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## Industrial Sickness in India- An Overview

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### Abstract

Corporate company's failure is major problem of developed countries as well as developing countries in the world. Failures are increasing day by day because of growing competition and the changing economic, political, social, cultural, legal and global environment. The companies number increasing in India every year. With the increasing number of companies, sickness in industries also flowed by it. In this paper, we tried to mention the thing to combat sickness problem in India. It includes the concept of types of sickness, reasons, adverse effect of sickness along with preventives measure which is provided by the Government in India.

### Introduction

Recently, we hear about the increasing evidence of industrial sickness especially in the large and medium sectors of industries and also in small scale sector. According to RESERVE BANK OF INDIA a sick industrial unit is one which has reported cash loss for the previous year of its operation and in the judgment of the financing bank is likely to incur cash loss for the current year has also in the following year. Sickness is also further categorized by a worsening debt-equity ratio and an imbalance in the unit's financial position. In short, a sick industrial unit is one that is not able to support itself through internal generation of funds, but look to external sources for funds itself through internal generation of funds, but look to external sources for funds for their survival. Such units operate below the break-even point continuously.

### Definition Of Sick Industrial Company

The sick industrial company act of 1985 which came into force from May 15,1987 defines "a sick industrial company as an industrial company (being a company registered for not less than 7years) which has an end of any financial year accumulated losses equal to or exceeding its entire net worth and has also suffered cash losses in that financial year and in the financial year immediately preceding it".

Net worth has defined as "total liabilities minus (current liabilities plus long-term debt).

Current liabilities are wages + short term loans tax +payable" and total liabilities are "current liabilities+ deferred liabilities + equity".

Long term debt = deferred liabilities like long term loan, i.e., debentures, loans from financial institutions, etc.

Equity = paid up capital(reserves)= retained earnings.

Initially only private sector companies were covered under the SICK INDUSTRIAL COMPANIES ACT. In December 1991, public sector companies were also brought under the preview of the act. The 1992 amendment has altered the criterion a little. According to the amendment, firms only need to be registered for five years, and the criterion of cash losses for two successive years has to be eliminated.

According to companies (2<sup>nd</sup> Amendment) Act 2002, Sick Industrial Company means an unit which has accumulated losses in any financial year which are equal to 50% or more of its average net worth during 4 years immediately preceding such financial years; or failed to repay its debts within any consecutive quarters on demand made in writing for its repayment by a creditor or creditors of such co.

Regarding small scale sector, an industrial unit is considered to be sick if the unit has

- (i) Incurred a cash loss in the previous accounting year and was likely to continue with losses in the current accounting year and erosion. On account of the cumulative cash losses to the extent of 50 percent or more of its peak net worth during the last five years; and/or
- (ii) Continuously defaulted in the meeting four consecutive installments of interest or two half yearly installments of principal on term loan and there were persistent irregularities in the operation of its credit limits with the banks. For tiny units it would suffice to satisfy either (i) or(ii).

## Distinguish Between Symptom of Industrial Sickness and Actual Sickness

### *Symptom of Industrial Sickness*

The symptoms of industrial sickness are failure to pay statutory liabilities like the provident fund, ESI contribution and failure to pay timely installments of principal and interest on loans taken from financial institution and through public deposits. Increase in inventories with the large number of slow-moving items, high rate of rejection of good manufactured, low capacity utilization and frequent industrial disputes are also indications of the unit becoming sick.

### *Actual Sickness*

Actual sickness indicates (a) Erosion of net worth by 50 percent and more;(b) industrial unit being closed for a total period of six months and more during the previous year; and (c) default in payment of loan installments. According to state financial corporations, any unit which fails to pay three consecutive half-yearly installment of interest and or principal is sick.

## Causes of Industrial Sickness

There are diversified causes for industrial sickness. It may be managerial, technical, financial and political. The causes are generally classified as industrial causes and external causes.

### *Internal Causes:*

- (a) Lack of experience of the promoters in the line of activity;
- (b) An improper choice of technology; unsuitability of product mix; wrong location of industry; and non-flexibility of fixed assets, particularly machinery in the context of diversified manufacturing set up;
- (c) Improper demand estimation of the product;
- (d) Defective capital structure and inability to raise adequate financial resources to adjust operational losses; shortage of working capital;
- (e) Failure to purchase the raw material at the right time;
- (f) Under-utilization of capacity due to labour problems;
- (g) Faulty control financial planning and managerial in efficiency

### *External Causes*

- (a) High cost of manufacture and low sales turn over,
- (b) High prices of raw material and non-availability of materials and other inputs;
- (c) Transport bottlenecks; marketing problems and poor supply of power, the lack of demand for the product; general recession in business and change in government's policy.

Many units are commenced without a through feasibility study. No long-term perspective is taken. Traditional industries such as sugar mills, textile mills etc. or prone to become sick by short sighted financial and depreciation policies. Above all, it is the mis-management that has been the most important cause for industrial sickness. According to the study conducted by the Reserve Bank of India, more than 50 percent among the sick units of large-scale industrial units are due to mismanagement, diversion of funds, lack of marketing strategy etc.

