CHAPTER I

INDUSTRIAL SICKNESS IN PSEs

The Need for Study

While there has been extensive research in India and abroad on industrial sickness in private sector enterprises, not much work on the sickness problem in relation to public sector enterprises has been done despite the public sector industry's commanding importance in the Indian economy and the existence of widespread sickness among PEs. Some factors causing sickness may be common between the two sectors, there are others which are peculiar to the public sector due to organisational characteristics. Moreover, it is not only with respect to causes of sickness that there are differences between public and private sector enterprises. The options available for solving the problem of sickness are also not the same in the case of the two sectors. Hence, sickness in PSEs requires a separate study. This is the main justification for undertaking the present study. Therefore, a better understanding of the problem relating to PEs has acquired greater importance. The recent pronouncement of the Finance Minister, Dr. Manmohan Singh, in the IMF - World Bank meeting at Bangkok that 'patently unviable' public sector undertakings will be closed down even without reference to the Board for Industrial and Financial Reconstruction indicates the gravity of the situation with regard to the sick public enterprises.
The main motivating factors responsible for the growth of public enterprises include; inadequacies of the private sector, benefits from natural monopolies, price stabilisation, mobilisation of savings, foreign exchange earnings, exploitation of national resources, the urge towards self-reliance, employment generation and other socio-political aspirations. In recognition of the paramount role of public enterprises in the process of industrialisation and as a factor of economic and social advancement of the developing world, the General Assembly of the United Nations had to adopt Resolution 32/179 of 19th December, 1977, :-

"to continue studying the role of the public sector in promoting the economic development of developing countries and in doing so to take into account the role of the public sector in implementing the long term strategy of industrialization".

The dismal performance of the public enterprises is a cause of concern for Government. The Government’s role as an investor and manager of public enterprises is the most crucial, controversial and difficult issue. Even the staunchest defender of public enterprises cannot ignore the glaring inefficiencies that afflict Government’s management of these enterprises. Nearly half of the commercial public enterprises are suffering losses. These losses are being met by borrowings or taxation which reduces the resource availability for development. Professor P.N. Dhar has observed that:

"the disabilities of a public sector enterprises start right from its conception and birth; from
The first stage when it is identified, appraised and selected for inclusion in the public investment programme... In theory, public-sector enterprises are owned by the people and run in their interest; in practice, they have spawned a number of economic interests and political constituencies which wield formidable power". (1)

The present attempt is an analysis of factors responsible for the decline of public enterprises from the "commanding heights".

Replying to the debate in the Lok Sabha on the Sick Industrial Companies Act, (Amendment) on 3.12.1991, the Finance Minister (Dr. Manmohan Singh) observed as under:

'.....The Government does not want India to go the way of some countries in East Europe and the country no longer afford PSUs which make losses year after year. The budgetary support this year for the Public Sector was Rs. 5000 crores and it was no longer possible to finance this sector through external or internal borrowings.....it did not make profits and its losses had to be met by increased taxation or deficit financing, it could not perform the task it was supposed to'.

(Record of Lok Sabha Proceedings, debate on SICA (Amendment), dated 3.12.1991.)

Socioeconomic Impact

Public policy should aim at promoting the best utilisation of the available scarce resources. A sick unit is a problem not only of the entrepreneur or financial institution but also for the Government and society at large as brought out by the following statement given to Parliament at the time of introducing the Sick Industrial Companies (Special Provision) Act, (SICA), 1985:
"The ill effects of sickness in industrial companies such as loss of production, loss of employment, loss of revenue to the Central and State Governments and locking up of investible funds of banks and financial institutions are of serious concern to the Government and society at large."

The developed countries have paid more attention to rapid adjustment of firms to market forces than to defensive preservation of a sick unit, but in India the whole emphasis has been on the latter. Relatively speaking, the Indian strategy has proved to be a relatively expensive form of social security. Using old equipment to produce outmoded goods for the protected domestic market may be more costly than using new equipment to compete in larger markets. Continued production from loss-making sick units deprives others of market opportunities and delay technological change. Without increased flexibility to adopt and to close uneconomic production units, the potential for increased industrial output through improving efficiency cannot be achieved. This keeps the country poor for all time.

What needs to be appreciated is that without efficient production, the goal of equity and social justice cannot be achieved and the economy will remain in the grip of poverty and social disparity. A sick industrial unit is incapable of generating surpluses. In the case of sick public enterprises, how long can the Government go on financing their losses through tax-payers money? This is becoming increasingly an
untenable policy. According to the former Deputy Chairman of the Planning Commission, D.T. Lakadwala, the public sector has given impetus to the growth but has failed completely in its mission as far as the establishment of 'equity in socioeconomic sphere is concerned'.

