SOME ASPECTS OF INDUSTRIAL RECONSTRUCTION IN INDIA

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Dissertation submitted in partial fulfilment of
the requirements of the degree of
Master of Philosophy,
Jawaharlal Nehru University,
New Delhi.

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1986

I hereby affirm that the research for this dissertation titled "Some Aspects of Industrial Reconstruction in India" being submitted to the Jawaharlal Nehru University for the award of the Degree of Master of Philosophy was carried out entirely by me at the Centre for Development Studies, Trivandrum.

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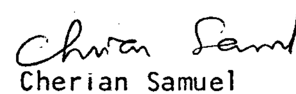

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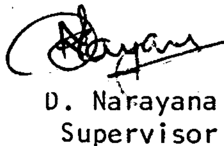

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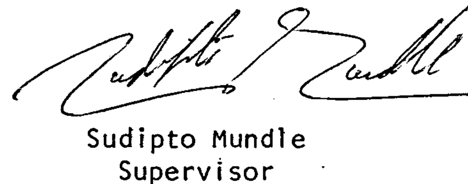

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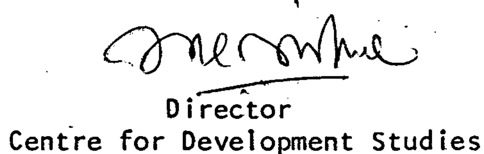

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ACKNOWLEDGEMENTS

My interest in industrial sickness began with the study that I undertook in 1981 for the Central Bank of India as part of the requirements for my Master's programme in Economics at BITS, Pilani. In the present study I could attempt a much wider canvas primarily due to the encouragement of Dr. K.N. Raj and Mr. Hiten Bhaya. Despite his very busy schedule, Mr. Bhaya was kind enough to discuss the issues and put me in touch with the people concerned. The study would have been impossible without the active cooperation of the management and staff at the Industrial Reconstruction Corporation of India (IRCI), United Bank of India, United Industrial Bank Limited at Calcutta and the Department of Industrial Reconstruction, Government of West Bengal.

I am deeply indebted to my supervisors D . Narayana and Sudipto Mundle for their unflinching standards and constant encouragement. N.C.B. Nath, Mridul Eapen and R. Nagaraj provided useful insights. My numerous friends at the Centre, specially Rita Mukherjee, Tirthankar Roy and Amit Mitra gave excellent support through difficult times. My thanks are also due to my present colleagues at ICRIER, New Delhi.

For secretarial assistance, I am grateful to Mr. J.S. Kondal, Ms. Meena Nangia at ICRIER and Mr. Suresh Chandran at CDS.

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Introduction and Approach

The deceleration in India's industrial growth since the middle of the 1960s is well-documented.[1] As firms are the micro units of growth or decline in the total industrial economy, a slow down in the latter is necessarily an outcome of the former; i.e. decline in the emergence of new firms, slow growth as well as mortality of existing firms. The immediate impact of the firm's decline is loss of output, dislocation of employment and wastage of capital all of which are of utmost significance in a developing country. These effects, in turn, can produce reactions in other firms and sectors and give rise to a decelerating tendency in the industrial economy as a whole.

In the present study, our endeavour is to understand the nature of firms in continuous decline in India - commonly termed as sick units[2] with focus on reconstruction strategies. Reconstruction strategies could be classified into two broad groups, (i) under the aegis of the 'state' and (ii) 'market' solutions. The basis for the distinction relates to the role of the state in management viz. direct or

indirect. In the present study we have considered six reconstruction strategies; under 'state' management, there are three: (a) appointing Board of Directors (b) take over of management by the central government under the Industries Development and Regulations (IDR) Act, 1956 and (c) management by Industrial Reconstruction Corporation of India (IRCI); under market solutions, we have considered (a) retention of old management (e) formation of industrial cooperatives by employees and (f) induction of new management. There are twelve case studies in all to illustrate the above strategies - six dealing with state managed reconstruction and six with market solutions. The thrust of each case-study is in three directions,(i) to assess the appropriateness of the revival strategy in relation to the causes for decline (ii) to identify problems under different revival strategies and (iii) to evaluate the outcome of reconstruction efforts with a view to arrive at policy prescriptions.

At this juncture, we may note that the strategies discussed herein are only illustrative and not exhaustive.[3/] This is primarily due to limitations of data. It is pertinent to note here that the data limitations have resulted in few studies on sick industries in India.[4/] The most comprehensive Indian study on the subject has been done by Dr.L.C. Gupta in 1980 for ICICI.[5/] This study is basically concerned with arriving at a set of statistically significant financial ratios which will aid in forewarning sickness and monitoring performance.[6/] The point of departure for our study is in taking up

individual case studies so as to examine the efficacy of alternate reconstruction strategies.

Edith Penrose (1959), in her seminal work on the growth of firms, identified three basic constraints on the firm's growth - (i) managerial ability, (ii) product or factor markets and (iii) uncertainty and risk. While (i) may be viewed as internal to the firm and (ii) as external to the firm, (iii) may be regarded as a combination of internal as well as external factors. On balance, Penrose concluded that, "Given other conditions, the fundamental limit to the productive capacity of a firm is within itself (viz. managerial abilities) rather than external demand and supply conditions". Likewise, the performance of the firm in crisis hinges crucially upon the quality/nature of managerial response.

Likewise, Marris (1964) saw growth of the firm as a managerial objective. He drew attention to marketing innovation and finance as key influences on the performance of the firm. He showed that the growth of the firm required investment in new products and marketing. Within this framework, decline of firms could be viewed as the antithesis to the growth process. The managerial theories of the firm, following Marris, have proceeded in this direction.

However, there does exist another school of thought which looks at decline per se; here there are at least three basic strands. The first approach is concerned with the analysis of industrial decline in

the developed countries following the global recession of the late seventies. The analysis is firmly rooted in international trade theory the issues discussed being shifting patterns of dynamic comparative advantage, role of new protectionism of the non-tariff variety etc.[7] The second approach is highly statistical in its scope; it uses Multi Discriminant Analysis (MDA) to identify the precise characteristics of declining firms vis-a-vis growing ones. Various financial ratios are analysed and a composite index arrived at - with a threshold value indicating the health of the firm.[8] The real usefulness of the approach relates to its predictive powers; expectations based on this play a crucial role in share price movements in the capital markets of the developed countries. The third approach is based on case-studies of declining firms at the micro-level to draw up lessons and come up with prescriptions for revival.[9] In the present study, we have followed this last approach.

Boswell's is one of the major studies in this approach. In his study on the rise and decline of 64 small firms in UK all employing less than 500 persons, Boswell (1973) found 28 (44%) of them to be in decline. At the outset, he makes the point that it is more difficult to explain decline than growth. Most of the declining firms belonged to industrial sectors that were declining or were under competitive pressures. All appeared to have serious management problems. As regards the causes of decline, market and technological factors and limitations of inheritor management were found to be the main ones; but the human factor appeared to be more important. Amongst older

firms, the incidence of decline was found to be greater. In the case of family run enterprises, problem of inheritance was common; business energies and abilities tended to drop after the first generation. Boswell found that external pressures and management problems came about together in the case of most of the firms in decline. In a number of cases, long-standing conservative management reigned concurrently with slowly eroding markets. In some firms, internal structures were weakening well before the external pressures came about; these provided the clearest cases of management responsibility for decline. The primary source for the external pressures was the maturing of the British economy in the throes of change, with some industries declining and others advancing.[10/] All of which puts a further premium on managerial abilities with reference to performance of the firm.

A dimension of managerial default, in the Indian context, relates to the question of deliberate mismanagement. Here, the nature of default was to divert funds from the firm in question to other avenues. The usual management policy here is to tie up purchase and sales to other sister concerns at high rates of commissions; over-invoicing of purchases and under-invoicing of sales is also resorted to.[11/]

In a capitalist economy, the decline of firms evoke three distinct responses viz. (i) merger with healthy firms, (ii) liquidation; in the case of multi-product firms, it may amount to

divestures of certain product lines, and (iii) support through concessional finance, protective tariff, etc. Though, (i) and (ii) are the usual responses, the last measure is resorted to in special cases, where the employment involved is large or the line of business strategic - as in steel making and ship building. As noted by Penrose, it may also be that in the case of large firms with extensive financial connections, the courts are prone to do everything possible to avert its failure as a going concern and it may operate for years in an insolvent ('failed') condition.[12/] We do recognise that this sort of support for ducks is really against the tenets of neo-classical theory, where the accent is on free mobility of capital in search of newer economic opportunities and more optimal use of society's resources.[13/] It is clear that the third response may lead to failure or success. The latter outcome is of special interest to us as the focus of the present study is on appraising reconstruction strategies.

Boswell's approach to revival (reconstruction) starts with recognition of the three basic strands in the literature viz. (i) decline cured by appropriate market forces and profit motives - also called the theory of adaptation (ii) analogy based on evolution wherein the cure for decline is provided by nature itself, in the Marshallian traditionalso termed the theory of extinction and (iii) revival brought about by persuasion and managerial revolution.[14/] While the theories of adaptation and extinction were found to be unreliable,

(iii) was useful only in a minority of cases. Over the long haul, most of the small firms were stuck/frozen; they were unable to either reform or sell out or wind up. This immobility among low-performance small firms - called congealment - was a serious problem amongst older ones, as also in cases where owner-managers were in charge.

In Boswell's original sample of 64 firms, there were 8 (13%) that were being revived. In all cases, the minimum gap between the onset of the crisis and revival was five years. Revivals were characterised by either one or all of three basic strategies; i.e. (i) rationalisation within an existing product strategy (ii) greater specialisation and (iii) diversification. Re-organisation, personnel changes and a shift to more vigorous marketing were found to be common for all cases. In some cases, revival in the first phase was marked by rationalisation of labour force.

As far as managerial conditions went, given the shortcomings of family management and the inheritor system that Boswell found in his sample, the following conditions were found to be conducive for revival (i) succession by a younger, more capable bunch of inheritors (ii) control by able newcomers, whether internally promoted or recruited from outside the firm and (iii) take over by new individuals. Boswell found that revival and progress were likely to emanate from professional managers, with outside experience than from internal promotees, who were often steeped in the stagnation of the firm. However, serious obstacles were present to recruit new management because of (a) unwillingness to recruit outside the firm (b) unattractiveness of old

declining firms to promising recruits and (c) the presence of established men at the top who could not be replaced, in view of their long service, share ownership or membership of the family. Finally, most of the declining firms could not reform themselves under the existing ownership.

Finance for expansion was often a problem. In general, firms practising long-term strategic planning, with abilities to anticipate rather than merely adapt to market changes did well. The need for more caution on the part of financial institutions in supplying funds was established. However, there was no evidence to suggest that declining firms were unjustifiably sustained by bank credit. Boswell observed that if it were that the old and declining firms were concentrated in depressed areas, so that the closure of firms would have serious social effects, the proper solution was industrial development and diversification, if necessary under public auspices, rather than indefinite propping up of declining private concerns. On balance, the prescription for the revival of declining firms was two fold viz. measures to deal with old firms and inheritance and encouragement of new entrepreneurship.

As far as the behaviour of the firm in crisis goes, the onus could be put on management, in the classic Penrosian fashion. At the same time, the limits to managerial action should be clearly recognised; specifically, if the causes for decline are primarily structural, management's leeway in remedial measures would be highly limited. The following indicators could be taken to reflect the state

of external environment facing the firms: (a) extent and nature of new firms emerging in the industry/region/economy, (b) additions to the list of 'sick'/declining firms (c) incidence of mortality/liquidation amongst existing firms and (d) conditions in the capital and stock markets. If those indicators move in unfavourable directions, we could characterise the environment as being 'adverse'.

Our analysis of the revival of firms should be seen against the above analytical pinnings.

The study is organised into five chapters. In the first chapter, we chart out the evolution of sickness in Indian industry. Starting with a descriptive account of the emergence of sickness in cotton textile industry first and then in the eastern region of the country - mainly in the engineering industry, we go on to establish the growing incidence and spreading nature of the problem. The evolution of reconstruction policy is presented in the second chapter. We identify the main instruments of policy and attempt a critical evaluation of the same. Chapter three is a collation of twelve case studies illustrating various reconstruction strategies. At one level, in Chapter three we are testing out the broad hypotheses formulated on the basis of the first two chapters. In chapter four, we attempt a critique of revival efforts basing ourselves on the cases discussed in chapter three. The conclusions of the study are presented in Chapter five.

Finally we may note the details about our sample and the under lying data-base used in the study. The selection of cases has been

primarily guided by the availability of data; the sample itself has been chosen from the portfolio of Industrial Reconstruction Corporation of India (IRCI) and the overnment of West Bengal. Within here, we have tried to capture the region specific and industry specific nature of sickness in the following fashion:

(i) All twelve units in our sample belong to the state of West Bengal, where the incidence of sickness is highest at the All-India level.

(ii) Out of the twelve units, eleven (91.7%) belong to the engineering industry which has the highest incidence of sickness in West Bengal and second highest at the All India level.

(iii) Nine units (75%) of our sample have received IRCI assistance

(iv) Six (50%) of our sample units belong to the SSI sector; interestingly enough, these are being reconstructed through strategies without state intervention in management, through market solutions.

Notes and References

1. See I.J. Ahluwalia (1985)

2. See Chapter 1 for a more rigorous definition

3. For example, we have not considered the highly successful practice of management contracts wherein successful, professional companies in public as well as private sectors take on ailing enterprises under their wings. The study does not consider the increasingly popular practice of merging sick companies with healthy companies following the promulgation of fiscal incentives for mergers of this kind by the central government since 1977. The study also does not include cases of nationalisation of sick companies by the state.

4. As per the secrecy clauses in the Indian Banking Act commercial banks and financial institutions are barred from divulging information about their borrowers.

5. See L.C. Gupta (1980)

6. Dr. Gupta categorically states that the ratio analysis is only a pointer to the causes for decline of an enterprise. According to him, only a thorough 'management audit would reveal the real reasons for sickness.

7. See Dyson and Wilks (1983)

8. The works of Bearer (1966), Altman (1982) and Delton (1974) belong to this genre.

9. Boswell (1973) is an excellent example of this approach.

10. Boswell (1973) op.cit.

11. As for example, noted in the case of cotton textiles by RBI in their study of 1977.

12. See Penrose (1959) op.cit. p.23. This is the closest approximation to the banker's view point on sickness that we come across in literature. (For others please see end of Chapter 1)

13. See K. Dyson & S. Wilks (1983)

14. Boswell (1973) op.cit.

Chapter 1

Emergence of Sickness in Indian Industry

In the present chapter, we chart out the spread of industrial sickness in the Indian economy in four sections. Section 1 makes a modest attempt at clarifying the notion of sickness. Section 2 discusses sickness in the cotton textile industry, Section 3 deals with the case of sickness in the West Bengal economy and Section 4 analyses the evidence on the spreading nature of sickness during the seventies and brings out the various dimensions of the problem.

Section 1

1. In the Indian context decline is known as 'sickness'. Sickness is synonymous with financial non-viability, i.e. the unit is unable to meet its cash requirements out of the proceeds of its output. In other words, 'sickness' is a case of continuous decline. It is widely accepted that financial viability itself consists of three interdependent elements of equal emphasis viz. profitability, liquidity and solvency; these may be represented by cash profit, net working capital and net worth respectively.

When two of these three parameters become negative, it is a case of incipient sickness and when all three are negative, the unit is termed as 'sick'.[1] We also note that financial viability is distinct from 'basic' viability. A firm could be basically viable, but financially non-viable for the time being, as is the usual case with sick units. But if a firm is basically non-viable, it will be financially non-viable too.[2] It is evident that the definitions are geared to the requirements of the financiers in question and the approach is basically commercial than economic.

2. The most widely used definition of sickness is the one formulated by the RBI in 1976 - "a sick unit is one which incurs cash loss for one year and in the judgement of the bank is likely to incur cash loss for the current year as well as for the following year and has an imbalance in its financial structure such as current ratio of less than one and worsening debt-equity ratio".[3] The additional element in this RBI formulation compared to the NCAER one is the explicit recognition of the role of banks in detecting sickness. By all counts, funding agencies like commercial banks and financial institutions are best positioned to pick out the initial signals of distress faced by a firm.

3. It is in this context that the soundness of the monitoring system for credit assumes crucial importance. Timely flow of information from the borrower to the lender is a must. Periods of crises are typically characterised by stretching of the accounts to their limits, request for reduced margins, excessive debit balances and finally stagnation in the

operation of the account itself. Periodic statements relating to stocks, receivables etc. would not be submitted. Dishonour of cheques drawn by the party is another sign. Accumulation of inventory, lack of turnover, issue of legal notices against the borrower, filing of suits by creditors and suppliers are other indicators in the short run. Dividend payments out of reserves, falling market share and high turnover of key management personnel are other pointers to the ensuing decline of the firm. In the case of firms listed on the stock exchange, sharp decline in share prices would follow.

4. The significance of these early warning signals lies in the fact that our approach to sickness hinges primarily on trends in ratios like cash profit, net working capital and networth, derived from the financial statements and firms become notoriously secretive and erratic with regard to submission of these financial statements when operations turn unfavourable. In fact, there is a school of thought which says that the 'cash loss' criterion is addressing the problem of sickness at a stage that is too late; earlier indicators of sickness can be and should be used.[4/] The advantage in taking recourse to these early warning signals is the leeway one gets in formulating an appropriate reconstruction package; above all, timely action holds the key in rehabilitation efforts.

5. At this juncture, we may note that the incidence as well as nature of sickness varies across firms of different size-classes, i.e. large, medium and small. By their very nature, SSI enterprises operate on very thin margins and hence their ability to survive a crisis is quite limited. In addition, most of these enterprises really hinge on the entrepreneurs - the classic one-man show affairs. The nature of the relationship

between large and small enterprises is another source of sickness; the various studies undertaken on sub-contracting relationships between large and small firms have clearly brought out the unequal nature of the exchanges. Specifically, there is the common problem of inordinate delays in the realisation of sales proceeds by SSI units from their larger counterparts leading to working capital problems.

If we were to take the position that births and deaths of firms are normal events in our economic system, sick industries become a serious problem in the following situations:

(i) Death rate(liquidation) of firms exceeding birth rate (new registrations) in an industry/region/economy in terms of number as well as investment

(ii) Large number of firms operating in one industry start declining (e.g. textile industry in India)

(iii) Large number of firms operating in a region start declining (e.g. West Bengal).

By these standards, the problem is indeed serious in the Indian economy the factors behind which are gone into in the remaining section of this chapter.[5]

Section 2

It is significant that sickness in India arose for the first time in her oldest organised industry, namely, textiles. This was

primarily due to lack of modernisation leading to technological obsolescence amongst majority of mills. Even during the period of the first plan, there were 150 "uneconomic" units in the industry.[6] The problems of the industry got compounded with the freezing of the weaving capacity (loomage) in the organised mill sector of the industry in 1954 following the recommendation of the Kanungo Committee. While this freeze helped in diversifying the industrial economy of the country, the textile industry itself suffered for want of resources for plough back and modernisation. While it is true that historically older companies help to set up new ones in the Indian case, this seems to have taken place at the expense of older companies.[7]

6. In the end, only a section of the textile industry modernised over the years so that the industry itself is marked by the co-existence of firms with widely varying levels of productivity and technical advances on the one hand and wide variations in financial performance on the other.[8] We get a feel of the problems faced by the industry when we look at the statistics relating to closures' in the industry.[9]

7. The industry's problems got accentuated since the mid-sixties, when the overall economy itself was showing signs of decline. We also note that except in 1966, more spinning mills remained closed than composite mills in any year - possibly due to the freeze on loomage. The other aspect of the structural change in the industry is the phenomenal growth of the power loom sector. Between 1951 and 1983, loomage in the mill sector grew

Table 1: Closure of Cotton Textile Mills

Year	Spinning	Composite	Total
1956	N.A.	N.A.	19
1961	N.A	N.A.	17
1966	9 (31.03)	20 (68.97)	29
1971	27 (51.92)	25 (48.08)	52
1972	18 (62.07)	11 (37.93)	29
1973	11 (78.57)	3 (21.43)	14
1974	4 (66.67)	2 (33.33)	6
1975	14 (77.78)	4 (22.23)	18
1976	24 (61.54)	15 (38.46)	39
1977	25 (65.79)	13 (34.21)	38
1978	16 (72.73)	6 (27.27)	22
1979	10 (76.92)	3 (23.08)	13
1980	11 (64.71)	6 (35.29)	17
1981	21 (56.76)	16 (43.34)	37

Source: "Industrial Sickness: The Challenge in Indian Textiles"(Ed) V. Padkai & V.Shanbag, ATIRA, Table XXI

Note : (a) Data refers to number of mills that remained closed at the end of the calender year.

(b) Figures in brackets are percentages of total

from 1,96,000 to 2,11,000, in handloom from 2,85,000 to 4,00,000 and in powerlooms from 24,000 to 6,00,000.[10/]

8. These shifts are further evident from the sectoral composition of output and changes therein. Of the 10,625 million metres of cloth produced in the country during 1982-83, about 3,450 million metres (32.5%) came from the mills, 3000 million metres (30.8%) from handlooms

and 3,900 million metres (36.7%) from powerlooms. As against this, out of a total output of 4,215 million metres of cloth in 1950-51, mill sector produced 340 million metres (80.7%) and decentralised sector 814 million metres (19.3%). One of the major problems faced by the industry is management deficiency as brought out by numerous investigations that have looked into the working of the industry. RBI (1977) for example, identified the following areas of managerial default. (i) indiscreet dividend policies; (ii) diversion of internally generated funds for other industrial activities; and (iii) failure to formulate a perspective plan for the modernisation of the industry. The study highlighted the lower tax incidence on textiles compared to other industries and showed the excessive dependence of the industry on external sources of finance.[11]

Section 3

1. In more than one sense, it was the dismal plight of enterprises in the eastern region in general and in West Bengal in particular since the mid-sixties that made sick industries a matter of national concern. To start with, we may briefly note some of the prominent feature of the West Bengal economy prior to the decline. At the dawn of independence, West Bengal was the premier industrialised State in the country with the firms catering mainly to export markets - like jute - and public sector demand - like railway wagon-making and ship building. The industrial

struc re was very closely knit in terms of linkages between inputs and outputs, for example, steel and heavy engineering or coal and transport equipment. Domination by multinational corporations (MNCs) and large business houses (LBH) was another feature of the state economy; the shackles put on MNCs and LBHs since the beginning of our planning endeavours naturally slowed down the state's industrial growth.[12] There is a view point that the LBHs and MNCs did not re-invest their profits in the state but instead remitted them abroad or set up industries in other states or promoted lavish life styles. Little was done to counteract the obsolescence of industries like jute and engineering by way of R&D and market development.[13] While jute industry lost out in the export market to its synthetic substitutes, the engineering industry languished due to the slow-down in public sector investment in the economy since the middle of the sixties. While this cut emanated from the overall resource crunch faced by the economy, its outcome was a marked deceleration in industrial growth. The closely knit nature of the state's industrial economy meant that crisis in one sector got quickly translated into others.

2. Simultaneously, there was a marked decline in the fortunes of old colonial firms in the country and many changed hands.[14] The fact that most of these were based in West Bengal added to the problems of the state's industry.[15] In this transitional phase, a new breed of entrepreneurs who had been associated with the colonial firms in some way or the other, came to the fore. Most of them had a long tradition in trading activities where the accent is really on short-term profits.

As opposed to this, the fundamental ethos for a manufacturing process is the commitment to long-term profits and proper maintenance of production facilities. Lacking these ethos, the entrepreneurs took to flogging the enterprises in the short-run for quick gains. The upshot of all this was the persistent decline of the state economy since 1965.

Table 2: Index of Industrial Production in West Bengal and All-India (1963 = 100)

Year	West Bengal	All India
1964	106.6	108.6
1965	112.8	118.6
1966	104.8	117.7
1967	103.1	116.7
1968	104.3	124.2
1969	99.3	133.0
1970	94.2	139.3
1971	95.2	143.6
1972	97.9	153.9
1973	96.9	152.2

Source: Economic Review, Government of West Bengal, Various Issues.

3. It is evident that while the recession at the All-India level lifted since 1968, West Bengal continued on its steep decline. This came about on the one hand due to the continuing ailing of existing units and on the other hand due to slowdown in the emergence of new firms lack of new investment. We may recall that, about this time,

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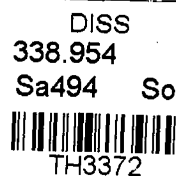
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i.e. during the course of the third five year plan - there was a marked shift away from heavy industries and towards industries based on petrochemicals and fertilisers at the national level. These structural factors proved binding in that the State economy was unable to shift into the new non-traditional industries based on foreign know-how, which came to be located in the eastern region of the country, principally, in Maharashtra.[16] Likewise, between 1965-1968, West Bengal received only 192 industrial licenses against Maharashtra's 409.[17]

4. The sharpest decline in performance came about in the engineering industry in general and railway wagon-making in particular - sectors that were crucially dependent on public sector demand.[18] It is interesting to note that, more than any other sector, the engineering industry in the state was subject to constraints that have been identified as having led to stagnation in the overall economy. Cutback in public sector investment and bottlenecks in infrastructure were perhaps the most important of these constraints. In addition, freight equalisation in respect of iron and steel from 1956 and the introduction of telescopic freight for the movement of coal by rail took away some of the locational advantages of the industry in the region. Shortages of steel, non-ferrous metals and the severe drought in agriculture compounded the problems of the industry.[19]

5. It is instructive to look at the railway wagon-making industry more clearly as it was regarded as a sort of 'mother' industry, in the state. It is the classic illustration of the hazards involved for an

industry dependent on a single powerful client. In the sixties, there were 16 firms in the industry - twelve of these were in West Bengal - with an annual capacity of 40,000 Four Wheeler Units (FWU). Capacity of this order was built up on the expectation of a large turnover of freight which did not materialise. Since wagon manufacture is primarily fabirication work with a low technology content and highly labour intensity with high ancillarisation any decline in wagon manufacturing causes a chain reaction.

6. Following the general paucity of resources in the overall economy, Railways drastically pruned their off-take of wagons. The orders declined from 26,280 FWU in 1964 to 20,704 FWU in 1966, 8,438 FWU in 1970 and 5,768 FWU in 1972; in 1974, it picked up to 16,903 FWU before declining to 10,050 FWU in 1980.[20] The placement of even these reduced orders were delayed by Railways as were the free supply-items like wheel sets, couplings and leaf springs. The non-availability of matching steel from Durgapur Steel plant added to the woes of the industry. Though the manufacturers tried to tide over the recession in the domestic market by undertaking exports, it turned out to be unremunerative in the absence of price-escalation clauses. In the end, only four firms in the industry could weather the crisis successfully; significantly these were multi-product firms diversified into related areas. The ailing undertakings have been finally nationalised by the central government so that the largest chunk of the capacity of the industry has come within the fold of the public sector. The firms have also diversified into other fields now in order to reduce their dependence on wagon-making.

7. The fall-out of this economic recession was the increasing incidence of closures - temporary as well as permanent-of industrial undertakings in the state. The process was abetted by the massive backlash of labour action in the wake of sudden, large-scale unemployment following closure of units due to recession, aided to some extent by the political changes in the state. In any case, reasons for the stagnation of the state economy are primarily structural rather than pertaining to labour.[21] Of the 399 permanent closures involving 29,965 people that took place in the state between 1967 and 1973, 212 (53.1%) units employing 17,239 (57.5%) people closed down for economic reasons; 96 (24.1%) units with 5,387 (18%) people closed for miscellaneous reasons while only 91 (22.8%) units employing 7,339 (24.5%) people were closed on account of labour trouble.[22] It is also significant to note that a large number of these units continued to remain closed during the seventies even as the political conditions changed and labour unrest ceased. As we shall see in the next chapter, it was this spate of continuing closures that led to the amendment of the Industries Development and Regulation Act, which empowered the central government to take over the management of erring private sector units and the founding of the Industrial Reconstruction Corporation of India (IRCI).

8. One aspect of the sick industry problem in the state was its acute incidence amongst small scale units. The tradition of large heavy engineering firms fostering the growth of ancillaries and SSI units led to the transmission of sickness to the latter. Most of the

SSI units were engaged in structural foundries, machinery and parts making, sheet-metal and job-work with wagons, structurals, railways, buckets, washers, cocks, valves and pipes as their main market. It is significant to note that of the 150 closed units examined by the enquiry committee on sick units 90 (60%) units belonged to the SSI category; also 64 (85%) units out of a total of 75 sick units belonged to this category. Labour trouble, financial stringency, lack of orders and scarcity of raw materials were found to be the fundamental factors behind the decline of these firms. Imbalance in the financial frame was found to be a common feature with the loan capital being four or fice times the equity capital; this came about since the borrowed capital did not produce the expected returns.

