Indian Banking, Non-Performing Assets & Corporate Governance: Why NPA So High?

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This paper concerns Indian banks' ability to respond to NPA once they arise. Once NPA arise, the management of these banks demands a specific type of knowledge-intensive human capital. This permits a meaningful participation of banks in possible restructuring under the insolvency and bankruptcy laws. The lack of proper employment structure and the neglect of proper restructuring of the stressed loans can translate into higher prospects of NPA. A lack of proper knowledge-intensive human capital constrains banks' choices in carrying out effective restructuring and banks would be relying more on freeriding. If so, the management of current NPAs could result in a much pronounced NPA prospects.

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Introduction

A central policy focus would be on the need for sustaining a greater bank credit flows to sustain higher growth phases. In the existing literature the need for human capital-related expertise to enhance operational efficiency of Indian domestic banks to control quality of loans (and therefore lower NPA) has received adequate attention. This can sustain the correlation between higher credit flows and growth. A mere emphasis on higher interest costs to control the quality of credit flow, for instance, can adversely impact economic activity and result in higher non-performing assets (NPA) of Indian Banks (Chavan & Gambacorta, 2016).

However, what is neglected is that the higher growth phases normally would also create stressed loans (RBI, 2010), especially the corporate ones. The challenges facing the nature of human capital-base and expertise to effectively restructure the loans that involve corporate governance issues have not received enough attention in the related literature. It would be reasoned how a lack of expertise, and such human capital base, to face the challenge of proper restructuring of stressed loans can cause the prospects of banks' freeriding that can translate into higher NPA.

To elaborate on this theme, we would highlight how existing Indian literature remains silent on the human capital expertise needed to address stressed loans arising in high growth phases. The emphasis would be on some factors that create such issues in high growth phases. We would address the need and importance of restructuring of loans to sustain higher credit flows with lower NPA. We would, then, examine the human capital expertise-centric challenges that face Indian banking and how neglect of this issue can raise the NPA prospects.

Human Capital Concerns

The average figures of NPA in Indian banking are considered high compared with that of the figures for the banks associated with the developed status of the countries. Though definitions of NPA are not comparable across countries, India's NPA as a percentage of total gross loans of 7.9 percent in the recent periods (taking 2000-2020) could be considered high as compared to that of the figures that lie generally below 2 percent for the fast growing countries like China and Korea and most of the developed countries (data.wouldbank.org/indicator/FB.AST.NPER.EZ; for recent trends, see RBI, 2021). Banking in India, especially in the market reform era, faces capital requirement targets in a more competitive environment. Non-performing loans and the resultant loss of value of the assets would mean the banks may lose out in extending their businesses or acquiring capital unfavorable terms. Both would indicate a serious loss of competitive advantages.

Non-performing loans and the resultant loss of value of the assets would mean the banks may lose out in extending their businesses or acquiring capital on unfavorable terms.

A proper accounting of NPA and the norms for capital adequacy ratio could represent a right policy focus. However, Huljak et al (2020) modeled how exogenous changes in NPA, say due to policy changes, are likely to impair economic activity through reduced credit flows. Such high NPA ratios in banks' balance sheets can adversely affect the soundness of the banking system through reduced profits, higher provisions, higher expenses associated with their monitoring and management. All this leads to an increase in funding costs, and higher risk weights-led higher capital needs. To maintain or boost capital adequacy, banks may thus deleverage, leading to a contraction in credit supply. Finally, the management of large NPA stocks can divert important managerial resources away from the core and more profitable activities. In these instances, reduced credit flows and resultant economic activities lead to a decline in the repayment capacity of borrowers and a further increase in NPA.

Therefore, if the policy focus would be on sustaining higher credit flows (and economic activity), a greater operational efficiency that sustains higher credit flows allowing for their quality assumes significance. Indian studies underline the role of advanced human capital that is information-intensive and the staffing pattern should reflect this aspect. Anand (2000), D'Souza (2002) and Kumar (2008), in particular, emphasize how staffing pattern tilted in favor of officers-dominated employees not only is associated with lower establishment costs, a more considerable value attached to customer relations and management of assets (and the risks), but also permits effective multi-tasking as the banking practices go beyond mere advance of loans to expand portfolio choices (to manage exposure to mere advances). Following this, there has also been related literature (Kamath, 2000; Mandal & Ghose, 2012) that emphasizes intellectual capital, a combination of human capital and related advanced technology-based physical capital that adds force to this aspect of banking that can add to efficiency and profitability. Banks face choices when they decide on advances to specific borrowers; the lack of proper employment would imply less control over NPA.

