International Journal of Business and Management Invention (IJBMI)
ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X
www.ijbmi.org || Volume 8 Issue 01 Ver. V || January 2019 || PP 46-51

Resolution of Corporate Bailout

Sameep Bafna[1], Nidhi S. V[2], Parousia Khan[3]
BCom F&A, Department of Professional Studies, Christ (Deemed to be University), Karnataka, India
Corresponding Author: Sameep Bafna

Abstract: *In this research project, we are pointing out all the shortcomings in the decision making process and the entire system of corporate bailouts. Corporate bailouts are arrangements when the government or other financial institutions prevent entities from failing and going bankrupt because it might lead to a nation-wide economic disturbance and harm the population at a large scale. However, the current corporate bailout system has multiple loopholes as the taxpayers money is used for the survival of a very small portion of the society and very often, even after injecting such huge amount of money in order to bring them back to a stable position, the government often neglects the other essential internal and external factors which play a major role in the revival of such huge entities which ultimately lead to further irrecoverable losses. This research paper gives a detailed insight on the various bailout cases that have occurred in the past and their impact and performance as a whole.*

Keywords: *Corporate Bailout, Government, Financial Institutions, Money, Losses*

Date of Submission: 04-01-2019 Date of acceptance: 19-01-2019

I. INTRODUCTION

When a business, an individual or a government gives money to a failing business in order to prevent its closure or bankruptcy then this kind of arrangement is known as the bailout. It can be in the form of loans, bonds, stocks or cash which may or may not be reimbursed later on. This usually happens in companies, segments and industries which are struggling to survive because of huge losses. The bankruptcies of such companies or institutions has a severe adverse impact on the economy as a whole and not just a particular sector or the industry.The biggest advantages of bailouts are that they ensure the short term or the long term survival of whichever entities are rescued under difficult economic situations. Bailouts even ensure that there isn't a complete collapse of a market, a public institution or the financial system when big companies and institutions start to fail. These industries or systems are relevant to people in their day to day lives and cause hardships or losses to a broader segment of the overall population. However, bailouts can also be disadvantageous because they encourage a moral hazard which is that the promoters and the stakeholders have to take higher-than-recommended risks in their financial transactions. This is usually because everyone starts anticipating a corporate bailout when the entity gets stuck in a difficult situation and is not able to recover from its losses.

II. REVIEW OF LITERATURE

1. **The power of inaction: Bank bailouts in comparison - Cornelia Woll - 2014**

In the above article, the author has done an excellent job on explaining a relationship that exists between various financial institutions and the government. She has briefly overviewed the bank bailout cases in more than 20 countries using various testimonies. Finally, she made a pair of 3, where a normal comparison could be drawn. USA and UK, France and Germany, Ireland and Denmark were chosen by her. But she concludes on a note where she reveals that there are various differences in each economy. She further added that the government is either strong and is able to impose terms or too weak and corrupt, in these economies. Finally, concluding her article she has explained how the cost burden of bailouts is borne by both the public and private sectors.

2. **Saving the banks: The political economy of bailouts - Emiliano Grossman, Cornelia Woll - 2014**

In the above article, the author has analysed corporate bailout cases across Europe and North America. Mainly Irish, Danish, British and French bank bailout cases are looked upon. Here it is shown that the strategies used by various governments to cope with the instability of financial markets do not depend on economic conditions alone. The author states that those strategies are developed based on the political and institutional settings of the country. It also depends on the kind of relationship maintained by banks with the public and also the policymakers. In this article the author, with the help of 4 case studies, the author has shown that a very tight or close relationship between the strategy makers and the bank management did not give out good results as compared to those countries where banks negotiated collectively with the private sector. Here the burden was shared by the private sector as well.

3. **Political connections and corporate bailouts - Mara Faccio, Ronald W Masulis, John J McConnell - 2006**

This article is the most cited article with over 1500+ citations. The author of this article has brought out the relationship that exists between bailouts and politically connected firms. This an excellent article where the answer for the question, "Why politically non-connected firms are less likely to get any financial help at the time of drowning?". When a home government is unable to help or rescue a politically connected firm, usually IMF or the world Bank jumps into the picture and they fund the home governments for this purpose. In the above article, the bailouts of 450 politically connected firms from 35 different countries during 1997-2002 are analysed.