As Ludwig Erhardt has right said, 'yesterday's profits are today's investment and tomorrow's jobs'. Profit criterion is an important indicator of the efficiency and competitiveness of an enterprise, whether public sector or private sector.

It is easy for public enterprises to get money from the Government and this is probably the reason for their indifferent performance. The allocation of funds does not necessarily depend upon how well the project has been prepared, its profitability and factors like that. The approval seems to depend upon how much you can lobby, and the equation of the Chief Executive with the persons who matter. This is bound to affect efficiency of allocation adversely.

**Meaning of Industrial Sickness:**

Sickness has been defined in various ways. According to Professor Pradeep Khandewalla sickness can be equated with a loss situation or 80% or more decline in profits in a year.(2) Another western scholar equates sickness with successive fall in profits culminating in a loss situation and a cash flow crisis.
The RBI adopted a definition of a sick unit as one that incurred a cash loss for one year and, in the judgment of the tending banker, was likely to continue incurring losses for the current year as well as in the following years and the unit had an imbalance in its financial structure, such as current ratio being less than 1:1 and there was a worsening trend in debt equity ratio. The RBI distinguishes a "sick" from a "weak" unit, the two really representing "shades" of sickness. The weak unit has the following characteristics according to RBI:

a) accumulated losses being 50% or more of its peak net worth in the immediately preceding five accounting years;
b) current ratio being less than 1:1; and
c) there being cash loss in the immediately preceding accounting year.

The Indian term lending financial institutions tend to consider a unit as sick if it has consecutively defaulted for four half-yearly loan and interest installments due to the financial institutions, has made cash losses during the previous accounting year and is also likely to incur cash loss in the year, and its net worth has been eroded by 50% or more and has mounting arrears of statutory and other liabilities and also shows persistent irregularity with regard to its credit limits with banks.

With the passage of Sick Industrial Companies...
(Special Provision) Act, 1985, (or SICA as we shall call it in short) the sick industrial units are grouped under two categories:

(i) A Company will be considered as sick, if it is registered for not less than 7 years and has at the end of any financial year accumulated losses equal to or exceeding its net worth and has also suffered cash losses in the latest financial year and the financial year immediately preceding such financial year. SICA does not at present apply to Government companies, shipping companies and small scale industries/ancillary units.

(ii) An industrial unit is termed as 'weak' if at the end of any accounting year, its accumulated losses equal to or exceed 50% of its net worth for the immediately preceding 5 accounting years. Basically, Sickness is defined in terms of financial viability consisting of three independent elements of equal emphasis and weight viz, profitability, liquidity and solvency represented by cash profit or loss, net working capital and net worth respectively.

Even in the case of large firms in the private sector in India, the Government does not ordinarily allow the sick enterprises to close due to the problem of unemployment. The best illustration of this is the textile industry in which the Government took over more than 100 sick textile companies by forming the National Textile Corporation. Such a tendency has led to "indiscriminate expansion of the public sector in all sectors of the economy regardless of cost and efficiency considerations, as well as for the continuation of loss-making enterprises in seeming perpetuity". (3) The public sector losses and
inefficiencies continue as there is no effective compulsion to improve performance because of soft budgetary options.

**Survey of Literature:**

In view of the large diversity of the Public Sector, it is interesting to know that no in-depth research has been undertaken to diagnose sickness in public enterprises and suggest concrete remedies. The Government has appointed from time to time experts Committees to report on various aspects of Public Enterprises. The Arjun Sengupta Committee, 1986, was appointed to review policy for Public Enterprises, The Economic Administration Reforms Commission on Government and Public Enterprises (1983-84) under the Chairmanship of L.K. Jha, the Economic Advisory Council - Report on Public Enterprises in India, under the Chairmanship of Prof. Sukhamoy Chakravarty, Expert Committee Report on Public Enterprises (August 1980-82) by a Committee comprising Shri Mohd. Fazal, Member, Planning Commission and Reports of the Working Groups of the Planning Commission. In addition, Reports of the Parliamentary Committees on Public Undertakings have been a good source of information on the performance of public enterprises. Public Sector projects under implementation are monitored by the Ministry of Programme Implementation, Project Monitoring Division and Monthly Flash reports, Quarterly Status Reports and Annual Reports are published indicating time and cost
over-runs and escalations in the cost of projects. The Bureau of Public Enterprises publishes comprehensive reports in respect of financial and physical performance of the public enterprises. In addition, the Bureau also undertakes specific studies and reviews, with regard to sick Public Enterprises and prepares schemes for revamping and rehabilitation. The Standing Conference of Public Enterprises (SCOPE) keeps on highlighting various issues confronting the Public Enterprises by way of organising conferences, seminars and publication of articles. The Institute of Public Enterprises, Hyderabad has the distinction of coming out with research papers on various aspects of Public Enterprises.