This emphasis on human capital would focus on bank-specific factors, such as the 'bad management' hypothesis, the lack of adequate leverage and capital-related issues, the scope of 'moral hazard' and risks, and the possible lack of proper size and diversification bases, etc. (for a review, see, Chavan & Gambacorta, 2016; for Indian specific studies, see, Rajaraman and Vasishtha (2001); Das and Ghosh (2007); Swamy (2012); studies analyzing the effect of the repayment ability of borrowers on the loan quality of banks with a special focus on public banks see, Ranjan & Dhal, 2003, and Misra & Dhal, 2010).

Banks may finance sub-prime borrowers who were not deemed credit-worthy and hence did not have an access to the credit market earlier.

However, allowing for operational efficiency and such institutional parameters, literature also suggests the independent role of macroeconomic parameters such as incidences of higher growth phases that highlight procyclicality of credit growth-led higher NPA. Minsky (1982) could be the first to provide a post Keynesian theoretical foundation of how banks' lending in high growth phases undermine that the loans are not hedged against long run payments. Recent literature provided alternative theoretical foundations, such as herd behavior, or various cognitive biases such as 'disaster myopia' or short-sightedness in underestimating the likelihood of high loss low-probability events, or how as growth picks up, banks tend to expand their credit limits because the valuation of underlying collateral goes up during the period, or banks may finance sub-prime borrowers who were not deemed credit-worthy and hence did not have an access to the credit market earlier (for a review, see, Jimenez & Saurina, 2006; Chavan & Gambacorta, 2016; RBI, 2016).

In this focus, Indian studies mostly concern the empirical validity of the procyclicality hypothesis (Chavan & Gambacorta, 2016; RBI, 2016). However, what is relatively neglected in this literature is how procyclicality is a problem and calls for banks' specific, new sets of expertise.

One, even when banks have the operational efficiency in the sanction of loans and have adequate knowledge of (or proper attention to) market conditions and borrowers, higher growth phases also typify demand and supply shocks and imply continuous changes in the market conditions facing borrowers and can also change the profile of the borrowers. Such shocks would have its effects on the profitability of the borrowers. Banks then have to keep a watch on how changing opportunities in the market impact the value of the assets in an ongoing manner (in the post-lending situations). Wilson (2000) cautions banking financial accounting has to adjust to both the risks and liquidity issues emanating from the constant coming up of new opportunities. In the face of continuous changes, he explains, accounting practices linked only to current business with a given set of parameters would be like driving a car guided only by the rear-view mirror. In the present discussion, it would be argued, this understanding provides the key to what drives up the NPA.

Second and typical of corporates, there is extensive literature on how post-high growth financial and corporate distress could be traced to violation of minority interests and (the resultant) tendency to take higher risks by the managers (Adams et al, 2000). What would be important, as Marris (1968) (also see, Hay & Morris, 1991) noted, higher growth phases would witness higher expansion plans of firms with long run survivability that can bring in the tradeoff between growth plans of firms and profitability. Beyond the need of maintaining market shares, expansion plans give more power to managers of corporates. With some separation of owners from the objectives of the firms, managers can pursue a higher growth objective (and imprudent, high-risk financial policies) that can come in conflict with the objective of profits maximization. That is, higher growth phases and more power of managers, can combine to undermine minority rights (whose interest otherwise would be more aligned to banks' interests). In general, firms not adapting to the shocks in high growth phases, or adjusting via higher risks raise corporate governance issues (Adams et al, 2000)

Both the above understandings of the effects of high growth can also correlate with collateral shocks, vulnerability to external sector shocks (exchange rate, foreign currency borrowings) that impact profitability and make clear the prospects of stressed loans. For instance, taking the Indian case, the increase in stress in banks' loan books has followed the outbreak of the global financial crisis and a period of remarkably high credit growth in the mid-2000s (RBI, 2010). The stress in loan books has become particularly striking after 2011 (discounting the pandemic related recent figures, see, RBI, 2021).

