

PART II

CREDIT MANAGEMENT AND INDUSTRIAL SICKNESS

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The increasing trend in the number of sick industrial units as well as in the amount of bank credit outstanding in these units is causing considerable concern at all levels in the Banking Industry.

The common effects of such sickness are lock up of financial resources, wastage of capital assets, loss of production and increase in unemployment. Therefore, the bankers, the financial institutions, the industrialists, the workers, the Government and the consumers are all concerned about industrial sickness.

In connection to the above, it is very necessary to diagnose the sickness at a very early stage and revive the sick units by taking timely steps.

Therefore, in regard to the dimension of the problem, an attempt has been made in this part to firstly study the existing system of identification, rehabilitation and nursing of sick units in commercial banks and secondly work out the practical problems faced by bankers in this area and suggest corrective measures accordingly.

CHAPTER 6

IDENTIFICATION OF INDUSTRIAL SICK UNITS

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Introduction

Sickness of industrial units is not a new phenomenon, either in India or elsewhere. In this complex and diverse world of uncertainty, inexperience, inefficiency, vast and rapid technological changes, changes in consumer preferences, monopolistic competition, growing unrest labour, breakdown and shortage of power and fast and unforciable changes in government regulations of industries, sickness of industrial units is bound to take place here and there.

Company failures in a traditional capitalist economy are considered as a way of weeding out the inefficient and getting the economy to perform at its optimum. However, the justice of the market place punishing the poor performers, does not seem to meet with the approval of even societies which are market oriented. The protest has come from the employees who lose their jobs due to closure of a company, the shareholders who lose their savings, suppliers who cannot collect their dues and customers who have to look elsewhere for satisfying their product needs.

In mixed economies like that of India, with a socialist economic philosophy, company failures are interpreted as failure of capitalism and the Government is keen to take over industries which are performing poorly, basically to avoid unemployment.

The Government of India through its policy on

'sick industries' announced in the Lok Sabha on 15th May, 1978³⁵ noted that :

- (i) the phenomenon of 'industrial sickness' both in large and small scale industry, has become increasingly common in the last few years,
- (ii) it is essential to do two things, one, set up suitable arrangements for monitoring and detecting 'industrial sickness' at an early stage, two, suitable steps be taken to deal with sick units.
- (iii) the primary responsibility of running a unit is that of the managements, if they are unwilling and unable to do so, the Government has to intervene to fulfill its larger social responsibility of ensuring efficient use of national resources, and
- (iv) the revival of a 'sick unit' is the responsibility of the Central Government and the State Government, the Labour, Financial Institutions, bank managements and shareholders. It goes to spell out individual responsibilities of financial institutions, State Governments and others.

Again in the Lok Sabha first session of July, 1985, the problem of Industrial sickness was discussed.

All the above developments show how the Government of India is determined to tackle the problem of 'industrial sickness'. But, inspite of all these

35. Lok Sabha Secretariat, Government of India Publication Division, 1978.

actions and motivations, 'sick industries' continue to grow at a very rapid pace. This extent of 'industrial sickness' is dealt with in the following section.

Section I

Magnitude of Industrial Sickness.

A Reserve Bank's study has estimated the extent of sickness as shown in Table 6.1.

Table 6.1 shows an increase in the number of 'sick units' as well as the total bank credit outstanding with them.

The number of sick units increased to 463 at the end of June 1983 from 435 as at the end of June 1982. The bank Credit outstanding against these units amounted to Rs. 1,913.10 crores at the end of June 1983 as compared to Rs. 1,728.95 crores in 1982, showing an increase of Rs.184.15 crores.

Table 6.1 : Sick Industrial Units and Outstanding Bank Credit in Medium and Large Industries.
(Rupees crores)

Industry	End June 1982		End June 1983	
	No. of units	Amount outstanding Bank credit.	No. of units	Amount outstanding Bank credit
1. Engineering and Electrical	91	345.23	101	365.74
2. Iron and Steel	39	138.33	38	142.45
3. Textiles	111	515.55	119	579.83

contd..

Table 6.1 contd..

