Chapter 2

INDUSTRIAL SICKNESS IN INDIA
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PART I

Concept, Causes & Symptoms

INTRODUCTION

The main object of the study is to examine as to how far the avowed objective of revival takes place through the process of the BIFR (i.e., a body of experts) constituted through legal sanction for taking speedy and appropriate preventive, ameliorative, remedial and other actions in respect of sick units.

For the above purpose, it is considered appropriate that the concept of sickness as prevailing in India is examined.

First part of this chapter gives an overview of concept of sickness and its causes & symptoms. Second part deals with magnitude of industrial sickness in India and measures taken by the Government and related agencies to prevent and/or to cure sickness in Indian industrial units.

Specifically, the following basic issues are dealt with in this part (Part I):

- What is Industrial sickness?
- What are the main causes of sickness?
- What are its possible symptoms?

The above issues are addressed in detail in the paragraphs that follow.
2.02 CONCEPT OF SICKNESS

The etymological meaning of the term sickness is 'disease' or act of 'being ill'. Sickness is a symptom of ailment and not an ailment in itself. It indicates that everything is not well but it does not in itself show what is not well. Sickness of physical body indicates that some part of the body of the organ is not normal and requires diagnosis and treatment. In India the word is used in connection with 'industry' or 'corporation' to mean 'illness' of a particular industry or a business unit. India has therefore coined her own terminology of 'industrial sickness' or 'corporate sickness'. In the studies abroad, the words 'corporate collapse', 'bankruptcy', 'failure' etc. are being used in this connection. An attempt is therefore made to interpret these terms in their own perspectives.

'Corporate Collapse' is used as a common term to exhibit a situation of sudden failure of a successful enterprise.

'Bankruptcy' means a situation when a person or corporate body fails to meet its financial obligation. In the United States of America (USA) there is Bankruptcy Act which provides detailed provisions in the subject. In the USA a bankrupt firm is either placed in receivership or had been granted the right to reorganise under the provision of Federal Bankruptcy Act. A company in perilous condition may file application for protection under Chapter XI of the Federal Bankruptcy Act and through the provision of that Chapter reorganisation may be effected. Statistics of 'legal failure' are compiled by Dun & Bradstreet in the USA. In many cases 'failure' has been regarded as synonymous with 'Bankruptcy'. Business failure may be defined at least from four standpoint: Social, Economic, Managerial and Legal. The term 'failure' is generally regarded as legal failure i.e., the inability of firm to pay its debts. However, failure may be temporary liquidity.

* In a study on "Corporate Response to Declining Rates of Growth" made by Hughes, Katherine the various code words used to signify decline in the corporate annual reports in U.S.A. have been listed. It may be noted that the word 'Sickness' has not been listed there. See Hughes, Katherine, Corporate Response to Declining Rates of Growth, Lexicon Books, Massachusetts, 1982.
embarrassment or, in the extreme case, an irretrievable state of solvency where the liabilities of the firm exceed a fair valuation of its assets.

Bankruptcy is clearly a defined legal event taking place at a definite point of a time and is undoubtedly a conclusive evidence of the firm having failed. In reality bankruptcy is only the culmination of failure. Economic failure of the firm i.e., a situation where the realised rate of return on capital employed is significantly and continuously lower than prevailing rates of similar investments generally precedes bankruptcy.

Though there may be subtle differences in these terms, it may be pointed out that 'sickness' is somehow different from these terms.

Despite several policy guidelines on sickness in industry, the term 'sickness' is yet to be properly defined. Like the differing perceptions of an elephant by six blind men, industrial sickness means different things to different people. The definitions of 'sickness' given by various authorities may be classified into two broad categories viz, theoretical definitions given by individuals and legal/institutional definitions given by Government/quasi-government authorities.

### Definitions given by Individuals

"Sickness broadly refers to the inability of a firm to operate as a going concern because it cannot generate enough surplus."