This has an important implication. Supposing, in higher growth phases (allowing for procyclicality of credits), most of the loan contracts are stressed. However, if proper attention is given to restructuring of the loan contracts, banks taking interests in restructuring of\the corporates to adapt to new conditions, such restructuring would reduce the scope of pure NPA.

The greater the expertise of the banks in effectively participating in these restructuring exercises, the higher would be the credit flows with better adaptions to growth and with lower NPA.

Huljak et al (2020), as held above in the introduction, stress how policy-induced exogenous increases in NPA can reduce credit flows that can adversely impact economic activity and NPA. However, the focus should not be only on a greater credit flow with a greater operational efficiency to maintain the quality of credit. This is because, the greater credit flows target the proper, high growth phase that also brings in demand and supply shocks that also affect the quality of the loans and highlights a greater need for restructuring to adapt to the continuous changes in markets. Putting differently, the greater the expertise of the banks in effectively participating in these restructuring exercises, the higher would be the credit flows with better adaptions to growth and with lower NPA. This issue is taken up below in the following section

Need & Importance of Restructuring

Given the challenges facing banks in the higher growth phases that comes with higher incidence of stressed loans, the need for restructuring and the operational considerations are well articulated in the literature. The starting point would be Friedman (2000)'s modeling of the counterfactual conditions that does not stipulate any restructuring at all. Supposing,

a. lending takes place through marketable securities that is marked daily

b. there is only one debt security against any one borrower (or lending is consolidated)

c. or the borrower's operation (and outcome), debt is an one-off transaction (no further borrowing is required)

If these conditions are satisfied, the efficiency of the stock market, its information processing outcomes, informs the banks about the status of their assets. In the extreme case, supposing the market evaluation stipulates no prospect of the assets, borrowers would stop payment if the present value of such payments exceeds the value of the collateral. The banks also would not have any incentive for restructuring – once the prospect is taken to be given, no amount of restructuring would change the fact. The fall in the market value of the assets would only be adjusted in their balance sheet and would reflect on their equity positions, and banks would only take the decision when to offload their stake in the securities to realize something greater than the value of the collateral.

It can be seen that if minority right (or the objective against which the one-off transactions took place) is not met, or the project is adapting to changing markets, or is getting irrelevant or obsolesce, there is no need of restructuring. One implication is, even if one is dealing with bank loans that are not traded in as marketable securities, declaring default in the event of non-performance should be a policy option.

However, first, as Friedman (2000) observed, apart from the fact that the bank lending is not marketable securities, banks generally prefer restructuring to declaring a loan default because more NPA implies less of future capital flows (and such businesses). Modern banking has made the transition from the banco ratto principle prevalent in the earliest banking practice in Italy in the Renaissance period (lumenlearning.com: introduction to bankruptcy). Defaulters would face: (i) banks capturing their current business, (ii) losing fixed costs (broken benches or banco ratto when benches were the fixed costs of the businesses) and (iii) no prospect of future capital flow. It is true, if so, both parties would consider the risks of defaults while entering into loan agreements seriously. The borrowers know a default could imply losing out in business practice altogether. The banks also take default seriously because it would mean fewer loan advances; their business will shrink if NPA becomes larger.

Bankruptcy laws give the honest debtor a fresh start and resolve disputes among creditors.