4. **Too big to fail: The hazards of bank bailouts - Gary H Stern, Ron J Feldman - 2004**

The above article is inspired by a book named "Too big to fail" written by Andrew Ross Sorkin. The author here has explained how the fall of Lehman Brothers, in the United States shook the entire nation's financial system and how the public was absolutely unhappy about the government not jumping in for the rescue. Here they have further talked about the public expectations, that commonly take a rise when a failing company is bailed out. There has always been a wrong perception in the public mind above corporate bailout. The results are not always positive. In fact, most of the times it is negative. Thus, the authors have suggested the policymakers to bring out certain reforms to reduce the expectations of bailouts when large institutions fail.

5. **Liquidity, efficiency and bank bailouts - Gary Gorton, Lixin Huang - 2004**

In the above article, the author has emphasized the importance of government in a bailout. The author is of opinion that, a bailout can be successful and effective only if there is an efficient government behind the same. Governments must stand at the back and put in it's best to ensure that there is enough liquidity in the market. When the same is disturbed, it's the government's duty to involve itself and come up with a solution. Banks are the major players in every financial market and a failing bank must be taken care of by the government to protect the investors' interest. Thus, in the above article the role, importance and duties of a government is briefed when a banking system is bailed out.

III. RESEARCH DESIGN

Banking industry is the oxygen of every nation's economy. They fulfil the security needs of an economy. Thus, a bank which holds people's money in its belly will naturally fall under the close watch of the government. A failing bank can affect an economy in many ways and thus avoid all those consequences, government jumps in for the rescue with "Bailout" as a solution.

Entities	Countryof Origin	State of Economy	Year of Bailout	Amount Involved
IDBI Bank	India	Developing	2018	$ 1.88 billion
UTI	India	Developing	2002	Rs. 14,500 crores
Lehman Brothers	USA	Developed	2008	-
21 Public Sector Banks	India	Developing	2017 and ongoing	$32 billion

Statement of problem:

Government, being a trusted and responsible authority by every taxpayer in an economy, autonomously takes a decision on choosing the entities for the purpose of a bailout. After having a rough check on the data available for the past decade, it's no secret that bailout has miserably underperformed or failed in majority cases. Hence, is it justified by the government's side, while it throws taxpayers' money into the pit of failing entities in order to lift them up?

slow's Hierarchy of Needs

The well-known Maslow's Hierarchy of Needs theory comes into play even when the government chooses the industries which should and should not be bailed out.

The industries which are essential for fulfilling a population's physiological and safety/security needs are the ones which government considers to be very important and the collapse of these industries would cause dents in the economy, which altogether finally take a form of a massive economic pit.

IV. DATA ANALYSIS

Banking Industry:

The banking industry works on a simple principle. Accepts deposits and funds from public and private entities and make loans at a higher interest rate than deposit rates. Conflicts of interest, bad credit approval processes, and Official estimates show 12% of all loans made in India - $150 billion worth - have gone bad.The Indian government has repeatedly faced calls to intervene in the banking system.Analysts consider the cash injection as a "significant" and "much needed" move that should help revive the country's inconsistent economy.A lot of investors have the same point of view. The banking industry falls under the category of industries which fulfil the physiological needs of an economy. However, not all the banks or institutions in the banking industry are helped by bailing them out. This also depends on the credit-worthiness of the banks and the chances of them recovering back and being able to repay the government's money as well as start making profits in a specified period of time.

2017 Bank Bailout Plan in India

In October 2017, the Indian government announced a $32 billion bailout for state-controlled banks and according to RBI, this is the only way we the industry can be brought back to a stable state where it would make healthy profits and the cycle of lending and borrowing can be resumed. Combined losses have been reported by thirteen state banks which amounts up to $8.6 billion losses in 2017. Only two state banks have reported profits till now which are again not enough for their sustainability. The government has already used 880 billion rupees to help out these failing banks and is going to inject 650 billion rupees in the current fiscal year. However, according to how events are taking place in the current scenario, the banks need 800 billion to 1 trillion rupees for the revival of their soured-asset provisions and to maintain their minimum capital ratios. This means that whatever money these banks are receiving right now won't be enough for their future lending growth.