"Sickness broadly means the failure of a unit to produce a surplus. If it incurs losses continuously, it would result in an erosion of the capital base. It will not have funds to meet the operating costs nor will it be possible for it to pay the mounting arrears of outstanding."

"The sickness may be due to general recession but sickness in industry does occur even when the health of the economy is sound."

L.C.Gupta while condemning the official yardstick for identifying sickness viz., the cash loss criterion as an instrument in delaying the
corrective action for several years, has given a three tier view on corporate sickness. According to him, 'inability to pay dividends' is the first stage of sickness, 'the defaults in meeting loan obligations' comes next and 'erosion of networth' and consequent closure or threat to closure of an enterprise' is the final stage of corporate sickness.

Prasanna Chandra\(^{11}\) has also opined that the approach to define sickness in terms of well defined financial indicators by the regulatory authorities is "deficient because sickness cannot always be captured so neatly by quantitative financial indicators". According to him\(^{12}\), "an industrial unit may be regarded as sick if (i) it faces financial embarrassment (arising out of its inability to honour its obligation as and when they mature), and (ii) its viability is seriously threatened by adverse factors".

Similarly, Sudarsan Lal\(^{13}\) has indicated two stages of sickness: "a unit can be considered sick if it is operating at less than break-even point, that is, where it is unable to meet its cost and depreciation; the unit, which has eroded its capital and reserves, should be considered to have reached an advanced stage of sickness".

**2.02.2 Legal and Institutional Definitions of sickness**

Legal and Institutional definition of 'sickness' may be presented in a chronological manner.

The Government of India for the first time took serious notice of the phenomenon of the industrial sickness in the Statement of Objects & Reasons of Industries (Development & Regulation) Amendment Act, 1971 and felt the need for action to rehabilitate such undertakings by investment of public funds and managerial skill. However, no formal definition of sickness was given in the Amendment Act or in the main Act viz., the Industries (Development & Regulation ) Act, 1951 (as amended)\(^{14}\).

Formal definition of industrial sickness was given by the banking industry first, since they were worst affected financially due to growing
phenomenon of sickness. In 1975 the Study Team of the State Bank of India on Small Scale Industries defined a sick unit as one which fails to generate internal surplus on a continuous basis and depends for its survival on frequent infusion of external funds. According to the definition given by the Reserve Bank of India (RBI), a unit is considered sick if it has incurred cash losses for one year and in the judgement of the financing bank is likely to incur cash losses for the current as well as following year and/or there is imbalance in the units financial structure, that is when the ratio of current assets to current liabilities is less than 1:1 and debt equity ratio (total outside liabilities as ratio of networth) is worsening.

Term-lending financial institutions classify a unit as sick after taking into account any of the following symptoms:

i) Continuous defaults in meeting four consecutive half yearly instalments of interest or principal in respect of institutional loans.

ii) Continuous cash losses for a period of two years or continued erosion in the net worth, say by 50%.

iii) Mounting arrears on account of statutory and other liabilities, for, say, a period of 1 or 2 years.

The definition of the RBI is generally followed by the banks for classifying a unit as sick. However the concept of the RBI has been stated to be 'illustrative' and not 'exhaustive' as it leaves enough elbow room to individual bank managers to make their own judgement in specific cases. The RBI's concept has also been criticized on the ground of non-infallibility. B.Bannerjee has made a case study on efficacy of the RBI's criterion in identifying sick units. Through the case study of certain textile units it has been found out that the RBI criteria does not work uniformly in identifying sick units. Some of the criticisms made by him are mentioned below:

i) Specifying cash losses criteria alone without reference to accumulated losses or reserves and surplus is not justified.
ii) Testing short-term liquidity by current ratio alone instead of studying it along with acid test ratio may not serve any purpose.

iii) The criterion "worsening D/E ratio" does not convey any unambiguous meaning. Also, whether a particular D/E ratio of a firm satisfactory or not depends among others, upon its cash flow position which is not considered.

Moreover the suggestion to include current liabilities as a part of debt for the purpose of calculation of the D/E ratio may be disputed.

