

# Sick Companies A Changed View

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## < EXECUTIVE SUMMARY >

◆ Sickness in Industry in our country has existed along with healthy industrial enterprises. It has registered a quantum jump with the onset of the new economic order, ushered in by liberalisation & globalisation. With this the approach to handle sickness has also undergone a gradual change. The Industrial Reconstruction Corporation of India (IRCI) was established in 1980's to provide financial assistance to sick

units. In 1985 the Sick Industrial Companies (Special Provisions) Act 1985, was enacted, where interested companies were invited to takeover, lease or amalgamate the sick Company into itself. Then in 1993, the public sector companies were brought under the purview of BIFR,. Now, this concept is being taken forward under the proposed amendment to Companies Act, 1956 by the Amendment Act, 2002.



Sickness in Industry in our country is a phenomenon, which has existed along with healthy industrial enterprises. Sickness has registered a quantum jump with the onset of the new economic order, ushered in by liberalisation and globalisation. The approach to handle sickness in the industry has undergone a gradual change. While earlier when the socialist approach was pre-dominant, the view towards sick companies was that no sick company should be allowed to die or close down, as employment shall be lost. In those times, efficiency of capital deployment, whether labour, financial capital or any other resource, was not the prime concern, but providing employment was the main objective of our planners. Such regime existed upto 1985 or

so, when a number of sick private companies were nationalized. An increasing number of sick, private textile mills which were nationalized became part of the National Textile Mills (NTC).

During the 1980s, the Govt of India had set up The Industrial Reconstruction Corporation of India (IRCI) to provide financial assistance to Sick Units, to enable them to revive under their then existing structure. Later it was converted to The Industrial Reconstruction Bank of India (IRBI), to carry the same function under a different mould. Now this has undergone further metamorphosis and has been re-christened as The Industrial Investment Bank of India (IIBI), with no obligation to fund the sick industries.

In 1985, The Govt of India realized that the policy of indiscriminate nationalisation and fund support to sick companies cannot be pursued and there is a need of assessment of viability of such sick companies in the private sector and with that objective The Sick Industrial

*The author is member of the Institute. The views expressed herein are the personal views of the author and do not necessarily represent the views of the Institute.*

Companies (Special Provisions) Act 1985 was enacted. In case the existing management could not revive the company, anybody interested could be invited to takeover, lease or amalgamate the sick company into itself. Later, in 1993, the Act was amended to bring the public sector companies under the purview of The BIFR and facilitate privatisation of sick public sector units.

Proceedings under the BIFR clearly conveyed the message that viability of operation was a pre-requisite for taking any measures for rehabilitation of a sick company. If the operations of the company were likely to remain un-viable, no measure of nationalisation or amalgamation with a healthy company could revive the sick company. Indirectly, this approach introduced the efficiency of capital/profit earning capacity of any business enterprise as the key for deciding the future course of action. This also introduced the idea of winding up of sick companies to re-deploy capital invested in them to a better productive use.

This concept is being taken forward under the proposed amendment to the Companies Act 1956 by the Amendment/Second Amendment Act 2002 in that a viable unit may be allowed to revive while an inherently sick company should be wound up and should not be a drag up on the national resources.

## GENESIS OF SICKNESS

Before delving further, an insight into the causes of sickness could throw light on the measures, which can be taken for revival. A Company could turn sick, either due to the management's failure to control the situation, or due to factors beyond the control of management. The failure of management could stem from the fact that it is not able to take corrective actions in time, inability to respond to the demand of the situation, dispute amongst the management/promoters or deliberate actions on the part of the scrupulous promoters. This deficiency can be set right by appointing suitably qualified people in place. However, inefficient, incompetent promoters may not easily relinquish control over the day to day affairs of such a company, and would still like to do the back seat driving or calling shots behind the scene.

The sickness of a Company could also be caused due to factors beyond the control of the management, like change in market preferences, shrinking market share of company's product, power or labour problems, and working capital constraints. These problems can be tackled by suitably correcting the problems that are identified. Paucity of working capital has often been cited as a

reason of the sickness of a company but in many cases, it would be observed that the promoter's margins are invariably less than the stipulated norms and some private companies mis-handled their working capital funds.

One more reason of sickness is not recording of the entire commercial activity. The Central and State Govts try to check tax evasions but still are not able to check the same fully. Such part of activity, which remains unreported also, is a contributing factor of sickness. The Central and State Govts may also consider evolving ways and means to plug loopholes in various revenue statutes to check the commercial activity that is going unreported.

Another possible reason for the sickness of a Company is the inability of our business enterprise to substitute their high cost debt by low cost debt or equity. In the present competitive times, the operating margins as well as volumes of sales have been under severe pressure. As a result, such high borrowing companies have found it difficult to absorb all the fixed costs of interest and depreciation in their profitability, as well as their cash flows have failed to service their installments and interest commitments in time.