9. If we were to look at the trends in capital market in the eastern region between 1976 and 1982, we find that investment activity has been sluggish; the capital issues that were made, were towards FERA dilution or for diverting funds from manufacturing to investment and trading activities.[23/] The industry-wise percentage distribution of the total Rs.162.08 crores raised through 635 new issues during the period was as follows: investment - 40; engineering, steel, drugs and chemicals - 18.8; textiles - 3; plantation - 9.9; trading and others 28.6[24/]

10. Now it is evident that the structural maladies in the state economy underlined above never got remedied. The imbalance in the

industrial structure of the state has remained - viz. concentration in engineering, jute and tea and lack of diversification into chemicals, electronics, etc. Our attempt at understanding the efficacy of reconstruction strategies through the case studies of sick units in the state should be seen against the above perspectives.

Section 4

1. The seventies witnessed a steady increase in the number of sick units and its spread across all industries and all states. The units which had fallen sick earlier were neither liquidated nor were they recovering as is evident from Table 3. The problem is concentrated in engineering and textile industries; they together accounted for 65% of the total amount in 1976 though the share dropped to 56% in 1982. Looking at trends in shares across industries over the seven-year period, we find that while it declined in the case of engineering, jute and cement, it has moved up in textiles, chemicals, sugar and rubber. The emergence of cotton textiles as the most sick industry in 1982 is a matter of serious concern when we note that figures are exclusive of 125 sick mills under NTC's fold.[25] The one-year long strike during 1980-81 has clearly added to the problems of the industry.

2. Of the total additional amount of Rs.1120 crores locked up in sick units during the seven-year period, cotton textiles accounted for 33%. We have earlier noted that the problems of the industry are

Table 3: Percentage Distribution of Bank Credit Among Medium and Large Sick Units-Industry-wise

Period	Engineering, Electricals, Iron & Steel	Textile	Jute	Chemicals	Sugar	Rubber	Cement	Others	Total
(a) December 1976	39.6	24.8	9.2	6.6	3.0	2.9	2.2	11.8	100.0
(b) June 1982	28.6	30.1	6.4	10.6	8.6	5.8	0.01	9.3	100.0
(c) Changes between December 1976 and June 1982	22.6	33.0	4.9	12.7	11.6	7.9	0.1	7.9	100.0
(d) Compound Growth Rate: 1976 to 1982	10.8	19.3	10.2	24.2	35.1	28.4	-1.4	12.2	16.1

Source: Report on Currency and Finance, various issues

Notes : 1. Figures for textiles do not include mills under the National Textile Corporation which has been the holding company for all sick textile mills since 1974

2. In December 1976, these were 241 sick units with Rs.608.75 crores in them. By June 1982, the figures came up to 439 units with Rs.1,728.40 crores in them.

basically structural which, as we see later, the reconstruction policy has not addressed at all. The spreading nature of the problem becomes clear when we look at the changes over the seven year period. Sugar, rubber, chemicals and textiles in that order have recorded growth rates of incidence above the All-India average. The high growth rates in sugar, rubber and chemicals is also due to their low base in 1976, though the relative share too has moved up during the period. Improved performance has led to declining shares in jute and engineering. In the case of engineering, the drop in share is also on account of the spate of nationalisation of sick units, mostly from the eastern region of the country. It is significant that sickness in cement industry has abated following the introduction of dual pricing since 1982. A quick look at the changes in output between 1976 and 1982 in the case of sugar, rubber, chemicals and textiles industries with greater than average rate in the incidence of sickness - point to rather high growth in output: in the case of sugar, production rose from 46,53,000 tonnes in 1976 to 8,452,000 tonnes in 1982.[26/] In the case of rubber, index number of industrial production (Base: 1970 = 100) rose from 121.7 in 1976 to 157.5 in 1982; for chemicals, it was 155.4 and 218.1 respectively in 1976 and 1982.[27/] This suggests that the incidence of sickness in these industries increased even as their overall performance improved. This leads to the plausible conclusion that the rising incidence of sickness in these industries is more due to firm-level factors than industry specific ones. In other words, the problem appears to be really one of sick units than sick industries.

3. In Table 4, we have presented the state-wise incidence of sickness which reinforces our arguments regarding its spreading nature; this is valid for large and medium units as well as small-scale ones. We note that the incidence of sickness is higher amongst states with a longer tradition and bigger base in industry; this is specially the case in 1976. During the seven year period, the combined share of the top four States, viz. West Bengal, Maharashtra, Tamil Nadu and Gujarat, fell from 80% in 1976 to 66% in 1982. Within this four, the combined share of the top two States, viz. West Bengal and Maharashtra fell from 58% in 1976 to 45% in 1982. In contrast, shares of U.P. Karnataka, Kerala and M.P. have moved up during this period. Their combined share rose from 9% in 1976 to 25% in 1982.

4. The spreading nature of the problem seems to be more marked in the case of SSI units. Between 1979 and 1982, the combined share of West Bengal and Maharashtra declined from 47% to 29% in fact, they accounted for only 20% of the incremental number of sick SSI units during the period. On the other hand, the combined share of Tamil Nadu, U.P. and Karnataka rose from 15% in 1979 to 33% in 1982; they also accounted for 42% of the changes in the number of sick SSI units during the seven year period.

5. The specifics of this spreading nature of sickness is brought out in Table 5. For West Bengal, increased incidence of sickness during the seven year period took place mainly in engineering, jute and rubber

Table 4: Trend in Industrial Sickness State-wise

(Percentages)

No.	State	Large and Medium Units				Small Scale Units			
		Dcember 1976	June 1982	Changes December 1976 to June 1982	Compund Growth Rate 1976-82	December 1979	December 1982	Changes December 1979 to December 1982	Compound Growth Rate 1979-82
	1	2	3	4	5	6	7	8	9
1	Maharashtra	23.8	20.7	18.9	13.7	13.3	10.1	8.3	20.8
2	West Bengal	33.8	24.7	19.8	11.0	33.3	19.1	11.3	12.7
3	Tamil Nadu	14.4	12.5	11.4	13.7	4.6	13.9	19.0	70.7
4	Gujarat	8.0	7.7	7.5	15.3	4.1	4.4	4.5	31.6
5	Uttar Pradesh	3.5	10.7	14.6	35.9	5.5	11.6	14.9	55.9
6	Andhra Pradesh	2.1	1.8	1.7	13.6	6.4	7.8	8.6	36.2
7	Bihar	2.5	2.3	2.2	15.1	3.9	4.3	4.5	32.5
8	Madhya Pradesh	2.0	2.5	2.8	19.7	2.5	2.0	1.8	23.1
9	Rajasthan	3.0	2.0	1.5	9.9	1.6	1.2	0.8	19.9
10	Karnataka	2.5	7.5	10.2	36.2	5.0	7.0	8.1	40.8
11	Kerala	1.1	4.3	6.0	40.9	3.1	2.1	1.6	17.6
12	Orissa	1.8	1.1	0.7	8.0	3.7	2.5	1.8	16.9
13	Others	1.6	2.3	2.8	22.4	13.1	14.2	14.7	32.0
14	Total	100.0	100.0	100.0	16.1	100.0	100.0	100.0	29.5

Source: (i) Data for large & medium units taken from Report on Currency and Finance, Various Issues.
(ii) Data for SSI units based on Answers in Parliament on 23-1-1985

Notes: (i) Data for large & medium units relates to the amount of outstanding bank credit to them. In June 1982, there were 439 units involving Rs.1728.40 crores, it was 241 units, with Rs.608.75 crores in December 1976.
(ii) Data for SSI units relate to number of units. On December 1979, there 20,840 SSI units; the figure rose to 58.549 by December 1982.

Table 5: Nature of Sickness in the Top Six States

(Percentages)

Sl. No.	State		Iron&Steel	Textiles	Jute	Chemicals	Sugar	Rubber	Cement	Others	Total
	1		2	3	4	5	6	7	8	9	10
1	West Bengal	a	56.5	1.3	24.5	0.9	0.6	4.2	-	12.0	100.0
		b	48.2	4.5	25.3	2.9	0.5	6.2	-	12.4	100.0
		c	40.5	7.6	26.1	4.8	-	18.1	-	12.7	100.0
2	Maharashtra	a	38.8	47.9	-	2.8	0.7	3.6	-	6.2	100.0
		b	31.3	60.2	-	0.8	0.3	1.7	-	5.8	100.0
		c	26.1	68.7	-	-0.01	-	-	-	5.5	100.0
3	Tamil Nadu	a	19.6	33.7	-	30.9	1.4	4.1	0.5	9.7	100.0
		b	6.5	33.6	-	48.7	4.9	-	-	6.2	100.0
		c	-2.5	33.5	-	60.9	7.3	-2.8	-	3.9	100.0
4	Uttar Pradesh	a	30.1	16.4	0.3	-	39.8	-	-	13.4	100.0
		b	17.0	32.5	-	-	42.1	-	-	8.4	100.0
		c	15.3	34.7	0.0	-	42.4	-	-	7.7	100.0
5	Gujarat	a	29.2	65.6	-	4.2	-	-	-	1.0	100.0
		b	28.1	67.4	-	-	-	-	-	4.6	100.0
		c	27.4	68.4	-	-2.5	-	-	-	6.7	100.0
6	Karnataka	a	47.9	-	-	31.4	21.0	-	-	-	100.0
		b	18.4	2.1	-	31.4	34.9	9.9	-	3.3	100.0
		c	14.5	2.4	-	31.5	36.7	11.1	-	3.9	100.0

Source: Report on currency and Finance, Various Issues

Notes: (i) a indicates percentage distribution of outstanding bank credit in medium and large scale sick units in 1976

(ii) b indicates percentage distribution of outstanding bank credit in medium and large scale units in 1982

(iii) c indicates the percentage distribution of changes in the amount of credit locked up in sick units between 1976 and 1982.

industries. One reason for the ailing of the engineering industry is the failure of the twenty mini-steel plants set up in the state during the seventies due to power shortage. Though we notice a decline in the share of engineering industry in 1982, along with jute it still accounted for about 74% of the bank credit locked up in sick units belonging to the state. In the case of Maharashtra, textiles accounted for as much as 69% of the increased incidence and together with engineering industry, 95% of the increased incidence during the period. The textile strike of 1981 has definitely contributed to this trend. Similarly, textiles accounted for 68% of the increased incidence of sickness in Gujarat; the combined share for the state comes upto 96% when we add engineering to textiles. Textiles also accounted for 34% of the increased incidence in Tamil Nadu; however, it is the 61% incremental share of chemicals that makes the State different from others.[28] Combined share of textiles and chemicals works out to 94% of the total changes in incidence for Tamil Nadu over the seven-year period. We also note the decline in sickness of engineering and rubber industries in the state. The ailing of chemical and sugar units is a feature in Karnataka too; they accounted for 68% of the increased incidence in sickness over the seven-year period. The drastic decline in the share of engineering and the rise in share of rubber is also notable in the case of Karnataka. Sugar is the most problematic industry in U.P.; together with textiles, it accounted for 77% of the increased incidence in sickness during the seven-year period. In contrast, the share of engineering industry has declined in the state. On the basis of the above evidence, we may conclude that the increased

incidence of industrial sickness during the 70s is closely linked to its spreading nature. Though concentration of sick units in order and mature industries in states with a long-tradition of industrialisation is still evident sick units in newer industries located in states with a much shorter grounding in industrialisation seems to be the emerging trend.[29/]

6. A quantitative picture of sickness in terms of bank credit is presented in Table 6. It may be seen that the rise in incidence has been the sharpest in the case of SSI units. In all the three cases of medium cases of medium and large. SSI and IRCI aided units the amount involved has risen at a much faster rate than the number of units. If we were to consolidate the portfolio of AIFIS as well for 1982, the total number of sick units in the economy comes up to 27,809 with Rs.2830.72 crores involved in them.[30/]

7. A better way of looking at the magnitude of the sickness problem in the economy is to see it in relation to the amount of bank credit outstanding. Ideally, we would have liked to compute the amount locked up in medium and large sick units as a proportion of outstanding bank credit to medium and large enterprises in the private corporate sector, industry-wise and state-wise. In the absence of this, we have attempted some estimates which are presented in Table 7.[31/] On an average, about one-fifth of total bank credit to the private corporate sector is locked up in sick units belonging to the medium and large category, i.e. enjoying credit limits of Rs.1 crore and above. It is possible that this proportion

Table 6: Credit to Sick Units (Rs. Crores), 1982-83

Sl. No.	Period	Bank Credit: Medium and Large No.	Bank Credit: Medium and Large Amount	Bank Credit: SSI No.	Bank Credit: SSI Amount	IRCI funds No.	IRCI funds Amount	Total No.	Total Amount
1	2	3	4	5	6	7	8	9	10
1	June 1979	345	1101.72	16805	181.71	91	55.88	17241	1339.31
2	June 1980	389	1232.70	22325	292.8	92	69.87	22806	1595.37
3	June 1981	422	1453.29	22360	321.52	96	90.36	22878	1865.17
4	June 1982	439	1728.40	26973	393.67	122	119.26	27534	2241.33
5	Compound Growth Rate: June 1979 to June 1982(%)	6.2	11.9	12.6	21.3	7.6	20.9	12.4	13.7

Source: (i) Report on currency Finance, Various issues

(ii) Annual Report of IRCI 1982-83

Table 7: Estimates of Sickness in relation to Total Bank Credit

(Percentages)

Sl. No.	Category	June 1976	June 1977	June 1978	June 1979	June 1980	June 1981	June 1982	Average of 3 to 9
1	2	3	4	5	6	7	8	9	10
1	A	17.7	22.6	20.6	20.9	21.9	22.0	25.0	21.8
2	B	13.8	17.8	16.1	16.0	16.5	16.4	18.6	16.5
3	C	14.1	19.1	18.5	18.5	17.4	N.A	N.A	17.5
4	D	12.3	16.5	13.6	15.6	15.7	N.A	N.A	14.7

Source: Computed from data in Report on Currency and Finance, various issues

Note : 1. Category A indicates the amount involved in sick units as percentage of total advances of all scheduled banks to medium and large units in the private sector.

2. Category B is similar to A, except that bank credit to SSI units are also included.

3. Category C indicates the amount in sick units as percentage of total advances of nationalised banks to medium and large industrial units.

4. Category D is similar to C, except that advances of non-nationalised, scheduled banks are also included.

could come up to one-fourth if we were to include sick units in the SSI sector; this we are unable to do on account of paucity of data., In any case, the evidence does indicate the dire threat to the very viability of the Indian banking system, if the present trends in sickness are allowed to persit.

8. Finally, we look at the industry-wise incidence of sickness in the portfolio of nationalised banks based on the outstanding working capital limits (Table 8). Since the data on term loans is not available

Table 8: Sickness in relation to Bank Credit - Industry-wise

Percentages

Sl. No.	Industry	December 1976	June 1982
1	2	3	4
1	Engineering, Electricals Iron and Steel	17.5	26.4
2	Textiles	25.2	49.4
3	Jute	52.7	66.5
4	Chemicals	7.5	18.4
5	Sugar	11.4	61.8
6	Rubber	15.0	38.0
7	Cement	23.8	10.7
8	Others	5.8	4.3
9	All Industry	13.8	18.6

Source: Report on Currency and Finance, various issues.

Note : Figures for textiles are exclusive of NTC mills.

to us, the proportions worked out are on the higher side.[32] As observed earlier, and as is reinforced by the evidence of Table 8, sickness has been

on the increase during the seven-year period in all industries except cement and others. The continued ailing of textile and engineering industry is borne out once again as is the spreading nature of sickness itself, exemplified by the sharp movements in the case of sugar, rubber and chemicals. It is indeed alarming that about half of the total working capital advances to textiles and nearly two-thirds of advances in sugar and jute are locked up in sick units.

9. Thus, in the traditional industries like engineering, textiles and jute either more firms are falling sick every year due to structural reasons or firms are continuing to stay sick. The latter appears more plausible as reconstruction efforts have failed in general. One pointer here is the extension of the take-over period for practically all the units whose managements have been taken over under the IDR Act of 1951. In fact, the maximum period of take-over itself has been revised from five to seventeen years. Similarly, the maximum period of granting relief status has been revised from seven to fifteen years.[33/] The other hypothesis about the growing incidence of sickness and its spreading nature being more due to firm-level factors than industry-level ones appears valid when we look at the increasing recourse to management take-overs under IDR Act of 1951.[34/] The deficiencies in the credit-follow-up and monitoring systems of commercial banks and financial institutions have naturally added to the problem. In particular, the institution of nominees directors had proved ineffective in checking the misuse of public funds. One reason here is that though the lead institution concept

has emerged with response to consortium financing, it is yet to take effect in the realm of monitoring.

10. In sum, the problem of sickness in the Indian context seems to be one of firms rather than industries. Over the years, investments have clearly moved away from older industries to newer ones and here too entrepreneurial behaviour has varied markedly vis-a-vis original line of business. While some firms have retained old business and diversified into newer ones by adopting a multi-divisional structure, others have let the old lines decline in the absence of re-investment and technological upgradation.[35/] The latter course has been easy too in the absence of deterrents to managerial defaults. The fact is that, older lines of business come to assume lesser importance in the entrepreneur's scheme of things over time. Unless new enterpreneurs emerge to take them over - as seems to be the case in jute industry in recent times - these are bound to languish. We also noted how the entrepreneurial stake diminishes in the case of declining firms and how the onus of reconstruction comes to rest squarely with the state. This then really becomes the context for the sickness problem in India.

Notes and References

1. See NCAER (1979) for details. For example, Supreme Court of India took recourse to this definition in 1983 to uphold the merger of International Tractors India Ltd., a sick unit, with the profitable Mahindra and Mahindra, under Section 72-A of the Income Tax Act, 1977.

2. If the firm is able to break-even, it is considered as being 'basically' viable; if it earns cash profit as well, it is financially viable too. In the case of sick units, the latter is not common, because of the past laibilities.

3. The basis for the number of years is not clear and hence would appear to be arbitrary. It is clear that if this definition is rigidly applied, many of the new units would be classified as sick. In the case of SSI units, the extent of erosion in net worth is also considered in addition to cash loss; if the erosion is more than 25%, the unit is termed 'sick'.

4. For example by recourse through the ratios identified by L.C.Gupta (1982).

5. In the present study we start with firms that have been classified sick by their financiers for a long period of time; to that extent we do not test the efficacy of statistical measures available in the literature to verify health. Whatever is done by us in this regard is really incidental to our primary concern, about appraising reconstruction strategies. Our handling and analysis of the data should be seen from this perspective.

6. This is as given in the Annual Report of the Industry Ministry. Presumably, the reference is to units incurring perennial losses.

7. R.K. Hazari (1966) for example found that the funds of old established companies were being used for the promotion of new ones.

8. C.P. Chandra Sekhar (1984) for details.

9. The table presents the number of mills that remained closed at the end of the calendar year. These closures may be temporary or permanent; the former normally is the outcome of industrial strife while the latter is primarily due to economic causes. Further, we could argue that industrial strife is again rooted in economic factors so that all closures stem necessarily from declining fortunes faced by the firm. It is often the case that managements choose to close the unit when the financial resources dry up for a declining firm.

10. "Cotton Textiles in a Trauma", Hindu Editorial, 22nd January, 1984

11. "Textiles: Self-made Crisis" Economic and Political Weekly 21st May, 1977.

12. It is worth noting that of the twenty LBHs examined by the Dutt Committee on Industrial licensing, twelve belonged to the eastern region, mostly West Bengal.

13. A Review of Industrial Growth in West Bengal, Commerce and Industries Department, Government of West Bengal, March 1978.

14. These colonial firms are distinct from MNCS in that they were incorporated in India as sterling companies by British entrepreneurs

15. B.R. Tomlinson (1981) analyses the reasons for the decline of colonial firms through a case-study of Bird-Heilgers. He found two plausible hypotheses for the decline: (i) colonial firms underwent a process of planned/forced retreat due to political changes leading to expectations of a worsening relationship with a national government and (ii) colonial firms suffered a natural process of decline due to overcommitment in unprofitable sectors. However, neither of them could be found as conclusive.

16. The region-wise break-up of number of approved foreign collaborations during this period is as follows:

Region	1964	1965	1966	1967	1968
Eastern India	83(20.5)	48(19.8)	36(17.8)	31(16.9)	29(22.0)
Western India	191(47.2)	124(51.2)	84(41.6)	83(45.4)	56(42.4)
Total	405	242	202	183	132

Note: Figures in brackets are as percentage of total

Source : Report of the Enquiry Committee on Closed & Sick Industries, 1969-70, Government of West Bengal pp.14.

17. See Enquiry Committee, op.cit. pp.14

18. If we compute the share of railway rolling stock in the total value added in the large-scale sector of the state economy it reads as follows:
(Rs.Crores)

1959	1962	1964	1965	1968	1970	1971
14.3	17.1	22.3	16.2	11.4	8.0	15.2

These are based on Table 8 A in Debdas Banerjee (1982)

19. The drought in agriculture affected the supply of agricultural raw materials for industry and the demand for industrial goods by the agricultural sector. See Deb Kumar Bose (1976). Bsed on D. Banerjee's calculations, we see that share of engineering industry in the total value added in the State fell from 34.8% in 1964 to 25.2% in 1968 and 23.6% in 1971.

20. Source: Directorate of Economics and Statistics, Government of West Bengal, 1983.

21. Debdas Banerjee (1983) for example, identifies the following structural changes, (i) growth of medium scale units compared to large units, (ii) growth of production in favour of elitist consumption.

22. See Labour in West Bengal, Government of West Bengal, 1973.

23. A. Avadhani (1984) pp.43-46.

24. Avadhani (1984), op.cit.

25. It is possible that if the SSI units were to be considered, engineering industry could turn out to be the most sick; this cannot be collaborated in the absence of hard evidence.

26. Report on Currency and Finance, RBI, various issues.

27. Economic Survey, GOI, 1983-84.

28. This could be due to the initial teething problems of giant fertiliser corporation in the state viz. Southern Petrochemicals Industries Corporation.

29. Amongst others, this could be due to the fact that newer industries came to be located in less industrialised areas of the country.

30. In 1982, there were 275 sick units under the portfolio of AIFIS with Rs.601 crores (principal only). See Development Banking of India, IDBI, 1982-83.

31. Our rationale for the categories of A,B,C,D, are primarily based on the form in which the data is available.

32. The other implicit assumption behind the exercise is that working capital limits are fully utilised.

33. Granting of relief status implies that the liabilities of a unit prior to take-over of management stands frozen in the sense that the unit can't be taken into liquidation by any of its past creditors, secured as well as unsecured.

34. At the end of March, 1982, there were 55 units whose managements had been taken over under the IDR Act.

35. The former path seems to be typical of firms in the jute industry - for example, Birla Jute is more of a cement company now than a jute company - while the latter course is seen in cotton textiles.

Chapter 2

Evolution of Reconstruction Policy

In this chapter, we make a detailed analysis of reconstruction policy as it has evolved in the Indian context. We do this in four sections. Section 1 examines some of the conceptual issues involved. Section 2 looks at the IDR framework for taking over management. In Section 3 we look at the institution of IRCI and its performance. Section 4 appraises other strategies like concessional finance for modernisation, tax concessions for merger, etc.

Section 1

1. The appropriateness of reconstruction policy depends on the proper identification of factors leading to the decline in the first place. In particular, decline arising out of firm-level factors i.e. a loss of relative competitiveness - has to be remedied through measures targetted at individual firms while decline due to external factors - i.e. a loss of absolute competitiveness - can be arrested only by structural adjustments at the level of industry/region, as the case may be.[1/] In our framework

laid out in Chapter 1, the spreading nature of sickness during the seventies calls for firm-level solutions. Measures like management take-over under IDR Act of 1951, nationalisation, tax concessions for merger of sick units with healthy units under Section 72A of IT Act 1977, etc. belong to this category. On the other hand, the continuing ailing of traditional or mature industries like textiles, jute and engineering requires industry-wide strategies. Providing concessional finance for modernisation, allowing recession-prone industries to diversify into selected sectors[2/] etc. belong to this genre.

2. We can also distinguish between two sorts of reconstruction strategies viz., preventive and curative, based on the timing of the measure. Appointment of directors under provisions of Section 408 of Companies Act to check mismanagement, concessional finance for modernisation through the soft loan scheme are some examples of preventive strategies. Institutionalisation of reconstruction through IRCI, granting of financial reliefs etc. belong to the curative category of reconstruction strategies.

3. Given the dominant role of the state in India's mixed economy and given the nature of industrial sickness, we have opted for the following classification of reconstruction strategies viz. state-managed and non-state managed. Wherever the state assumes management, control, directly as under IDR Act or indirectly as under the aegis of the the financiers i.e. AIFIs and banks we term it as state-managed

reconstruction. All others are classified non-state managed ones. It is true that the distinction is not really water-tight; the real test is the nature of control. During the course of our study, we attempt a critical evaluation of these two varieties of strategies through our case-studies. In particular, we look at the appropriateness of reconstruction methods in relation to causes for decline.

Section 2

1. IDR Act of 1951 provides statutory measures to deal with the problem of failing corporate health that is not warranted by prevalent conditions in the industry.3/ The original enactment did not provide for take-over of management by the central government 4/; the amendment of 1953 - new Chapter III A enabled the government to do so following an enquiry and entrust the unit to an Authorised Person which replaces Board of Directors (BOD). Subsequent to this, the operation of the Companies Act for these units ceases. The BOD is usually replaced by a Board of Management (BOM). The Authorised Person could be a single individual/IRCI/Corporation (private/public) which appoints a BOM or a Chief Executive to run the firm on its behalf. In the wake of continuing closure of industrial units in the eastern region of the country during the seventies, the Act was further amended in 1977 - Chapter III AA was inserted with the following additional powers to the central government: (i) take-over of management without investigation,

(ii) take over of managements of units lying closed for a period of three months or more and (iii) take over of managements of units in liquidation directly or following an investigation. The take-over period is initially five years; since 1974, the maximum take-over period has been raised from ten years to seventeen years. At one level, this extension itself reflects the failure of reconstruction efforts under IDR Act.

2. The primary determinants of outcome through management take-over is the ability of the Authorised Person in supplying the two crucial inputs of finance and management. Profit making professional public sector corporations like BHEL, HMT, etc. are probably the best bets in this regard.[5] On the other hand a Board of Management is beset with problems like high turnover of key management personnel and financial problems. At the heart of the finance problem for an IDR unit lies the fact that pre-take-over liabilities are frozen - for a maximum period of eight years - following the take-over of management. The implication is that the dues of secured creditors become non-preferential debts. The upshot is the refusal of erstwhile financiers to fund the unit any longer as there is no guarantee of repayment of past dues. Hence, working capital advances in the post-take-over period are normally granted only against guarantees from central government/state government/IRCI/other reputed corporations, acceptable to the bankers. Similarly, long-term finances needed to bring about structural changes in the unit also become scarce in the absence of proper security. Given this scenario, Board of

Management is least suited as Authorised Person to overcome the difficulties compared to the government, IRCI or other corporations.

3. The other defect of the method is that the Act is administered centrally so that nobody except the central government has the authority to order investigations or take over management. On the whole, it is a very tedious process so that the state steps in at a very late stage - in some cases, unit would be beyond redemption by then. It is also important to note the problems associated with the final disposition of units under the Act. The alternatives here are (i) sale of the undertaking as a running concern[6], (ii) financial reconstruction of the company[7], (iii) merger with a healthy unit, (iv) nationalisation, (v) denotification upon which the unit is reverted to the original management failing which it goes into liquidation. Of the above five options, the first two are long drawn-out and arduous, involving considerable sacrifices on the part of banks, financial institutions, labour and other government agencies. The third option is also beset with procedural difficulties, though it has recently received a fillip following the amendment to Income Tax Act in 1977. Nationalisation basically brings about physical reconstruction as it comes under the public sector fold with subsequent cash losses being met out of budgetary provisions by the government. Herafter, the firm would stop getting classified as sick irrespective of its performance. The other dimension of nationalisation is the write-offs that they necessitate for commercial banks and financial institutions: this happened following the nationalisation of coal industry in 1971 and textiles in 1974.

Denotification normally leads to liquidation - as the old management would no longer want the unit - and hence to loss of employment wastage of capital. It is a hard choice at the best of times, more so when the labour has a strong union - as with the textile labour in Bombay and the industrial labour in Calcutta.