## **Rehabilitation of Sick Units**

Industrial sickness in India is taking alarming proportions and it is eroding the vitals of the economy and also obstructs industrial development. Hence, many measures are attempted to be implemented to set right the sick units. For purposes of rehabilitation, industrial sickness has been classified into three categories: (i) genuine sickness in spite of sincere efforts of the promoters, and factors beyond the control of the management. (ii) 'sickness at birth' due to faulty for the planning and conception and financially non-viable; nevertheless, brought to existence. (iii) induced sickness due to wrong policies and managerial incompetence.

Of these three types of sickness, only the first one deserves help for rehabilitation; the second and third should be allowed to die and do not deserve any consideration. Hence, financial institution must adopt a vigorous project appraisal before extending loans. They should satisfy that the project is fully viable.

## **Board of Industrial finance and Reconstruction**

Another important step in the rehabilitation of sick units is the passing of SICK INDUSTRIAL COMPANIES ACT in 1985 which provides the establishment of a board for the purpose. According to this act, a BOARD FOR INDUSTRIAL AND FINANCIAL RECONSTRUCTION (BIFR) was setup and it makes into existence on January 12,1987. According to this act, it has been made obligatory on the part of the management of the company board to a report sickness of the company to the BIFR. The BIFR has been given powers to decide, after investigation whether the company is sick or not and give reasonable time for the company with direction to mend itself. The BIFR has power to devise suitable measure like reconstruction of share capital, sale or leasing out of a part or the whole of an undertaking or its amalgamation or merger with the healthy unit. BIFR can even change the management of the sick company. The BIFR has power to propose relief measure by means of fiscal concession package of the revival of the unit and make it viable in the long term. It can also direct the financial institution not to extend any financial assistance if it is satisfied that a company is managing the affairs in a manner detrimental to the interest of the company. The BIFR has overriding the powers of all laws other than FERA and the urban land ceiling act, BIFR consists of seven members and the board's ruling can be applied only to three-member Appellate authority or the Supreme Court. Through the amendment of the sick industrial companies' act, the public sector enterprises were also brought with purview of BIFR.

## **Industrial Reconstruction Bank of India**

In order to provide a focal point to handle the task of rehabilitation of such units, the Industrial Reconstruction Corporation of India has been reconstituted as the INDUSTRIAL RECONSTRUCTION BANK OF INDIA(IRBI) on March 20, 1985.The IRBI is now the principal agency for the reconstruction and rehabilitation of sick industrial units. The approach towards rehabilitation is very selective and only potentially viable units are considered for rehabilitation.

## Goswami Committee Report

The Government of India appointed a committee on industrial sickness and corporate reconstructing in May 1993 under the chairmanship of Onkar Goswami. The committee was asked to examine the bottleneck in industrial and corporate reconstructing and to suggest suitable measures for early closure of unviable units and quick revival of viable units. The salient points raised in the reports are as follows:

- (i) According to the report, the inclusion of the condition “fully eroded net worth” in the definition of sickness under Sick Industrial Companies Act (SICA) does not allow for timely detection of sickness. The committee recommended a change in the definition of sickness to (a) default of 180 days or more on repayment to term lending institution; and (b) irregularities in cash credits or working capital for 180 days or more.
- (ii) The committee pointed out considerable delays in the BIFR process extending even to 2 years or more due to its quasi-judicial nature depending on consensus at almost all stages. These delays make the sick company difficult to turn around and rehabilitates. Hence, the committee recommended that BIFR should use the winding up provisions of the act more frequently to expedite the sale of economically and unviable units and also pose a threat to the parties concerned who may adopt delaying tactics.
- (iii) The committee, further recommended steps to reduce delays in winding units by setting up of five fast-track winding up tribunals, situated at Bombay, Calcutta, Madras, Delhi and Bangalore. These tribunals should examine only winding up cases and to that extent expedite the process.
- (iv) In order to recover corporate debts to secured creditors, the committee recommended the setting up of five recovery tribunals exclusively. These should only cover cases exceeding Rs 50 lakhs.
- (v) Presently under section 15(1) of SICA, it is mandatory for a sick firm to refer itself to BIFR. The committee recommended voluntary reference to BIFR i.e., the company should have an option of coming or not coming to BIFR. This recommendation is born out of the belief of the committee that many cases can be settled outside the board.
- (v) The committee further recommended that the industrial disputes act should be amended so that there is no need for seeking prior approval of the government for lay off and for permanent closure.

The recommendation of Goswami committee shows that the committee is in favour of liquidation of sick units rather than their rehabilitation. Such a shift in policy would have serious consequences on the economy as there are hundreds of sick units involving millions of rupees and lakhs of workers.

## Suggestions to cure and prevent industrial sickness

### 1. Proper project planning

- Location of project
- Availability of raw material
- Availability of Labour and Technical staff
- Availability of finance at reasonable rates

### 2. Paper Market Analysis

- Demand forecasting
- Study of opportunities and threats of environment
- Consumer tastes and preferences
- Availability on reliable distributors

### 3. Soft loans for sick units

### 4. Avoid over capitalization

## Conclusion

In a planned and underdeveloped labour surplus economy like India, industrial sickness can have serious consequences. The sick units may be attempted to be turned around through efficient management, change in top level executing a turnover strategy

*“Sickness is mankind’s greater defect”*

*“HEALTH IS NOT VALUED TILL SICKNESS COMES”*