However, stringent default procedures and the resultant seizure of businesses throw the insolvents out of business; in addition, business will not flourish for few would be willing to risk being personally burdened forever by crushing debt. Bankruptcy laws give the honest debtor a fresh start and resolve disputes among creditors. Without it, it can be reasonably supposed that the level of economic activity would be far less than it is. The need for the growth of capital flows and the responsibility of the banks guides the transition towards bankruptcy laws that target recognition and restructuring of stressed loans. Second, modern banking is also very sensitive towards capital requirement norms. More of defaults can force the banks into disadvantageous positions and can imply less of business. Third, most of the loan agreements are not one-time affairs. Loan contracts have provisions for ongoing need for continuous flow of credit to borrowers and the bankers therefore keep ongoing relationship with specific borrowers. The information set permits them to assess the businesses and provide the needed credit. In this context, as Friedman (2000) noted, in the case of non-performance, or not meeting the requirements of original loan contracts, the banks opt for restructuring because this can bring in new credit to the businesses. A default would otherwise imply no new credit. That is, individual banks prefer restructuring over default knowing by this the borrower can also attract new credit from others (and prospects of revival of the business concerned).

Corporate Restructuring & Human Capital Need

Given the greater need for restructuring of stressed loans in high growth phases, the related literature focuses more on the mechanism of the restructuring. The focus would be on when loans are not consolidated, a specific bank has to take the lead (Adams et al, 2000) and whether formal bankruptcy procedures or out-of-court debt restructuring permits less of economic costs of restructuring (Gilson et al, 1990; Rajan, 1992; Huang & Huang, 2009), the emphasis would be on different mechanisms and stakeholders that could be involved (IMF, 2010; Baudino & Yun, 2017; Demertizis & Lehmann, 2017).

Indian banks would face the more challenging issue of whether they have the expertise to effectively participate in restructuring.

Beyond these operational issues facing the option of restructuring, Indian banks would face the more challenging issue of whether they have the expertise to effectively participate in restructuring. Coming back to Friedman (2000)'s model, restructuring arises also because bank loans do not take place via marketable securities. Modern banking then evolves to ensure the mechanisms for effective monitoring of borrowers that should be accompanied by stringent collateralized loans with provisions for possible callback of loans in case borrowers do not meet certain conditions. It can be assumed that banks have the expertise and human capital-base to effectively monitor on behalf of ordinary investors who may not have the ability to do so (Rajan & Winton, 1995; Paglia & Mullineaux, 2006). This monitoring permits the lenders to extend new credit as workouts when the firms/borrowers face distress or effectively manage the costs of distress.

However, monitoring expertise is not enough. Possible workouts and extensions of new credit to financially distressed firms aim at proper corporate governance. Banks should also have the human capital expertise to bring in restructuring by way of changes in management or/and equity participation that can improve corporate governance (Adams, 2000). The focus would be on safeguarding minority rights or possible involvement of mergers and acquisitions (Adams et al, 2000) and financial institutions, and the laws in developed countries would be well versed on such issues (Scherer & Ross, 1991).

In this focus, how the Indian banks could face such restructuring challenges has not been adequately highlighted. For instance, it could be that even the formal development financial institutions in India, due to the pre-reform company laws (and inclinations of finance ministry), remain mostly passive in corporate governance issues.

Second, an important consideration, also, is that the banks' involvements in monitoring and restructuring are a costly affair (see below). The literature highlights how in a multiple lenders situation, some lenders would try to free ride (Rajan, 1992; Angelo, et al, 2019). The present note extends the literature to show that banks as lenders, if they do not have the expertise to monitor, or do not invest proper, say in human capital, to do this function effectively, they can also free ride through relying on capital markets-based mergers and acquisitions. It would be argued how this free riding also comes with a higher economic cost in terms of higher NPA. That is, the aim of restructuring could be to provide financial assistance to distressed firms and reduce NPA, but this involves expertise and lack of this can result in higher NPA.

Indian Banks & Corporate Governance: The challenges

To start, for pure monitoring purposes, banks generally rely on a working relationship with borrowers, and at the heart of this relationship is information on individuals on operating the business. However, this mechanism works well when the businesses, the market conditions, the supply chain, the labor force, etc. are local in nature, and firms are small in their operations. The banks have some stable expectations bounded by stable local conditions, and only serious departures from this are well monitored. What is important is that the mechanism does not operate when firms are larger corporates who operate on a national or global scale relying on such supply chains and skill sets. In high growth phases, such businesses become susceptible to national and global influences, changing opportunities in technology, new completion, supply chains, etc. They also are subject to credit risks denominated in foreign currencies. That is, monitoring also involves how growth (and procyclicality of credit growth) impacts firms.