A large number of thinkers have contributed to the existing literature on Public Enterprises. A study was conducted in mid 70s by V. Sri Ram, N. Sharma and K.K.P. Nair, "Performance of Public Sector Undertakings", under the aegis of Economic and Scientific Research Foundation. The study related to the profitability of large private sector companies vis-a-vis. the central Public Sector Enterprises in the same industry and established that the profitability of private sector companies was generally far higher than that of the Central Public Enterprises. The study also established that the incidence of sickness in large private sector was lower as compared to sickness in central Public Sector Enterprises. Laxmi Narain, Sankar and the Centre for Monitoring the Indian Economy
(CMIE) made an attempt to quantify the size of Public Enterprises both at the Central and State levels which created a good deal of awakening about the future roles of these enterprises. (4) Authors like Laxmi Narain, (5) Anand Rao, (6) Jagdish Prakash, (7) Sankar and Geeta Gouri, (8) Surya Prakash, (9) Chadha, (10) Gadokh, (11) Ram Reddy, (12) and Patil (13) have studied the various aspects of the Government PEs. Their studies have emphasised that parliamentary control should be strengthened as it had not been effected because of the constraints of time, expertise and interest in the working of PEs on the part of the Members of Parliament. These studies also highlight the role of Parliamentary Committee on Public Undertakings as they intensively examine the working of Public Enterprises in relation to their objectives, outcomes, problems and future course of action. However, the coverage by COPU is not sufficient to be able to govern the Public Enterprises.

The study by the Institute of Public Enterprises (14) reveals the over-dominating nature of the ministerial control of Public Enterprises. The study indicates that 84 approvals had to be obtained before commencing the operations in a newly set up Public Enterprise. Whereas according to Laxmi Narain (15), there had been only two general directives issued by the Government and others were enterprise specific, written directives, the number of which was small.
Circulars and office orders were binding in nature. The Boards were made ineffective because of Government's power to appoint Directors. They could not play any effective role in policy making. The employees of the PEs were harassed because of large number of investigations ordered by Government and resulting in registering of cases against employees of PEs. The relationship between the Government and a PE was that of master and servant rather than that of a guide and friend.

A significant number of works have dealt with the problem of physical and financial performance of Public Enterprises. Notable among these works are the studies conducted by Sankar(16), Venugopal Reddy(17), Om Prakash(18), Mishra(19), Ravishankar(20), Krishnaswamy(21), Bhatia (22), Trivedi (23), Murthy (24), Dholakia (25), Shiva Ramu (26) and Sai(27). These studies have established that the performance - both physical and financial - had fallen short of expectations. Some improvements in the performance of Public Enterprises vis-a-vis the private Enterprises was also highlighted. The main causes of failures on the financial front have been wrong investment decisions and wrong criteria for selecting the projects, the time and cost over-runs and the internal mismanagement. The financing decisions were studied in detail by Mishra (28), Nandagopal(29), Kar(30) and Chakravarthy(31). These studies had looked into the extent of financial resources required by Public
extent of financial resources required by Public Enterprises, financing patterns, source of financing and cost of funds. The findings of these studies are interesting. The Public Enterprises have often exaggerated their financial requirements. They did not pay any heed to evolving enterprise specific debt equity ratio. Diversification of resource base was completely out of the minds of the Public Enterprises executives. The studies have suggested that Public Enterprises should exploit the foreign financial sources as also the internal capital market.

Mishra(32), Rajeswara Rao(33), Banerjee (34), Bari (35) and S.S. Murthy(36) have studied the viability of working capital decisions. The findings of these studies are that PEs faced scarcity of working capital because of locking up of funds in inventories, receivables and cash. The relationship with the bankers was also not very cordial.