4. In any case, it is clear that management take-over under IDR is useful only in solving special problems of specific enterprises; it is not the answer when sickness is wide-spread in a region or industry. However, in the Indian case, it has been used in the latter context. For example, IDR Act was extensively used during the sixties in the cotton textiles industry and in the eastern region of the country during the seventies. At the end of March 1982, there were 55 such units.[8/] We may illustrate the problems associated with IDR units by looking at IRCI's experience with them. At the end of December 1981, IRCI was the Authorised Person for five IDR units which accounted for 37% of IRC's cumulative disbursements of Rs.82.68 crores.[9/] A review undertaken in September 1981 of units under IRCI assistance for a period of seven years and more showed that the IDR units accounted for 38% of the total outstanding amount of Rs.36.81 crores. These figures point to two conclusions, (i) per unit commitment for IDR units are much higher than others and (ii) units have continued to ail despite IDR take-over. In the light of these unhappy experiences, the current thinking is to resort to management take over only as a last option. In fact, IRCI has been directed by the Finance Ministry since 1981 to assist units prior to take-over only;

financing in the post take-over phase should be done only at the behest of the government. Subsequently, only 23% of the total sanctions of Rs.104.8 lakhs between 1981 and 1983 went to IDR units. We may close by noting that, other than IDR Act, IFCI Act of 1948, IDBI Act of 1976 and State Financial Corporations (SFC) Acts provide for direct management take-over of units which faily to repay their advances, though these are rarely used. Here, the primary motive is recovery of dues and not reconstruction per se. Even commercial banks may, after seeking exemption from provisions of Section 19 of the Banking Companies Act, 1949, acquire more than 30% of a firm's equity to exercise voting rights for bringing about a change in management. From time to time, the central government has also carried out special legislations to facilitate take-overs outside IDR Act in industries like textiles, coal, tea, sugar and jute. Apriori, this could be considered a superior policy measure to the IDR framework in that it came about in response to industry-wide problems.

Section 3

1. The Industrial Reconstruction Corporation of India (IRCI) was set up in April, 1971, with headequarters in Calcutta, to bail out ailing enterprises, specially those belonging to the eastern region. This followed the recommendations of the enquiry Committee of the government of West Bengal in 1970 which studied the problems of sick units and suggested other reconstruction measures as well viz. (i) association of

workers in management via Board or equity participation, (iii) diversification/promotion of new units in non-traditional lines of manufacture, i.e. petrochemicals, fertilisers, etc.[10] In 1972, the State Relief Undertakings Act was passed, which enabled the State government to freeze all liabilities, except public dues for a maximum period of fifteen years so that reconstruction could go on unhindered. Also a separate department termed the closed and sick industries department was set up in 1972 - the names has been changed to the department of Industrial Reconstruction in 1981 - for the revival of closed and sick industries.[11] The department grants 'relief' status to companies, acts as Authorised Person for IDR units and provides financial assistance. Currently, the department is the Authorised Person in respect of 13 IDR units employing 8,300 people; a sum of Rs.16.94 crores have been granted to these units between 1972 and 1982.

2. Before we go into the details of IRCI, we look at the experience of similar institutions in other economies on which it is modelled. The earliest of them is the Italian Institute per la Ricostruzione Industriale (IRI) set up by the Mussolini distatorship in 1933. It was part of a scheme to relieve Italian banks of the burden of depressed industrial companies in which they held big equity stake.[12] Currently, IRI is the biggest non-oil company outside America embracing 1078 companies in industries as unrelated as chocolates, steel and banking.[13] In contrast, Britain set up its Industrial Reconstruction Corporation (IRC) in 1966 to promote industrial efficiency and profitability and to reorganise and

develop British Industries.[14] Unlike IRI, IRC did not hold shares in assisted companies and restricted itself to loan operations.

3. Since our own IRCI is modelled more along the lines of the British IRC - even to the extent of its name - it is useful to note some of the lessons from the latter's experience. IRC found that careful monitoring held the key to the most efficient use of public funds in private corporate sector. Monitoring was always done by a different organisation from the one who appraised the project. Twice-a-year visits at the time of interim results and final results and representation on Board were the main elements of follow-up. In contrast, IRCI does the monitoring on its own in all assisted units; periodic progress reports and field visits are the main elements here. In addition, IRCI assumes the share control (voting rights only) and board control in all assisted units; in the IRC case, this was done on a very selective basis. The other important difference between the two institutions is the fact that while IRCI was initially set up as a subsidiary of IDBI and incorporated as a Public Limited Company under the Indian Companies Act of 1956, IRC had a sweeping mandate with wide powers to do anything.[15] IRCI also assumes direct management control in certain IDR units as distinct from IRC. Above all, unlike IRC, restructuring and reorganising certain industries is outside IRCI's concern.

4. Now, we may briefly go into IRCI's modus operandi. Firstly, assistance is given only to companies with limited liabilities.[16]

Upon application, IRCI undertakes a diagonistic study of the unit to identify its strengths and weaknesses and formulates a suitable reconstruction package. Funds are then provided to help the company to pay off its pressing creditors, statutory liabilities, and close the resource gaps, viz. working capital margin and start-up expenses. Money for capital expenditure is given as per the operational plan. Of late, IRCI even provides working capital finance for units facing problems on this count. Assistance is also provided for installing generators in case of units facing acute power shortage. Revamping of management is a central concern in the IRCI strategy as management deficiencies have been identified as one of the leading causes behind sickness. While IRCI is in charge, appointments to key functional areas in the organisation can be made only with its concurrence. Since 1976, IRCI has launched the Industrial Management Pool (IMP) to attract professional managers for deputing to assisted concerns; this, however, has not been a success.

5. There has been significant changes in IRCI's activities since its inception in 1972. Firstly, IRCI's assistance has spread to units all over the country; this is depicted in Table 9 below. The similarity in figures for the two columns is due to the fact that in its first year of operation, the total disbursement of Rs.1.7 crores went to 27 units located in West Bengal. The subsequent dispersal of assistance to firms in other tates is also due to the fact that the sickness itself has spread elsewhere - a fact we established in the first chapter. Pattern of

Table 9: Percentage Distribution of IRCI Loan Disbursements: State-wise

Sl. No.	State	Position on 30-6-1983	Changes between 1972 and 1983
1	2	3	4
1	Andhra Pradesh	1.1	1.2
2	Delhi	1.2	1.2
3	Gujarat	3.1	3.1
4	Kerala	1.7	1.7
5	Maharashtra	4.3	4.3
6	Orissa	1.4	1.4
7	Tamil Nadu	1.9	1.9
8	Uttar Pradesh	1.5	1.5
9	West Bengal	80.5	80.3
10	Others	3.3	3.3
11	Total	100.0	100.0

Source: IRCI Annual Report 1982-83

Notes: (i) Total disbursed amount on 30-6-1983 was Rs.153.94 lakhs; 63 units have repaid Rs.14.78 lakhs which leave on outstanding amount of Rs.139.16 lakhs. The total change in disbursed amount between 1972 and 1983 works out to Rs.152.24 lakhs. (ii) The figures are net of cancellations. At the end of June 1983 six units in West Bengal and one each in Punjab, Delhi and Tamil Nadu have repaid their dues in full. (iii) Total cummulative disbursements are 68.6% of total disbursements. (iv) Others include Assam, Haryana, Punjab, Madhya Pradesh, Bihar, Karnataka and Rajasthan which have received under 1% of total disbursements.

assistance itself seems to be proportionate to the incidence of sickness across the various states as dipicted. As expected, West Bengal has received as much as 81% of the total Rs.154 crores disbursements made

during the twelve-year period. Hence, the corporation has definitely achieved its primary objective of assisting ailing enterprises in the eastern region of the country.

6. In Table 10, we have presented the industry-wise distribution of IRCI's assistance during the twelve-year period. The figures in the last

Table 10: Percentage Distribution of IRCI Loan Disbursements: Industry-wise

Sl. No.	Industry	As on 30-6-1972	As on 30-6-1983	Changes between 1972 and 1983
1	Engineering	33.2	38.3	38.2
2	Cotton Textiles	34.6	11.3	11.1
3	Rubber	2.7	22.8	23.0
4	Jute	-	12.6	12.7
5	Chemicals and Pharmaceuticals	0.7	4.5	4.5
6	Others	28.8	10.5	10.3
7	Total	100.0	100.0	100.0

Source: IRCI Annual Report 1982-83

Notes: See under Table 9.Engineering consists of metal products except machinery and equipment,machinery except electrical, electrical machinery and equipment, transport equipment. Others include food manufacturing except beverages, paper and paper products, miscellaneous industries.

two columns of the table are similar because the total outstanding loan amount between 1972 and 1983 are similar; this is so because of the total disbursed loan amount of Rs.153.94 crores till 30-6-1983, only Rs.1.7 crores

was disbursed during IRCI's first year of operation. What is noticeable over the twelve-year period is the steady encompassing of industries under the Corporation's loan portfolio. Coming to individual industries, we find that engineering, rubber and jute in that order, have received the maximum extent of assistance; between them, they accounted for 74% of the total loan amount disbursed. This is so because, these are precisely the three industries in West Bengal with the maximum incidence of sickness (See Table 10) and the state has received 80% of the total loan amount disbursed by IRCI so far.

7. As a summary measure, we look at the financial performance of the corporation, which is depicted in Table 11, below. In general, IRCI's performance has been poor and the extent of success small, compared to the tasks on hand. Thus at the end of June 1983, only nine units have fully repaid their dues out of a total of 162 units assisted so far. In fact, total outstanding arrears rose from Rs.11.14 crores in 1978-79 to Rs.46.89 crores in 1982-83; as a proportion of outstanding loan amount arrears work out to 21% in 1978-79 and 34% in 1982-83. The picture becomes clearer when we compute the total amount received by the Corporation as a proportion of total amount that is due. It works out to 8% in 1978-79 and 13% in 1982-83 which sums up the poor performance of IRCI.[17/] The continued ailing of assisted units is also clear from the fact that, at the end of June 1981, 45% of the total outstanding amount of Rs.81.82 crores to IRCI was accounted for by 40 units which had been under assistance for seven years or more. To be fair, we note that IRCI comes in at a stage

Table 11: Financial Performance of IRCI: 1977 to 1983 (year ending 30 June)

(Rs. lakhs)

Sl. No.	Category	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83
1	2	3	4	5	6	7	8	9
1	Income from Operations (a to e)	126.91	144.46	241.93	399.36	438.87	781.47	1028.08
	a. Interest on Loans	61.03	24.83	63.08	118.89	134.32	212.25	402.68
	b. As % of Income	48.1	21.7	26.1	29.8	30.6	29.5	39.2
	c. Hire Rent	0.01	0.39	2.37	5.99	11.25	8.25	7.31
	c. Others	0.27	-	0.02	-	1.05	1.58	15.70
	d. Interest on Debentures and Investments	52.30	50.76	73.46	94.94	61.79	76.61	132.25
	e. Subsidy from Government	13.30	38.48	103.00	179.54	242.76	419.78	470.14
	As % of Income	10.5	33.6	42.6	45.0	55.3	58.4	45.7
2	Less Cost of Money	100.84	149.14	233.08	310.33	375.98	561.72	840.21
3	Net Income	26.07	(34.68)	8.85	89.03	62.89	156.75	187.87
4	Expenditure	42.80	48.42	55.38	108.04	87.03	134.73	162.68
	As % of Income	33.7	42.3	22.9	27.1	19.8	18.8	15.8
	As % of Loan Interest	70.1	195.0	87.8	90.9	65.0	63.5	40.4
5	Profit	(16.73)	(83.10)	(46.53)	(18.84)	(24.12)	22.02	25.09
6	Provision for Bad and Doubtful Debts	-	-	-	42.98	3.39	27.48	20.84

Source: IRCI Annual Reports, various years.

Notes : Figures in brackets indicate negative amounts.

when the efforts of other institutions to revive the unit have failed and are unwilling to provide any more finances. However, there is a distinct improvement in performance during the eighties as indicated by the profit figures since 1981-82, This has been basically due to a rise in interest on account of loans and higher support from the government subsequently, expenditure as a proportion of both operating income and interest from loans, has declined significantly.

8. Thus, 1981-82 really signifies a turning point in IRCI's performance since its inception in April 1971. This has come about due to deliberate policy measures aimed at improving IRCI's profitability which, we shall argue, has brought about a fundamental change in its very orientation: for example, the decision to stay away from IDR units. Druing 1981-82, IRCI joined the Inter-institutional Meeting (IIM) - the consortium of All India Financial Institutions(AIFI) involved in the funding of large projects mainly belonging to the Large Business Houses (LBH) of the private corporate sector. The results are clear when we look at changes that have come about in purpose-wise loan disbursements (Table 12). First of all, the cumulative sanctions of Rs.63.58 lakhs during 1981-82 and 1982-83, works out to 42% of the total change in loan disbursements between 1972 and 1983. Subsequently, IRCI's average assistance to 69 regular units works out to Rs.451 lakhs only, whereas 40 IIM units received Rs.1 crore each. A closer look at purpose-wise disbursements suggests a distinct shift towards the first two categories and away from the other three categories. Typically, the former is of importance to better-off units while the latter is for cases of pronounced sickness. In the two years since IRCI joined IIM, expansion and working

Table 12: Percentage Distribution of IRCI's Loan Disbursements: Purpose - Wise

Sl. No.	Purpose	As on 30-6-1972	As on 30-6-1983	Changes between 1972 & 1982	Cumulative for 1981-82 and 1982-83
1	2	3	4	5	6
1	Expansion/Renovation/Balancing of Equipment/Diversification	18.1	31.5	31.6	51.3
2	Margin Money/Wokring Capital	11.6	29.2	29.4	25.2
3	Cash Losses	-	27.2	27.5	21.1
4	Repayment of Pressing Liabilities	57.8	6.6	6.0	1.2
5	Others (including start-up expenses)	12.4	5.6	5.5	1.3
6	Total	100.0	100.0	100.0	100.0

Source: IRCI Annual Report 1982-83

Notes : See under Table 9.Total disbursements between 1981-82 and 1982-83 are Rs.63.58 lakhs.

capital loans claimed as much as 77% of the total disbursement. At one level, the situation is ironical in that at least in some cases of pronounced sickness reconstruction failed largely due to IRCI's hesitation to provide finances for modernisation after closing resource-gaps and other start-up expenses.

9. Thus IRCI has clearly shifted away from units that are genuinely sick and hence seems to be abandoning its original mandate. This draft is brought into sharper focus when we look at the percentage distribution - unit-wise - of the total sanctioned amount of Rs.30.8 crores between December 1982 and May 1983. (i) Natioanlised Units - 2.2%; (ii) IDR units 8.3%; (iii) IIM units - 31.0%; (iv) Units belonging to Large Business Houses - 47.8%; (v) Regular Units - 10.7%.[18/] Thus, between them, IIM and LBH units claimed as much as 79% of the total amount sanctioned during the period.[19/] This shift has been ostensibly on account of adopting a preventive approach towards sickness with the accent on technological upgradation.[20/] However, we know that financial institutions have been operating the soft loan scheme since 1976 for precisely this purpose. In practice, IRCI is increasingly becoming a cheap source of finance for LRHs; IRCI's interest rate for LBHs is 12.5% per annum compared to 14% per annum in other financial institutions. It is believed that the entry of large units into IRCI is on account of their intense lobbying due to shortage of funds in other AIFIs. In recent years, IRCI has diversified into allied activities like consultancy service on sick units to banks and financial institutions, equipment leasing and merchant banking in the fields of amalgamation, mergers, etc.

10. It may be argued that the very shift in IRCI's postures with reference to sick units is an implicit admission of its failure in reconstructing/rehabilitating them. We may cite number of factors leading to this. Firstly, IRCI lacks norms on crucial variables such as expected pay-back period, type of industry it would like to assist, total fund commitment, etc. Secondly, in the case of most assisted units, IRCI action was restricted to the Board level and divorced from the executive level. Thirdly, IRCI's status, vis-a-vis assisted units, was purely as a creditor as its nominees had no statutory protection; since 1983-84, the situation has changed as IRCI has been converted into a statutory corporation, on par with other AIFIs. In fact, the corporation had to withdraw its nominees from the Boards in the case of number of assisted units, fearing legal action from Provident Fund (PF) and Employees State Insurance (ESI) authorities. Fourthly, IRCI was unable to find professional managers of the desired quality to bring about management restructuring in assisted units which was so central to the IRCI strategy. Finally, IRCI's involvement in IDR units and their intractable problems added to its problems otherwise. At one point, IRCI nearly went along the IRI lines by mooting the idea of ownership in five IDR units for which it was the 'Authorised Person'. Above all, the continuing stagnation in the industrial economy of West Bengal also led to the poor performance of IRCI assisted units as they were concentrated in West Bengal. In a nutshell, the capacities and capabilities of IRCI was definitely not equal to the challenges it faced and the original objectives that it had set for itself.

Section 4

1. In the first chapter, we have noted that cotton textiles was the first industry in the country that contracted sickness and that it stemmed from structural factors. Hence, it is instructive to look at reconstruction policy here. As noted before, IDR Act was extensively used in the industry during the sixties. The first reconstruction move in the industry dates back to 1954 when the National Industrial Development Corporation (NIDC) was set up to provide rehabilitation finance to ailing units on concessional terms. Until it transferred its loan operations to IFCI in 1967, NIDC provided 70% of its total loans of Rs.28.19 lakhs given to 114 units to 67 textiles units. This approach was basically preventive in nature. However, it did not bring about the expected fillip to the process of modernisation as some managements feared take-over and others were content to let the state take-over derelict plant and machinery. Subsequently, take-overs under the IDR Act became the rule rather than the exception in the industry. The next step in reconstruction was the setting

up of National Textile Corporation (NTC) in 1968 under the Ministry of Commerce with the following objectives: (i) advise government on report of investigation committees in case of units under enquiry and on report of Authorised Persons in case of units managed under IDR Act, (ii) provide funds to IDR units and consider applications from companies for financial assistance, (iii) assist government in investigations under IDR Act, and (iv) set up new mills, specially export-oriented ones.[21/] Thus the original mandate of NTC was purely advisory in character.

2. However, NTC was made the custodian of 14 take-over mills in 1972; in the case of 31 other take-over mills, it had to oversee the management. Thus, NTC was gradually trnasformed into a supervisory body fully responsible for recuperating ailing enterprises in the industry. Further changes came about in 1974 when 103 sick undertakings all over the country were nationalised and put under NTC's charge. For purposes of management, nine subsidiary corporations were registered under the Companies Act with a holding company at Delhi. The subsidiaries and the number of mills managed by them are as follows:

(i) NTC (AP, Karnataka, Kerala, Mahe)	13
(ii) NTC (Delhi, Punjab, Rajasthan)	6
(iii) NTC (Gujarat)	11
(iv) NTC (MP)	7
(v) NTC (Maharashtra North)	11
(vi) NTC (Maharashtra South)	17
(vii) NTC (T.N., Pondicherry)	15
(viii) NTC (UP)	5
(ix) NTC (WB, Assam, Bihar, Orissa)	18
(x) NTC (Holding Company)	7
Total	103

In 1974, these sick mills represented 16% of spindleage, 22% of loomage and 18% of workforce of the entire textile industry. In addition to the institutionalisation of reconstruction through NTC, textile industry also has been the single largest beneficiary of the 'soft loan' scheme launched

in 1976 to aid modernisation on moderate concessional terms. Despite the fact that NTC mills have continued to make losses - at the end of March 1982, accumulated losses came up to Rs.426 crores against paid up capital of Rs.180 crores - due to excess capacity, surplus labour, obsolete plant machinery and inadequate management, more undertakings have come under NTC fold over the years. By 1978, management of eight more mills were taken over; in October 1983, 13 mills more were added to the list which has brought up the total number of mills under NTC to 125. Like other loss-making public sector enterprises, NTC has been rescued through budgetary support by the central government; total assistance till 1982-83 came to Rs.555 crores. In any case, NTC has not succeeded in altering the structural maladies of the industry while protecting employment. This is primarily due to the fact that NTC itself has been designed as a repository for ailing enterprises, in the curative sense than in the preventive sense.

3. Thus, by the middle of the seventies, state-managed reconstruction was clearly found to be insufficient to cope with the increasing incidence and spreading nature of sickness in industries. This marks the beginning of active reconstruction measures without the direct patronage of the state. The first of this is the soft loan scheme launched in 1976; it was conceived as a preventive measure to stem further spread of sickness. Originally, 'weak' units belonging to cotton textiles, jute, cement, sugar and sections of engineering industries were granted rehabilitation finance at concessional terms since they could not raise and service loans on

normal terms. Hence the rate of interest was kept at 7.5% per annum against AIFI's normal lending rate of 11% per annum; other concessions in respect of promoter's contribution, debt-equity ratio, initial moratorium and repayment period also existed. The scheme is operated by IDBI, IFCI & ICICI with the overall administration vesting in IDBI. IFCI is the lead institution for jute and sugar, ICICI for engineering and IDBI for cement and cotton textile. In many ways, the operation of the scheme provides good insights into the nature of Indian private corporate sector. Due to intense lobbying and non-utilisation of the scheme, the financial institutions were forced to dilute the original stipulations of the scheme. Now, even profit making units are granted soft loans to cover part of their financial requirements for modernisation - the justification being that the scheme was aimed to aid modernisation and not mere survival of sick firms. Since March 1980, the scheme has come under a two-tier interest rate structure where the soft and normal components carry 7.5% per annum and 11% per annum respectively.

4. The original convertibility clause of the scheme was waived in November 1977. The institutions would not seek a change in management except where defaults took place. This goes directly against the evidence that recalcitrant management is one of the basic causes in the onset of sickness and that change in management is conducive to revival. The list of engineering industries was expanded in August 1978 and the requirements that the units should have been set up fifteen years age was reduced to ten years. Finally, the scheme was thrown open to all industries in 1981.

In the case of well-to-do units, the scheme has been used to lower the average cost of term finance for them. For example, during 1978-79, of the total Rs.196 crores sanctioned to better-of units, Rs.63 crores carried 7.5% per annum only and Rs.21 crores at 9.5% per annum.[22] Despite these liberalisations, progress under the scheme has been tardy, as shown in Table 13. Though the sanctions to applications ratio is about 67%, disbursements to sanctions ratio is only about 56%. As expected, textiles and engineering have received maximum assistance as the incidence of sickness is highest in them. Between them, they accounted for 72% of applications received, 78% of sanctions and 77% of disbursements. The high figures for textiles are on account of the large sums advanced to NTC mills for modernisation. The most lukewarm response has come from the jute industry, as seen from its small shares in applications received, amount sanctioned and amount disbursed, though 60% of the applied amount was sanctioned, only 28% of the sanctioned amount was disbursed to the industry. It is hence clear that, modernisation cannot be forced upon unwilling managements.

5. The launching of the merger scheme for sick units in 1977 by providing tax concessions is perhaps the clearest indicator of the trend towards reconstruction without State management. As per the amended Section 72-A of the Income Tax Act, 1977, the accumulated losses and unabsorbed depreciation of a merging sick company could be set off against the profits of a healthy company a period of eight assessment years. The role of the government is confined to an approving authority, without any

Table 13: Progress of Soft-Loan Scheme: As on 30-6-1983

(Rs. Crores)

Sl. No.	Industry	Applications received			Sanctions			Disbursement			Sanctions as % of Applications	Disbursements as % of Sanctions
		No.	Amount	% to total	No.	Amount	% to total	No.	Amount	% to total		
1	2	3	4	5	6	7	8	9	10	11	12	13
1	Textiles	389	794.0	51.7	364	516.9	50.5	427	325.8	56.7	65.0	63.0
2	Cement	26	245.3	16.0	23	144.2	14.1	22	69.9	12.2	58.8	48.5
3	Sugar	39	90.4	5.9	37	62.7	6.1	48	48.4	8.4	69.4	77.2
4	Jute	27	85.1	5.5	26	51.4	5.0	13	14.5	2.5	60.4	28.2
5	Engineering	144	321.8	20.9	142	249.3	24.3	130	115.5	20.1	77.5	46.3
6	Total	625	1536.6	100.0	592	1024.5	100.0	640	574.1	100.0	66.7	56.0

Source: Report on Currency and Finance, 1982-83

Note: Figures are net of cancellations

managerial responsibilities as under IDR Act. Conceptually, mergers are sound as a reconstruction strategy as healthy firms can supply the deficient inputs for sick units specially in regard of management, finance and marketing. In fact, as we shall see through our case-studies, complete corporate back-up is a must for successful reconstruction. There are number of advantages for the healthy firm also. If the merger takes place between firms in related product-lines, overall capacity is raised and hence the firm's market power; in case of unrelated products, merger is an easy route to diversification,specially so if the item is reserved for SSI or has capacity restrictions.[23] It is clear that mergers in the long-run could raise product-wise as well as country-wise concentration, specially when firms belonging to Large Business Houses are involved. The only solution to this dilemma is to encourage mergers with public sector corporations to the extent possible.[24] The repository of highly skilled labour force and prized real-estate properties are other attractions of sick units; more so in the case of units with a long standing.[25] Finally, tax benefits accruing to healthy companies work out to be much greater than revival costs, more so in the case of inter-related companies.[26] Above all, mergers lead to transfer of immovable property at no extra cost, by avoiding payments of sizeable stamp duties and registration fees which regular purchase of property entails.

6. In many ways, the merger scheme has had a chequred course similar to the soft loan scheme that we discussed earlier. To start with, following pre-conditions existed: (i) the company taking over the sick unit should

have the experience of manufacturing the same products made by the sick units, (ii) the sick unit should belong to an industry suffering from chronic, wide-spread sickness, (iii) there must be a demonstrable gain to public interest through the merger; (iv) the sick units should have assets over Rs.50 lakhs/employees more than 100, and (iv) the merging companies should not be interconnected.

7. However, in the face of continuing non-cooperation/non-utilisation by the private corperate sector all these caveats were gradually dropped. The only condition that holds now is that the amalgamated company should use the tax benefit towards revival and supplement it with own sources. In practice, the scheme is being increasingly used by LBH to effect in-house mergers and reap huge tax bonanzas.27/ This is tantamount to rewarding recalcitrant managements who are responsible for the decline and sickness of the firms in the first place. We may close by nothing the basic limitations the merger scheme viz. (i) The merger requires the approval of a large number of creditors and members. (ii) The elaborate legal procedures, which includes MRTP clearance, makes the whole process very time-consuming. (iii) There are no safeguards to protect employment following the merger.28/

8. It is clear that the reconstruction strategies that we have discussed so far are primarily directed at medium and large units without any concern about SSI units where we have noted the problem of sickness to be really rampant. For example, only 3% of IRCI's total disbursements have gone to SSI units;29/ efforts are currently under way to rectify this imbalance. IRCI itself has started operating a line of credit scheme for sick SSI units under which funds are disbursed to state-level corporations who go

on to assist the units directly. The other major step in this direction has been the setting up of state level Inter Institutional Committee (SLIIC) following the recommendations of the State Bank of India (SBI) study team in 1975, which examined the various issues in SSI financing. The purpose of SLIIC is to ensure co-ordination between commercial banks and financial institutions regarding problems pertaining to SSI units; it is convened by RBI. We also note the launching of a margin money Scheme for sick SSI units in January 1982 by the Central government wherein the units would receive assistance between Rs.1000/- and Rs.20,000/- on the basis of SLIIC recommendations.

9. We have earlier established the crucial role of commercial banks and financial institutions in detecting sickness in its incipient stages. We have also noted their important role vis-a-vis reconstruction in the Indian economy. Hence, we may briefly look at recent guidelines from RBI regarding revival of sick units as listed below:

(i) A unit can be considered viable if it can service its debt in about 8-10 years,

(ii) Rate of interest could be concessional, but not below RBI's prescribed minimum lending rate and in no case below the cost of funds to banks.