It can be reasoned that by definition, corporations refer to financial devices in which capital flows are guided by long run business opportunities and the involvement of professional managers and well-functioning stock market provides the stability to the realization of the opportunities. Professional managers working on behalf of owners would take care of the banks' interest. In this specific sense, the issues pertain mainly to corporate governance. Once owners are in control, the corporate would be sensitive to both profitability and equity issues. The focus might not be on the maximization of current profits (and distributed income of the shareholders) as such. Long run stability also requires reinvestment of profits and a long run relationship with other stakeholders such as consumers, better compensations (and long-term incentives) to employees, etc. Supposing the minority shareholder interest refers to some satisfactory level of profits that comes with a higher expectation of an increase in them, it would be aligned to banks' interests.

The norms of corporate governance that can ensure minority rights and banks' interest however involve a vast subject and do not permit any standard definitions (Bloomfield, 2013). However, from the present perspective on banks' monitoring, the focus can be on the issue of separation of ownership from control that touches upon the issue of managerial discretions to depart from the objective of profit maximization. In this, the starting point is that the minority shareholders have less voting rights and remain passive in corporate boards who take the important decisions of the running of the concern. Further, the incidences of passive owners permit managers of the firms discretions enough to depart from the owners' interest in profit maximization (Berle & Means, 1932; Bains, 1968:73-83; Hay & Morris, 1991: 276-78; Bloomfield, 2013). Here, the voting rights remain central to passive owners' positions, but in an important operational sense, the minority shareholders are passive because they lack the knowledge base and competence to make a true assessment of the factors that make clear the changes in profitability (Hay & Morris: 277). Profitability may fluctuate due to changes in demand and supply conditions, or due to bad decisions. Specific technology (and supply chains supporting it) employed remain a business secret and so would be information on the scale of employment and compensations that the technology would stipulate.

The lack of business knowledge has other important implications. A corporation as a dominant firm can undertake many marketing, and advertising-related expenditure, on a high scale, that adds to present costs (and lower current profits), but it can add to its higher future market shares and profits (Shepherd, 1990: 387-9). Similarly, the dominant firms may undertake strategic costs, say raising rival costs, that adds to current costs (and results in lower profits), but by pitting its rivals in a disadvantageous position, it can add to its longer run markets share and profits (Salop & Scheffman, 1983; Scheffman & Higgins, 2014; Hviid & Olczak ,2016). That is, the time preference of a retail shareholder – say how much current profits should be distributed (current income flows) and how much to be retained for reinvestments (future income flows) – would be different from that of the board that controls the corporation (Hay & Morris: 277). Moreover, the outcomes of advertising and strategic investments are hit and miss affairs, though are courses of actions to survive and maintain market positions in the face of potential competition. Corporations are not all about running current business prospects. By design, for long run survivability, they continuously adjust to new opportunities. The information set regarding future changes in technology, product lines, and supply chains is not available to the ordinary owners.

The outcomes of advertising and strategic investments are hit and miss affairs, though are courses of actions to survive and maintain market positions in the face of potential competition.

Similarly, high compensations to professional managers (and their perks and expenses) have raised issues. However, they can remain unrelated to current income and can be part of strategic conduct or adjust to new opportunities (Hay & Morris, 1991: 298-303; OECD, 1999: 40-43; Gillan, 2006, L'Huillier, 2014). They still remain a concern: whether the excess employment and compensations are linked to current business or concerns strategic conducts or investments towards future opportunities or perhaps linked to some rent-seeking unproductive activities, remain in the realms of speculations.

It is sometimes maintained that a change from managerial control to owners' control, be it a majority or a minority control by one large block owner, but who also heads the board of control, can ensure proper information sets, transparency, and safeguard the interest of all owners (and banks). Profits of firms are the income of the owners and owners in control would aim at their maximization. There is some merit in this argument but is not a sufficient condition per se. OECD (1999: 24-25) study shows how such tight control by a few large owners can lead to their rent seeking activities for private benefits in collusion with management that comes at the cost of weak minority owners. Similarly, tight control by a few active owners, and the neglect of minority rights, can also lead to less of owners' equity investment and such liquidity position of firms (OECD, 1999). If so, it can be supposed that the adaptability to new opportunities in high growth phases would also be low that in turn negates expansions and such control over costs. It can be supposed, owners in control may not look only at how the firms' business affects them from the source side. They can have a stake in how banks' activities can impact them from the user side. Certain expenses (given their income source) add to their utility though they also add to costs. Still, the expense in the accounting sense can be seen as an investment – for instance, real estate in foreign countries, gold, etc. can also be seen as investments to hedge against foreign currency fluctuations; socials are also part of investments in public relations, corporate diplomacy and so on.

