was impacted by the announcement was identified. Then the stock prices of the identified companies were collected. The abnormal gain/loss during the period after the announcement was calculated by calculating the percentage change in the stock prices. Also for the same period the percentage change in the indices of the industry i.e. Nifty Financial Services & Nifty Banks and the index of the economy i.e. Nifty 50 was calculated.

ANALYSIS & FINDINGS

Company: IL&FS Transportation

Figure 1:Here one announcement dipped the

Announcement:

Rating agencies dropped down the ratings of this arm of IL&FS.

Announcement date:

1 August, 2018

Abnormal gain or loss:

-24%

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Index	Change in percentage
Nifty Financial Services	-0.046
Nifty Bank	+0.8
Nifty 50	+0.3

Company: IL&FS Investment Manager

Here the share price dipped from 13.93 to 13.29 from 17^{th} august to 27^{th} august.

Announcement:

This arm defaults on repayment of the commercial papers.

Announcement date:

27 August, 2018

Abnormal gain or loss:

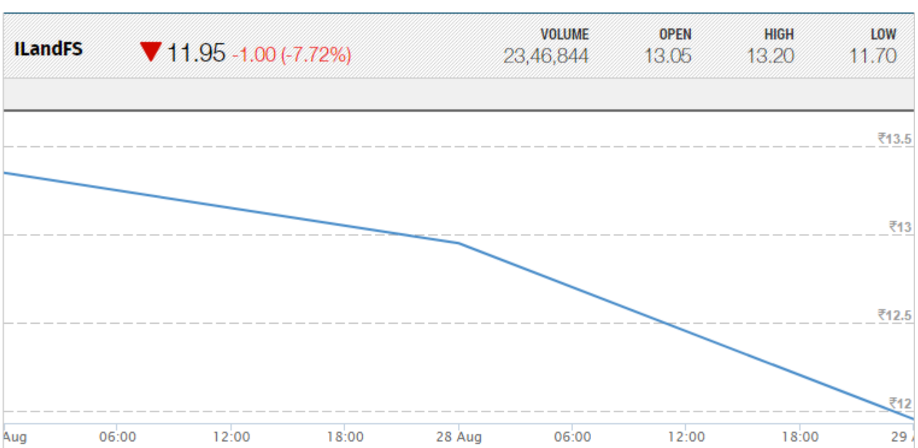
-10%

Figure 2: share price from 42.55 to 33 from 1^{st} august to 16^{th} august.

Index	Change in percentage
Nifty Financial Services	+1.0
Nifty Bank	+0.5
Nifty 50	+1.9

Company: IL&FS Investment Manager

Here the stock price dipped from 13.29 to 11.95 from 27^{th} august to 29^{th} august.



Announcement:

Rating agencies dropped down the ratings of this arm of IL&FS.

Announcement date:

17 August, 2018

Abnormal gain or loss:

-4.5%

Figure 3

Index	Change in percentage
Nifty Financial Services	+0.56
Nifty Bank	-0.1
Nifty 50	0

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Company: IL&FS Investment Manager

Here the share price dipped from 11.46 to 10.2 from 7th September to 10th September.

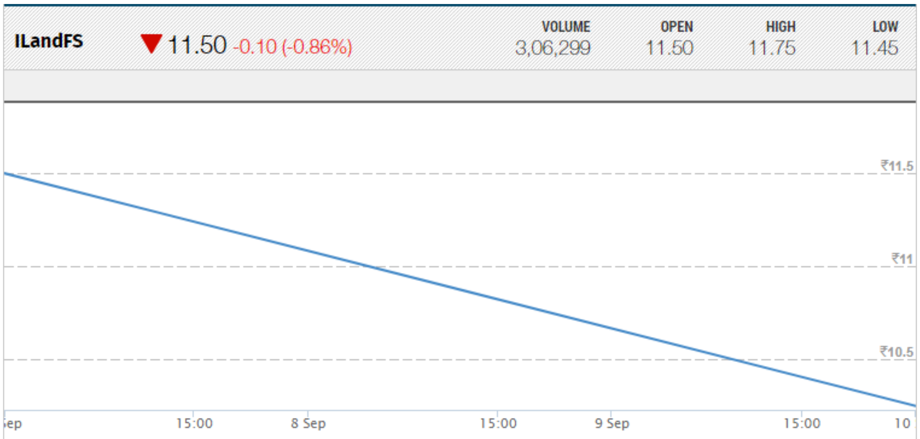

Figure 4

Announcement:

ICRA and CARE cut ratings on IL&FS non-convertible debentures to BB from AA+.

Announcement date:

7 September, 2018

Abnormal gain or loss:

-7.44%

Index	Change in percentage
Nifty Financial Services	-1.4
Nifty Bank	-1.0
Nifty 50	-1.3

Company: IL&FS Engineering & Construction

Here the stock price dipped from 16.8 to 15.5 from 7th September 2018 to 10th September 2018.