IDBI Bank

Facts of the case:

IDBI Bank's lending portfolio is mostly in the corporate segment and that is one of the major reasons for the surge in its bad loans.IDBI reported a net loss of Rs.2,255 crore in December quarter against Rs.2,184 crore in the year-ago period. Gross non-performing assets (GNPAs) rose to Rs. 35,245 crore at December-end 2016 from Rs.30,134 crore in the previous quarter. The current Tier-I capital stands at 8.53 per cent.

Life Insurance Corporation of India i.e. LIC came into the rescue of IDBI by pumping in an amount close to $1.88 billion for a 40% stake in IDBI. This is over and above the 11%, the insurer already holds in this bank.

Analysis

The current bailout also doesn't guarantee that public sector banks will be in a position to give their customers new loans. LIC being a government corporation used its insurers' funds in order to save IDBI from falling into the pit of insolvency. The government's continued involvement in the sector - its 21 banks hold roughly two-thirds of industry assets - could also be part of the problem.

UTI Bank

Year: 2002
Location: India

Facts of the case:

- UTI bank (now known as Axis Bank) is a Public sector undertaking.
- The Indian government infused over Rs 14,500 crore and repaid the investors that had invested in UTI schemes.
- The Indian government can recover its capital by selling its stake in Axis Bank.
- The government holding in Axis Bank as on July 19, 2017, was Rs. 14,300 crores.
- Because of UTI, the Indian government also has holdings in L&T and ITC.

Analysis:

- UTI's bailout worked in 2002 but now we can see a lot of demerits and flaws in this bailout.
- To destress banks, another Rs. 91,000 crores have to be infused in the next two years.
- The government has already agreed to infuse Rs. 20,000 crores in this year but this amount won't be enough to help banks completely.
- The Indian government doesn't have the money for another bailout.
- Looking at the government finances, revenue to GDP of the government is low at 21.4 per cent while the general debt to revenue stands at 317 per cent.

Lehman Brothers

Facts of the case:

- Lehman Brothers filed for bankruptcy on September 15, 2008.
- Lehman was the fourth-largest U.S. investment bank and had 25,000 employees at the time of its collapse.
- The already existing financial crisis in 2008 intensified because of Lehman's collapse which caused an erosion of $10 trillion in October 2008. This happened because of market capitalization in the global equity markets. This was the biggest monthly decline until that time.
- Barclays, a British bank was contemplating purchasing Lehman but nobody could guarantee its operations for a private acquirer.

Analysis:

Lehman Brothers was a major investment bank and it's collapse affected the entire economy.
The government could easily bailout Lehman Brothers but it was allowed to fail. However, there was no reluctance shown in the bailout case of Bear Stearns. The main reason behind the huge losses that this firm had started making were the extremely risky real estate investments. It formed a cycle and by the time it reached Lehman Brothers, it was already too late.

A loss of $3.9 billion and a write-down of $5.6 billion was reported. The firm also announced a strategic restructuring of its businesses. However, Lehman's credit ratings were a little dicey and in order to avoid a further downgrade of its credits, they would have to sell a majority stake. Because of this, there was a 42% plunge in the stock of September 11. By the end of that week, Lehman was left with only $1 billion left and they didn't have a lot of time left to recover or even stabilise themselves. Barclays PLC and Bank of America Corp. aimed at taking over Lehman but were unsuccessful. On September 15, Lehman Brothers declared bankruptcy and there stock fell down by 93% from its previous close on September 12.

Through a bird's eye view, when we take a look at various nations with a different maturity of economies, one common factor comes through. Every firm with some sort of political backing or leverage has always had a helping hand while drowning, unlike private firms. Most of the bailout cases which can be found in the recent decade or prior to that period, in India, are all of the public sector firms.

The corporates which can or cannot be bailed out is on the basis of the answers to these two basic questions-
1. How critical would their collapse be for the fulfilment of a population's physiological and safety needs (the two basic type of needs that any person has according to the Maslow's need of hierarchy theory)
2. Whether the corporation is a public or a private unit

India has bailed out many businesses which were hit by the market collapse in 2008. One major industry in these bailouts has been the financial industry.