D.P. Gupta has mentioned that "a unit might have fallen sick although the cash flow may not be negative. Some industrial units already included with sickness take sometime before they reveal such sickness in the form of continued losses. A long period of declining profitability may precede the period of recurring cash losses and financial difficulty".

It is also argued that the RBI criterion works too late and may not effectively serve as early warning system for the purpose of taking any corrective or remedial measure in respect of such sick unit.

In view of the mounting industrial sickness in the country and its serious ill effects on the national economy a need was felt to enact in public interest a legislation to provide for timely detection of sickness in industrial companies and for expeditious determination by a body of expert of the preventive, ameliorative, remedial or other measures that would be adopted with respect to such companies and for enforcement of the measures considered appropriate with utmost practicable despatch. Government of India accordingly enacted the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA, 1985).
It may be pointed out that the SICA, 1985 is largely based on the model bill submitted by the Tiwari Committee* in its Report in 1983. Hence, the legal definition of sickness as given in the SICA, 1985 had the origin in the Tiwari Committee Report. The definition of sick unit suggested by the Tiwari Committee had three ingredients viz., (i) cash loss for one financial year, (ii) adverse current ratio and (iii) the erosion of networth by accumulated losses by 50%.

The preamble to the SICA, 1985, is broad-based, which emphasised on timely detection of sick and potentially sick units; and speedy determination by Board of experts [i.e., Board for Financial and Industrial Reconstruction (BIFR)] for preventive, ameliorative, remedial and other measures that would be needed with respect to such units. In order to achieve this, the two way classification of the sick unit viz (i) sick unit and (ii) potentially sick unit was made in the Act.

According to the SICA, 1985 if a company which has been 7 years existence, incurs cash losses for two financial year and the accumulated losses of the company equal to or exceed its entire networth, it is termed as 'sick industrial company' [Sec 3(1) (o)]. Also the SICA, 1985 deals with incipient sickness. An industrial company within the meaning of this Act will have to report the BIFR when 50% or more of its peak net worth during the preceding five year period has been eroded by cash losses. Thus, when net worth of a unit is eroded by accumulated losses to the extent of 50% and above, it is a potentially sick industrial company. Now, the criteria of the sickness as contained in the SICA, 1985 are applied by all institutions and agencies who are concerned with industrial sickness.

An examination of the legal or institutional definitions of Industrial Sickness reveals there is a bias towards defining sickness in terms of well defined financial indicators22. While such an approach might be motivated by a desire to ensure that agencies involved in handling sick

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* The Reserve Bank of India constituted in May, 1981 a committee of 11 members, headed by Shri Tiwari (the then Chairman of the Industrial Reconstruction Corporation of India) to examine the legal other difficulties faced by the banks and financial institutions in the rehabilitation of sick industrial undertakings and to suggest remedial measures, including changes in law. The Committee is commonly known as "Tiwari Committee".
units operate within a uniform framework, it seems deficient because sickness cannot always be determined so neatly by quantitative financial indicators. Also the 'cash losses' concept is not free from criticism as through creative accounting techniques, it is also possible to manipulate cash losses. Moreover 'incurring continuous cash losses' as the main criterion for classifying a unit as sick is fraught with difficulty because the affected unit would be either beyond revival or would require major revival measure such as merger, reorganisation etc. The SICA, 1985 though provides for reporting of incipient sickness, it is silent on measures to be taken by the BIFR as regards potentially sick units reporting their incipient sickness.