(iii) The irregular portion of the cash credit account to be made into a frozen term loan account secured by pari passu first charge on fixed assets.[30]

(iv) Cash losses to be financed by banks, six months, before and after IDBI involvement.[31]

10. The other general comment relates to the very nature of the banks/FIs' handling of sickness. The focus is always on the transactions in the account and never really on the actual condition of the unit. Thus, accounts are classified as difficult and irregular and advances as sticky. Even the financial analysis that is carried out is of a very rudimentry nature. There are no comparisons to healthy firms on industry averages while looking at the performance of the sick unit. In general, the reconstruction policy also seems to have been oblivious to the fact of growing mis-management and its relation to increasing incidence of sickness. However, the budget-speech of the Finance Minister during 1984-85 seems to indicate a break with the past on this count. According to it, a company's management is expected to seek a fresh mandate from shareholders after the erosion of the networth of the company to the tune of 50%; when the entire networth is lost, they forfeit the right to management automatically. All above, entrepreneurs with records of mismanagement are not to be granted assistance by financial institutions for new ventures. Finally, legislation is to be undertaken so that legitimate dues of workers rank pari passu with secured creditors such as banks in the event of closure of the company, since workers are the worst victims of industrial sickness. Such dues will rank above the dues to government also.[32/]

11. Revival of a firm in decline depends crucially on the quality of managerial response; and further still on proper diagnosis of the reasons for decline. One of the major problems in this context is lack of

systematic analysis of declining firms in industries or regions. Lack of studies affect policy making and to that extent policy making is not founded on sound logic. Depending on the nature of control, reconstruction strategies could be classified as state-managed and non-state managed. Direct take-over of management under IDR Act has failed in general. Likewise, IRCI's efforts at reconstruction have also failed. Even measures of the preventive variety like the soft loan scheme, haven't made much headway. Given all this, the emphasis in reconstruction in recent times have clearly moved towards non-state-managed strategies for e.g. the merger scheme of 1977. We have also noted that the banker's approach to decline and sickness of firms has been basically financial and commercial on an account by account basis and not economic and holistic.

Notes and References

1. See Boswell (1973)

2. At a more general level, recent policy measures aimed at the 'broad banding' of capacities serve the same purpose.

3. The purpose behind IDR Act was to make planning effective in the private corporate sector. Its main instrument is industrial licensing, meant to channelise investment into desires activities and to levels laid down under five year plans.

4. It should be noted that only management can be taken over and not ownership.

5. Also due to concerns about curbing concentration, monopoly etc. that could arise if private sector firms are involved. However, as our case-studies will show, nature of the relationship between the sick firm and public sector is a crucial one.

6. The purpose here is either to recover the dues of financiers or to find a new management for reconstruction. The sale may be effected through auction, direct sale, sale through court etc. after fixing a basic price - called Reserve price - below which sale may not be effected.

7. This may comprise of restructuring of capital i.e. increase/reduction of capital, issue of different classes of shares, revaluation of assets, scaling down or writing off debts and liabilities, other compromise or arrangement with creditors and members etc. It is governed by Section 391 of the Companies Act. It may be that the controlling block is transferred to a new management in this process.

8. See Annual Report of Ministry of Industrial Development, 1981-82.

9. IRCI Annual Report.1981-82.

10. See Report of the Enquiry Committee.

11. Under the amended rules of business in December 1981, the cases of closed and sick SSI units would be dealt with by the cottage and SSI department.

12. See Holland (ed)

13. Economist 1 March, 1986.

14. See Young and Lowe (1974)

15. The picture has changed significantly from 1983-84, as IRCI has been converted into a statutory corporation called Industrial Reconstruction Bank of India (IRCBI), on par with other All India Financial Institutions.

16. Thus, a partnership firm would have to turn into a private limited company at least to avail of IRCI finances.

17. Computed on the basis of figures taken from IRCI's Annual Reports for 1978-79 and 1982-83.

18. See "Physician, heal thyself", Mukaram Bhagat, Update, 25th July, 1984, Table No.4.

19. It is interesting to note that even some of the hotel projects for ASIAD were assisted by IRCI during 1981-82.

20. See Chairman's Statement, IRCI Annual Report, 1981-82 & 1982-83.

21. Annual Report, Ministry of Commerce, 1968-69.

22. IDBI Annual Report 1978-79.

23. For example take-over of Kolay Buiscuits by Duncan Agro Industries gave the latter an entry into a reserved item. Brooke Bond's take-over of Karnataka Scooters is a clear case of diversification. The attempted take-over of Centron Industrial Alliance by the Malhotras, who already hold a monopolistic position in the razor blade market, is an attempt to enhance market power. Similar is the effort of Hindustan Development Corporation to buy up the liquidated Raymon Engineering so as to enter wagon-making, where capacity is currently frozen.

24. For example, BHEL has revived two sick units in Karnataka and merged them. Likewise Andrew Yule has revived and merged Brentford Electric and is currently in charge of another sick engineering unit at Madras.

25. For example, sale of prime urban land is one of the basic ingredients of the reconstruction package for textile mills in Bombay and Ahmedabad.

26. Thus, in the merger of Coimbatore cotton Mill with Laxmi Mills, the latter earned tax benefits to the tune of Rs.70 lakhs against estimated revival cost of Rs.50 lakhs. In the case of the Navbharat enterprises — Vijay Durga Cotton Trading merger, the revival costs were estimated at Rs.28 lakhs against tax benefits of Rs.47 lakhs. See Business Standard, 24th July, 1983. "Marriages of Convenience".

27. Thus, Birlas have proposed the following mergers. Birla Jute with Bally Jute; Birla Cotton Spinning and Weaving Mills with Texmaco; India Tool manufactures with Zenith Steel Pipes. Bangurs are merging Hastings Mills and Shree Digvijay Cement. JK Singbania has already merged J K Steel and J K Synthetics, Business Standard, op. cit.

28. In this context, we note that the Expert Committee on Tax Measures to Promote Employment observed that there should be provisions in the merger scheme to protect employment for a period of five years at least from the year of merger. Failure to honour the obligation should entail proportionate withdrawal of the concession through a recapture provision in the Income Tax Act. See Report of the Expert Committee on Tax Measures to Promote Employment, Ministry of Finance, Department of Revenue, 1980.

29. See Report on Currency and Finance, 1982-83.

30. This in turn could lead to problems regarding capital expenditure for lack of security that could be offered to financing agencies, as explained earlier. In the course of our case-studies, we would specifically highlight the imbroglios that emerge out of here amongst financiers.

31. See Report on Trend and Progress of Banking in India, 1980-81.

32. See Budget Speech of Finance Minister, 1984-85.

Chapter 3

Emergence of Sickness and Types of Reconstruction Strategies: A Case Study of Twelve Firms

This chapter is a collection of twelve case-studies illustrating five types of reconstruction strategies viz.

(i) take-over of management under IDR Act (Nos.1,4,5,6)

(ii) board of Directors (Nos.2,3),

(iii) retention of old management (Nos.7,8,9),

(iv) formation of workers' co-operative (Nos.10,11) and

(v) induction of new management (No.12).

The four IDR units could be further classified on the basis of the 'Authorised Person' involved viz., Board of Management(No.1), IRCI (No.4) or the state government of West Bengal (Nos.5,6) - as the outcome is crucially dependent on this. In two of the cases (Nos.1,2), tie-up with public sector units was also tried out. Given all this, we have divided the chapter into six sections viz.

(1) management by Board of Directors (Nos.1,2)

(2) management under IRCI (Nos.3,4)

(3) management under state government (Nos.5,6),

(4) retention of old management (Nos.7,8,9)

(5) management by Workers' Co-operative (Nos.10,11) and

(6) induction of new management (No.12)

Section 1

Management by Board of Directors

Case Study No.1

1. In our first case, reconstruction took place in three phases, each time with a different management set up.While the entrepreneur remained in charge during the first phase, reconstruction took place under the aegis of IDR Act,in the next two phases with Board of Directors. A leading public sector corporation was associated in the final phase till the unit was denotified by the central government. The mismatch between reconstruction strategy and causes for sickness in all the three phases is clearly brought out. In particular, the folly of retaining the indifferent management in the initial phase of reconstruction when that was the basic cause for sickness is well illustrated. We also see how the onus for reconstruction ultimately fell on the state and the subsequent take-over of management under IDR Act; problems relating to finance and management that are typical here are illustrated. Finally, we see that the management take-over

could not achieve its primary objective of protecting employment.

2. The firm was set up as a private limited Company in 1948 by a medium sized business house with wide-ranging interest in jute, textiles, chemicals, etc. The unit was engaged in the production of class 'A' insulation motors in the 1-15 HP IEC frame-sizes with licensed capacity of 66,000 H.P. per annum and Installed capacity of 24,000 H.P. per annum; it employed 455 people. The products manufactured were of the following kind: (i) textile loom motors for jute industry, (ii) total enclosed fan-cooled motors, (iii) buffing and polishing machines for foundries, metal coating and finishing industries, and (iv) motors for agricultural operations.

3. Losses were incurred initially due to stiff competition from established manufacturers upon which 60% of production was marketed under a different brand name from 1955 onwards. In 1958, the installed capacity was doubled to 48,000 H.P. per annum though production did not pick up. This expansion was financed by a Rs.3 lakhs term loan from West Bengal Financial Corporation, secured by a first charge on fixed assets.

4. In 1963, battery charging sets were developed and the designs of motors of all sizes were changed. However, updating of manufacturing technology did not take place on a significant scale despite a technical tie-up with a British firm. Hence the cost of production remained high, specially on the materials side. Round about this time, the firm terminated its selling arrangements; the upshot of all this was that the firm could make profits only in 1951 and 1965. In fact, losses to the

tune of Rs.10 lakhs were incurred between 1959 and 1962. The three indices of profitability, liquidity and solvency - shown by cash profit, tangible net worth and net working capital - had turned negative by 1971, on account of continuous cash losses starting from 1967-68. On the other hand, the debt incurred by the unit nearly double by 1971, compared to 1966; this is also reflected in the upward movement in the debt equity ratio (Table 14).

Table 14: Summary of Performance - (Year ending 31 December)

Rs. lakhs

Sl. No.	Item	1966	1971	1974	1981
1	2	3	4	5	6
1	Cash Profit	5.16	-45.59	-31.92	-21.35
2	Tangible Net Worth	8.43	-68.17	-137.78	-354.83
3	Net Working Capital	24.06	-39.99	-69.33	N.A
4	Debt	23.12	40.07	97.87	385.33
	Relationships: (Ratios)				
5	Debt/Equity	1.36	1.59	2.32	9.14
6	Accumulated loss/Equity	0.50	3.71	4.27	9.42
7	Cash profit/Net sales	N.A	-3.05	-9.88	-0.30
8	Internal Sources/Total Liabilities	0.19	0.20	0.19	0.08

Source: Annual Report, respective years

Note : See Annexure II for details on financial analysis

5. The structure of the balance sheet (Table 15), for 1966 and 1971, clearly points to the declining share of assets and increasing

Table 15: Structure of Balance Sheet (Year ending 31 December)

(Percentages)

Sl. No.	Category	1966	1971	1974	1981
1	2	3	4	5	6
A	LIABILITIES				
1	Share Capital	18.1	19.5	19.2	8.4
2	Reserves and Surplus	1.0	-	-	-
3	Unsecured Loans	37.8	30.0	15.0	12.2
4	Secured Loans	26.1	31.2	38.4	67.4
5	Current Liabilities and Provisions	17.0	19.3	27.3	11.7
	Total	100.0 (88.53)	100.0 (115.49)	100.0 (219.10)	100.0 (500.80)
B	ASSETS				
6	Net Fixed Assets	21.2	10.4	4.6	0.01
7	Current Assets, Loans and Advances	69.2	17.0	13.3	20.1
8	Debit Balance of profit and loss account	9.6	72.6	82.1	79.3
	Total	100.0 (88.53)	100.0 (115.49)	100.0 (219.10)	100.0 (500.80)

Notes: Figures in brackets represent totals in Rs. lakhs

Source: Annual Report, various years.

share of losses; this marks the beginning of distortions in the financial frame of the company. By 1971 net sales had fallen so drastically that the sale value of production had turned negative (Table 16). Also the

Table 16: Performance Statement (Year ending 31 December)

(Rs. lakhs)

Sl. No.	Item	1970	1971	1974	1981	September 1982 to August 1983
1	2	3	4	5	6	7
1	Net Sales	43.56	14.56	3.23	71.02	20.64
2	Sale Value of Production(SVP)	N.A	-4.68	-0.40	101.43	10.07
3	Variable Costs	33.77	13.75	1.14	59.75	7.31
		(77.5)	-	-	(58.9)	(72.6)
4	Contribution	9.79	-18.43	-1.54	41.68	2.76
		(22.5)	-	-	(41.1)	(27.4)
5	Fixed Costs	18.80	19.39	23.79	21.64	25.14
		(42.8)	-	-	(21.3)	(22.8)
6	Earnings before depreciation interest and Tax (EBDIT)	-9.01	-37.82	-22.25	20.04	22.38
7	Interest	6.17	7.77	9.67	41.39	32.67
		(14.10)	-	-	(40.8)	(325.5)
8	Cash Profit	-15.18	-45.59	-39.92	-21.35	-55.15
9	Depreciation	1.13	1.13	1.06	1.18	1.20
10	Net Profit	-16.31	-46.72	-32.98	-22.53	-56.35
11	Break even SVP	83.65	-	-	52.66	91.72
		N.A	-	-	(51.9)	(910.8)

Source: Annual Report, various years

Notes : Figures in brackets are as percentage of the sale value of production, except in 1970 where it is as percentage of net sales.

owner's stake in business, measured by tangible net worth (i.e. net worth to accumulated losses) plus loans from Directors, had turned negative. In contrast, the unit owed Rs.70 lakhs in long-term liabilities and Rs.25 lakhs, in short-term. Hence, the onus for reconstruction came to rest

primarily with the financiers to the unit rather than the entrepreneur.

6. At the heart of the unit's technological obsolescence was its failure to upgrade the insulation wire used in the winding of motors from A to E. The sub-standard quality of the unit's product was also reflected in its failure to get the ratings of the Indian Standards Institution (ISI) which compounded the marketing problems. The fact that the management was indifferent to this problem seems to suggest that funds were siphoned off into activities that were not directly beneficial to the firm. In fact, during 1970-71, the auditors to the firm indic ted the management for despatching goods to fictitious parties; their suspicions were aroused by the mounting book debts at the Delhi branch of the firm. The other major problem with the unit was its poor industrial relations and the subsequent labour troubles that arose. Thus, there was a three-month lock-out during 1965-66 and an eight-month closure during 1967-68. The bonus dispute between management and labour over Rs.0.18 lakhs in 1959 dragged on till 1975 when it was decided in favour of the management. Market conditions were not unfavourable to the firm as the success of the green revolution and the subsequent wave of energisation of the rural economy gave a definite fillip to the demand for electric which seems to suggest that indifferent management policies were the basic causal factor for the setting in of sickness in the unit:

7. In the first phase of reconstruction, the entrepreneur-director was retained to carry out executive functions despite the deficiencies in this realm having led to the decline in the first place. At the level of the Board, IRCI was in charge by virtue of their granting of Rs.13.30

lakhs to the unit in March 1972. As the firm's working capital account with the banks had become overdrawn, the irregular portion was sought to be transferred to a frozen loan account, to be secured by first charge on the fixed assets of the company. However, this was not acceptable to WBFC who held the first charge and this brought about the working capital shortage in the unit. From then, bankers provided working capital assistance only against guarantee from IRCI. The IRCI assistance helped the unit to raise production from 450 motors and 338 battery charging sets in 1970-71 to 2729 motors and 551 battery charging sets in 1971-72. However, no initiative was taken either to upgrade technology or develop new products.

8. In October 1973, workers were laid off by the management for want of working capital finance. The closure continued for one year during which disposal of finished goods worth Rs.3.23 lakhs only were made. This is reflected in the negative sale value of production for 1974 (Table 16). Comparison of the figures for 1971 and 1974 from Tables 14 and 15 further attest to the general failure of reconstruction. The mounting debt burden - IRCI provided Rs.25.66 lakhs from 1971 to 1974 - went primarily to meet the unit's cash losses and claims of creditors. Net worth became negative to the tune of Rs.138 lakhs twice the 1971 level.

9. The second phase of reconstruction started with the take-over of the management of the unit under section 18 A of the IDR Act by the central government in October 1974. A Board of Directors was appointed as the Authorised Person for the unit; this continued till 1980 when a

public sector unit was associated with the management. Though the initial take-over was for a period of five years, it was extended from time to time till the final denotification in October 1984. The factory was re-opened in the beginning of 1975 with 202 workers surmounting the surplus labour problem,[1] but working capital shorage was acute following the IDR Act as all the pre-take-over liabilities were frozen under the Act.[2] Hence the unit became solely dependent on IRCI for all its financial requirements which turned out to be a major handicap when production picked up.

10. The other major problem in the post-take-over phase was the instability in management emanating from high turnover of key personnel. In fact, IRCI had to depute one of its officers as the chief executive of the unit during 1975-76. These gaps in management rendered the formulation of any long-term plan for the rehabilitation of the unit extremely difficult. The tight market conditions added to the problems and made the recovery of past dues from dealers difficult. Finally, the unit switched over to the production of 'E' class motors under ISI ratings in October 1976 and monthly production indicated a rising trend. The cash losses incurred by the firm were reduced considerably as sales rose from Rs.28.84 lakhs in 1977 to Rs.42.74 lakhs in 1980 and the cash losses declined from Rs.23.43 lakhs in 1977 to Rs.6.21 lakhs in 1980. A study done at the instance of the Ministry of Industry identified the following weaknesses in the unit: (i) absence of financial and technical planning, (ii) deficiency in management, (iii) outdated technology, (iv) inadequate marketing, (v) accumulations of inventory, (vi) poor

industrial relations. Updating of design and production technology of the existing range of motors, induction of competent management personnel, increase in annual production of motors from 2500 pieces to 7500 pieces, capital expenditure of Rs.45 lakhs and overall organisational changes were suggested. This marked the end of the second phase of reconstruction.

11. The third and final phase of reconstruction began in November 1980, when a reputed public sector corporation engaged in the manufacture of electrical machinery and equipment - who had earlier undertaken the study for the Industry Ministry - deputed a chief executive. The association was also envisaged as a spring-board for the public sector unit in the eastern region where it did not have any manufacturing facility. Initially, the tie-up worked out smoothly, as may be seen from the operating results for 1981. (Table 16). The unit could break even and earn gross profits after a gap of nearly two decades which re-established 'basic' viability of the unit. The high interest charges forming 41% of SVP - emanating from the huge borrowings of the past - meant that the unit incurred cash losses. The improvement is, however, clear from the sharp drop in cash losses per rupee of sales (Table 14), this was only 30 paise in 1981, compared to nearly Rs.10 in 1971.

12. One way of correcting the imbalances in the financial frame would have been through capital restructuring viz. conversion of loans into equity, waiving of interest on pre-take-over borrowings, moratorium of

interest on post-take-over loans for a fixed period, phased repayment of statutory liabilities, etc. However, no attempt of this sort was made during a decade of state management under IDR Act. In the absence of total corporate back-up from the public sector corporation, the progress attained during 1980-81 could not be sustained in the next year (Table 16). In the end, the unit was denotified by the central government in January 1984 and it has currently gone into liquidation. The failure of reconstruction in the final phase was in the absence of precise guidelines governing the nature of the public sector involvement in the unit.

Case Study No.2

1. In the case of the second unit, reconstruction took place in two stages. The first phase from 1974 to 1980 was through a Board of Directors under the auspices of the unit's bankers and the second phase from 1980 to 1984 involved the participation of an efficient, professionally - run public sector corporation. The reconstruction efforts failed owing to inadequacies of management in the first phase while the public sector tie-up failed in the absence of clear guidelines, as in case study 1. However, as opposed to the first case, finances were never a problem for this unit as it had the backing of its bankers. Hence, the case clearly illustrates the point that reconstruction efforts have to go much beyond mere financial assistance. As in the first case, reconstruction could not

even achieve its primary goal of protecting jobs. IDR Act was never invoked unlike in the first case. The fact that retention of old management is inimical to reconstruction efforts, when sickness emanates from managerial factors, is once again clearly brought home.

2. The unit was incorporated in 1944 for the manufacture of electric fans; in 1947, manufacture of electric lamps was started viz. general lighting, train lighting and miniature lamps.[3] In the case of the first two items, the licensed and installed capacities were 14.1 million numbers per annum and 11.4 million numbers per annum respectively; for miniature lamps, licensed and installed capacities were 6.0 million numbers per annum and 3.25 million numbers per annum. It employed 440 people.

3. The unit made steady progress till 1971-72 when the decline set in on account of infighting amongst partners. This led to cash losses of Rs.2.48 lakhs in 1972-73 and Rs.21.48 lakhs in 1973-74 and the unit thus became sick. Reconstruction was initiated by the unit's bankers who recast the Board of Directors,[4] however, one of the entrepreneurs was retained on the Board as a whole-time director till 1977. IRCI provided rehabilitation assistance to the tune of Rs.21 lakhs in June 1974; matching working capital assistance was provided by the bank. Though, production picked up following this, financial performance did not improve due to the continuation of unremunerative selling arrangement with a sister concern. That this could happen reflects very poorly on the monitoring capabilities of the bank and IRCI. Subsequently, operations were affected which led to a lock-out in September 1975.

4. A study of the working of the unit about this time suggested rationalisation of man-power, strengthening the market set-up, balancing of product-line, etc. for toning up the performance of the unit. On this basis, 253 employees out of the total 450 were retired voluntarily at a compensation of Rs.20.72 lakhs which was provided by IRCI; they also gave an additional sum of Rs.12.8 lakhs for restarting. The lock-out was lifted and production re-started from September 1976. Canteen subsidy and incentive schemes were abolished in a bid to prune the overhead costs. The sole-selling arrangement was scrapped and the unit set up its own marketing channels. The main problems upon re-opening turned out to be erratic power and gas supply, irregular supply of glass shells - a crucial raw material - and instability of top management. IRCI provided diesel generating sets and arranged supply of LPG to tide over the difficult situation. As a supportive measure, the bankers lowered the rate of interest to 10% per annum with annual rests. Above all, the state government granted relief status to the unit in June 1977 to ensure smooth reconstruction. Despite such substantial assistance, the decline of the unit could not be arrested; operations had to be suspended since February 1980 for want of working capital. The contours of the decline are clear from Tables 17,18 and 19, presented below.

5. The high values of the accumulated loss to equity ratio and debt to equity ratio (Table 17) suggest that most of the debt incurred went

Table 17: Summary of Performance (Year ending 31 March)

(Rs.lakhs)

Sl. No.	Item	1979	1980	1981	1982
1	2	3	4	5	6
1	Cash Profit	-33.07	-45.21	-24.67	5.19
2	Net Working Capital	-84.19	-111.72	-87.08	-79.43
3	Tangible Net worth	-201.85	-248.61	-269.62	-270.33
4	Debt	303.96	345.87	395.77	448.96
	of which IRCI	121.62	137.87	187.02	211.26
	Relationships (Ratios)				
5	Debt/Quity	16.7	19.0	21.8	24.7
6	Accumulated loss/Equity	12.1	14.7	15.8	15.9
7	Cash profit/Net sales	-0.43	-0.37	-0.15	0.02
8	Internal Sources/Total Liabilities	0.05	0.04	0.04	0.03

Source: Annual Reports, various years

to meet the losses. We also note that internal sources accounted for only 4% of total liabilities in 1980; it incurred a 37% cash loss on net sales. The net result of the first phase of reconstruction is seen from Table 18. The average annual cash loss of Rs.40 lakhs against annual SVP of Rs.60 lakhs leads to an average 69% cash loss on SVP during this phase. We also note the high levels of overheads and interest charges in relation to the sale value of production so that the break-even SVP works out to be about 262% of the SVP that was achieved in practice. The

Table 18: Performance Statement (Year ending 31 March)

(Rs.lakhs)

Sl. No.	Item	Six years upto September	1980-81	1981-82	1982-83
1	2	3	4	5	6
1	Net Sales	N.A	164.64	287.10	N.A
2	Sale Value of Production (SVP)	359.62	188.66	349.54	66.57
3	Variable Costs	281.72 (78.3)	149.86 (79.4)	270.53 (77.4)	58.05 (87.2)
4	Contribution	77.90 (21.7)	38.80 (20.6)	79.01 (22.6)	8.52 (12.8)
5	Fixed Costs	204.59 (56.9)	44.70 (23.7)	48.54 (13.9)	47.66 (71.6)
6	Earning Before Depreication Interest, Taxes (EBDIT)	-126.69	-5.90	30.47	-39.14
7	Interest	120.50 (33.50)	17.73 (9.40)	21.97 (6.30)	30.32 (45.50)
8	Cash Profit	-247.19	-23.63	8.50	-69.46
9	Depreication	11.81	2.21	3.58	4.32
10	Net Profit	-258.39	-25.84	4.92	-73.78
11	Break-even SVP	942.90 (262.2)	217.30 (115.2)	214.70 (61.4)	572.60 (859.4)

Source: Annual Report, various years

Notes: Figures in brackets are as percentage of sale value of production.

structure of the Balance Sheet in Table 19 amplifies the above trends. The decline in share capital and the rise in borrowings, specially long-term, is evident. Similar is the decline of assets and the increase of losses. Against this background, IRCI was no longer willing to aid the

Table 19: Structure of Balance Sheet (Year ending 31 March)

(Percentages)

Sl. No.	Item	1977	1980	1982
1	2	3	4	5
A	LIABILITIES			
1	Share Capital	7.4	4.4	3.0
2	Deferred Liabilities	31.4	41.9	39.4
3	Bank Borrowings	44.4	47.9	38.0
4	Other current liabilities and provisions	16.3	5.5	19.4
	Total	100.0(230.53)	100.0(385.08)	100.0(579.63)
B	ASSETS			
5	Net Fixed Assets	9.2	6.4	6.5
6	Inventories	15.8	10.4	21.1
7	Other Current Assets, Loans and Advances	11.0	14.0	22.7
8	Debit Balance of Profit and Loss Account	64.0	69.3	49.8
	Total	100.0(230.53)	100.0(385.08)	100.0(579.63)

Source: Annual Report, various years

Notes: Figures in brackets are totals in Rs. lakhs

unit without a thorough revamp with the active participation of a professional public sector unit dealing in similar products; the same unit had been also involved in the revival of another sick unit at IRCI's instance.

6. The public sector corporation agreed to provide corporate support in June 1980 by way of (i) nominating three of their executives on the five-member board of the company including an active part-time Chairman; IRCI and the bank had a nominee each; (ii) deputing two technical experts to streamline quality control, machinery maintenance and inventory management at the unit; (iii) ensuring supply of glass shells; (iv) taking up the marketing function of the company gradually. Production was re-started from July 1980 and in September 1980, a commercial selling agreement between the two was concluded. As per agreement, the public sector corporation would sell 85% of the company's annual production, subject to a minimum of 5 million pieces per year; the commission towards this was fixed at 7½% of the invoice price. The sale proceeds were to be deposited with the unit within fifteen days of its receipt at the public sector corporation. Fortunately, the bankers agreed to the total waiving of interest on old borrowings about this time; no other unit in our sample received such help from bankers in reconstruction.

7. The first eighteen months of the second phase turned out to be extremely encouraging. The SVP level for 1980-81 was thrice the average level reached in the previous six years (Table 18). It was still better in 1981-82, when the unit could even earn a net profit of Rs.5 lakhs. Improved production really holds the key in reconstruction which was brought out by the public sector tie-up. The unit made 2% cash profit on net sales in 1982 (Table 17). Likewise, the share of accumulated losses dropped sharply and the share of assets increased. This turnaround

was, however, completely reversed in 1982-83, when SVP was less than one-fifth of the 1981-82 levels due to poor marketing and sales remittances. Apparently, the public sector unit itself faced marketing problems during this period. Further, their sporadic despatch orders led to high inventory of finished goods and delay in sales remittances resulted in serious liquidity constraints. The public sector unit pointed to poor quality of bulbs at the unit as responsible for the problems while the unit refuted this on account of the strict supervision of production by the public sector unit. In any case, the unit contended that the quality complaint with reference to its bulbs related to physical appearance only and not to technical quality. The unit also maintained that the public sector unit often supplied raw materials in an indiscriminate fashion. The average collection period for the sales proceeds worked out to be two months against fifteen days stipulated in the tie-up. The public sector unit adjusted the cost of raw material supplies against sales proceeds despite any such provisions in the tie-up. Above all, the former did not keep up its promise of deputing a chief executive to man the unit; instead, a technical manager alone was provided.

8. In a nutshell, the arrangement proved to be unequal in character, working to the disadvantage of the unit and compounding its problems. Production in the unit came to a stop in September 1982. The nominee of the public sector unit resigned from the unit's Board. Following this the unit faced technical and marketing problems due to shortage of manpower and systems. In fact, the sales set-up had been wound up and

the branch offices closed while the tie-up was on. Finally, a three-man committee - consisting of representatives of the unit, bank and the public sector unit - was set up in February 1983 to sort out the issues. The committee found that problems arose on account of divergent perceptions over the role of the public sector corporation in reconstruction. The public sector unit sought to provide only management support and technical advice while IRCI envisaged total management take-over. The committee advocated either thorough re-organisation of the company or management take-over by another company.[5] To start with, it was decided to re-orient the unit's production towards own brands. In June 1983, production was re-started after nine months of shut-down; IRCI provided Rs.11 lakhs towards this.