Free-riding Possibility & Higher NPA

As held above, growth accompanied by demand and supply shocks highlights the human capital bases of banks for specific monitoring purposes. The point is banks relying more on the working relationships with customers and such personal information sets can neglect investments in costly knowledge-based human capital that processes post-lending information of how the supply and demand are changing and impact businesses. It is not all about the mere human capital base to monitoring the performances. It would also involve what Hay and Morris (1991: 277) highlighted as the enforcement-related expertise to know whether changes in profitability are due to business-related changes or due to management negligence. Moreover, in the latter case, there is a need for assessing the potential change in management (and ensuring this change) that can bring in improvement. These human capital-centric costs can be substantial. If no such human capital investment takes place, banks would be above their heads in recognizing growing stressed loans and making necessary adjustments to them.

Without the knowledge-based human capital, it would remain passive – as passive as passive owners.

Then, the human capital bases both for monitoring and enforcement permit banks playing an active role in restricting stressed loans in high growth phases. Banks can then insist on some equity participation with intents for the change of control and management of corporates that ensures some safeguards of the interests of the minority shareholders (Adams, 2000). However, banks can play an active role in bringing in the restructuring, but without the knowledge-based human capital, it would remain passive – as passive as passive owners. Transparency in the flow of funds can do that much. One can get information on what heads how much funds are allocated, the information on the scale of funds in each fund belongs to a different universe of discourse. Supposing banks' greater capital flows are indexed to restructuring, the outcome can remain an unknown quantity.

Should the banks invest in this otherwise costly human capital? There are possible freeriding possibilities. Other stakeholders can monitor the performance on behalf of the banks. The related literature underpins how the nature of passive owners, their activism, the involvement of pension, institutional, mutual funds, etc. has been important developments that have resulted in greater monitoring of corporations (Hay & Morris, 1991: 279-80; Appel, et al, 2016; McNutty & Nordberg, 2016; Grove et la, 2020); In these instances, the passive owners also monitor performance and influence decision making, in principle.

Perhaps, most important in the present perspective, neglect of minority interests can be corrected by capital market disciplines, such as allocational takeovers that can change the management and bring about more accountable behavior (Hay & Morris, 1991: 512-14). It can be supposed that banks cannot play an active role in bringing in these changes that can safeguard minority interests or it is not easy to replace existing, experienced management or the existing management may not be passive to such takeover bids (Sen, 2006), or takeovers are not successful without further investment commitments (OECD, 1999).

Given the complexity of the governance issues facing banks-led restructuring and banks lacking the human capital based expertise, banks may take to the easy options. One could be some institutional arrangements such as the setting up of Assets Reconstruction Companies (ARC), both for freeing their stressed loans and bringing back the corporate governance for the revival of businesses involved. However, as RBI (2021) report notes, the mechanism has not been successful in bringing the much needed changes in management or bank participation in equity via equity debt swaps; for instance, the reporting of the stressed debts in ARC does not permit a mechanism for any meaningful equity participation of banks (or their effective monitoring of the management).

In the normal business practices, the percentage of mergers involving non-performing target firms is insignificant.