The need for early recognition of sickness cannot be overemphasised. In studies abroad, a situation of several years of deteriorating profits is termed as decline. Decline is business failure from a managerial standpoint. Declining firms which are in a plateau of performance mediocrity needs turnaround. In the USA too, there is a problem of late recognition of turnaround needs. Turnaround means to produce a noticeable and durable improvement in the performance, to turn around the trend of result from down to up, from not good enough to clearly better, from underachieving to acceptable and from losing to winning. When a company either as whole or in one of its division or departments, is consistently performing below the average or mid point of the industry group, it can be recognised as an opportunity calling for special effort to raise the performance above the group average. Such company is termed as a turnaround situation. Turnaround programme is somewhat akin to rehabilitation or revival programme though 'sickness' and 'turnaround' needs are measured by adopting different criteria. Goodman has pointed out that "........competitive, free-market environment generates an in exhaustible supply of turnaround opportunities, accompanied by low recognition of their existence and low action drives towards making most of these opportunities".

It is always stressed by the experts that sickness never comes overnight. If an industrial unit has shown signs of incipient sickness
though not yet incurring cash losses, remedial measures should be
taken at that stage and management need not wait for cash losses to
occur. In a study of 11 randomly selected units Yadav\textsuperscript{26} has shown
that erosion of net worth is a slow process. The time gap between first
occurrence of cash loss and year of 50\% erosion of net worth is
sometime more than seven years. However, erosion of balance 50\% of
networth has occurred rather quickly within 2 or 3 years. Thus, the
action taken, or proposed to be taken at the level of erosion of 50\% of
networth, are practically too late. It is in the intermittent period, i.e., on
the occurrence of the first cash loss or to be more precise on the
occurrence of earning declines, the corrective action may be called
for. The concept of 'initially sick' as advanced by L.C. Gupta may be
useful in this regard.

However, whether all the cases of 'initially sick' or 'potentially sick'
units should come under the purview of remedial measures to be
undertaken by the BIFR would be a matter of policy. In this era of
liberalisation and free play of market forces it would be rather
undesirable to seek intervention always through Government agency
like the BIFR in such cases for better results. Such cases may be kept
open for taking corrective measures by the management, banks and
other lending institutions.

\textbf{2.03 CAUSES OF SICKNESS}

Having discussed the concept of sickness, it is worthwhile to find out
the causes which lead corporate towards sickness. Placing the blames
for sickness or corporate failure in proper perspective is an age old
debate alike to the chicken-and-the-egg debate.

Theoretically, causes of industrial sickness may be grouped under two
categories viz., uncontrollable external reasons and controllable internal
reasons.

There are many studies in eighties which try to find out the causes of
sickness e.g., Chatterjee\textsuperscript{27}, Pai\textsuperscript{28}, Yadav\textsuperscript{29}, Khandwalla\textsuperscript{30}. The findings
of those studies hover mainly around the causes as summarised in the
Tiwari Committee Report. An illustrative list of causes of sickness from the Tiwari Committee Report is given in Table 2.01.

**Table 2.01**

**Causes of Sickness**

A. **INTERNAL CAUSES:**

(1) **Planning**

(a) Technical feasibility : Inadequate technical know-how, locational disadvantage, outdated production process.

(b) Economic viability : High cost of inputs, break-even point too high, uneconomic size of project, underestimation financial requirements, unduly large investment in fixed assets, over-estimation of demand.

(c) Financial management : Poor resources management and financial planning, faulty costing, liberal dividend policy, general financial indiscipline and application of funds for unauthorised purposes, deficiency of funds, over trading, unfavourable gearing or keeping adverse debt equity ratio, inadequate working capital, absence of cost consciousness, lack of effective collection machinery.

(2) **Implementation** : Cost over-runs resulting from delays in getting licenses / sanctions, etc., inadequate mobilisation of finance.

(3) **Production**

(a) Production management : Inappropriate product-mix, poor quality control, high cost of production, poor inventory management, inadequate maintenance and replacement, lack of timely and adequate modernisation etc., high wastage, poor capacity utilisation
(b) Labour management: Excessively high wage structure, inefficient handling of labour problems, excessive manpower, poor labour productivity, poor labour relations, lack of trained/skilled competent personnel.

(c) Marketing management: Dependence on a single customer or a limited number of customers/single or a limited number of products, poor sales realisation, defecting pricing policy, booking of large orders at fixed prices in an inflationary market, weak market organisation, lack of market feedback and market research, lack of knowledge of marketing techniques, unscrupulous sales/purchase practices.