9. The case studies clearly point out to the need for inducting more capable management personnel in reviving units. Finance is a problem but not as serious as that of management. The failure of reconstruction is essentially owing to the lack of adequate support by the public sector corporations in the absence of proper guidelines on the nature of relationship.

Section 2

Management under IRCI

Case Study No.3

1. Reconstruction in this unit has been primarily under IRCI's

patronage since 1972 and hence highlights many of the problems under this strategy; especially that of unstable management. At one level, it is the classic case of a colonial firm in decline; however, unlike many other colonial firms, the rot had set in prior to its passing into Indian hands. The inability of the Indian owners to set right the mistakes of the past finally snowballed into sickness in the seventies. The ultimate failure of reconstruction is closely related to management deficiency in the later period also. The fact that financing by multiple agencies leads to problems of coordination regarding sharing of securities and hence to the final detriment of the unit is clearly illustred. We also get a feel of the surplus labour problem faced by the unit and the subsequent extra overheads during its reconstruction phase. In the final analysis reconstruction meant little more than mere financial assistance, as we have observed in the first two cases.

2. The unit was incorporated as a private limited company in 1922 engaged in the manufacture of aluminium-based products[6] with a licensed capacity of 1500 metric tonnes and an installed capacity of 1,740 M.T. per annum. The unit was basically engaged in fabrication with a labour force of 1255. Till the second world war, the unit produced aluminium utensils, hollow ware, tea-garden equipments and bobbins for jute mills. During the war, it switched over to the manufacture of defence items like gas masks and hand grenades. During this period, the unit added equipments for pressure-die casting to complement the existing facilities of gravity-die casting and fabrication. However, the unit had to alter

its product-mix in a major fashion following the war, as the defence orders dried up; it also had to reckon with growing competition in its traditional product lines from smaller manufacturers of utensils. Hence the output became more geared to industrial and commercial uses like aluminium components for Railways; substantial sub-contracting was done for Jessop Co. for items like coach doors, underframes, wind-screen, etc. In fact, 40% of the sales related to Railways by 1964.

3. Between 1959 and 1965, capital expenditure to the tune of Rs.32 lakhs was undertaken, by way of extending the existing plant facilities, in order to cope up with the changed order pattern. As a result, the lay-out of the plant became very congested; equipments remained obsolete and material handling system inadequate in the absence of a deliberate modernisation effort. It seems as though the management was more concerned about short-term gains than the long-term growth prospects of the unit. Subsequently, the financial performance of the unit remained poor. After having been in business for 38 years, the unit had an accumulated loss of Rs.5.31 lakhs at the end of 1960. Even during the best years of the engineering industry from 1960-61 to 1964-65, the company just managed to recoup past losses and build a small reserve. At the end of 1964-65, net worth stood at Rs.38.79 lakhs including general reserves of Rs.4.53 lakhs. If we exclude Rs.24 lakhs - the share capital raised during the period - the net addition to net worth from 1959-60 to 1964-65 would be only Rs.1.50 lakhs, i.e. an annual figure of Rs.0.30 lakhs which is quite low. Following continuous cash-losses since 1965-66, net worth became negative

to the tune of Rs.15.33 lakhs in 1967-68. The recession in the engineering industry and the unsettled political and labour conditions in West Bengal compounded these internal problems.

4. It appears that the management had been contemplating the closure of the unit since 1965; they did the next best thing by selling the unit to an Indian industrialist in February 1969. The fact that the entire block of shares of Rs.30 lakhs was sold for a consideration of Rs.1 lakhs clearly points to the poor condition of the unit. The new Indian management faced tremendous challenge when it took over in 1969. Despite these problems, we would observe later on that the entrepreneur could enthuse number of financiers to provide adequate assistance during this period. The firm could break even in 1969-70 when SVP reached Rs.166.38 lakhs. From Table 20, we note the reduction in raw material costs and the wage bill, the latter due to rationalisation of labour during 1969-70 involving compensation of Rs.2.04 lakhs. On the other hand, burden of interest charges rose, as the borrowed capital failed to generate the expected profits. All of this finally snowballed into labour trouble at the unit leading to lock-out for 2½ months during 1971-72. This marks the beginning of reconstruction in the unit.

5. IRCI gave reconstruction assistance of Rs.24.50 lakhs in 1972 against second charge on fixed assets and assumed Board and share (voting rights only) control. ICICI and WBFC disbursed Rs.5 lakhs and Rs.2 lakhs respectively towards capital expenditure. Before the change over to Indian management, a consortium of two banks — including a foreign bank -

provided working capital with limits of Rs.25 lakhs against guarantee from the parent multinational. With the change-over, a third bank came into the fray with a limit of Rs.20 lakhs against book debts. They also issued a guarantee for Rs.20 lakhs favouring a foreign bank which was invoked in 1973; from then on, they became the unit's principal bankers. Interestingly, the consortium was later on joined by two other banks. The upshot of this multiple financing was the natural imbroglio over the sharing of securities. In the end, the unit received little help from those banks and became solely dependent on IRCI for funds. Thus, between February 1972 and January 1977, IRCI injected funds to the tune of Rs.149.56 lakhs whereas the banks gave fresh assistance of only Rs.13.40 lakhs. One reason for the imbroglio was the unwillingness of the parent multinational to extend further the guarantee for the working capital advances. This led to the unit's account with the main bankers remaining inoperative from 1972; they also stopped attending Board meetings since July 1973.

6. The other component of reconstruction was to convert unsecured loans of directors to the tune of Rs.10 lakhs into equity capital which raised the paid.up capital to Rs.40 lakhs. Though this didn't improve the cash flow position in the unit, it improved its financial structure when we compare figures for 1970 and 1973 (Table 22). The entrepreneur director was retained on the company's board while the erstwhile executive were replaced in May 1973. Despite this, the unit continued to be plagued by instability at top managerial levels. The global shortages of silicon

a crucial raw material for aluminium castings—and the resultant high prices compounded the problems of the unit. Operations were substantially affected due to five-day work schedules on account of power cuts between August 1974 and August 1975. On account of all these, cash losses kept mounting in the unit (Table 20). The losses

Table 20: Performance Statement (Year ending 31 July)

(Rs. lakhs)

Sl. No.	Item	1967	1970	1975	1981
1	2	3	4	5	6
1	Net Sales	128.50	131.08	151.52	160.20
2	Sale Value of Production (SVP)	128.13	129.19	140.17	163.26
3	Variable Costs	73.21(57.1)	62.22(48.2)	78.68(56.1)	122.92(75.3)
4	Of which Raw Material Costs	61.91(48.3)	50.01(38.7)	51.35(36.6)	85.31(52.3)
4	Contribution	54.92(42.9)	66.97(51.8)	61.49(43.9)	40.34(24.7)
5	Fixed Costs	73.20(57.1)	74.12(57.4)	99.32(70.9)	131.08(80.3)
	Of which Wages & Salaries	62.76(49.0)	56.49(43.7)	78.21(55.8)	118.55(-90.74
6	Earnings Before Depreciation Interest and Tax (EBDIT)	-18.28	-7.15	-37.83	-90.74
7	Interest	5.77(4.5)	9.38(7.3)	47.25(33.7)	62.48(38.3)
8	Cash Profit	-24.05	-16.53	-85.08	-153.22
9	Depreciation	2.69	1.83	1.66	3.51
10	Net Profit	-26.74	-18.36	-86.74	-156.73
11	Break-even SVP	170.78(133.3)	142.98(110.7)	226.41(161.5)	530.49(324.9)

Source: Annual Reports, various years

Note : Figures in brackets are as percentage of total sale value of production.

were financed by contracting more debt as in the case of other sick units. By 1976, debt/equity, accumulated loss/equity and cash loss/net sales ratios had sharply moved up while internal sources/total liabilities ratio went down. The indicators of profitability, liquidity and solvency had also deteriorated badly. All this led to distortions in the financial frame of the company (Tables 21,22). As typical of other

Table 21: Summarised Performance — (Year ending 31 July)

(Rs. lakhs)

Sl. No.	Items	1970	1973	1976	1980
1	2	3	4	5	6
1	Cash Profit	-8.25	-14.19	- 85.08	-100.97
2	Tangible Networth	-36.49	-76.81	-252.60	-568.11
3	Net Working Capital	N.A	-26.05	-74.46	- 73.02
4	Debt	74.67	125.46	296.89	630.44
	Of which IRCI	Nil	18.94	114.01	292.52
	Relationships (Ratios)				
5	Debt/Equity	1.54	2.22	5.31	11.30
6	Accumulated Loss/Equity	1.75	2.36	5.52	11.18
7	Cash Loss/Net Sales	0.05	0.11	0.56	0.48
8	Internal Sources/Total Liabilities	N.A	0.21	0.12	0.03

Source: Annual Report, various years

sick units, net worth diminished and debts went up; assets declined and losses mounted. The decline in the share of unsecured loans is a clear

Table 22: Structure of Balance Sheet (Year ending 31 July)

(Percentage)

Sl. No.	Items	1970	1973	1976	1980
1	2	3	4	5	6
A.	LIABILITIES				
1.	Share Capital	15.9	20.5	8.7	5.0
2.	Reserves and Surplus	9.7	8.5	3.5	2.0
3	Secured Loans	39.5	64.2	64.9	78.9
4	Unsecured Loans	14.2	11.3	5.1	3.8
5	Current Liabilities and Provisions	20.8	34.8	17.8	10.4
	Total	100.0 (189.12)	100.0 (272.06)	100.0 (457.50)	100.0 (799.13)
B.	ASSETS				
6	Net Fixed Assets	9.7	9.0	3.7	2.1
7	Current Assets	44.3	60.0	28.9	17.6
8	Loans and Advances	1.1	2.0	0.01	1.1
9	Debit Balance of Profit and Loss Account	44.9	68.2	67.4	78.1
	Total	100.0 (189.12)	100.0 (272.06)	100.0 (457.50)	100.0 (799.13)

Source: Annual Reports various years

Notes: Figures in brackets show totals in Rupees lakhs

pointer to the drying up of working capital finances from the bankers. The unit was granted relief status in June 1977 by the state government to ensure smooth reconstruction.

7. IRCI estimated that the overmanning in the unit was to the extent of 400-500 rationalisation of which was ruled out due to political compulsions. In a nutshell, the unit could not undertake any capital expenditure to impart long-term viability, as the available resources could only meet the losses incurred. One reason for the poor profitability in operations has been the change in product-mix over the years. During 1972-73, the units total sales of Rs.176.04 lakhs was distributed in the following fashion. (i) automobile and engine components - 35% (ii) railways - 30% (iii) defence - 2% (iv) general engineering and others - 33%. By 1976-77, sales had risen to Rs.227.54 lakhs with the following distribution (i) automobile engine components - 46% (ii) railways - 3% (iii) defence - 21% (iv) general engineering and others - 30%. Of these, the orders for defence in particular, turned out to be unremunerative. When the credit limits to the unit were realigned in 1980, the entrepreneur was unwilling to extend personal guarantee and concede equitable mortgage on his residential premises. Hence the banks did not release any funds after that except at the explicit instance of the state government. To be fair we note that the entrepreneur had no active role in the unit ever since IRCI had taken charge in 1972.

8. Following this, the principal bankers to the unit filed suit against guarantors in November 1980 to recover a sum of Rs.128 lakhs. Another suit was filed to enforce the equitable mortgage of residential premises, though further assistance of Rs.7.50 lakhs was provided later against guarantee from state government. While the suits were in

progress, the government of West Bengal amended its earlier notification of June 1977 in July 1981 the effect being that the bank's right to file suit for recovery of dues was suspended. This was successfully challenged by the bankers in court who granted permanent stay of the government notification in August 1982. In the wake of this general failure of reconstruction efforts, the unit approached the state government in September 1981 for permission to close permanently. This was denied and the government offered to meet the cash losses arising out of surplus labour. In the light of these developments, IRCI has currently put up the unit for sale.

Case Study No 4

1. The main component of reconstruction in the fourth case has been the enforcement of the IDR Act in 1971. Thereafter two phases followed; firstly under a Board of Management and then through IRCI. Problems relating to management and working capital finances could not be tackled successfully in either of the two phases, leading to the final failure of reconstruction efforts.

2. A British Managing Agency set up the unit as a public limited company in 1935. It specialised in the manufacture of rubber goods for railway fittings and employed about 550 people. The company enjoyed a monopoly position in the market for about a decade. With the advent of the second world war, the unit developed large number of items for defence

Between 1945 and 1965, at least a dozen new manufacturers emerged to make rubber fittings for the Railways which posed keen competition for the unit. The management proved equal to the challenge and introduced several new items like tennis balls in collaboration with Slazenger, UK, cots, aprons, printing rollers etc. This helped the firm to maintain its growth and profitability. However, the British management divested in 1958 - the reasons for this are not clear to us - and the control passed into a medium-sized Indian business group connected with refractory and mining industries in the eastern region. This proved to be the turning point for the firm.

3. Instead of consolidating the unit's sound position in the market, the new management went about dismantling the dynamism and professionalism of the company which were its forte. They indulged in systematic siphoning of funds from the unit in two distinct ways by setting up a new selling agency which was allowed a 10% commission on sales; by inter-corporate investments which were finally written off. Thus, the company obtained unsecured loans of Rs.9.91 lakhs from other group companies and invested Rs.15.59 lakhs in them. The new management did not undertake any development work and started interfering with the technical management. This triggered off the exodus of technical personnel so that the factory was virtually without any competent guidance from then on. The unit also lost out on railway orders and the general quality of products declined. Subsequently, operations of the unit were severely affected leading to losses; statutory liabilities piled up and arrears in wages and salaries came about. In fact, the accounts of the company were not audited after

1969 and the books of account remained in arrears. It is not clear how the financiers to the unit viewed the situation. The other factor which led to this state of affairs was the family feud that came about in the controlling group which rendered the top management inoperative.

4. Thus, by 1971, the firm had turned completely sick and on the verge of collapse. The total outside demand liabilities of the firm stood at Rs.135 lakhs of which statutory dues were Rs.59 lakhs and dues to bank Rs.46 lakhs. Following representations from employees, the central government ordered an enquiry into the affairs of the unit under section 15A of the IDR Act, 1951. The management of the unit was taken over in September 1972 with a Board of Management appointed as the Authorised Person. This marks the beginning of the first phase in reconstruction. Though the initial take-over was only for a period of five years, it was periodically extended till its final denotification in January 1984. Though not directly in charge of management, IRCI was also involved in reconstruction in its first phase. In July 1972, they gave a loan of Rs.21.46 lakhs; a matching, fresh working capital limit of Rs.15 lakhs was provided by the bank only against guarantee from state government. This was so because under the IDR Act, all past liabilities were frozen and hence recovery of the same were doubtful. The subsequent shortage of working capital faced by the firm is a basic problem faced by all IDR units.

5. A study undertaken on the unit found little scope for expansion in the existing lay-out of the factory. The company was advised to

concentrate on high-value items like vaccuum hose, tennis ball, aprons, rollers and buffer springs; suitable personnel had to be found to fill the depleted technical sections of the company. Much more serious problems arose at the top managerial levels which frustrated rehabilitation. The Board of Management was recast in June 1974, July 1975 and October 1976 which made it clear that the Board could not function cohesively. Following this, the state government withdrew its Rs.15 lakhs guarantee for working capital so that the unit became solely dependent on IRCI for its finances. The operational problems became severe as the instability spread to the executive level too. Thus, between 1972 and 1977, as many as four chief executives (CE) came and left being unable to effect any improvement in the working of the company. This rendered long-term planning very difficult. The longest tenure any CE had was between January 1975 and April 1977 - i.e. 27 months. This was precisely the period when the unit recorded its best performance in terms of SVP (Table 23). Given the above inadequacies in management, the unit continued to execute railway orders that were patently unremunerative. As a result, cash losses of the unit could not be arrested; the rising debt burden, seen in the increasing interest to SVP ratio (Table 23 column 6), just sufficed to meet the losses. In its first phase of reconstruction, the unit managed to break even in just one year viz. 1975-76.

6. The appointment of IRCI as the Authorised Person in August 1977 marks the beginning of the second phase in reconstruction. The Board was reconstituted in January 1978 with a new Chairman who also headed

Table 23: Performance Statement in Post-Take-Over Period

(Rs.lakhs)

Sl. No.	Year	Sale Value of Production	Earnings before Depreciation Interest & Tax	Cash Profit	Interest	(6) as % of (3)
1	2	3	4	5	6	7
1	18-9-72 to 31-3-73	7.96	-10.12	-11.52	1.40	17.6
2	1973-74	62.74	-16.54	-21.28	4.74	7.6
3	1974-75	50.61	-34.61	-42.78	8.17	16.1
4	1975-76	113.11	1.45	-12.82	14.27	12.6
5	1976-77	106.81	-12.38	-27.88	15.50	14.5
6	1977-78	91.48	-18.30	-35.78	17.48	19.1
7	1978-79	71.79	-37.03	-55.98	18.95	26.4
8	1979-80	101.59	-36.34	-62.61	26.27	25.9
9	1980-81	137.89	-32.16	-62.46	30.30	22.0
10	1981-82	193.40	-27.11	-68.69	41.58	21.5

Source: Annual Report, various years

the two other sick rubber units in the state, taken over under IDR Act and assisted by IRCI. The state government granted relief status to the unit in January 1978 to prevent the unit being taken into liquidation by past creditors. This was necessary as the validity of section 18FB of the IDR Act, which served the same purpose, was limited to five years.[7/]

7. The problems in the second phase of reconstruction were similar to that of the first phase and in fact grew more serious with respect to management and working capital finances. With regend to management, the Board itself was reconstituted thrice in this phase. In the meanwhile, five chief executives came and left; the longest tenure was for two years - between June 1979 and May 1981. It is significant that the best production peformance during the second phase was also chalked up during this period. This once again highlights the crucial role of stable management in revival efforts. With respect to working capital, we have noted that the unit had come to depend solely on IRCI for all its finances. Bank was ready to provide money only against guarantee from the central government which took 20 long months to materialise.

8 . In view of its principal role in revival IRIC did a detailed study on the unit in March 1982 and advocated its nationalisation. A subsequent study in March 1985 could not establish the basic viability of the unit and denotification was recommended which was carried out in January 1984.

Table 24: Structure of Balance Sheet (Year ending 30 April)

(Percentages)

Sl. No.	Item	1971	1981
1	2	3	4
A	LIABILITIES		
1	Share Capital and Reserves	14.9	3.7
2	Bank Borrowings	13.6	18.3
3	IRCI	Nil	58.7
4	Statutory Liabilities	56.9	10.1
5	Other Liabilities	14.6	9.2
	Total	100.0 (111.16)	100.0 (721.00)
B	ASSETS		
6	Net Fixed Assets	3.5	9.0
7	Investments	14.0	1.2
8	Current Assets	5.5	27.6
9	Debit Balance of Profit and Loss Account	77.0	62.1
	Total	100.0 (111.16)	100.0 (721.00)

Source: Annual Report, Various issues

Note : Figures in brackets are total amounts in Rupees lakhs

9. The case highlights the problems of reconstruction under IDR Act specifically relating to Board of Management and IRCI. The case also provides good insights into entrepreneurial behaviour of a sort which is divorced from the long-term interests of the unit. We have

clearly shown the sole motive of the Indian management, which took over from the British, as being one of siphoning off of resources from an enterprise with great potential

Section 3: Management under State Government

Case Study No.5

1. Reconstruction in our fifth case has gone on under the aegis of IDR Act since 1979 with the state government as the Authorised Person. The unit has an excellent, technically sound product; it fell on bad days due to managerial problems alone. The unit is of relatively recent origin, unlike many others in our sample. This case clearly illustrates the crucial, positive role played by professional management in turning an ailing enterprise around. We also highlight how the problems of the unit got compounded due to its unique position in the industry. As far as problems regarding paucity of working capital go, it is like all other IDR units. It is also significant that the unit never faced any problems on the labour front, specially with respect to overmanning, unlike many others in our sample. On the basis of evidence gathered from here, reconstruction under state management does appear to be an efficient strategy. The main problem here is the resource constraint faced by the state governments specially when many units have to be assisted, as in West Bengal.

2. The unit was started in 1956 by two Indonesians in association with an Indian entrepreneur. Initially, only metallic zip fasteners were made with licensed capacity of 30.48 lakh metres per annum and installed capacity of 13.72 lakh metres per annum; the unit employed 312 people. The unit had access to technology and machinery from YKK, Japan - the world leaders in the industry. Following this good progress, the unit diversified and set up a unit in Hyderabad for making nylon (non-metallic) zip fastners. The foreign promoters left the company after 1966 which set about the decline in the unit. Following orders from Calcutta High court in 1973, the profitable nylon unit at Hyderabad was handed over to another Company belonging to the promoters. This was due to a Board resolution of the unit in June 1973, confirmed at an extra general meeting of the company. Subsequently, the unit made a cash loss of Rs.2 lakhs in 1973-74, as seen from Table 26. Though the progress appears moderate from Table 25, it was not upto the satisfaction of the central government who appointed two directors on the Board of the company. From all indicators the incidence of sickness appears to be of a much less severity than in other units of our sample. The unit's main problem relates to management. In the event, the unit was taken over under Section 18 AA of the IDR Act in July 1979 with the state government as the Authorised Person. To support, state government granted relief status to the unit about this time.

3. Before we go into the specifics of the reconstruction strategy, we note the following features of the unit. The unit survived the general

Table 25: Structure of Balance Sheet (Year ending 31 March)

(Percentage)

Sl. No.	Items	1972	1974	1977
1	2	3	4	5
A	LIABILITIES			
1	Share Capital	2.4	6.2	7.0
2	Reserves and Surplus	8.0	10.5	11.9
3	Secured Loans	Nil	3.1	1.5
4	Unsecured Loans	9.6	12.6	11.2
5	Current Liabilities and Provisions	79.8	67.3	68.4
	Total	100.0 (34.29)	100.0 (63.98)	100.0 (72.14)
B	ASSETS			
6	Net Fixed Assets	25.2	11.6	11.7
7	Investments	1.5	-	-
8	Current Assets, Loans and Advance	73.9	87.3	88.3
	Total	100.0 (34.29)	100.0 (63.98)	100.0 (72.14)

Source: Annual Report, various issues

Notes: Figures in brackets show total amount in Rs.lakhs

recession in the state economy after mid-sixties and fell sick at a much later date. Labour relations in the unit remained cordial. The decline has been primarily due to managerial default. We also note that the unit had a unique position in the industry which has a marked proliferation of SSI manufactures; this was the only unit registered

Table 26: Performance Statement (Year ending 31 March)

(Rs.lakhs)

Sl. No.	Items	1972	1973
1	2	3	4
1	Net Sales	53.60	53.18
2	Sale Value of Production (SVP)	61.27	52.70
3	Variable Costs	28.13(45.9)	28.76(54.6)
4	Contribution	33.14(54.1)	23.94(45.4)
5	Fixed Costs	28.56(46.6)	25.74(48.8)
6	Earnings before Depreciation Interest, Tax	4.56	-1.80
7	Interest	0.07	0.43(0.01)
8	Cash Profit	4.49	-2.23
9	Depreciation	0.82	0.53
10	Net Profit	3.69	-2.76
11	Break-even SVP	52.80	56.66
		86.2	107.0

Source: Annual Reports, various issues

Note: Figures in brackets are as percentages of total sale value of production

with DGTD.[8] These SSI units operate on low overheads and enjoy the advantages of excise duty exemption.[9] The unit also had to compete with liberal imports against REP licenses. However, the most important constraint faced by the firm related to that of working capital as the account with its main bankers had been inoperative ever since IDR take-over. It is also worth noting at this point that the unit owed only about Rs.0.83 lakhs to the banks - a relatively small sum compared

to others encountered so far. The fact that the unit has to purchase raw materials, viz. Brass wires, strips and special manganese- aluminium wire and strips, on a cash-down basis aggrevates the problem. The present working capital limits of Rs.8 lakhs is way below the requirements of the unit.

4. One of the important features of reconstruction has been the solid backing-political and economic - of the state government in reconstruction. The unit received Rs.80 lakhs of assistance from the state government between July 1979 and March 1983, who have become the only source of fuels. The unit has a stable of professional top management, specially its chief executive - a thoroughbred technocrat. The fact that he is on the Board of Management of the unit is a crucial factor that aids the active participation of the Board in the operations and performance of the unit. This, we see, is in contrast to most other sick units in our sample where executive roles are clearly divorced from the supervisory ones at the Board level. Hence, this is one of those rare cases where reconstruction is being frustrated on account of deficient financial resources; the unit appears sound otherwise.

The primary problems here appear to be the lack of ordination between IRCI and state government in reconstruction efforts.

Case Study No.6

5. In the case of unit No.6, reconstruction has taken place under IDR Act since 1976 under the aegis of state government and has been a

success. It is similar to unit No.5 in numerous ways. For one, this is the youngest unit in our sample: decline came about due to deliberate mismanagement by entrepreneurs. The unit has an excellent product backed by foreign technology. Like our last case, the unit survived the worst phase of the recession in the state economy before going into liquidation. This is one of the two cases in our sample, of a company being reconstructed from liquidation. Like all other IDR units, finances, specially working capital, is the biggest problem faced by the unit. The main factors behind the turn around of the unit has been the consistent support of the State government and a very competent chief executive - features that it shares with No.5. Thus, the case highlights the cruciality of the Authorised Person - the state government in this case in reconstruction under IDR Act.

6. The unit was incorporated in April 1962 for the manufacture of machine tools with foreign collaboration. The machinery for the unit was provided by the foreign collaborator who also held 8.5% of the total equity capital of Rs.46.47 lakhs;[10] it employed about 315 people. Initially only injedtion moulding machines for the plastic industry were made with licensed and installed capacities of 150 machines and moulds. The fact that the unit managed to attract project finance from IFCI, WBFC and the banks, speaks highly of the potential of the unit. It did perform well in the initial years despite recessionary conditions in the state economy. The decline, however, set in following financial mismanagement by the entrepreneurs; purchases and sales were

Table 27: Performance Statement (Year ending 31 December)

(Rs.lakhs)

Sl. No.	Item	1970	1971	1975	1978
1	2	3	4	5	6
1	Net Sales	45.75	20.42	5.44	46.64
2	Sale Value of Production (SVP)	42.42	-3.81	11.29	68.37
3	Variable Costs	26.07(61.5)	31.07	8.61(76.3)	22.56(33.0)
4	Contribution	16.35(38.5)	-34.88	2.68(23.7)	45.81(67.0)
5	Fixed Costs	22.0 (51.9)	10.87	4.56(40.4)	33.04(48.3)
6	Earnings Before Depreciation, Interest Tax	-5.65	-45.75	-1.88	12.77
7	Interest	6.72(15.8)	3.59	10.78(95.5)	7.11(10.4)
8	Cash Profit	-12.37	-49.34	-12.66	5.66
9	Depreciation	3.45	3.45	3.45	3.83
10	Net Profit	-15.82	-52.79	-16.11	1.83
11	Break-even SVP	57.08(13.46)	19.21(70.2)		49.31(72.1)

Source: Annual Report, various issues

Notes: Figures in brackets are as percentage of total sale value of production

tied to sister concerns and funds were siphoned off.[11] Thus, between 1966 and 1971, the company accumulated losses to the tune of Rs.41 lakhs which nearly wiped out its net worth leading to acute shortage of working capital. The management declared a lock-out in September 1972; by that time, SVP had turned negative (Table 27), net worth and net working capital became negative and cash losses mounted (Table 28). In fact, the cash loss per rupee of sales was over Rs.two. Similarly, share capital and assets declined while loans and losses increased (Table 29).