V. FINDINGS AND SUGGESTIONS:

Public enterprises that are set up, run or invested in by the government are typically found to be the cases that get discussed in newspapers. Governments invest public money collections from taxation and duties and setup, own and manage large industrial, banking and transportation government-owned enterprises. The government has accountability to either keep the enterprises alive since they impact the lives of the general population and cause hardships. The question is when does the government specifically step in to bail out such enterprises?

Any enterprise aligned to meeting the survival and security needs (better described by Maslow's hierarchy of needs) of the common public, with a substantial government holding, will require the government to step in. Police, defence, law and order, water safety, electricity generation are aspects that the government needs to ensure are up and running to not impact the daily lives of its citizens adversely. Some examples of these are railways, police, water supply which are completely government owned. An interesting case would be since electricity generation has been privatized in some aspects, where BSES and others are now privatized and owned by private conglomerates, would the government step in to rescue. Our contention is yes since it is critical need of the citizens of the country, the government will be forced to step in to ensure that power generation and supply is maintained and could be forced to look at bailing out a private enterprise. Private enterprises operate in the private domain. Take the risk, price their products according to market conditions and compete in the marketplace. Their destiny is tied to the decision they make. The newly introduced bankruptcy law provides from them to seek protection and claw their way out of distress. Asset restructuring companies now being established in the market also play a role in disbanding, realigning, selling off the assets and for the demise of a company based on private enterprise. That is the nature of markets and the economy. A bailout for such entities is managed in the system of private capital and distress management. The government does not and should not interfere in this aspect of the economy except for some exceptional circumstances described above that cater to the survival, safety and well being of its citizenry.

VI. CONCLUSIONS:

Through our analysis, we can draw the following conclusions:
1. The bailout is done only when the potential beneficiary is a major player in the market that significantly impacts the daily lives or livelihood or security and survival of its citizenry. Its exit might affect the economy or public, considerably. Hence, when the entity is large, it's implied that the cost of lifting the company out of the pit of insolvency will be large. Thus, the government must act responsibly before spending a huge amount of taxpayers' money on a single entity. Such failures should look for private bailouts and restructuring available in the markets.
2. Bailout definitely gives a second chance for a failing entity to breathe again. But the government should keep a close check on the operations and aftermath of the bailout. It has to track the return of capital for the bailout since it has a responsibility to safeguard public funds and assets so that it can be used for improving the lives of citizens in general rather than rescue based on bad decisions made by a few individuals. As the taxpayers' money is being spent, the government cannot sit back with its hands folded, after the bailout. Close monitoring has to be done to check if the money that is poured, is being used justifiably.
3. A private entity with good potential should definitely be considered and deserving companies must definitely get a second chance to hit back at the market. This would be true based on the determination of government holding in the entity (a PSU) to provide for the return of invested capital or for significant issues impacting its citizens' well-being, survival and security.
4. There has to be a willingness on the part of the government to actually sell off its stake to make its capital more efficient and deploy it in areas where no private capital is currently deployed. There's no will at the moment to reduce its stake to below 51% or 50% so that the private sector can become majority shareholders so the government should focus on statistically significant sectors that provide for the basic needs of its citizens rather than trying to run an airline.

BIBLIOGRAPHY

[1]. https://qz.com/india/1187854/how-india-will-pour-in-33-billion-to-save-its-banks-explained/
[2]. https://uk.reuters.com/article/europe-banks-bailouts/factbox-what-has-happened-to-more-than-30-bailed-out-european-banks-idUKL5N10W0XJ20150821
[3]. https://www.theguardian.com/business/2015/jul/02/greek-debt-crisis-unsuccessful- bailouts-lessons
[4]. https://www.hhs.se/contentassets/c5d085a8ded74f0bad6ba57ceb8c9ced/ginekanz_bailout_01122015.pdf
[5]. https://www.businesstoday.in/sectors/banks/bank-bailout-indian-government-axis-bank-uti-schemes/story/257018.html
[6]. https://qz.com/india/1187854/how-india-will-pour-in-33-billion-to-save-its-banks-explained/

Sameep Bafna" Resolution of Corporate Bailout" " International Journal of Business and Management Invention (IJBMI), vol. 08, no. 01, 2019, pp 46-51