The costing, budgeting, pricing and profitability decisions were studied by Rampershad Sengupta(37), Nandagopal(38), Naidu (39) and Sankaraiah(40). These studies have disclosed that budgets were implemented indifferently, costing as a system has not been adopted, prices have no bearing on the cost and efficiency norms. The studies have also established that accumulated losses were increasing year after year.
Maheswari(41) has pointed out the lack of organisational objectives resulting in lack of accountability on the part of their managers. Khandewalla(42) regards PEs as mechanistic organisations lacking innovativeness and capacity to bring about changes for growth. Pareek and Rao(43) have found that in most of the PEs, there is no serious commitment to the human resource development. According to Singh(44), Khandewalla (45), Sharma(46) and Krishnamurthy(47), the bureaucratic form of leadership dominates the public enterprise scene. Mishra and Ravishankar(48) have argued that various aspects of personnel management have not been standardised. De(49), Khandelwal(50) and Laxmi Narain(51) have studied the issues relating to organisational behaviour, quality of work life and workers' participation. They have advocated the workers' participation in PEs for better performance.

The studies made by Swamy (52), Maheswari(53) and Mohd. Fazal (54) on material management have highlighted that the production, planning and control, engineering, quality and designing aspects were in a poor state in Public Enterprises. Singh(55) and Tagat (56) have found that Public Enterprises lacked marketing orientation. The studies of Bhat (57), Venkata Ratnam (58) Trivedi (59), and Basu(60) were concerned about the future of PEs and found that the Public Enterprises did not plan their future well. They had not dove-tailed their plans in the National
Plans and had no internal auditing and accounting system. They also suffered from lack of a common objective because of a unified top level executive. They have also found the existence of rifts between the Chairman and the Chief Executive and failure to decentralise and delegate.

The problem of sickness in Public Sector Enterprises has been directly or indirectly felt by all but a complete pathology of sickness is still lacking. Sickness is a gradual phenomenon and the virus multiplies faster in the Public Enterprises due to large size and peculiar circumstances which are unknown in the private enterprises. Despite appointment of a number of high power committees to make recommendations on certain pertinent issues, no concerted attempt has so far been made to amortise the sickness of the Public Enterprises. Stray references here and there, have been made. The sickness is detected generally at the "emergency ward", a stage much beyond the scope of any turn around strategy. As a matter of fact the phenomenon of sickness is not considered seriously in public enterprises because of budgetary support and fulfillment of obligations other than economic considerations. This work may be termed as the first serious attempt to diagnose the sickness in public enterprises.

There is fairly extensive literature on the subject of Public Enterprises. Leroy P. Jones has
attempted to define Public Enterprises in terms of means and ends; "means implying the pattern of ownership of the enterprise and the manner in which decisions are taken within it; ends mean the type of products produced by the Enterprise". (61) Public ownership of enterprises also emanated due to the lack of managerial and entrepreneurial capacity and unwillingness of the private sector to enter into many economic activities. (62) According to Allen F. Davis, poverty resulted not necessarily from moral inferiority but from inadequate opportunities for the poor to participate in economic activities. That phenomenon was leveled as "poverty of opportunity" and the remedy to cure such poverty was in State intervention to provide opportunities where they did not exist. (63)

A recent study on Public Enterprises has concluded that Government-owned Enterprises, rather than serving as a focal point for collecting resources for their own investment or for other purposes, have generally placed a financial burden on parent Governments. (64)

Ralph Turvey has questioned whether it is possible to establish a general pricing rule for Public Enterprises; "each particular Public Enterprise has its own particular conditions relevant to optimising pricing and investment". (65)

According to Malcolm Gillis, the lending activities of major donors of foreign aid and technical
assistance agencies have been a factor in the creation of public industries in some countries in Africa and Latin America. (66)

Rehman Sobhan regards the Public Enterprises that as an instrument of policy in anti-poverty strategies in South Asia They have not been successful. They have had some success in achieving an element of regional dispersal of public investment to backward areas and to some extent have benefited some elements of the working class. (67)

**Scope of study**

This study is restricted to Central Government undertakings which represent the bulk of PEs investment. PEs operate at three levels in India, the Central, the State and the municipal. Excluding the municipal enterprises, the ratio of investment in the Central PEs and State level PEs is of the order of 7:3 according to the Central Statistical Organisation. (68)

This indicates that the Central Public Enterprises "control commanding heights of the economy and provide the sinews for its growth" (69)

If the sinews are weak and infirm, we cannot think of building a sound economy in the country. The disheartening performance of Public Enterprises is perturbing. It is in this regard that we have to search for a solution which is economically justified and politically acceptable. The problem of industrial
sickness prevalent among the public enterprises has been seldom realised because of the social objectives and soft budget options. This is where the main attention of this study will be focussed.