Table 28: Summary of Performance (Year ending 31 December)

(Rs lakhs)

Sl. No.	Item	1970	1971	1975	1978
1	2	3	4	5	6
1	Cash Profit	-12.37	-49.34	-12.66	5.66
2	Tanginle Net Worth	10.09	-18.01	-87.08	-143.38
3	Net Working Capital	9.28	-10.85	4.49	12.17
4	Debt	69.63	74.18	145.29	201.80
	Relationships (Ratios)				
5	Debt/Equity	1.49	1.60	3.13	4.34
6	Accumulated Loss/Equity	0.78	1.39	2.87	4.09
7	Cash Profit/Net Sales	-0.27	-2.42	-2.33	0.12
8	Internal Source/Total Liabilities	0.27	0.24	0.17	0.13

Source: Annual Reports, various issues

7. On an application made by a creditor, the company was directed to be wound up by the Calcutta High Court in July 1973 and it went into liquidation. In view of the intrinsic potential of the unit and the employment involved, the central government took over the management of the company in August 1975 under Section 18FA of the IDR Act. The government of West Bengal was appointed as the Authorised Person. The company was re-opened in September 1975 after a three-year closure and production was re-started in October 1975; the unit was granted relief status by the state government

Table 29: Structure of Balance Sheet (Year ending 31 December)

(Percentages)

Sl. No.	Item	1970	1971	1975	1978
1	2	3	4	5	6
A	LIABILITIES				
1	Share Capital	27.3	24.0	17.3	13.2
2	Secured Loans	40.4	36.6	44.7	36.8
3	Unsecured Loans	0.0	1.6	9.5	20.5
4	Current Liabilities and Provisions	31.8	37.8	28.6	29.5
	Total	100.0	100.0	100.0	100.0
		(170.18)	(193.95)	(268.46)	(352.14)
B	ASSETS				
5	Net Fixed Assets	38.7	32.2	18.2	11.8
6	Current Assets, Loans and Advances	39.9	34.6	32.0	34.3
7	Debit Balance of Profit & Loss Account	21.4	33.2	49.7	53.9
		100.0	100.0	100.0	100.0
	Total	(170.18)	(193.95)	(268.46)	(352.14)

Note: Figures in brackets show total amount in Rs. lakhs

Source: Annual Report, various years

in December 1975. The immediate problem faced by the unit related to working capital finances like all other IDR units - as the unit's erstwhile financiers were unwilling to fund the unit any longer in view of the uncertainty over past debts. In the event, the unit became solely dependent on the state government for its finances who

provided a sum of Rs.10 lakhs. In the first two years of reconstruction, not much headway could be made. During 1966-67, it could sell only three machines, SVP was Rs.11.93 lakhs only while cash losses came to Rs.12.06 lakhs. During 1977-78, sales improved to six machines with SVP of Rs.18.64 lakhs and cash losses of Rs.18.79 lakhs. This was so because while the unit was lying closed, market competition had increased considerably and unlike its competitors, the company had no policy of after-sales service.[12] The goodwill of the company had taken a beating in the market place on two counts, viz. (i) previous management had taken advances from customers without effecting deliveries. To make up for this, the unit provided spares and services free of cost. (ii) Arrears with suppliers of raw materials on account of old purchases was pending; this too has been cleared. Problems arose also because of the unit's single product-line viz. manufacture of injection-moulding machine. This has been overcome since 1980 as the unit diversified into the production of high capacity twin extruders for pipes and sections - an item currently imported under OGL.

8. Above all, the resource constraint was a binding one as the unit was solely dependent on the state government for funds. The state assistance is basically limited as many other units require help; all the same, the unit received assistance to the tune of Rs.143.27 lakhs till December 1982. Proposal for expansion and diversification have been submitted to IDBI. Despite the above limitations, the unit has shown a marked improvement in performance since 1978-79 when the unit broke even and even made a net profit (Table 27). The working capital situation too improved through

contracting more debt, as internal sources of funds diminished (Table 28). The unit made a 12% cash profit on net sales. This improvement is not immediately visible in the financial structure of the company (Table 29) as it is primarily a legacy of the past distortions. The primary factor behind the turn-around of the unit has been the competent guidance of the chief executive who is also on the Board of the company, as in our case No.5. The consistent support by the state government has been the other supplementary aspect in reconstruction. The stability in management helped the unit in chalking out the proper course of action while the State support ensured crucial political commitment to the survival and continuance of the unit. It is interesting to note that IRCI played no role in reconstruction; banks too did little, which is again similar to case No.5. In short, stable management, stable financial support and product diversification held the key to revival.

Section 4: Retention of Old Management

Case Study No.7

1. Reconstruction in this case has taken place through the retention of the old management, with assistance from IRCI and the bank.[13] It illustrates how problems in the incipient stages can finally snowball into long-term ones, impairing the very viability of the firm. As we observed before, retention of an inefficient management set-up can never

revive an ailing enterprise. It is interesting to find the juxtaposition of roles between the bank and IRCI in this case. While the bank supported the unit to the hilt, IRCI wanted to take legal action on account of its mistrust in the management.

2. The unit was incorporated in June 1965 as a SSI unit for the production of meehanite castings - sole licensee in eastern India - under license from a UK-based firm[14] Commercial production was started from June 1967 with 85 employees. The chief promoter was a technocrat who continued to be employed elsewhere till 1975; the unit was looked after by his brother and another promoter. As the promoters were of limited means, number of essential production and testing equipments were omitted. This made the foundry ill-equipped right from the beginning and led to low yields and high rejections in later years. In addition, overall recessionary conditions prevailed in the state economy so that the firm continued making losses despite its young age and captive market possibilities. It could make a profit only in 1970. One aspect of the technical problem was the long period of time taken to standardise the production of meehanite and other graded castings. In the absence of the chief promoter, management capabilities remained at a low level specially with respect to securing of orders and delivery of quality products. Subsequently, the unit approached IRCI for assistance in 1972; though a sum of Rs.4.73 lakhs was sanctioned in February 1972, none was disbursed due to delays in submission of audited accounts. Following a joint meeting between the bank, IRCI and the unit, it was decided that

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IRCI and bank would disburse a sum of Rs.5.53 lakhs and Rs.7.73 lakhs respectively; in practice, IRCI gave only Rs.2.58 lakhs.[15]

3. Following this assistance, the four-member board was recast with IRCI nominee becoming the Chairman; the nominee of the bank and the two entrepreneur directors were the other members. However, no management restructuring was undertaken at other levels, so that the executive control was retained by the old management. Though IRCI arranged for technical tie-up with a leading firm, the technology could not be absorbed due to floating technical personnel and overall poor performance. It was observed that the unit received funds for payment of wages and other expenditures from its main customer, though the precise nature of the relationship was not clear. However, the fact that the unit continued to execute unremunerative orders for this customer raises doubts about off-the-book transactions between the two. In general, IRCI had no trust in the management. This was following the reported expenditure of the management, through the issues of eightfive cheques without necessary sanction by the interal auditor. The unit allowed the building of a stress-relieving furnace inside the factory without the prior approval of IRCI and the bank. IRCI regarded the monthly expenditure on remuneration of entrepreneurs on the high side. Above all, the management paid no heed to IRCI's advices. At one stage, IRCI even wanted to initiate legal proceedings for recovery of its advances; this was, however, deferred at the instance of the bank.

4. In contrast, the bankers gave wholehearted support to the unit. Interest remission to the tune of Rs.0.37 lakhs was granted in March 1976. Though IDBI evolved a nursing package in March 1979, it was rejected by the financiers as it involved too many sacrifices. With IRCI's interest waning, the bank took up the initiative for reconstruction. By October 1977, the total credit limits to the unit stood at Rs.18.45 lakhs. The Chairman of a leading public sector corporation was induced as the bank's nominee on the Board to become its Chairman. Subsequently, the unit became a registered ancillary to the public sector corporation. However, these efforts of the banks haven't succeeded in toning up the performance of the unit.

5. By far, 1979 has been the best year during reconstruction when SVP was at its highest enabling the unit to break even. The performance in general has been indifferent, though devoid of sharp swings. Cash losses have increased in magnitude on account of rising interest burden. By 1982, interest formed as much as 52% of SVP(Table 30). The imbalances in financial frame are similar to those noted earlier viz. decline of net worth and assets and rise of loans and losses (Table 31). A detailed study undertaken in July 1982 by a consultant identified the following reasons for sickness: (i) defective lay out of the factory which created large gaps between licensed capacity, installed capacity and production levels, (ii) insufficient production facilities (iii) inadequate quality control, (iv) production of low-value items (v) failure to keep up delivery schedules and overall gaps in functional management and (vi) low morale

Table 30: Statement of Performance (Year ending 31 March)

(Rs.lakhs)

Sl. No.	Item	1973	1976	1979	1982
1	2	3	4	5	6
1	Net sales	4.33	11.92	13.58	11.66
2	Sale Value of Production (SVP)	3.62	11.61	15.37	10.76
3	Variable costs	2.55(70.4)	9.51(81.9)	7.32(47.6)	6.15(57.2)
4	Contribution	1.07(29.6)	2.10(18.1)	8.05(52.4)	4.61(42.8)
5	Fixed Costs	3.47(95.9)	6.63(57.1)	8.07(52.5)	7.86(73.0)
6	Earnings before Depreciation, Interest, Taxes (EBDIT)	-2.40	-4.53	-0.02	-3.25
7	Interest	0.37(10.2)	1.18(10.2)	2.41(15.7)	5.56(51.7)
8	Cash Profit	-2.77	-5.71	-2.43	-8.81
9	Depreciation	0.13	0.14	0.25	0.19
10	Net Profit	-2.90	-5.85	-2.68	-9.0
11	Break-even SVP	11.74(324.0)	36.65(316.0)	5.41(100.0)	18.35(171.0)

Source: Annual Reports, various years

Note : Figures in brackets are as percentage of SVP

of labour force due to delayed wage payments though it did not lead to any labour trouble as such. The binding constraint on technological upgradation has been paucity of resources towards capital expenditure emanating from the wrangle with IRCI over submission of audited accounts. The unit was also affected by floods during 1976 and 1977. The other factor behind the decline is the dissension in the top management itself

Table No.31: Structure of Balance Sheet (As at 31st March)

(Per centages)

Item	1973	1976	1979	1982
1	2	3	4	5
A. Liabilities				
Share Capital	28.2	15.4	10.8	7.1
Reserves and Surplus	1.2	0.01	0.0	0.0
Term Loans	-	30.0	29.1	23.0
Unsecured Loans	19.8	3.5	2.4	1.6
Current Liabilities and Provisions	50.8	50.5	57.3	67.9
Total	100.0 (15.42)	100.0 (28.32)	100.0 (40.46)	100.0 (61.09)
B. Assets				
Net Block	13.9	9.9	8.6	4.6
Investments	3.7	2.4	0.01	0.0
Current Assets, Loans & Advances	34.5	23.6	21.3	12.6
Debit Balance of Profit and Loss Account	47.9	64.2	69.4	82.3
Total	100.0 (15.42)	100.0 (28.32)	100.0 (40.46)	100.0 (61.09)

Sources: Annual Reports, various years

Notes : Figures in brackets show total in Rs. lakhs

following which a founder director left in 1977.[16]

6. Quite expectedly, by 1983, IRCI came around to the view point that change of management was essential for future progress. In tandem

Table 32: Summary of Performance: As on 31 March

(Rs. lakhs)

Sl. No.	Item	1973	1976	1979	1982
1	2	3	4	5	6
1	Cash Profit	-2.77	-5.71	-2.43	-8.81
2	Net Working Capital	-2.52	-7.63	-8.56	-33.79
3	Tangible Net Worth	-2.85	-13.65	-23.54	-45.72
4	Debt	3.55	11.61	24.23	40.0
	of which IRCI	-	2.58	3.18	3.80
	Relationships (Ratios)				
5	Debt/Equity	0.78	2.56	5.34	8.83
6	Accumulated Loss/Equity	1.62	4.01	6.20	11.09
7	Cash Profit/Net Sales	-0.64	-0.48	-0.18	-0.76
8	Internal Sources/Total Liabilities	0.29	0.15	0.11	0.07

Source: Annual Reports, various issues

the bank has refused further assistance without IRCI's participation.

7. On balance it is clear that indifferent attitude of entrepreneurs has been a major factor behind the failure of reconstruction efforts. The onset of sickness may be traced back to the initial stages of the project itself. Deficiencies relating to the installation of production facilities never really got remedied. Above all, the situation with reference to managerial default remained unchanged which prolonged the problems.

Case Study No 8

8. Like our previous case, reconstruction in this unit has gone on under the aegis of the old management with help from IRCI and the bankers. Unlike many other units of the sample, the unit was not chronically sick. Deliberate mismanagement continued through the reconstruction phase. What is striking is the total lack of control by financiers over the course of reconstruction and the affairs of the unit. Thus, the case once again highlights the crucial role played by management in reconstruction. The other interesting aspect of the unit is the fact that though majority of the shares were owned by workers, their interests have been sidelined almost always.

9. The unit was set up in February 1930 as a partnership and was converted to a private limited company in 1939; it was registered as a SSI unit in November 1969. The unit has a record of Workers' participation from earlier times, as revealed in the ownership pattern. The total of Rs.5 lakhs of paid-up-capital was distributed as follows (i) A trust for the benefit of workers - 60% (ii) Directors - 20% (iii) Workers - 20%. In practice, the control rests with the directors. The unit is engaged in fabrication and structural engineering in chemical and mechanical industries, the installed capacity is 100 metric tonnes per month. The company's factory at Calcutta undertakes fabircation while erection is carried on at the sites. The factory employs 260 people; together with the people at the site, total strength comes up

to 400. One of the company's features is its substantial interest in real estate, the security of which, as we shall see, was to form the basis for the financier's trust. In the company's land at Durgapur, it promoted and patronised a number of ancillary units though the exact nature of this relationship is not clear. An estimate in 1980, put the value of the company's Calcutta land at Rs.52.84 lakhs.

10. Between 1958 and 1963, the company received a loan of Rs.5.98 lakhs from the Refugee Rehabilitation Department, Government of India, in lieu of which employment to 235 displaced persons was provided; the unit is yet to repay this loan. After making small profits during 1964-65, the firm incurred continuous cash losses from 1966-67 and became sick. At the end of 1971, accumulated losses stood at Rs.11.30 lakhs against networth of Rs.5 lakhs; at this stage, IRCI was approached for assistance. IRCI sanctioned Rs.6.60 lakhs but disbursed only Rs.4.34 lakhs as the share control was not transferred in IRCI's favour. This was on account of legal problems in transferring control from the workers' trust; subsequently, IRCI could not place its nominee on the board, the only unit in our sample of this kind. The working capital limit was also raised to Rs.5.30 lakhs following the IRCI package. IRCI had identified the following factors behind the sickness of the unit: (i) overall mismanagement by directors who were incompetent as well, (ii) absence of suitable technical management, (iii) shortage of funds, absence of financial planning and control, (iv) execution

of unremunerative orders, and (v) unplanned capital investments in land which led to the blocking of working capital. Though IRCI initiated steps to correct some of the above imbalances, the management proved to be unwilling and averse to any control. Thus, though IRCI provided for the appointment of a commercial superintendent to look after sales promotion, estimation, tendering etc. and a secretary to look after financial planning and control, no appointments were made.

11. Towards the end of 1972, IRCI initiated discussion with a reputed firm for a tie-up with the unit to upgrade production technology which fell through. The firm in question was also a big customer to the unit; the continued execution of under-rate contracts for the firm by the unit roused suspicions of off-the-book transactions between them.[17] The net result was the continued incurring of cash losses by the firm. IRCI was in general dissatisfied by the style of management in the unit, for example, senior appointments were made without its knowledge. The company also did not disclose details about its lucrative site contracts. In short, the management was averse to any sort of external control, so much so that, it refused IRCI's second loan for Rs.8 lakhs in 1973. On account of all these factors, IRCI deliberated on the recall of its advances which was ultimately deferred at the instance of its bankers.

12. The haphazard management style was commented upon by the internal auditors to the firm as well. No proper recording and accounting system

existed in the unit: even interest for the loan from rehabilitation department was not provided for. There were pointers to inflated expenditures and diversion of funds. Even the principal banker could not exercise adequate control as all transactions were not routed through them; thus, between 1-9-80 and 31-8-82, the credit and debit summations in the account were only Rs.40.68 lakhs and 50.75 lakhs respectively against sales of Rs.85.00 lakhs. The morale of the employees was at a low ebb due to irregular payments of wages and salaries; non-allocation of jobs also led to huge loss of man-hours. Ultimately, the case was referred to IDBI in 1979; it proved to be of no avail as the unit dragged its feet over details sought by IDBI which is another pointer to the indifference of management. Though SVP has drastically improved over the years, the fluctuations in costs have been so wide that the unit has ended up making cash losses in all the years except 1976. (Table 33). Thus, variable costs increased in 1979 compared to 1976 even as SVP declined; on the other hand, when SVP doubled in 1982 compared to 1979 fixed costs too were doubled. On this evidence, the remark of internal auditors regarding inflated accounts arising from doctoring of figures appears to be well-founded. The lower outgoings on interest payments is due to the non-provision of interest for the loan from rehabilitation department.

13. In any case, it is closer that the performance of the unit is not akin to that of a chronically sick enterprise like the ones encountered in the last chapter. The decline of networth and the rise of loans are

Table 33: Performance Statement (as at 31 August)

(Rs.lakhs)

Sl. No.	Item	1973	1976	1979	1982
1	2	3	4	5	6
1	Net Sales	18.05	26.11	22.45	43.64
2	Sale Value of Production (SVP)	18.82	28.99	26.03	44.65
3	Variable Costs	8.92(47.4)	8.55(29.5)	11.19(43.0)	9.34(20.9)
4	Contribution	9.90(52.6)	20.44(70.5)	14.84(57.0)	35.31(79.1)
5	Fixed Costs	15.41(81.9)	19.00(65.5)	21.11(81.1)	42.8(95.9)
6	Earnings before Depreciation, Interest and Taxes	-5.51	1.44	-6.27	-7.49
7	Interest	1.15(6.1)	1.18(4.1)	1.85(7.1)	4.67(10.5)
8	Cash Profit	-6.66	0.26	-8.12	-12.16
9	Depreciation	0.61	0.70	0.61	0.77
10	Net Profit	-7.27	-0.44	-8.73	-12.93
11	Break-even SVP	29.29(155.6)	26.95(93.0)	37.03(142.3)	54.12(121.2)

Source: Annual Reports, various issues

Note : Figures in brackets are as percentage of total sale value of production

The decline of networth and the rise of loans are like other sick units; within loans, the decline of term liabilities and the rise of current liabilities is indicative of the declining role of IRCI and increasing role of banks in the financing of the unit. On the other hand, share of accumulated losses fell while that of assets rose; this is unlike the

Table 34: Statement of Balance Sheet (Ast at 31 August)

(Percentage)

Sl. No.	Item	1973	1976	1979	1982
1	2	3	4	5	6
	A. Liabilities				
1	Share Capital	10.9	9.3	8.0	7.4
2	Term Liabilities	35.8	32.9	28.4	22.0
3	Current Liabilities	53.3	57.9	63.6	70.6
	Total	100.0 (45.67)	100.0 (54.00)	100.0 (62.28)	100.0 (84.43)
	B. Assets				
4	Net Fixed Assets	20.4	17.9	13.9	15.0
5	Non-current Assets	9.9	10.9	5.9	4.0
6	Current Assets, Loans and Advances	26.5	35.3	38.6	43.1
7	Debit Balance of Profit and Loss Account	43.3	35.9	41.6	38.0
		100.0 (45.67)	100.0 (54.00)	100.0 (62.28)	100.0 (84.43)

Note: Figures in brackets are totals in Rupees lakhs

Source: Annual Report, various issues

sick units that have been encountered so far. Likewise, though the distortions in the financial frame are similar to those of other sick units, the magnitudes are much smaller (Table 35). Thus, per rupee cash losses have come down to 4 paise in 1982 from 11 paise in 1973. The fact that debt to equity ratio is more than twice the accumulated

Table 35: Summary of Performance (As at 31 August)

(Rs. lakhs)

Sl. No.	Item	1973	1976	1979	1982
1	2	3	4	5	6
1	Cash Profit	-1.94	2.19	-2.47	-1.76
2	Tangible Net Worth	-14.76	-14.41	-20.92	-25.81
3	Net Working Capital	-12.24	-12.21	-15.57	-23.22
4	Debt	20.99	22.9	29.04	54.36
	of which IRCI	4.60	5.84	6.56	7.72
	Relationships (Ratios)				
5	Debt/Equity	4.20	4.44	5.81	8.67
6	Accumulated Loss/Equity	3.43	3.87	4.11	4.26
7	Cash Profit/Net Sales	-0.11	0.08	-0.11	-0.04
8	Internal Sources - Total Liabilities	0.11	0.09	0.8	0.07

Source: Annual Reports, various issues

loss to equity ratio suggests that the debt that was contracted could have been diverted to purposes other than meeting losses alone. Though the indicators of profitability, liquidity and solvency clearly point to the sickness of the firm, the relative stagnation in the indices over the years suggests that the firm is not chronically sick.

14. Hence, reconstruction efforts so far has not managed to revive the unit, owing mainly to the uncooperative attitude of the management. The real key to the understanding of this outcome is the tight control of management over the unit and the apparent failure of monitoring

systems devised by the financiers. In particular, the latter does not seem to be having a clear picture of the affairs at the unit viz. investment in real estate, details of the lucrative site contracts substantiates our thesis regarding the inappropriateness of retaining management when the decline is primarily due to them.

Case Study No.9

15. The most interesting aspect about this case is the revival of the unit under the aegis of the old management which proved to be very dynamic to the challenges faced by the firm. The decline itself was due to external factors. Interestingly the role of IRCI has been very marginal like the other success stories of our sample. The solid support given by the bankers proved to be a major contributory factor. The other feature in reconstruction has been the ingenuity shown by the management in revaluing fixed assets so as to remove the distortions in its financial frame. There has been only one phase in reconstruction viz. under the old management.

16. The beginning of the unit dates back to 1918, when it was incorporated as a proprietory concern; it was converted into a private limited company in 1934. The initial product lines consisted of cocks and valves; manufacture of ceiling fans was taken up in 1942 and the range expanded thereafter to table fans, pedestal fans, cabin fans, exhaust fans and air circulators. Till the tie-up with two big manufacturers in 1956,

average sales came to Rs.6 lakhs annually; following this five year tie-up till 1961, annual sales rose to Rs.22 lakhs. After 1961, the unit started off-loading as much as 90% of its production to Directorate General of Supplies and Disposals (DGS&D) under rate contract. In 1965, the books of account were seized by the Central Bureau of Investigation (CBI) following certain allegations, though no case was ultimately filed. However, DGS&D order was cancelled and sales dipped in the absence of alternate marketing arrangements. The decline in sales was from Rs.25.86 lakhs in 1964 to Rs.17.07 lakhs in 1965, Rs.7.8 lakhs in 1966 and Rs.4.86 lakhs in 1969. Subsequently, the cash profit of Rs.0.45 lakhs in 1965 became a cash loss of Rs.0.09 lakhs in 1969. The management of the unit proved to be dynamic and responded to the crisis in the following ways. The unit was registered as a SSI unit in May 1968; out of the total employees of 524, about 100 people were retrenched between 1966 and 1969.

17. Despite the above measures, the decline could not be arrested so that accumulated losses at the end of December 1971 stood at Rs.5.85 lakhs against networth of Rs.4.88 lakhs. There were raw material problems with regard to ball bearings and stampings and the market for fans had become highly competitve; problems regarding deficiency of working capital also existed. Against the above setting, IRCI was approached for assistance in 1971 and Rs.2.25 lakhs sanctioned in March 1972. Accordingly, the bankers revised the working capital limit to Rs.5.50 lakhs; the limit was further revised to Rs.18.30 lakhs in April 1975,

Rs.22.90 lakhs in May 1978 and Rs.40.52 lakhs in December 1983. There were two contributory factors in the bank's solid support to the unit : (i) The unit was in possession of 11 acres of land within its factory premises which formed prized urban real estate, (ii) Bank's high opinion of the capabilities of unit's management. In view of the unit's improved performance, it did not avail of IRCI's second loan for Rs.2.30 lakhs in December 1973; in fact, all of IRCI's dues were cleared by July 1983. The other innovative strategy of the management was directed at altering the distortions in its financial frame (Table 37). The fixed assets of the company were revalued in June 1978 and the net appreciation value of Rs.25.40 lakhs was transferred to balance sheet, of which Rs.7.96 lakhs was set off against accumulated losses.

18. On the marketing front, management appointed two sole-selling agents to boost sales. Accordingly, sales to private parties came to account for 60-65% of total sales as against the previous over-dependence on DGS&D. In view of the severe competition in the fan market, a decision was taken in February 1981 to diversify into mancoolers, flow fans, centrifugal blower and roof extraction electric motors. There has been steady improvement in SVP over the years from 1979 to 1983 and the unit has broken even; it could even earn a net profit in 1981. (Table 36). The financial prudence of the management is clear from the lower outgoings on interest; on account of the asset revaluation, from 1979 the share of accumulated losses declined (Table 37). The solid support of the bank and the marginal stake of IRCI is clear from the shares of current liabilities and term

Table 36: Performance Statements (Year ending 31 March)

(Rs. lakhs)

Sl. No.	Item	1979	1981	1983
1	2	3	4	5
1	Net Sales	65.42	81.67	90.94
2	Sale Value of Production (SVP)	64.64	84.85	84.58
3	Variable Costs	49.47(76.5)	63.22(74.5)	60.71(71.8)
4	Contribution	15.17(23.5)	21.63(25.5)	23.87(28.2)
5	Fixed Costs	13.94(21.6)	16.14(19.0)	19.96(23.6)
6	Earnings before Depreciation	1.23(1.9)	5.49(6.5)	3.91(4.6)
7	Interest	3.01(4.7)	3.92(4.6)	5.45(6.4)
8	Cash Profit	-1.78	1. 57	-1.54
9	Depreciation	0.65	0.93	1.09
10	Net Profit	-2.43	0.64	-2.63
11	Break-even SVP	59.40(91.9)	63.31(74.6)	70.73(83.6)

Source: Annual reports, various years

Note: Figures in brackets are as percentage of total sale value of production

liabilities respectively. The success of reconstruction is reflected further in the increased share of assets. Likewise, debt to equity and accumulated loss to equity ratios dropped significantly and cash loss per unit of net sales has become nagative (Table 38). Tangible net worth has become positive and internal resources contributed as much as a quarter of the total fund requirements.

Table 37: Structure of Balance Sheet (as at March 31)

(percentages)

Sl. No.		1971	1975	1979	1983
1	2	3	4	5	6
A	LIABILITIES				
1	Share Capital	17.6		6.4	5.5
2	Reserves and Surplus	2.5	13.0	22.9	19.5
3	Term Liabilities	14.6	14.3	8.4	3.3
4	Current Liabilities and Provisions	65.5	72.6	62.3	72.1
	Total	100.0 (20.60)	100.0 (37.43)	100.0 (76.12)	100.0 (89.53)
B	ASSETS				
5	Net Fixed Assets	11.1	6.3	39.9	38.3
6	Current Assets, Loans and Advances	58.3	71.9	56.6	57.5
7	Debit Balance of Profit and Loss Account	28.4	21.7	3.5	4.2
	Total	100.0 (20.60)	100.0 (37.45)	100.0 (76.12)	100.0 (89.53)

Source: Annual reports, various years

Note : Figures in brackets are totals in Rs. lakhs

19. In short, the reconstruction efforts in this case have proved to be a success. The prime mover behind the turn around of the unit has been the dynamism of the management and the positive support of the bank.

Table 38: Summary of Performance (As at 31 March)

(Rs. lakhs)

Sl. No.	Item	1975	1979	1983
1	2	3	4	5
1	Cash Profit	N.A	-1.78	-1.54
2	Tangible Net Worth	-3.26	19.66	18.56
3	Net Working Capital	-0.26	-4.36	-13.07
4	Debit	23.45	33.26	38.95
	of which IRCI	8.56	9.94	2.65
	Relationships (Ratios)			
5	Debit/Equity	4.81	1.49	1.75
6	Accumulated Loss/Equity	1.67	0.12	0.17
7	Cash Profit/Net Sales	N.A	-0.03	-0.02
8	Internal Sources/Total Liabilities	0.13	0.29	0.25

Source: Annual Report, various years

Section 5: Management by Workers' Cooperative

Case Study No. 10

1. There have been two distinct phases of reconstruction in the case of this unit - first under the old management and then through the formation

of an industrial cooperative of all the workers. The latter has performed much better than the former, going by the evidence so far. The concept of workers' cooperative itself is quite radical in nature as workers also become the owners of the means of production; the support of the state government has been crucial for the promotion of the idea. In the first place, the decline and failure of the firm itself is the classic case of a single-product firm failing due to the drying up of orders/demand from its monopoly buyer. This coupled with the failure of reconstruction efforts in the first phase under the auspices of the old management validates our constant refrain about how inimical the retention of old management is for reconstruction when failure has been primarily due to inadequate management capabilities.