(d) Financial management: Poor resources management and financial planning, faulty costing, liberal dividend policy, general financial indiscipline and application of funds for unauthorised purposes, deficiency of funds, over trading, unfavourable gearing or keeping adverse debt equity ratio, inadequate working capital, absence of cost consciousness, lack of effective collection machinery.

(e) Administration management: Over centralisation, lack of profession, lack of feed-back to management (Management information System), lack of controls, lack of timely diversification, excessive expenditure on R&D, divided loyalties( where the same management has interest in more than one unit, cases are known where promoters of limited companies who also own private ownership first tend to look after, often at the cost of the former), dissatisfaction within the management, incompetent management, dishonest management.
B. EXTERNAL CAUSES:

(a) **Infrastructural bottlenecks**: Non availability of/irregular supply of critical raw materials or other inputs, chronic power shortage, transport bottlenecks.

(b) **Financial bottlenecks**: Non-availability of adequate finance at the right time.

(c) **Government controls and policies, etc.**: Government price controls, fiscal duties, abrupt changes in Govt. policies affecting costs/prices/ imports/exports/licensing, procedural delays on the part of the financial/ licensing/other controlling or regulating authorities (banks, RBI, financial institutions, govt. department licensing authorities, Monopolies and Restrictive Trade Practices Board etc.).

(d) **Market constraints**: Market saturation, revolutionary technological advances rendering the products obsolete, recession—fall in domestic/export demand.

(e) **Extraneous factors**: Natural calamities, political situation (domestic as well as international), strikes and multiplicity of labour unions.


The list exhibits that sickness attributable to management deficiency may be classified into three stages of a project: (1) sickness arising at the time of planning, (2) sickness arising during implementation and (3) sickness arising after implementation or during production stage. It may be pointed out that the Tiwari Committee has laid stress on management deficiency as the main cause of industrial sickness. This stress may be due to the findings of a study conducted by the Reserve Bank of India in respect of sick industrial undertakings enjoying credit limit of Rs.10 million and above from the banking...
The study covered 378 units and considered their position as on 31st Dec. 1979. The findings of the study has revealed the following (Table 2.02):

### Table 2.02

<table>
<thead>
<tr>
<th>Unit</th>
<th>Percentage</th>
<th>Cause</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>52</td>
<td>Units which have gone sick due to mismanagement, management deficiencies including diversion of funds, infighting, lack of marketing strategies</td>
</tr>
<tr>
<td>2</td>
<td>14</td>
<td>Units which have gone sick due to initial faulty panning and other technical drawbacks</td>
</tr>
<tr>
<td>3</td>
<td>2</td>
<td>Units which have gone sick due to labour trouble</td>
</tr>
<tr>
<td>4</td>
<td>23</td>
<td>Units which have gone sick due to market recession</td>
</tr>
<tr>
<td>5</td>
<td>9</td>
<td>Units which have gone sick due to reason other than above (power cuts, shortage of raw materials etc.)</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>Total</td>
</tr>
</tbody>
</table>

Source: Business India, November 22-December 5, 1982, p.47

It might be a sheer coincidence that a study in the USA on causes of decline made through survey of 81 Turnaround Company Chief Executives in April, 1978 has also revealed more or less same picture as detailed in Table 2.03.
Table 2.03

The Principal Reasons for Corporate Decline

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sheer bad luck</td>
<td>1</td>
</tr>
<tr>
<td>External factors beyond management's control</td>
<td>8</td>
</tr>
<tr>
<td>Real balance of external and internal factors</td>
<td>24</td>
</tr>
<tr>
<td>Internal problems triggered by external factors</td>
<td>15</td>
</tr>
<tr>
<td>Internally generated problems within management's control</td>
<td>52</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>


The internal causes during planning stage as mentioned in Tiwari Committee Report has been termed as inherent cause by Nadkarni. Inherent causes of sickness imply those causes which cripple a unit right from its conception.