The other way can be seeking "mergers and acquisition" routes. That is, as the cases resolved under the Indian insolvency and bankruptcy code illustrates (https://en.wikipedia.org/wiki/Insolvency_and_Bankruptcy_Code,_2016), banks would prefer the involvement of well-established firms, with reputation regarding good performance in profitability could count. However, in the normal business practices, the percentage of mergers involving non-performing target firms is insignificant, especially when the objective of mergers is larger scale expansions or achieving a higher market power (Scherer & Ross, 1990: 162; Martin, 1989). Still, there can be cases when bad performance or lower profitability is due to some missing assets (that are not readily available in the open market), and mergers could add to the assets base, performance and profitability of the target firms. Similarly, the industry configuration might not be supporting some reasonable market power-based returns to firms with higher fixed costs, and mergers and acquisitions by way of a change in industry structure may permit the needed returns. However, the question would remain: why these instances of market opportunities-led realignments didn't take place in the first instance, which otherwise would have avoided the target firm's present insolvency status (and the need for restructuring)? Are there the roles of some additional incentives at play?

Therefore, it could be that the restructuring-prompted mergers and acquisitions would be guided entirely by tax savings incentives (Scherer & Ross, 1990: 162-3; Auerbach, 1990; Gilson, 2012; for a review, see Federal Trade Commission, 1987). Mergers purely guided by tax incentives, seen as an alternative to efficiency-guided ones, may not be allowed by the law, but when the case in point is debt restructuring, mergers can be made to happen through the mode of debt finance with commitments towards greater post-merger depreciation allowances, greater bank financing of working capital, etc. It is the tax savings that can bring forth the commitment towards the mergers. Banks would be happy because whatever may be the terms of restructuring and accounting practices, their loss of present value (and such accounting in the balance sheet) would be recouped (or they meet their capital requirement targets) and there would be some increases of current profitability. Still, consideration of the maintenance of the present value of the original loan contract and such project appraisal would demand much higher future long run profitability. In any case restructuring would stipulate the risk adjusted capital requirement could be higher. The restructuring that necessitates further lending to the firm concerned should then stipulate a higher rate of interest. Therefore, beyond short run tax savings-led short run profits, a proper restructuring would call for higher long run profits arising not necessarily in higher productivity to wage increases (or such costs savings), but in a higher ratio of the productivity to some costs inclusive of capital costs. If such long run profitability is not forthcoming, resolutions of current NPA create new, higher ones.

It should be stressed that the planning for mergers would also take into account some post-merger reduction in costs, say, some reorganization-led costs advantages. However, whatever may the source be of costs reduction possibilities, the post-merger organizational confusions (from the corporate governance perspectives) can raise costs without control (Scherer & Ross, 1990: 187). While mergers would result in higher fixed costs, the statistical evidence on post-merger performance to support the fixed costs is mixed and not encouraging (Scherer & Ross, 199: 172-74). It could be that higher fixed costs are more sustainable in a higher growth phase, but in these phases, mergers remain alternatives to internal expansions that otherwise would have had brought in fresh investments and more competitive processes-based growth (Martin, 1989: 247). Moreover, banks-led restructuring can do that much: whatever is done is done – the only thing is one might end up saddled with more NPA. As Scherer and Ross (1991:188) note, once mergers take place and the results are coming in, eggs are already scrambled; unscrambling would involve much costs and organizational confusion.

Human capital expertise to attend to corporate restructuring should be the hallmark of well-developed financial institutions.

To conclude, it could be reasoned that the human capital expertise to attend to corporate restructuring should be the hallmark of well-developed financial institutions seen as an interrelated whole. Banking should be operating in an environment of a properly developed financial institutions well versed in the issues involved. The present note's challenge facing Indian banking would then be indicated when post-1990 major restructuring in the financial sector, two major financial institutions, *viz.*, ICICI and IDBI converted into banks. A significant shrinkage of such segment of the credit market (RBI, 2007) only poses greater challenges facing banks to maintain competitive advantages. Investment in human capital and such scope of banks' effective participation in restructuring then becomes a policy focal point. Put differently, in lieu of an empirical note, the paper suggests banks' board should be constituted so to incorporate experts well versed in corporate affairs or the members who can effectively participate in board of directors of corporates. If restructurings and further credit lines would come with some banks' insistence of ownership rights and participation in the boards of corporates, it should also come with some advantages. Specifically, Rajan and Winton (1995) covenants be so operated so that banks can have the right to withdraw loans (or sanction further loans) or control of specific assets on the condition that they effectively participate in market-led mergers and acquisition routes if needed.

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