2. The unit was originally set up as a proprietorship in February 1936 for the manufacture of a few varieties of gun-metal and bronze-based pipeline fittings. It was converted into a partnership in July 1965 and a private limited company in April 1972. In 1961, it was registered as a SSI unit with 262 employees on its rolls. Towards the end of 1940s the unit switched over to the manufacture of bronze and gun metal valves and cocks for boilers and steam locomotives. From 1962 onwards, the firm supplied nearly 90% of the country's requirements of cast iron and bronze mountings and fittings for steam locomotives; subsequently, sales to railways came to account for nearly 80% of the unit's capacity. However, following the policy of the government to discontinue the manufacture of steam locomotives, sales declined continuously from 1966-67 onwards. The proposed diversification

into industrial valves did not come through due to general recession in the engineering industry. Other factors which precipitated the decline were (i) lack of proper production planning, (ii) heavy inventory accumulation and the consequent tightening of liquid resources, (iii) rising burden of interest as borrowings increased without concomitant production increases, (iv) manpower and machinery utilisation was far below the optimum, (v) ineffective sales set-up and inadequate management control all-round and (vi) deficiencies of the controlling family management in general.

3. The course of decline is clearly charted in Tables 39 and 40. The sharp drop in sales triggered off continuous cash losses from 1969-70 onwards. The working capital situation had turned adverse since 1966-67 and net worth became negative in 1970-71. The high outlay on wages and salaries kept the fixed costs high. Likewise, share of net worth and assets declined while share of loans and losses rose (Table 40). During 1970-71, the unit's account with the bank became sticky; debit balance at the end of December 1971 stood at Rs.2.26 lakhs against limits of Rs.1.50 lakhs. Though the credit limits were renewed in August 1971, neither of the two partners were willing to execute the deed of guarantee; thereafter, the bank refused to extend further assistance to the unit. This was a clear pointer to the waning interest of entrepreneurs in the unit and its prospects. It was against the above setting that the unit approached IRCI for assistance in 1971. IRCI sanctioned Rs.4.90 lakhs and assumed share and board control of the unit. The constitution of the company was changed from partnership to private limited. A four-member board took over with two IRCI nominee

Table 39: Performance Statement (As on 31 March)

(Rs. lakhs)

Sl. No.		1967	1970	1971
1		2	3	4
1	Net Sales	21.75	14.13	12.25
2	Sale Value of Production (SVP)	21.70	14.75	13.03
3	Variable Costs	11.62(53.5)	3.75(25.4)	4.56(35.0)
4	Contribution	10.08(46.4)	11.00(74.6)	8.47(65.0)
5	Fixed Costs	8.91(41.1)	10.33(70.0)	10.54(80.9)
	of which Salaries and Wages	7.26(33.5)	8.68(58.8)	8.90(68.3)
6	Gross Profit	1.17(5.4)	0.67(4.5)	-2.07
7	Interest	0.67(3.1)	0.68(4.6)	0.45(3.5)
8	Cash Profit	0.50	-0.01	-2.52
9	Depreciation	0.19	0.16	0.07
10	Net Profit	0.31	-0.17	-2.59
11	Break-even SVP	19.18(88.4)	13.85(93.9)	16.21(124.4)

Source: Annual Reports, various years

Note : Figures in brackets are as % of total sale value of production

and the two entrepreneurs. However, executive management remained with the entrepreneur directors, which in retrospect proved to be the major drawback of reconstruction in the first phase.

4. Other measures included the appointment of a financial controller by IRCI, laying off of 58 workers in September 1971 to cut overheads and going into new product lines like cast iron sluice gates, steam valves,

Table 40: Structure of Balance Sheet (As on 31 March)

(Percentages)

Sl. No.	Item	1967	1970	1971	1974
1	2	3	4	5	6
A	LIABILITIES				
1	Share Capital	17.8	11.3	9.4	5.2
2	Reserve and Surplus	0.6	0.0	0.0	0.0
3	Term Liabilities	-	-	-	27.2
4	Current Liabilities and Provisions	82.0	88.7	90.6	67.5
	Total	100.0 (17.23)	100.0 (19.77)	100.0 (23.58)	100.0 (40.50)
B	ASSETS				
5	Net Fixed Assets	12.8	9.3	7.2	18.1
6	Current Assets, Loans and Advances	82.6	89.8	79.1	39.3
7	Debit Balance of Profit and Loss Account	4.6	8.9	13.7	42.6
	Total	100.0 (17.23)	100.0 (19.77)	100.0 (23.58)	100.0 (40.50)

Source: Annual Reports, various years

Note: Figures in brackets show total in Rs. lakhs

painted cast iron bibcocks, stop cocks, etc. Despite all this, performance did not improve in this phase and the IRCI funds went to meet losses and

working capital requirements. Other factors which foiled reconstruction in this phase were: (i) increased raw material prices (ii) unbalanced inventory holding (iii) high overhead expenses (iv) lack of ISI ratings for the products (v) poor sales promotion (vi) inappropriate product-mix as the unit relied solely on cocks of taps meant for domestic use. These were low-margin items with keen competition from plastic wares as opposed to industrial valves with wide applications in process industries. Given the abvoe scenario a joint-meeting of institutions in May 1978 came to the view that as the entrepreneurs had little stake and interest in the unit, the onus for reconstruction rested with the bank, IRCI and the employees. A decision, hence, was taken to form an industrial cooperative of the workers which will take over the land, building and machinery of the unit on a lease basis. The move had the active political backing of the state government following the good progress of the other workers' cooperatives in the state.

5. Presently, the cooperative society is being run by a nine-member managing committee, including two IRCI nominees. The duration of the lease is for a period of nine years from July 1981 at the rate of Rs.2.50 lakhs in the first years and Rs.6 lakhs in the following years. These rentals from the cooperative are expected to service the past debts of the unit: as usual, the old management is yet to honour this commitment. The workers cooperative has been advanced Rs.20 lakhs by banks and Rs.30.11 lakhs by IRCI; the results so far indicate good progress. Plans are afoot for the manufacture of copper-based ingots and valves, though

problems abound on the sales front, even now. Rigid inspection norms and enormous delays in the case of boilers is another issue. Above all is the big question mark over the future status of the unit. Despite all these limitations, the formation of industrial co-operative by workers appears to be a plausible solution to the problem of wide-spread sickness amongst SSI units.

Case Study No.11

1. Like case No.10, reconstruction in this unit has taken place through the formation of an industrial co-operative by workers, though under different circumstances. The unit had actually gone into liquidation on account of deliberate mismanagement. In fact, the entrepreneures in question are the ones who controlled case No.4 and indulged in similar tactics to bring about total ruin of the firm; thus, it once again highlights the crucial role of management in the performance of the unit. At another level, the case is representative of the class of firms which passed into Indian ownership from foreign ownership and declined on account of short-term profiteering by unscrupulous entrepreneurs. We have already remarked how this process, amongst others, contributed to the overall decline of the eastern region of the country. Finally, the case highlights the potential of workers' co-operative as a strategy in combating sickness amongst SSI units and the problems therein viz. lack of ownership over assets leading to shortage of securities for financial assistance and the question over future status.

2. The unit was incorporated as a public limited company in March 1927 for the manufacture of printing ink. It had a paid-up capital of Rs.13 lakhs against authorised capital of Rs.20 lakhs. The management was in the hands of Norwegians with four factories at Howrah (260 employees), Bombay (87 employees), Madras (100 employees) and Delhi (107 employees). The company ran two well-known press-men schools, conducted by foreign experts, at Bombay and Calcutta, for providing free training to Indian printers. It supplied one-third of the country's printing ink requirements and ran on good profits with sizeable amount of exports. This professionalism of the foreign owners should be contrasted with the mismanagement of the Indian entrepreneurs described later. In 1958, the controlling block was purchased by a medium-sized management group which purchased unit No.4 above. However, they could not assume control till 1964 due to litigation by Indian directors. Upon taking over, the management essayed a series of moves aimed at plundering the company rather than consolidating its position. Thus, between 1964 and 1973, dividends to the tune of Rs.33.46 lakhs was paid out against net profits of Rs.105.11 lakhs; this yields a pay-out ratio of 27% which was clearly divorced from the long term growth and survival of the firm. The chief beneficiaries of this generous gesture unmistakably belonged to the management group.

3. The other major tactic was in the realm of inter-corporate investments, almost all of which were considered irrecoverable later on. Money to the tune of Rs.22.54 lakhs was appropriated in sundry names and deemed as bad debts later. A sum of Rs.50 lakhs was diverted

in the guise of general expenses, commissions, motor car expenses, travelling charges, low charges etc.[18] Another pointer to the doctoring of accounts is the fact that profits declined even when production picked up. Thus, between 1964-65 and 1969-70, annual net profits averaged Rs.15.48 lakhs against production of Rs.163.44 lakhs; however, between 1970-71 and 1972-73, profits dropped to Rs.4.09 lakhs only against increased production of Rs.179.52 lakhs. The statement of accounts was not prepared for the years 1973-74, 74-75, and 1975-76; the company also did not bother to answer the questions of the statutory auditors in this regard. On the other hand, efforts were made to remove machinery from Howrah factory which was successfully foiled by the workers. Following the partitioning in the management group in 1972, three independent units were formed. In June 1974, units at Delhi, Bombay and Madras were made subsidiaries of the Calcutta unit; these were converted into separate, independent companies in June 1976. In the books of account, Rs.1 lakh was stated to be the sale value of each of the three factories while the market values of the factories at Madras, Bombay and Delhi were estimated to be Rs.5 lakhs, Rs.70 lakhs and Rs.68 lakhs respectively.

4. Interestingly enough, the liabilities were not apportioned and the Calcutta unit was made liable for all of it. While efforts were made to expand facilities at Delhi, Bombay and Madras, nothing was done to utilise the Calcutta factory fully. Thus, it was clear that the management had no further interest left in its Calcutta unit. The state

government enquired into the affairs of the unit during 1975-76, so did the Company Law Board next year. It was even discussed in the parliament in June 1976; however, the management made no efforts to secure proper administration of the unit. Wage payments were completely stopped and a purported closure declared in December 1977. In February 1978, the company was directed by the Calcutta High Court to be wound up following a winding up petition filed by a creditor for Rs.0.68 lakhs in April 1977. A repayment schedule of Rs.6000 p.m. was fixed by the court; the company paid only the first instalment so that the creditor moved another winding up petition. This was not contested by the company at all so that the court passed an ex-parte order for the winding up of the firm in February 1978. Following the advice of the state advisory committee on industry, the workmen of the Calcutta factory decided to form a co-operative in March 1978; the industrial co-operative was registered in April 1978.

5. The co-operative took the assets of the firm from the liquidator on lease for a consideration for Rs.1.2 lakhs per annum for an initial period of one year. The authorised capital is Rs.10 lakhs with Rs.4.61 lakhs paid up. The management is vested in a twelve member executive committee with a government nominee as the Chairman. The performance in this phase is summarised in Tables 41,42 and 43. Though SVP has declined in 1978-79 compared to earlier years, so did fixed costs as the employees drew only 80% of their salaries in view of the financial crunch (Table 41). The lower outgoings on interest meant that cash losses reduced in 1978-79 even with lower production levels. Since February 1980, break-even monthly

Table 41: Performance Statement (As on 30 June)

(Rs.lakhs)

Sl. No.	Item	1974	1975	1979
1	2	3	4	5
1	Sale Value of Production	59.80	48.62	27.25
2	Variable Costs	36.89(61.7)	22.90(47.1)	19.15(70.3)
3	Contribution	22.9(38.3)	25.72(52.9)	8.10(29.7)
4	Fixed Costs	37.50(62.7)	31.59(65.0)	9.61(35.3)
5	Gross Profits	-14.59	-5.87	-1.51
6	Interest	4.00(6. 7)	5.57(11.5)	0.95(3.5)
7	Cash Profit	-18.59	-11.44	-2.46
8	Depreciation	0.80	0.80	-
9	Net Profit	-19.39	-12.24	-2.46
10	Break-even SVP	97.88(163.7)	91.68(188.6)	32.33(118.6)

Source: Annual Report, various years

Notes: Figures in brackets are as percentage of total sale value of production

production of Rs.4.30 lakhs has been achieved; in fact net sales reached Rs.64 lakhs in 1982. Subsequently, salary levels of the employees have been restored to earlier levels since February 1980; in March 1980, the lease from liquidator has been renewed for further three years. The depleted administrative and technical sections of the unit have been blostered through fresh recruitments. One of the vital components behind the revival has been the active support of the state government Till July 1981, direct financial assistance to the tune of Rs.13.55 lakhs

Table 42: Summary of Performance (As on 30 June)

(Rs.lakhs)

Sl. No.	Item	1979	1981	1983
1	2	3	4	5
1	Cash Profit	-1.51	-6.82	-5.12
2	Net Working Capital	11.57	1.74	-11.28
3	Tangible Net Worth	2.4	-16.96	-34.42
4	Debt	19.03	43.86	53.69
	Relationships (Ratios)			
5	Debt/Equity	4.13	9.23	11.75
6	Accumulated Loss/Equity	0.54	4.57	8.53
7	Cash Profit/Net Sales	-0.10	-0.10	-0.09
8	Internal Sources/ Total Liabilities	0.18	0.08	0.06

Source: Annual Reports, various years

was provided in addition to furnishing a guarantee for Rs.43 lakhs against which bank provided working capital assistance of Rs.35 lakhs.

6. At the same time, it is important to take note of the various problems that the co-operative had to encounter in its initial phase. For one, the starting of the co-operative in December 1978 coincided with the press strike. The reputation of the company had suffered following its three-year absence from the market; the erstwhile management had even taken on orders without executing them. Surplus labour of about 60 heads

Table 43: Structure of Balance Sheet (As on 30 June)

(Percentages)

Sl. No.	Item	1979	1981	1983
1	2	3	4	5
	A. Liabilities			
1	Share Capital	18.0	7.8	5.9
2	Term Liabilities	37.2	34.0	32.5
3	Bank Borrowings	37.3	37.9	37.4
4	Other Current Liabilities and Provisions	7.5	20.3	24.2
	Total	100.0 (25.57)	100.0 (61.01)	100.0 (76.85)
	B. Assets			
5	Net Blocks	-	2.7	1.9
6	Inventory	46.4	23.0	16.5
7	Other Current Assets, Loans, and Advances	44.0	38.7	30.9
8	Debit Balance of Profit and Loss Account	9.7	35.6	50.7
	Total	100.0 (25.57)	100.0 (61.01)	100.0 (76.85)

Source: Annual reports, various years

Note : Figures in brackets show total in Rs.lakhs

had to be pruned; working capital was short on account of the Rs.20,000/- per month repayment of the term loan from the bank. The nature of the product demanded tight control over raw material usage for improving performance. Above all, the limited period of license from the liquidator

rendered long-term planning difficult; initial customer apprehension regarding the stability of the organisation deterred many from entering into big contracts. The net effect of the inadequacies described above are reflected in the poor profitability, liquidity and solvency shown in Table 43; as also the small equity base of the company. The balance sheet structure shown in Table 43 is similar to that of other sick units viz. declining share of net worth, assets and increasing share of loans and losses. The other distinctive feature is the whole spirit behind the idea of workers co-operative as a vehicle for combating sickness amongst SSI enterprises. The unit appears once again set on a steady growth path.

Section 6: Induction of New Management

Case Study No.12

1. Reconstruction in this unit has taken place in two phases: firstly under the old management which proved to be a failure and the induction of a new management group with equity participation, with good success. The case once again highlights the pitfalls of retaining old management when the decline itself occurred due to indifferent management policies despite being a pioneer enterprise. This is shown to be in sharp contrast to the outlook of the new owners. The other highlight of the case is the positive support of the bankers to the

unit when other sources like IRCI had dried up.

2. When the unit was founded in 1918, it was one of the pioneers in the domestic manufacture of electric fans. The original line was domestic fans only the market for which gradually grew competitive. Following this, the company diversified into the manufacture of industrial fans viz. air circulators, exhaust fans, man coolers, axial blow fans etc. about 1955. Performance improved subsequently and a term loan of Rs.4 lakhs was contracted with West Bengal Financial Corporation (WBFC) in 1962 towards expansion of factory premises; labour strength was raised to about 215. However, the expansion bore no fruit as the labour-management relations became very strained; it got further vitiated due to the political and economic turmoil in the state from 1966 onwards. From 1964 onwards, sale value of production (SVP) declined consistently and continuous cash losses began from 1967 Thus cash losses of Rs.0.76 lakhs was registered in 1969 against SVP of Rs.25.62 lakhs while 1966 had seen a cash profit of Rs.15 lakhs against SVP of Rs.41.94 lakhs. Our analysis on the decline of the unit points to indifferent management policies as the main factor rather than labour militancy and high overheads as advanced by the management. This is because, while the wage bill was pruned from Rs.5.2 lakhs in 1964 to Rs.3.89 lakhs in 1970, outlay on advertisements, cars, delivery etc. increased; the latter could be questioned given the declining fortunes of the firm.

3. On the other hand, reserves and surpluses of the unit got depleted in this period; dividends were declared at the high rate of 65% to the

sole benefit of the family that controlled the unit. The managing director even withdrew a sum of Rs.0.50 lakhs to set up another SSI enterprise for the manufacture of fans, ostensibly on account of the labour problems in the unit. The remuneration for the top management was on the high side and continued to be so despite the decline of the firm. Above all was the lack of professional management so that it was really a proprietory concern of the managing director. The statistical outline of the firm's decline is provided in Tables 44,45 and 46. Though the worsening performance during the sixties is evident, it is anything but steep. It was against the above setting that the unit approached IRCI for assistance in 1971. A loan of Rs.3 lakhs was sanctioned following a tripartite agreement between labour, management and IRCI. IRCI acquired share and broad control and the four-member Board was recast. However, the executive management remained with entrepreneur directors which ultimately proved to be the major weak point in the reconstruction strategy.

4. During the course of reconstruction under the old management between 1972 and 1980, the unit could break even and earn cash profits during only three years viz. 1972, 1973 and 1976. Over this nine-year period, SVP averaged Rs.43 lakhs against cash losses of Rs.5 lakhs, i.e. losses mounted specially since 1977 despite increased production levels. One reason for the continued ailing of the unit has been managerial deficiencies in key functional areas. In addition, the unit continued to be plagued by poor industrial relations; there was a lock-out between March and June 1975 and reopened after a tripartite agreement between

labour, management and IRCI. In June 1978, there was a stay-in-strike at the factory for the revision of the incentive scheme, settled again through a tripartite agreement. One interesting ploy adopted by the management during this phase was to keep their account with the bank very regular; the bank, in turn, reduced the rate of interest from 16% p.a. to 12½ p.a. in 1978 and raised the working capital limits to Rs.22.26 lakhs. Consequently the financing of cash losses was done through default of statutory creditors, IRCI, WBFC and non-payment of salaries to senior staff.

5. In May 1979, IRCI withdrew its nominee from Board for fear of being prosecuted for arrears in statutory payments; it did not have the statutory protection then which it enjoys currently following its conversion to a full-fledged, autonomous, All-India financial Institution like IDBI, ICICI etc. Another lock-out followed in the same month and a purported closure notice was served in August 1979, deferred at the instance of the employees' union. Even contribution became negative in 1979 following the lock-out (Table 44) as did the profitability, liquidity and solvency indices (Table 46); all of which led to a severely distorted financial frame (Table 45). Hence, it became clear that the existing management was incapable of sorting out the unit's problems; as a result, the financiers decided to assist the unit further only if a new management came in with equity participation. Since February 1980, a new management has taken over with equity participation.[19]

6. Upon re-opening in May 1981, the authorised capital of the firm was raised to Rs.10 lakhs and the share control transferred to IRCI,

Table 44: Performance Statement (As on 31 December)

(Rs.lakhs)

Sl. No.		1964	1970	1975	1979	1982
1	2	3	4	5	6	7
1	Net Sales	N.A	29.82	42.29	12.04	72.13
2	Sale Value of Production (SVP)	42.87	30.54	49.14	5.15	68.39
3	Variable Costs	26.58 (62.0)	18.21 (59.6)	31.34 (63.8)	5.87 (104.0)	38.91 (56.9)
4	Contribution	16.29 (38.0)	12.33 (40.4)	17.80 (36.2)	-0.72 -	29.48 (43.1)
5	Fixed Costs	12.21 (28.5)	10.83 (35.5)	18.84 (38.3)	9.69 (188.2)	29.57 (43.2)
6	Gross Profits	4.08	1.50	-1.04	-10.41	-0.09
7	Interest	0.36 (0.01)	1.09 (3.6)	2.56 (5.2)	3.40 (61.0)	8.36 (12.2)
8	Cash Profit	3.72	0.41	-3.60	-13.81	-8.45
9	Depreciation	0.70	0.67	0.61	0.45	0.51
10	Net Profit	3.02	-0.20	-4.21	-14.26	-8.90
11	Break-even SVP	32.13 (74.9)	26.82 (87.8)	52.01 (105.8)	- -	68.60 (100.3)

Note: Figures in brackets are as percentage of total sale value of production

Source: Annual reports, various years

Table 45: Structure of Balance Sheet (As on 31 December)

(Percentages)

Sl. No.	Item	1967	1970	1975	1979	1982
1	2	3	4	5	6	7
	A. Liabilities					
1	Share Capital	14.0	14.5	8.1	6.4	6.9
2	Reserve and Surplus	10.6	5.4	5.0	2.4	1.1
3	Term Liabilities	11.6	11.7	17.9	27.9	17.4
4	Bank Borrowings	29.8	37.1	38.2	29.4	35.1
5	Other Current Liabilities and Provisions	34.0	31.2	37.5	34.0	39.6
	Total	100.0 (28.61)	100.0 (27.55)	100.0 (49.2)	100.0 (62.75)	100.0 (31.15)
	B. Assets					
6	Net Block	35.2	34.2	16.4	10.1	4.9
7	Investment	3.2	4.7	1.2	0.0	3.7
8	Inventory	37.3	43.2	32.9	8.8	24.9
9	Other Current Assets, Loans and Advances	20.8	17.7	30.1	15.9	39.6
10	Debit balance of Profit and Loss Account	3.5	0.0	19.6	64.4	46.7
	Total	100.0 (28.61)	100.0 (27.55)	100.0 (49.29)	100.0 (62.75)	100.0 (131.15)

Source: Annual reports, various years

Note : Figures in brackets are totals in Rs. lakhs

Table 46: Summary of Performance (as on 31 December)

(Rs. lakhs)

Sl. No.	Item	1967	1970	1975	1979	1982
1	2	3	4	5	6	7
1	Cash Profit	-1.74	0.41	-3.60	-13.81	-8.45
2	Net Working Capital	-1.55	-2.01	-3.72	-24.07	-23.97
3	Tangible Net Worth	6.02	5.45	-4.20	-34.92	-50.76
4	Debt	11.90	13.46	26.73	35.93	68.75
	of which IRCI	-	-	7.40	15.17	20.97
	Relationships (Ratios)					
5	Debt Equity	1.70	2.45	4.88	6.56	12.54
6	Accumulated Loss/Equity	0.14	0.01	1.77	7.37	11.18
7	Cash Profit/Net Sales	-0.06	0.01	-0.09	-1.15	-0.12
8	Internal Sources/ Total Liabilities	0.26	0.20	0.11	0.09	0.08

Source: Annual Reports, various years

though not the board control. Of the total interest arrears of Rs.3.46 lakhs to IRCI, Rs.1.50 lakhs was repaid upon which IRCI granted fresh term loans of Rs.6 lakhs; a two-year moratorium was granted on the re-payment of principal. The bank followed suit and granted fresh working capital limits of Rs.18.50 lakhs after converting the old dues of Rs.21.01 lakhs into a term loan. Thus, finances have been more forthcoming in this second phase than in the first phase with the management being no more recalcitrant; it has predictably led to much improved performance. The unit has broken even in 1982 on account of higher sales (Table 44) similarly, share of losses has come down significantly (Table 45) as

also the cash losses per rupee of sales (Table 46). The unit is planning to diversify into industrial fans which offer better margins. The fact of good labour relations under the new management disproves the complaints of the previous management with regard to militancy of labour. Before we close we note that the new management has not proved tobe any better than the old one as far as control by financiers goes. None, including IRCI, have a nominee on the Board which has been recast as many as four times in this short span without the concurrence of the institutions. Even the selected operational data that is being submitted to the financiers - which forms the core of the monitoring by financiers - is being done without the scrutiny of the internal auditors to the firm On balance, it may be said that the institutions should be more vigilant in monitoring the affairs of the unit.

Notes and References

1. Full and final settlement of the remaining 253 workers, at a compensation of Rs.16 lakhs, came about only in August 1980. The strategy of starting with a smaller work-force after a closure, in the case of a declining firm, is sound and equitable on two grounds (i) unabsorbed labour is provided support payments (ii) labour is re-absorbed as and when production picks up.

2. Given the uncertainty regarding recovery of past dues, bankers were unwilling to give any more money unless guaranteed by a third party. This clearly shows how poorly the IDR Act is conceived with respect to financial problem faced by a declining enterprise; we have commented on this aspect in the last chapter.

3. The fan division is currently lying closed.

4. By this time, the unit owed about Rs.74.66 lakhs to its bankers.

5. A multinational company has evinced keen interest in taking over the company.

6. The parent company, a Britih MNC had in fact two other Indian Subsidiaries; of this, one has been wound up in 1976 while the other is making good progress.

7. This limit has now been revised to eight years from the earlier five following amendment in 1978.

8. Currently, the industry is exclusively reserved for the small scale sector.

9. Now that this 26.25% excise duty has been abolished in the 1984-85 budget, the fortunes of the unit would be much better.

10. The foreign share holding was probably as a guarantee for the performance of the machine. Royalty payments were fixed at 5% of Net sales.

11. The same entrepreneure group indulged in similar mismanagement in the case of four other units in the state.

12. This has been remedied currently through the opening of branch offices at Bombay, Delhi and Madras while another one is proposed at Bangalore.

13. Though IRCI had the Board control, it had no role in executive management.

14. Cast iron in which molten metal is treated with calcium silicide is know as Meehanite. Meehanite castings have better damping capacity, higher endurance limits, easy machine ability and better amenability to surface treatment and hardening.

15. The break-up of this assistance was as follows: (a) Capital expenditure - Rs.0.52 lakhs (b) Statutory creditors Rs.0.55 lakhs (c) Pressing creditors - Rs.0.12 lakhs (d) Interest on IRCI loan - Rs.0.21 lakhs (e) Margin money - Rs.1.18 lakhs.

16. He even filed a suit for recovery of arrears in remuneration; this was finally settled through the court with payments in instalments.

17. This was established by the internal auditors to the firm.

18. The figures are on the basis of submission given by workers to the Calcutta High Court in 1978. In general, the asset-stripping behaviour of management is clear though the details vary between this unit and case-study No.4

19. It may be pointed out that the chief promoter belongs to a firm of chartered accountants who were also auditors to the "Sanchaita" investments. It is now well-known that Sanchaita perpetrated a massive fraud on its investors, most of them small, to the tune of Rs.300 crores. The fact that the new management group is flush with funds could possibly be related to this.

Chapter 4

A Critical Analysis of Reconstruction Strategies

In this chapter, we attempt a critical analysis of reconstruction strategies on the basis of the case-studies presented in Chapter 3. The effort is to compare and contrast the various factors across the case-studies, so as to try and arrive at some general remarks on revival. This is done in two sections. In Section 1, issues pertaining to decline are taken up while Section 2 deals with revival.

Section 1

1. An interesting starting point for us is to note the similarity between our cases and Boswell's sample of 'small' firms: As many as nine of our units, out of twelve (75%), employed less than five hundred people and hence belong to the Boswellian 'small' category; another unit had employment levels just over 500.[1] This furnishes us with a useful point of comparison.

2. Majority of the declining firms were older firms, nine out of twelve (75%) were established prior to 1950, employing more people on an

average which meant that the pressures for revival were much more intense in their cases.

3. Three of the firms (25%) were colonial firms, they were very dynamic and professionally managed. In fact, this dynamism, in the sense of product diversification was common to many firms at various stages. In the case of two firms (No.4, No.11), problems arose once they passed into the hands of Indian entrepreneurs. In the case of the third unit (No.3), problems arose prior to the transfer of management into Indian hands. All three were incorporated as public limited companies; amongst the other nine firms of Indian origin, only one (No.6) was set up as a public limited company. This happens to be one of the youngest firms being set up in 1962 with strong support from the AIFIS. The remaining eight companies (66.6%) were private limited companies with family managements and hence subject to the limitations noted by Boswell. Finally, we note that five of our cases (41.7%) belong to the SSI sector, where, as we have noted,the nature as well as the extent of sickness is distinctly different from that of the medium and large sector. In all the twelve cases, the onset of sickness was marked by decreasing sales, cash losses and both net worth and net working capital becoming negative.