If any industry has no revival prospect right from its birth there is no use of infusing fund in it. Such cases of sickness require proper identification and timely decision on their closer as the prospect of revival would be very remote.

In a vast and diverse country like India the different basic reasons obtaining in various States have also led to different types and extents of sickness in industries. The position of Eastern Region and more particularly West Bengal is relatively worse than many other States in other Region. According to a study of Indian Chamber of Commerce, the chief causes of sickness in this region are as follows:

1. Shortage of power supply specially lack of uninterrupted supply of power for the manufacturing activity based on continuing processing in West Bengal and the Eastern Region is a major...
constraint. Although supply of power has improved marginally in West Bengal in recent years. It is still worst in Bihar and Orissa.

2. Resistance to modernisation: Modernising plants and upgrading technology are linked with rationalisation of employment. The labour laws are opposed to modernisation and retrenchment of the workers is nearly impossible. Hence, even when funds are available, modernisation may be difficult to achieve.

3. Lack of requisite or sufficient financial assistance from banks and financial institutions, specially to small-scale and medium industries, is another major constraint. Want of financial assistance has been hindering the modernisation of the industry.

4. Investments and financing of industrial houses in West Bengal and the Eastern Region by the Central Government and the financial institutions are insignificant during the recent years and far behind those in other States like Maharashtra and Gujrat. Even with regard to the investment in the Central projects, according to the Chief Minister of West Bengal, the position of West Bengal has gone down to some other States. For example, the Central investment has increased from 3.1% to 15.2% in Maharashtra, but it has dropped from 11.7% to 3.5% in West Bengal during 1970 and 1984 and that per capita investment is one of the lowest in West Bengal.

5. Central Government's 'Freight Equalisation Policy' (which was continued for about 30 years) in respect of iron ore, steel and coal had caused serious imbalance in the economy of West Bengal and the Eastern Region and had been severely hitting the textile, steel and coal-based industries (including power and energy) in West Bengal. This policy had deprived West Bengal, Bihar, Orissa of their locational advantage and discriminated against the Eastern Region.

India has been following a path of highly regulated economy so far as industrialisation is concerned. The fate of many industries is
dependent on government policies. Also the government spending being a very major part of total demand the budgetary allocation generally play a major role in patterning the demand structure of any particular industry e.g., cement, steel etc. Also their is perennial infrastructure constrains like power shortage. Thus the contributory role of the external factors in sickness cannot be over emphasised. The study of B.N. Pai\textsuperscript{35} has comprehensively dealt with the external causes.

The internal factors though apparently within the control of the management can also cause unexpected problems, as they are not completely outside the orbit of the influence of external factors. For instance, the implementation of the project itself may be bogged down owing to the following reasons:

- Delay in project appraisal by the financial institutions, banks;
- Delay in getting necessary permission from the government;
- Delay in getting import license where the machinery/raw materials are to be imported;
- Delay in getting power sanction/connection;
- Delay in getting subsidy and development loan from State/Central Government;
- Delay in arrival/erection of machinery (may be owing to lockout/strike in the companies from which they are to be purchased).

In fact the completion of the project may be unduly delayed owing to various factors. This results into escalation in the cost of the project, posing serious problems to the entrepreneurs in finding out source of finance. Thus, internal causes can also be affected by external environment, confounding the plight of the harassed promoters.

The causes cited above may also be termed as external. On a more theoretical perspective, the external factors which causes sickness may also be divided into five categories\textsuperscript{36}: economic change, competitive change, government constraints, social change and technological change.

Among these factors competitive change arising out of liberalised economic policy by the Government of India in 1991 may deserve
certain elaboration. Most companies operate in a world of constantly shifting competition. The emergence of foreign low cost products, the merger of two competitors, the announcements of competitors new range of products, the appearance of an entirely new company in the industry are changes that can have profound impact on the fate of any company. Competitive change often takes the form of price-war. However, competition can cause decline only to companies that are not monitoring the outside environment.