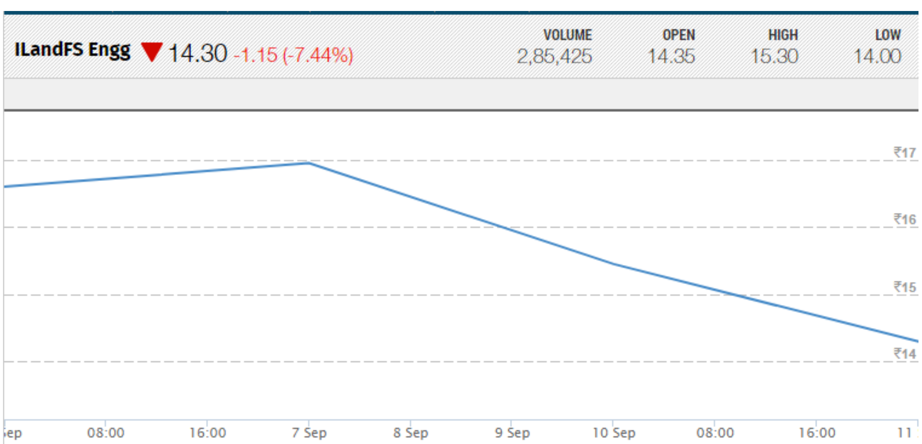

Figure 5

Announcement:

ICRA and CARE cut ratings on IL&FS non-convertible debentures to BB from AA+.

Announcement date:

7 September, 2018

Abnormal gain or loss:

-11%

Index	Change in percentage
Nifty Financial Services	-1.4
Nifty Bank	-1.0
Nifty 50	-1.3

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Company: IL&FS Transportation

Here the stock price dipped from 30.1 to 25.95 from 7th September 2018 to 10th September 2018

Announcement:

ICRA downgrades ratings on NCDs and CPs of IL&FS to default category.

Announcement date:

17 September, 2018

Abnormal gain or loss:

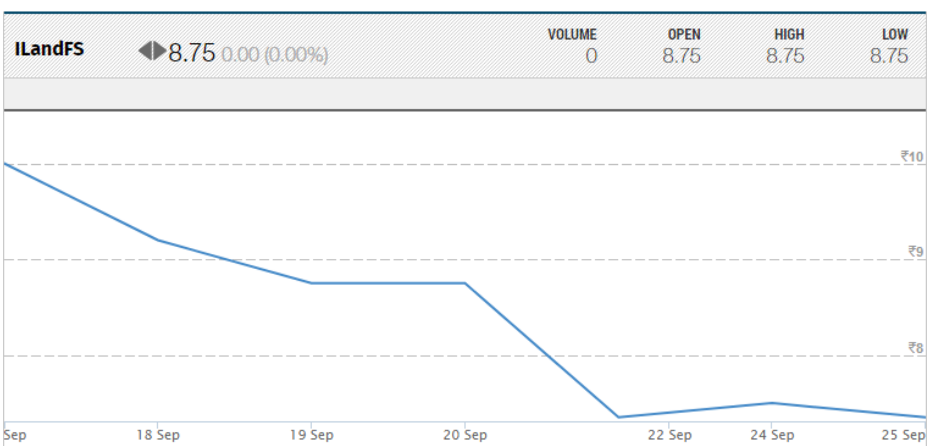
-25.7%

Figure 6

Index	Change in percentage
Nifty Financial Services	-1.4
Nifty Bank	-1.0
Nifty 50	-1.3

Company: IL&FS Investment Manager

Here the stock price dipped from 10.04 to 7.4 from 17th September 2018 to 25th September 2018.



Announcement:

ICRA and CARE cut ratings on IL&FS non-convertible debentures to BB from AA+.

Announcement date:

7 September, 2018

Abnormal gain or loss:

-13.8%

Figure 7

Index	Change in percentage
Nifty Financial Services	-4.8
Nifty Bank	-5.6
Nifty 50	-2.7

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Company: Dewan Housing Finance (DHFC)

The share price of dipped tremendously from 610 to 351 from 19 Sept 2018 to 21 Sept 2018.

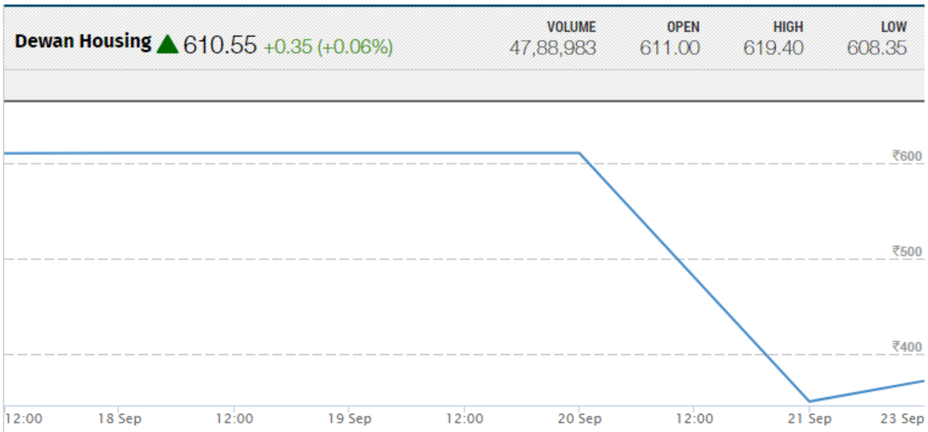

Figure 8

Announcement:

LIC Chairman said that they won’t let IL&FS collapse.

Announcement date:

25 September, 2018

Abnormal gain or loss:

+38.3%

Index	Change in percentage
Nifty Financial Services	-1.0
Nifty Bank	-2.6
Nifty 50	-0.8

Company: IL&FS Investment Manager

The share price of the company increased from 7.46 to 10.32 from 25 Sept 2018 to 5 Oct 2018.

Figure 9

Announcement:

DSP Mutual Fund sells debt papers of Dewan Housing Finance Corp at a steep discount.

Announcement date:

19 September, 2018

Abnormal gain or loss:

-42.4%

Index	Change in percentage
Nifty Financial Services	-4.4
Nifty Bank	-3.5
Nifty 50	-6.8

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