4. All the units in our study belonged to the engineering industry (except No.11) located in West Bengal, which bore the brunt of the deceleration in India's industrial economy since the middle of the

sixties. This is broadly in line with Boswell's finding regarding declining firms belonging to industries in decline. However, only in three cases - viz. machine tools, meehanite castings, fabrication and erection of structurals - can the decline be attributed to adverse external conditions. In another three decline had set in prior to 1960 and among the rest decline had set in in the 70s. Hence industrial deceleration does not seem to be the main factor responsible for decline.

5. It is pertinent to note that no unit became sick primarily due to labour-related reasons though two units (No.1, 12) had long records of poor industrial relations. However, in the case of No.12, marked improvement was noticed in industrial relations following the induction of a new management; this indicates that the labour unrest here was primarily due to the postures of the old management. This finding of ours goes against the often-mentioned charge of labour-induced sickness, specially in the context of West Bengal.

6. What emerges as the major cause of decline is deliberate mismanagement by way of siphoning off of funds from the units: 7 of the units (58.3 per cent) declined on account of diversion of funds. Various methods were adopted for diverting the funds: carrying out purchases and sales through sister concerns and paying exorbitant commissions; undertaking inter-corporate investments and writing them off; and executing unremunerative orders of the main customers. Dissention and infighting among partners or members of controlling families is also quite common.

7. In general, managements remained oblivious to the need for modernisation and upgradation of technical skills which finally led to obsolescence and un-economic product mix. This is despite the fact that all the cases except Nos 10, 9, and 8 operated with relatively sophisticated technologies. Within these nine units, all except Nos.2 and 12, had tie-ups for foreign technology at one time or the other. Of the twelve cases, eight - (66.6%) except four (No.4,5,6, and 11) - would fit Boswell's description of conservative managements reigning concurrently with slowly eroding markets. Case No.7, had been plagued by technical imbalances from the start itself lack of diversification, specially in the face of erosion of monopoly market and lack of upgradation of technology is quite common. Generally poor management on the technical front seems to be a major cause of decline and some times it has existed from the very beginning. This along with diversification of funds seems to be a characteristic of a segment of Indian industrialists.

8. The gamut of issues relating to managerial default and quality of managerial response to decline is linked to the question of entrepreneurial stake in business. In all the twelve cases, we have noted continuous depletion of this stake, in the absence of ploughing back of profits. In practice, this removed the very basis for an abiding entrepreneurial interest in these units and put the onus for reconstruction on others like the financiers and the state. Also the primary burden of decline fell on the labour force as arrears in wages and statutory liabilities were wide-spread amongst the units. All of these, in fact,

strengthen our hypothesis regarding the problem of sickness as being one of sick 'units' and not of sick 'industries' as such.

9. If we were to classify the firms according to the extent of decline, three (Nos.7,8,9 - 25%) are mild cases, five (No 2,5,6,10, 12 - 41.7%) are medium and four (Nos.1,3,4,11 - 33.3%) are 'extreme' cases.[2/] It is interesting that the extreme cases are also the oldest ones in our sample; this is in line with Boswell's finding that the incidence of decline was greater amongst the older units.

10. Over-manning (surplus labour) is a feature of declining units and the reduced level of output becomes insufficient to support the erstwhile level of employment. Consequently, retrenchment of labour came about following the decline (units 1,2,10); in the case of No.3, which had the largest workforce in our sample, retrenchment was deferred only at the behest of the state government who agreed to fund the cash losses arising out of the surplus labour component.

11. Like labour, the financial system also suffered on account of sickness. At the macro level, we have noted that the current magnitude of sickness indeed poses a threat to the future of our banking system. Our case-studies reveal that the follow-up and monitoring of credit has been poor; the approach is basically commercial and largely divorced from economic considerations. The financiers deal with the problem on an account by account basis and operate currently without any precise guidelines from RBI regarding the financing of sick industrial units.[3/]

We may close this Section by noting the imbalances in the financial frame of the units due to decline and sickness. In the face of mounting losses, debts are contracted which go to meet the losses rather than create productive assets. As a result, we would observe a decline in networth (own finances) and an increase in the share of loans on the liabilities side. Likewise, the share of assets declines and the share of losses increases on the assets side. As we shall see later, this imbalance has important implications for reconstruction strategy.

Section 2

1. Given the above background on declining firms, we may now analyse the reconstruction strategies that have been adopted to tackle the problem. As noted before, the key variable in revival is the match between reconstruction strategy and the causes for decline. Broadly speaking, five types of strategies were adopted in revival viz. (i) Take-over of Management under IDR Act (Nos.1,4,5,6) (ii) Board of Directors (Nos.2,3) (iii) Retention of old Management (Nos.7,8,9) (iv) Formation of workers' Co-operatives (Nos.10,11) (v) Induction of new management (No.12). The case of IDR units could be classified further on the basis of the 'Authorised Person' involved, Board of Management (No.1), IRCI (No.4), state government of West Bengal (Nos.5 and 6). In two of the cases (Nos.1,2), tie-up with public sector units were also tried out. Finally, there were two units (Nos.6,11) which were re-

constructed out of liquidation.

2. Reconstruction efforts succeeded in the case of four units (Nos.5,6,9,12); in the case of two other units (Nos.10,11), substantial progress had been made following the revival efforts under the aegis of workers' co-operative. Except No.11, the other five firms which were revised were set up by Indians. All the six units including No.11 were under family management prior to their revival. Looking across these firms which were revived, we do not find any pattern as far as age-distribution goes; some are old firms (Nos.9, 12,11,10) while others are young (Nos.6,5). Understandably enough, the nature of products varies markedly across these two categories. Three of the older firms were engaged in metal working (No.10) and Fans (No.9, 12) while the fourth (No.11) made printing ink. In contrast, the two younger firms produced articles of relatively higher technology, viz. zip fasteners (No.5) and machine tools (No.6). Another feature of these six units is their lower size, measured by employment - compared to the other six firms which did not revive; No.7 is of course an exception to this. We also note that four of these revived firms (Nos.9,10,11,12) were registered as SSI units.

3. As noted before, all except one (No.9) of these six units had declined due to reasons that were internal to the firm - in the realm of inadequacies and defaults of the managements in control. In the case of No.9, revival was primarily due to the dynamism of the management in coping up with an adverse external environment viz. pruning of labour force, diversification and capital restructuring. The firm support of

its bankers was a complementary factor here. In the other five cases, starting point for recovery was provided by managerial changes at the top.

4. In the case of No.5 and No.6, the managements were taken over by the central government under IDR Act - with the state government of West Bengal as the authorised person so as to set right the acts of deliberate mis-management which had precipitated their decline. The factors which aided revival in the two cases were managerial stability at the top, professionalism of the Chief Executives, accent on product diversification and above all, the consistent financial and political support of the state government. The record is all the more creditable when we take note of the heavy odds that IDR units face upto specially with regard to working capital finances. This is so because, under the IDR Act, all past liabilities are frozen to ensure smooth reconstruction and post take-over liabilities are granted preference over pre take-over ones. Given this uncertainty regarding the recovery of past dues, financiers are unwilling to provide further funds except at the express behest of the state or other reputed institutions who would furnish guarantees. The other issue relates to multiple financing (it is prevalent amongst most of the sick units), i.e. involvement of numerous financiers and the subsequent wrangle over the sharing of securities. The problem arises when fresh finances - working capital as well as capital expenditure - are sought by the ailing firms. Once the wrangle comes about, the unit becomes solely dependent on one agency for its

funds - short-term as well as long-term-which puts severe constraints on the operations of the unit. In any case, compared to other cases of revival, banks and IRCI played no role here.

5. The fact that induction of new management with fresh equity participation is the best prescription for revival is shown by our case No.12. The argument is strengthened when we note that the revival efforts in the first phase which lasted over a decade under the aegis of IRCI and banks proved to be of no avail on account of the retention of the old management. The gesture of the bankers in reducing the rate of interest from 16% per annum to 12½% per annum also played an important role in revival. As a general strategy, the induction of new management does have its limitations in that many sick units might not find new suitors. However, the merit of the strategy lies in its ability to inculcate an abiding interest in the unit on the part of the entrepreneurs.

6. Finally, we consider the two cases (Nos.10,11) that have made good progress through the formation of workers' co-operative. In the case of No.10, the co-operative was formed in the wake of futile revival efforts by IRCI under the old management. Case No.11 even had gone into liquidation on account of deliberate mismanagement and diversion of finances. The strategy of co-operatives is being actively promoted by the state government of West Bengal as a new hope for ailing enterprises in the SSI sector. The main difficulty for the workers' co-operative is the non-possession of assets - to be offered as securities to financiers -

as they operate on a leaveand license basis. While No.11, could manage a guarantee from the state government for working capital advances, No.10 is really short of funds. The other problem before the co-operative is the limited period of the licence and uncertainty over future status of the unit. The licensors in No.10 and No.11 are the old management and the liquidator respectively; in the case of No.10, it is ironical that the unit would be returned to the indifferent management when the lease expires after nine years. Despite these numerous problems, the merit of the strategy lies in the close involvement that it brings about amongst employees - as seen in No.11, when the employees of the co-operative drew only 80% of their emoluments on account of tight finances. The additional factor is the steady support of the state government which plans to promote the strategy on a very wide scale.

7. In the case of the other six firms, reconstruction efforts have failed totally. Two of these (No.3,4) were colonial firms to start with; in case No.3, the decline set in prior to the change-over to Indian management while in No.4, the decline had set in after this transition to Indian management. In general, these six firms, except No.7, were older than the six firms that were revived; they also employed more people. All of which implies that their problems were much more complex than those of the rest. The product portfoilios across these firms were quite diverse viz. electric

motors, bulbs, meechanite castings etc. which were not affected by the general recession in the engineering industry implying that the causes for their decline were primarily in the realm of management. Despite this evidence, the old management was retained in four cases (Nos.1,2,7,8), which proved to be patently inappropriate and led to predictable failures of revival efforts. This is in agreement with Boswell's findings that most of the declining firms could not reform themselves under the existing ownership. In the case of No.1 and No.2 change of management was effected later on, while No.7 and No.8 continued under the old management.

8. As regards reconstruction strategies, three methods were employed viz. (a) Management take-over under IDR Act (No.1,4; authorised persons were Board of Management and IRCI respectively) (b) Board of Directors (No.2,3; under the aegis of bank and IRCI respectively) (c) old management (No.7,8). The failure of revival under IDR take-over has been due to financial (discussed earlier) and managerial problems. They faced the problem of unstable executive management, as reflected in the high turnover of chief executives and other key personnel. This instability removed the basis for long-term planning in the organisations, specially in the realm of modernisation and diversification which is so fundamental to the turn around of decling firms. The financial and managerial problems faced by Nos.2 and 3 were very similar to that of the IDR units and hence the failure of the revival efforts. In the case of No.2,

main bankers to the firm played a very active role, in view of their heavy commitments; interest rates were reduced and later waived altogether. Case No.3 was similarly supported by IRCI in the revival efforts. We also note that, in two cases (No.1,2), active association of professionally run public sector corporations was tried out. The tie-ups failed in the absence of clear-cut guidelines governing them. However, it is clear that the tie-ups did help in the initial stages when these units recorded their best performances in the reconstruction phase.

9. In cases 7 and 8, old managements were allowed to continue, which ultimately proved to be the shortcoming of the reconstruction strategy. To start with, the decline in these units was really mild in character, compared to others. Problems of No.7 date back to the project implementation stage itself and the management inadequacies were never set right. While IRCI was wary of the integrity of the management, at one stage they even deliberated legal action for recovery of dues, the bankers extended full support; interest remission to the tune of Rs.0.37 lakhs was allowed. The case of No.8 was very similar to this with the management being much more averse to any sort of outside control. While IRCI fell out and thought in terms of legal action, bankers stood firmly behind, in view of the real estate under the possession of the unit. In both cases, the financiers suspected off-the book transactions between the units and their principal customers. From all this evidence, it is clear that No.7 and No.8

as also No.10 in the first phase of reconstruction come closest to Boswell's concept of 'congealment', the state of stagnation coupled with low performance. They neither revived nor died; they just remained in their existing conditions.

10. One of the supplementary measures in revival has been the granting of 'relief' status to six of the units (No.1 to 6) by the state government; the intention here is to prevent the unit from being taken into liquidation by its creditors so as to ensure smooth reconstruction. However, as we have noted from our case-studies, the relief status had negative effects in practice with regard to further financial assistance; this is due to the uncertainty over the recovery of the past dues.

11. We may look at the role of IRCI - the specialised agency in revival - in reconstruction. As expected, active reconstruction in all our cases had begun from 1971 onwards - the year in which IRCI was set up. All units, except three (Nos.5,6,11), were assisted by IRCI at one time or the other. Interestingly enough, these three units were on way to recovery; even in the other three revived cases (No.9,10,12), except in case of No.12, IRCI's involvement has been really marginal. All of which casts doubts on IRCI's efficacy as the premier rehabilitation agency in the country. We also note that compared to the six first cases, IRCI's assistance in cases 7 to 12 have beeen really marginal. This is because the latter set of firms are mostly SSI units where IRCI's involvement is limited. Our case-studies

also suggest that IRCI's attitude towards sick SSI units has been high-handed; certainly out of proportion to their commitments. For example, in cases 7 and 8, IRCI wanted to intiate legal action for recovery of their dues; this was deferred at the instance of the financing banks only. Monitoring efforts were generally inadequate, as seen from cases, 7,8,10 and 12, where the financiers could not mend the ways of the old management.

12. Our case-studies also vindicate our hypothesis regarding the onus for reconstruction coming to rest squarely with the state and its agencies viz. banks, IRCI and other AIFIs as also seen from the constitution of re-construction assistance.[5] The primary motivation here is the protection of jobs (employment aspect) and recovery of dues (financial aspect). This is most clearly seen in the four cases (No.1,4,5,6) where IDR Act was invoked; in the case of No.3, state government came forward to finance the cash losses arising out of the surplus labour component. Likewise, strong backing was provided by the State Government for revical of No.10 and No.11 under the aegis of industrial co-operatives of workers. In practice, however, retrenchment of labour was carried out in four cases (41.7% - Nos.1,2,9,10).

13. Coming back to the Boswellian prescriptions for revival, we have seen that our findings are in agreement with his. In particular, the remarks relating to the quality of managerial response to the crisis at the level of the firm. We also recognise the limits to managerial capabilities set by an adverse external environment; in our case, the continuing stagnation in the West Bengal economy.

Notes and References

1. This is quite distinct from the 'small scale' industry category in the Indian context which is linked to the value of investment in plant and machinery; currently, this investment limit is Rs.30 lakhs.

2. This classification is following Boswell's Scheme - See Boswell (1973) op.cit.pp.135.

3. Some guidelines do exist on paper which we noted in Chapter two but are not implemented in practice.

4. See, for example, footnotes 4,8 and 10, in Chapter 3.

Chapter 5

Summary and Conclusions

1. The problem of failing corporate health is common to all economic systems, the nature and magnitude of the problem and the response it evokes, however, vary. The distinct feature of the problem of sick industries in India is that its genesis and growth stems from factors that are internal to the domestic economy. This is in contrast to developed countries where firms and industries have ailed primarily due to competitive imports. As in other realms of economic activities the Indian state has assumed the leading role in reconstruction, specially in the medium and large sectors of the industrial economy.

2. Coming to the problem itself, widespread sickness arose in the textile industry during the fifties and in engineering industry in the eastern region, specially West Bengal, after the middle of the sixties. While the factors at the macro-level were largely structural in nature, our case studies establish indifferent management policies - in some instances, amounting to deliberate mismanagement of a fradulent nature - as the chief component of this. Specifically, managerial default in most cases was found to be in the realm of technological upgradation.

3. During the course of the study we have found that the nature of the problem has definitely changed during the seventies; while the erstwhile sick firms have continued to ail, firms belonging to other industries and other regions are failing as well. This has been so, even while the industry in general performed well. In other words, currently, the problem is really one of sick units and not sick industries as such. We could argue that the absence of punitive measures to deter mismanagement has nurtured entrepreneurial behaviour of this sort. The above trend also points to the overall failure and inadequacy of reconstruction measures pursued so far. We have found that the increase in incidence of sickness is alarming and that the present set of statistics understate the magnitude of the problem in a significant fashion. In fact, it is our contention that the revamping of data-base is crucial for better understanding of the problems and for more effective policy formulation. One pointer to the current gravity of the sickness problem is the passing of the Sick Industries Act in the Parliament (Act I of 1986) and the subsequent constitution of the Board for Industrial and Financial Reconstruction (BIFR) to deal with sickness on an urgent basis.

4. Coming now to the case-studies, we note that all our firms except No.3 are similar to the 'small' firms of Boswell's sample. Likewise, all our firms - except No.11 - belong to the engineering industry which bore the brunt of the industrial decline in the Indian economy since the middle of the sixties. We also note that incidence of decline is greater amongst the older firms. The severe erosion of profitability, liquidity

and solvency has been observed in the case of all twelve units; and hence the imbalance in the financial frame. In all cases, the stake of entrepreneur in business had diminished to such a marginal scale that the onus for reconstruction came to rest on the financing agencies and the state. As expected, the hardships on account of sickness has been the maximum for labour and the financiers; default of statutory payments was widespread. There was retrenchment of labour as well in some cases while in no unit was labour the proximate cause for sickness. At the policy level, we have found a clear shift to non-state management from state-management as the latter had failed. Our case-studies vindicate this general failure of reconstruction efforts under the direct patronage of the state; on account of data limitations, we could not examine non-state reconstruction in the case of medium and large units. Of the three state-managed strategies analysed, viz. Board of Management, IRCI, and state government, reconstruction under the aegis of the State government has proved to be most effective. Amongst others, the strong political support of the state government has contributed to this.

5. It should be noted that in the case of four units out of the total six units under state-managed-reconstruction, management was taken over underIDR Act. While the general problems of units in the reconstruction phase related largely to management and finance. We found that the problems got more complicated with the invocation of the IDR Act. Given the very ad-hoc nature of the management take-over and the related structure of decision-making, we find that the IDR Act should be invoked

only with a final view to nationalisation. In practice, the Act has been invoked instinctively to prevent loss of employment without definite economic rationale; largely due to political compulsions, as in textiles.

6. Board of Management has been found to be least effective in reconstruction. Here the involvement of public sector corporations failed in the absence of clear-cut guidelines. On balance, reconstruction with the help of public sector does appear to be a bright solution. Professionally-managed public enterprises being rare and their product lines specialised, there are limits to this strategy. Similar association with private sector firms could be the other alternative, though it may raise the overall level of concentration in industry. The point is that institutional backing is crucial to the success of reconstruction efforts; this is to provide crutches to the sick units in view of the general depletion of resources and skills in them.

7. Likewise, reconstruction efforts under the aegis of IRCI have been failures in general. While management restructuring formed the core of IRCI strategy - which was appropriate in most cases - they were unable to carry it out in practice, despite specific measures like forming an Industrial Management Pool. In recent times, IRCI has moved away from direct management of assisted units; they even seem to be distancing themselves from the genuine sick units which really goes against their primary mandate. The recent upgradation of IRCI into a full-fledged financial institution could improve its effectiveness

in reconstruction. This shift in IRCI's stance is part of the overall policy change noted before viz. state-managed reconstruction to non-state managed one.

8. The financing banks provided good support in all cases, even where IRCI harboured doubts about integrity of managements. In selected cases, interest rates were reduced and even remission of interest was granted. The incidence of multiple financing often led to wrangle between financiers over the sharing of securities - specially in medium and large units - and worked ultimately to the detriment of the units in question. The upshot in most cases was that there was no relation between the actual utilisation of funds and the original purpose for which it was allocated. What is ineed striking is the absence of clear guideline from RBI with reference to financing of sick units. On the other hand, the concept of 'lead institution' in the realm of monitoring, where number of financing agencies are involved, is yet to take root. We have also found that the other supportive measure of the state government by way of granting 'relief' status to medium and large units compounded their financial problems in practice. Our study reveals that the general approach of bankers to sick units is basically commercial/financial and quite clearly divorced from economic aspects. This is so, given the normal practice of bankers in classifying accounts as irregular and advances as sticky; this is clearly an accounting approach devoid of any economic rationality. In no case except one, measures aimed at capital restructuring were attempted.

9. Though sickness is widespread and rampant amongst SSI units, no legislation exists for direct state intervention like the management take-over under IDR Act in the ase of medium and large enterprise. Amongst the three strategies we examined for SSI units viz. retention of old management, workers' co-operative and induction of new management, all except two cases under old management have made good progress. The recovery is complete in two cases, one where new management was inducted and the other where the old management was retained and proved dynamic enough to counter the crisis. Our argument against retention of old management, when prima facie evidence points to managerial weakness leading to sickness stands vindicated. This tallies with Boswell's finding that revival of declining firms can't take place under existing ownership. Induction of new management with fresh equity participation is found to be most effective. Paucity of similar willing entrepreneurs to run a sick firm with fresh investment puts limits on this method as a general strategy. Industrial co-operative of workers is an innovative solution though beset with numerous problems like non-ownership of assets, uncertainty about future status, etc.

10. Our case studies, specially the successful ones, indicate that once the capability of management is established, the key to success lies in the ability to consolidate, through upgradation of technology or diversification. Here raising resources for these endeavours could prove to be a problem given the past record of the unit and specially the

imbalances in financial structure. As noted above, this is one of the vital dimensions of financing sick units. In particular, banks should not be asked to fund against their commercial judgements as seen in some cases where the state had to furnish explicit guarantees. We may argue that in such cases, the government should create an industrial rehabilitation fund out of its own budget and do the financing. In general, it has been labour and the financial system which has borne the brunt of sickness in the Indian case. In case of units beset with problems of surplus labour, the state could promulgate a Redundancy Payments Act like the British Act. Hence, our reconstruction policies appear to have regulated the right of firms to leave an industry just as the licensing policies have regulated their entry. In the long run, specific employment programmes to rehabilitate displaced labour should be current practice of pouring funds into unviable units; this is in line with Boswell's findings on declining firms

11. Our case-studies also vindicate some of the other findings in the Boswell study relating to revival; for example, the need for managerial changes in the top rungs of the organisation. Similarly, the interesting concept of 'congealment' which is characteristic of all the non-reviving firms in our sample. We have found that even liquidation of firms do not amount to their 'deaths' in practice; the emphasis is almost always on propping them up to protect the jobs on considerations that are often political and not economic.

12. To repeat, our study has clearly highlighted the need for reorganising the present set of statistics on industrial sickness -

preferably through the NIC classification along the lines of ASI. It is also necessary to publish the report of the enquiry committees which looks at the affairs of the sick units prior to the take-over of management under IDR Act. The other area where urgent reform is required is in the realm of treatment of sick units by the financing agencies in general and banks in particular; there is a definite need to move away from the present narrow financial view and towards a more economic one. Likewise, there is the need for grounding policy on a firm empirical analysis of the problem. As far as future themes of research go, it is important to look at the reconstruction through nationalisation and management tie-up with private sector corporations. While it is true that our present study could have been more comprehensive if done in a comparative framework with healthyunits in similar product-lines, the paucity of data has put obvious constraints.

Annexure 1

On the Data-base for Industrial Sickness

1. Since 1976, the Reserve Bank of India, through its Reports on Currency and Finance furnishes details of outstanding bank credit in the case of medium and large units enjoying credit limits of Rs.1 crore and above with commercial banks;[1/] this information is available state-wise and industry-wise. In the case of SSI units, however, only aggregate figures are presented[2/]. It is relevant to note that though management take-overs of units under Section 18A by the central government are always based on detailed investigation reports, these documents are not made public. They could be useful for purposes of understanding the short comings on the managerial side leading to sickness of industrial units.

2. The first thing to note about the present published data on industrial sickness is its highly aggregated nature. We have no idea about the age-structure, size distribution, ownership pattern, product-portfolio, financial frame, organisational make-up, operating results, etc. As we shall see later, these are crucial parameters in the formulation of reconstruction strategies. Even the industry-wise classification is far from precise. Adoption of the National Industrial Classification

(NIC) like the Annual Survey of Industries (ASI) would be much more useful as it would enable us to view the sickness problem against the broad developments in the industry and enable us to study whether the decline of the firm is due to firm-level factors or industry-level ones. Hence, it is our contention that one of the main causes behind the ineffectiveness of reconstruction policy in the Indian context is the inadequate data-base on which it is formulated. This will become more clear when we come to the case-studies presented in Chapter 3.

3. In any case, RBI figures understate the problem of sickness for the following reasons:-

(i) Since the 'cash loss' criterion addresses the problem of sickness fairly late, for every unit that is classified as sick, there is at least one that escapes detection.

(ii) The figures are exclusive of closures and liquidation which represent further stages in the process of sickness [3/]

(iii) Suit-filed accounts and re-scheduling of loans are excluded; these are also characteristics of sick enterprises.

(iv) Public sector units are not classified sick; they would fall under the sick category if the norms are followed [4/]

(v) The sick unit portfolio of All India Financial and Term lending institutions are available only for 1982-83 [5/]

With a view to having an overall estimate of sickness in the economy,

we have consolidated the figures for nationalised banks, Financial institutions and IRCI for the year 1982; however, this is exclusive of state level financial institutions and other banks involved in the financing of sick units.

Notes and References

1. This has been subsequent to the setting up of a sick unit cell in 1976 at the Central Office of RBI, Bombay to act as a clearing house for information on sick units. The data emanates from the quarterly statements of Scheduled banks all over the country. The published data seems to be at the level of factories/plant and not companies which normally consist of more than one factory.

2. The disaggregated figures that we present for SSI units are on the basis of answers given in Parliament.

3. We have already noted that closures take place primarily due to declining performance.

4. A recent study has shown that 43 public sector units under the Departments of Heavy Industry and Industrial Development have losses exceeding the paid-up-capital; 21 of them had been incurring cash losses for five successive years from 1977-78 to 1981-82, See Business Standard July 1983.

5. Industrial Financial Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI), Industrial Development Bank of India (IDBI), Life Insurance Corporation (LIC), General Insurance Corporation (GIC), Unit Trust of India (UTI) are the All India Financial Institutions. The data relating to their portfoilio is taken from "Report on Development Banking in India", brought out by IDBI since 1979-80. However, the data relates to the principal amount involved only and excludes the interest component, which is usually more than the principal for sick units.

Annexure 2

On Financial Analysis

Our financial analysis has three elements, (A) analysis of balance-sheet, (B) analysis of profit and loss statement and (C) summary of performance. The salient features are as follows:

(A) Analysis of balance-sheet:

With a view to bringing out the imbalances in financial frame brought about by decline and sickness, we have looked at the structural changes in the balance sheet over the years. This has been done by analysing the composition of liabilities (net worth, bank loans, statutory liabilities etc.) and assets (fixed assets, current assets, losses etc.) over time. To the extent that the financial problems in sick units emanate from factors that are distinctly different from that of healthy units, we haven't carried out the usual funds-flow analysis.

(B) Analysis of Profit and Loss Statement:

Our primary concern here has been to understand the cost structure of the firm. We start with Net sales, then adjust for changes in stock of finished goods to arrive at the sale value of

production (SVP). Variable costs - material costs, power, transport etc. - are then subtracted from SVP to arrive at 'contribution' 1/. Next, we have deducted fixed costs - wages, salaries, rent etc. - from contribution to arrive at earnings before depreciation, interest and taxes (EBDIT)2/. Once interest is removed from EBDIT, we get cash profit which tells us, the extent of cash generated from operations cash profit minus depreciation and taxes gives us Net profit. We also compute the break-even value of SVP and compare it to the actual figure. The cost structure is always seen in relation to the level of SVP that is achieved.

(C) Summary of Performance:

Here, we start with the trends in cash profit - indicating profitability, Net working capital indicating liquidity - and tangible net worth - indicating solvency - as these are the three interdependent elements of financial viability. We also examine the trends in debt as well as its composition. As far as relationships go, we look at four ratios (i) debt/equity - the gearing ratio, (ii) accumulated loss/equity - indicates financial frame, (iii) cash profit/net sales - indicates profitability, (iv) internal sources/total liabilities - reflects owner's stake in business.

Notes and References

1. A negative contribution is tantamount to the 'shut-down' point in the neo-classical theory of the firm.

2. EBDIT is also termed 'gross profits' in the literature. A positive EBDIT implies that the firm is operating above the break-even point.

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