Industry	End June 1982		End June 1983	
	No. of units	Amount outstanding Bank credit	No. of units	Amount outstanding Bank credit
4. Chemicals	25	194.13	27	209.24
5. Sugar	45	149.34	44	180.11
6. Jute	37	111.35	37	120.53
7. Rubber	15	110.41	16	108.33
8. Cement	3	12.08	3	9.23
9. Miscellaneous	69	162.53	78	197.64
TOTAL	435	1728.95	463	1913.10

Source : RBI Report on Currency and Finance 1983-84 p.69.

The Textile Industry has more sick units. The number of sick units in this industry increased from 111 to 119 and the amount outstanding against them rose from Rs. 515.55 crores at the end of June 1982 to Rs. 579.83 crores at the end of June 1983.

In the case of Iron and Steel and the Sugar Industry, the number of sick units declined slightly but the amount of bank credit outstanding with them increased by Rs. 4.12 crores and Rs. 30.77 crores respectively.

A comparison of these sick industrial units with that of 1977 throws more light on the rapid growth of sick units in these industries. This can be shown in Table 6.2 .

TABLE 6.2 : Credit outstanding in medium and large sick industries.

(As on end September 1977*)

Industry	No. of Units	Credit Outstanding (Rs.crore)
Engineering	72	211.26
Iron and Steel	19	40.40
Textiles	68	230.30
Jute	29	73.61
Chemical	15	78.98
Cement	3	10.90
Rubber	4	20.10
Sugar	23	23.49
Others	37	74.66
TOTAL	270	773.70

Note * : March 1978 Count is Rs. 882 crores.

These figures exclude the National Textile Corporation with 105 units under its command and all of small industry.

Source : RBI, Report on Currency and Finance, 1977.

As at the end of September, 1977 there were 270 sick industrial units (medium and large) with outstanding bank credit of Rs. 773.70 crores, while in 1982 and 1983, they were 435 and 463 sick units respectively with bank credit outstanding of Rs. 1,728.95 crores and Rs. 1,913.10 crores respectively. This means that within only 5 years, the number of sick units has been

multiplied by more than 1.5 and the bank credit outstanding by more than 2.

An unpublished source of the Indian Banks' Association gives again more details about the continual increase of industrial sick units.

TABLE 6.3 : Trend of Industrial Sickness in Large and Medium Industries*

End of		No. of sick units ⁺		Outstanding Bank Credit (Rs. crores)	
December	1976	241	(81)	609	(207)
June	1978	325	(109)	956	(340)
June	1979	345	(117)	1102	(377)
June	1980	389	(124)	1233	(436)
June	1981	422	(129)	1453	(499)
June	1982	439	(111)	1728	(516)
June	1983	463	(119)	1913	(580)

Notes : * Refers to industrial units availing of Bank Credit of 1 crore and above.
In addition, there were 26,973 sick small scale Industrial Units involving bank credit of 394 crores.

+ Figures in brackets show the number of, and dues from sick Textiles (Including Jute Textile) units respectively.

Source : Indian Banks' Association.

Sickness in small industry is more widespread. According to the RBI's Report on Currency and Finance 1983-1984, the number of sick industrial units identified by banks in the small scale sector more than doubled rising to 64,388 units at the end of June 1983 from 36,973 at the end of June, 1982. Bank credit outstanding against these units rose to Rs. 626.52 crores at the end of June 1983 from Rs. 293 crores a year ago.

Out of 64,388 small sick units, 5,983 units with outstanding credit of Rs. 194.50 crores were considered by banks as potentially viable and 50,384 units with outstanding credit of Rs. 354.63 crores as non viable units. Banks have yet to assess the viability of the remaining 8,021 units with outstanding credit of Rs. 77.39 crores. Of the viable units, 2,257 units were under nursing programmes of banks. As regards the overall incidence of sickness in industrial units (small, medium and large) financed by the banking system, there were 66,062 sick units involving an amount of Rs. 3,792.67 crores which constituted 7.9 % of the banks' total advances.

Having an idea about the extent of 'sick industrial units' in the Indian Industry, the second step of the investigation is to study how 'industrial sickness' is perceived by Government, Industry and financial institutions. This introduces the following section relating to the perception of 'industrial sickness'.

Section II

Perception of Industrial Sickness.

Several discussions and meetings with government and bank officers at different levels enabled the investigator to realise that there is widespread debate about industrial sickness. Government, Industries, Financial Institutions and Commercial banks have all adopted different criteria reflecting their needs.

I - Perception of Industrial Sickness as per the Government of India.