By drawing attention to and pin-pointing organisational and managerial weakness in the system of public sector enterprises, we come nearer a solution to the problem by adopting devices to eliminate those weaknesses within the public sector system or if this system does not allow this, transfer the enterprises to joint or private sector. It has to be ascertained how far the weaknesses are of a kind which can be overcome through some of innovative devices.

**Methodology**

The tools and techniques applied in this endeavour include an application of the economic, financial and statistical techniques. The information obtained for research has come from secondary sources including the Annual Reports and accounts of PEs. Data published by competent authorities and organisations has been used. Attempt has also been made to moderate the data and also question the assumptions behind them. To understand the dynamics and nature of real line problems pertaining to PE operations, the researcher established a sound rapport with the top executives of Bureau of Public Enterprises, senior Officers of the Ministry of Finance, Ministry of Power and Energy, concerned Advisers of the Planning Commission and top
executives of various Public Undertakings like SAIL, CIL, BHEL, NTPC, NTC, Maruti Udyog, IFFCO and FAI. The author also had discussions with top executives of Tata Group and also the Head of Tata Energy Research Institute (TERI). Discussions were also held with eminent academics like Dr. L.C. Gupta, erstwhile Professor of Economics, Delhi University and Dr. Roopa Joshi of BICP. Discussions with persons dealing with the practical problems both at the field level and the Secretariat level were highly educative and enlightening.

Chapter Layout:

It is difficult to deal comprehensively with all the issues of policy and strategy concerning the effective role of Public Sector in India's economy. The treatment of the subject is specific and concentrated on the vital issues relating to the Public Enterprises including the role of the Government.

Chapter One deals with the role, the policy initiative undertaken in India from time to time and issues confronting Public Enterprises. The declining position of the Enterprises as such and the necessity to review the role.

The second chapter emphasises the need for study of industrial sickness in Public Enterprises and reviews the existing literature on the operational and policy issues with reference to Public Enterprises.

Chapter three describes the performance of Central
Public Enterprises as a whole. While in aggregate the Central Public Enterprises have been profitable, in reality the high level of performance of a few sectors like oil and a few enterprises like BHEL, STC, masks the chronic losses of the manufacturing segments. The chapter also highlights the role played by the Public Sector in India's economic development and also in fulfilling the social objectives of the Government policy.

Chapter four deal with the micro-level analysis and identifies the costs of various options available. The major options available are revamping, closure and privatisation. The merits and demerits of each option have been highlighted.

Chapter five deals with the causes of sickness. The factors responsible for poor performance of the loss-making units are analysed. The major cause of poor performance is lack of competition and efficiency.

Chapter six concentrates on turn around strategies and viability conditions including capital restructuring and efficient, dedicated management is a prerequisite to bring about a turn around. An effective turn around strategy must be preceded by a scheme of prioritisation of activities.

Chapter seven examines the role of Memorandum of Understanding in promoting autonomy and accountability reducing Government intervention and providing
positive encouragement for efficiency. The chapter presents a critical review of effectiveness of the MOU concept.

Chapter eight concentrates on the Government-Enterprise relationship which is particularly crucial in India. The holding Company concept keeps the Government at an arm's length and presupposes the existence of market economy and autonomy of the enterprise. The holding company concept will not succeed if it over dominates the subsidiary companies and resorts to price manipulations.

Chapter nine deals with the new emerging trends which is taking the shape of a wave of privatisation. Various issues relating to privatisation have been examined. In the context of recent policy pronouncements, the concept has acquired great urgency. A large number of problems such as correct valuation of assets, putting the assets for sale at the right price, lack of well developed capital market and finding a right private entrepreneur, make the process of privatisation difficult in over populated countries like India, privatisation may prove to be political dynamite because of consequential unemployment.

Chapter ten deals with the pricing policies of Public Enterprises products. Among the common causes for the poor performance of Public Enterprises are unclear or conflicting objectives, distorted pricing
policies, protection from competition and administered prices. Various options for fixing the prices of Public Enterprise products have been discussed. Subsidies induce inefficiency and must be phased out.

Chapter eleven examines the procedures in Public Enterprises with regard to investment decisions and project implementation. The chapter illustrate the method by which Public Enterprises investments are prepared, appraised, approved and executed. Wrong investment decisions, poor project appraisal, defective feasibility studies, unrealistic assumption about supply of materials and availability of capital resources result in time and cost over-runs. Because of heavy escalations, the Enterprise is born sick ab initio.
References


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