There is controversy regarding role of internal or external factors in bringing sickness. Are the internal factors alone responsible for sickness? This is a debatable issue and many studies have pointed out how external factors may outweigh internal factors in causing sickness to a firm.

According to the Study \(^{37}\) made at the Workshop organised by the Federation of Indian Chambers of Commerce & Industry (FICCI) the external factors outweigh internal causes. Some other researchers have also said that the contribution of factors outside the entrepreneurs' control like taxation, time bound payment stipulations, credit restrictions, high interest rates, price controls, industry location policy and labour laws have unfortunately not received the attention they deserve \(^{38}\).

Generally, there is interaction of both kind of causes that create sickness and therefore attributing sickness to any particular cause may not be correct.

In a recent study on sickness in Paper Industry in India, Achalapati \(^{39}\) concluded that there exists a chain of causation to the corporate sickness and remedy to the malady lies in unraveling such chain of causation. He observed "the chain starts with root cause which differs from unit to unit, leading to consequential causes. These two causes, which are generally invisible, together reduce the resistance power of the unit and make it prone to the visible causes which are common all units in an industry, generally external and virus in nature. The visible and invisible cause put together culminate into terminal cause".
The point, that invisible internal causes & visible external causes put together take the unit to death knell and invisible causes are also root causes which deserve proper management attention in containing sickness of a firm is very vital.

"The problem does not arise from external conditions, but a change of external conditions causes imbalance. The problems come from an internal problem, but the triggering mechanism that suddenly make things that formerly worked no longer work is a charge in external things - a condition of high interest rates, a condition of flattering industry sales, or any combination of those things. It works on your internal problems so that you can no longer live with them, so you have at this point to either fall by the wayside or correct the internal problems."

The BIFR, the body created for rehabilitating sick units has also listed down certain causes found out through case study of sick units registered with it. The causes as described below include both internal and external ones.

1. Lack of detailed techno-economic analysis of all the factors bearing upon and relevant to the success of proposed project.

2. Detailed market studies are not made and the Indian entrepreneurs have displayed a herd mentality in selecting projects simultaneously.

3. Non-availability of power.

4. Failure to modernise equipments, particularly, for jute and textile industries.

5. Exorbitant trade union demands leading to wages much above the prevailing wage level in the region.
6. Failure of management by itself i.e., incompetence of top management.

7. Endemic cost and time overruns.

8. State & Central Government policies, bureaucratic bottlenecks, slow release of promised fund or incentives, tardy release of forest resources, inappropriate import and tariff policies, licensing system etc.

9. Establishment of industries in backward area where labour productivity is poor and managerial/skilled staff cannot be attracted from other region.

10. Conspicuous absence of monitoring by the banks.

Ultimately it is the management which is responsible to identify the root causes of sickness. In most situations where the management is open minded enough to pay heed to the external signals, it will be able to head off a good portion of the outside factors which created the crises of existence. It may be apt to quote from John Argenti, who has rightly analysed the position by drawing an analogy of sickness from sinking of a ship. "It is never sensible to push any analogy too far, but the collapse of a company is in some ways similar to the sinking of a ship. If a ship is in good condition and the captain is competent, it is almost impossible for it to be sunk by a wave or succession of waves. Even if there is a storm, the competent captain will have heard the weather forecast and taken whatever measures are needed. Only a freak storm for which quite inadequate notice has been given will sink the ship".

2.04 SYMPTOMS OF SICKNESS

Symptoms of sickness are very much evident and almost common to all enterprises. However, such symptoms become clear only at the
terminal stage of sickness. An illustrative list of symptoms of sickness from the Report of the Tiwari Committee is given in Table 2.04.

**Table 2.04**

**Symptoms Of Sickness**

(a) Continuous irregularity in cash credit accounts.

(b) Low capacity utilisation.

(c) Profit fluctuations, downward trends in sales and stagnation or fall in profits followed by contraction in the share of the market.