The Government of India defines sick units as "those units where the losses, past and present have erased 50 % of capital and reserves."

II - Perception of Industrial Sickness as per the Federation of Indian Chambers of Commerce and Industry (FICCI).

The F I C C I uses the following guidelines for determining sickness, "Cash inflow during the last three years has been progressively going down in relation to revenue commitments, when cash inflow is less than operational commitments and debt - servicing, when debt - service liability is equal to or less than one, when the company has negative working capital and when the unit continues to make losses, cumulative losses exceed capital and reserves."³⁶

36. Federation of Indian Chambers of Commerce and Industry, Memorandum on Revival of Sick and Weak Industrial Understanding, July 19, 1976.

III - Perception of Industrial Sickness as per Commercial banks.

According to the Reserve Bank of India, a Unit may be considered sick if 'it has incurred cash losses for one year and (in the judgment of the commercial banks) is likely to continue to incur cash losses for the current year as well as the following and which has an imbalance in its financial structure, such as current ratio is less than 1:1 and worsening debt - equity ratio (total outside liabilities to Net work).³⁷

The State Bank of India defines a sick unit as 'one which fails to generate internal surplus on a regular basis and depends for its survival on the Constant infusion of funds from outside.'³⁸

IV - Perception of Industrial Sickness as per Financial Institutions.

They prefer to use the term 'problem project' rather than sick industrial units. According to the Industrial Credit and Investment Corporation of India (ICICI), a problem project is 'One whose financial viability, actually and potentially, is threatened by adverse factors. This might relate to management market, fiscal burdens, labour relations or any other. When the impact of these factors reaches a point where a company begins to incur cash losses leading to an erosion of its funds there is a threat to its financial viability'.

37 and 38. Based on the study of different materials pertaining to industrial sickness.

The definition of the I C I C I is based on the criteria of the financial success or failure of a project and the other lending institutions also abide by it. Commercial bank on their side are following the RBI's definition.

An analysis of the above definitions shows that, with the exception of that of the I C I C I, they focus on one or more indicators of financial health viz., funds generation and profitability, liquidity and working capital, capital structure and net worth. That is to say they do not indicate the process by which the ill - health of these elements leads to sickness in a unit.

At the individual bank level, sticky accounts are often used in the place of sick units. The sticky accounts pass through 6 stages viz., hard, slow, distressed, sticky, doubtful and bad. All this, is nothing but the consequence of the stage of sickness of a Unit. Therefore we prefer to investigate right from the unit itself down to the bank/financial institution.

As a consequence of the above, among all the definitions, that of the I C I C I's seems to be more comprehensive since it is in terms of financial viability and also gives a sequence between adverse factors, cash losses, erosion of working capital and threatening of financial viability. This means that sickness is a process which begin by signals, symptoms and causes. A list of signals, symptoms, and causes drawn from the various discussions I had with senior Bank Officers as well as Senior Financiers is shown in Annexure I and II.

The various stages of sickness are known as Tending towards sickness, Incipient sickness, Sickness, Chronic sickness and complete sickness.

Tending towards sickness is a stage when the performance in one of the areas of production, marketing, finance and personnel starts deteriorating in different degrees and assumes a continuing nature leading to the weakening of financial viability.

Incipient sickness is a stage when a unit has incurred cash losses, net working capital has become negative and net worth is very small or negligible.

Sickness is a stage when the continuance of cash loss results in negative net worth resulting in the extinction of financial viability. The unit is likely to incur cash losses in years to come.

Chronic sickness is a stage when the intensity of sickness varies with the quantum of cash losses incurred and the extent to which net working capital and net worth becomes further negative. Sickness becomes chronic if the potency of causal factors is not checked in time.

Complete sickness is the final stage where, in the absence of rehabilitation measures, sickness, will become terminal resulting in the winding up of the unit.

The definition of the various stages of industrial sickness is therefore based on the financial viability of a unit. This financial viability consists of three inter - dependent elements, viz., profitability, liquidity and solvency which are represented by

cash, profit or loss, net working capital and net worth respectively. Viewed in another way, solvency and liquidity are the two vital organs of financial viability and profitability its life blood.

After diagnosing the sick unit (i.e. finding out the signals, symptoms and causes and keeping in mind the various stages of sickness), the next stage consists in prescribing a treatment. This introduces the next chapter relating to the system of Rehabilitation and Nursing of sick units.