From Recoveries to Turnaround: Mindset change and role of ARCs- MINT

Asset Reconstruction Companies (ARCs) in India have long been perceived as vehicles solely for the recovery of bad loans, with limited scope beyond securing delinquent assets. This narrow focus has prevented ARCs from achieving their full potential. Instead of just being agents for recovering non-performing loans, ARCs must evolve into entities that can not only recover assets but also rehabilitate and turn around distressed businesses. The regulatory framework in India must allow ARCs to shift from a reactive stance to a more proactive role in the business ecosystem.

The Asset Reconstruction Company (ARC) sector in India has grown significantly since the Reserve Bank of India (RBI) first allowed this license category under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act in 2002. As of recent data, there are over 28 licensed ARCs operating in the country, collectively managing assets under management (AUM) worth approximately ₹5 trillion (around $60 billion). Despite the presence of these entities for over two decades, ARCs have yet to fully exploit their potential in reviving distressed businesses. Their primary focus has remained on the recovery of bad loans, with limited attention paid to business turnarounds. However, with the right regulatory and operational support, ARCs can play a far more transformative role in the Indian financial landscape.

ARCs have been formed with the intent of acquiring bad loans for recovery. Whilst this was relevant then, the prospect of early identification, sale to ARCs, and turning around of those assets for value is of paramount importance. Whilst regulation has now enabled SMA account acquisitions, maybe a step further in acquiring assets of early warning would make this industry work. The ARCs on their behalf need a mindset change, skill build and capital to execute turnarounds. The building of a trust institution with the right governance will enable that process. Capitalizing on early identification like non financial matrix like customer continuity and newer innovations, in addition to financial EWS indicators in the sector, may trigger the sale of assets

The Insolvency and Bankruptcy Code (IBC) has been instrumental in enabling the law to provide for struggling businesses to be revived with the right intent under new or existing leadership; however, there is a need for that kind of thinking amongst stakeholders, as default may be too late a trigger for corrective action. Turnaround could be a catalyst to work with the law to make business revivals sustainable. Successful turnarounds across sectors have proven this point. In steel, for example, the resolution of CG Power, Suzlon, Bhushan Steel and Essar Steel showcased how large, distressed companies could be revitalized under new promoters with a clear roadmap. What is needed are institutions like ARCs and Private credit firms aided by specialist turnaround consultants and in-house teams. The IBC should also be amended to include covenant defaults and EWS indicators as triggers by financial creditors. Prepacks would also go a long way in this as long as existing promoters have a fair chance at their businesses.

Currently, Indian ARCs have developed expertise in asset recovery, financial restructuring, and legal frameworks related to insolvency. They understand the mechanics of stressed assets and have built strong networks with banks, legal advisors, and debtors. A mindset change aided by the system, ie, lenders, Borrowers, as well as regulation, could enable specialist asset turnaround basis early identification a reality. Raising capital, either as a blind pool managed by ARCs or other non-bank capital providers, would be critical to fund the turnaround. If new capital is being managed or arranged from regulated entities, prudential norms on restructuring should apply to ARCs with a say 2-year moratorium to avoid misuse of provisions.

Turnaround is an accepted concept globally. India too would need to leverage its Management institutions to have additional courses on turnaround, which would enable finance professionals to take this up as an emerging profession, especially given the impending third Industrial revolution, where businesses will transform and grow. Fresh capital would require operational, financial, and strategic corrections, and a Turnaround would play a big role. An impending one that needs immediate correction is Vodafone India and SpiceJet.

The Regulators should move towards ARCs being the prime asset manager for the turnaround of assets, where Regulated entities focus on asset growth and ARCs focus on turnaround and recoveries. Private credit would provide the requisite capital and manage the same from their return perspective. This ecosystem is now required, given that the twin balance sheet is beyond us and we need to prepare for the next cycle, which history has proven will happen.

In conclusion, India needs a formal Turnaround ecosystem aided by the Insolvency and Bankruptcy law to enable better realizations of any future stress that can be identified earlier on. With evolving business models, the requirement cannot be underemphasized.

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