(d) Higher rate of rejection of goods manufactured.

(e) Reduction in credit summations— whenever the companies are in financial difficulty, they open a separate account with another bank and deposit all collections therein.

(f) Failure to pay statutory liabilities.

(g) Larger and longer outstanding in the bill accounts.

(h) Longer period of credit allowed on sale documents negotiated through the bank and frequent returns by customers of the same.

(i) Constant utilisation of cash credit facilities to the maximum and failure to pay timely installment of principal and interest on term loans and installment credits.

(j) Non-submission of periodical financial data/stock statement etc. in time.

(k) Financing capital expenditure out of funds provided for working capital purposes.
(l) Decrease in working capital on account of —

i) increase in debtors and particularly dues from selling agents;

ii) increase in creditors;

iii) increase in inventories which may include large number of slow or non-moving items.

(m) A general decline in that particular industry combined with many failures.

(n) Rapid turnover of key personnel.

(o) Existence of a large number of law suits against the company.

(p) Rapid expansion and too much diversification within a short time.

(q) Sudden/frequent changes in management - whether professional or otherwise and/or dominated by one man/few individuals.

(r) Diversion of funds for purposes other than running the unit.

(s) Any major changes in the share holdings.


It is generally common to identify sickness through its symptoms more commonly the financial one. The definition of sickness as given by the RBI or in the SICA, 1985 is also based on 'cash loss' & 'erosion of networth' criterion. Main symptom of sickness is however cash flow problem. The emphasis on cash flow is well placed in the sense that scope of window dressing in cash flow indicator is rather limited. Bankers while identifying sick units place reliance of position and conduct of cash credit account. Persistent irregularity in the account is
considered as danger signal of incipient sickness in a unit\textsuperscript{45}. A list of financial adverse indicators termed as 'red flags' developed by a vice president of a foreign bank is shown in Table 2.05.

Table 2.05

List of Financial Adverse Indicators termed as Red Flags

(1) Slowness in submitting financial exhibits by the borrower. This can be the result of either unwillingness on the part of the borrower or a lack of experience of manpower in the financial part of the company.

(2) Declining deposit balances, overdrafts and/or returned cheques. The former, declining deposit balances, may be unnoticed for a period of time, but the latter, overdrafts and/or returned cheques, appear with traumatic suddenness.

(3) Inventories to perform on other obligations, including personal debt of the principals. This information can come from a variety of sources; however, the importance of not allowing split borrowings can be seen in this regard.

(4) Inventories become swollen. This flag can usually be found in the financial data supplied by the borrower or as the result of credit inquiries received from suppliers.

(5) Loan payments become delinquent with past due periods increasing.

(6) Slowness in bank's ability to arrange plant visits or meetings with principals.
Borrower becomes a target of legal process or actions. Such actions would include the filing of security interests by other creditors; tax liens, including those for withheld taxes; attachments and/or levies against bank accounts, etc.

Trade payable and/or accruals begin to build. This observation can be prompted by the submission of financial information by the borrower or inquiries and leads from suppliers and others.

Adverse information from competitors and customers of the business concern.


Though this study concentrates on rehabilitation of firms where sickness is firmly established, it may be pointed out that sickness or problems with most ailing organizations start from a functional blindness towards early symptoms of weakness. Generally, these symptoms are the least revealing one and may be termed as weak signals. Some such weak signals are:

i) Adverse trend signals e.g., declining margins, declining working capital, decline sales revenue etc.

ii) Decline in the rate of reinvestment.

iii) Adverse behavioural signals like poor communication system within the organization, low morale, etc.

The discussion on symptoms may be concluded with the remarks that symptoms of sickness or incipient sickness, or corporate sickness are always there. The trouble is that only few people recognize them in their proper perspective.
References


17. Business India, November 22 - December 5, 1982, p. 47.


25. Ibid., p. 11.


32. Business India, November 22- December 5, 1982, p. 47.

34. Dutta, L.N., *op. cit.*, pp. 1.51-1.52.