Our country has a shortage of capital, and that is why our banking and financial sector has funded projects on the promoter's contribution of 25% to 30% of the project costs. The remaining 70% to 75% of the cost of the projects have been funded from the term loans, which might have been sustainable in the past, when the demand and supply of any product was controlled by the Govt by way of Industrial licensing, but is no longer now in this free market regime. A strong primary market could have supplemented the efforts of our Govt and the Industry, to set up projects with viable leverage of equity and debt. However, weak regulatory framework, and unscrupulous entrepreneurs caused heavy loss to the investing public, and dried up a possible source of funds for industrial financing. It is every Finance Minister's endeavor to restore the investor confidence through various measures. However, it is a difficult task to bring the investor back into the market, who has suffered massive losses as a result of vanished companies, defaults in repayment of deposits and interest and almost negligible values of equity quoted on the stock exchange.

## URGENCY TO RECOVER BAD LOANS

India is a signatory of The World Trade Order (WTO) and almost 13 years have been allowed to corporate, industry and business to gear itself to be able to do

business in a world market. By 2005, the entire provisions of The WTO shall become applicable and all import restrictions shall be abolished. The World shall become one market and in that regime, each of our participants have to compete. India also has to move towards the capital account convertibility of its currency and to achieve full convertibility, one of the pre-requisites, as per the Tarapore Committee recommendations was to bring down the level of bad loans, or impaired assets or Non Performing Assets of the Banking Sector. The idea is to first use the internal resources to the maximum and look for the financial support only in the event of deficit. It would be imprudent to raise loans and allow the own funds to remain locked up in non performing assets.

The Govt has recently come out with a spate of legislations to arm the Banking Sector with enough powers to ultimately realize their dues, without allowing an opportunity to business to take advantage of the legal wrangles and delays. These are briefly discussed below, which should convey a clear message that the Govt wishes to proceed very fast with the recovery of funds unnecessarily locked up in industrial units and which funds are proving to be non-productive to the economy and society. Such non performing assets are found to be not paying any taxes, do not repay loans with interest and which should be recovered and could be utilized for further industrial development and increasing the country's GDP in general.

**(a) The Recovery of Debts due to Banks and Financial Institutions Act 1993.**

This Act was enacted to enable the banks and the FI's to start the recovery proceedings with the payment of the maximum Court Fee of Rs.1.50 lakhs without invoking the help of the regular Civil Courts, where the Court Fee worked out to be prohibitive. All cases where the amount due to the banks or the FIs was more than Rs.10 lakhs were to be handled by the Debt Recovery Tribunals (DRTs) set up under this Act. While this Act has served its limited purpose of compelling borrowers to pay back their loans or else face attachment, sale of properties, the DRTs have become overloaded with work and cases take time of even more than 2 years for the entire process to be over. There after begins the process of attempting to recover the dues by the sale of properties of the borrowers/guarantors, which does not yield the desired results.

**(b) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002**

The Govt has empowered the Banks and the FIs to take control of the assets created out of loans granted to a borrower. Such assets have been referred to as The Security Interest. No intervention of the Court is required to takeover the assets as also to sell them off to recover their dues. In case any borrower wants to contest the action of the Secured Creditor, an appeal can be filed before the DRT but can be heard only if at least 75% of the dues demanded by the Secured Creditor are deposited with the DRT. Such powers already existed with the State Level Institutions under Sections 29 and 30 of the SFC Act 1951 and vide Section 13(4), similar powers have now been given to the Public FIs and the banks.

However this legislation is also not fool proof and is fraught with some uncertainties. The investment climate in the country is presently not very strong and there may not be many buyers of such assets readily. The assets to be so transferred may come with liabilities towards electricity, excise, sales tax, which may be a deterrent for any purchaser. Such issues are not clear and may need a judicial ruling to set right the controversy.

The FIs and the Banks have issued mandatory notices under Section 13(2) of the aforesaid Act, but have not proceeded further in all cases, in view of the uncertainties involved cited above. However some borrowers have come forward to negotiate settlement of their dues.

**(c) Companies (Amendment)(Second Amendment) Act 2002**

Most recently, the Govt has made amendments in the Companies Act 1956, bringing therein the provisions for either reviving Sick Companies or winding them up. The SICA 1985 was widely perceived as an impediment and is, therefore, proposed to be replaced by the Amendment Act. This Act is yet to be notified.

However, the scheme of provisions incorporated in Sec 24 of the above Act suggest that our Govt would like the revival of only those industrial companies to be attempted which have signs of temporary sickness and not inherent sickness. Inherently sick companies shall be ordered to be wound up at the first stage of inquiry, after filing of the reference by the sick company.

It is widely believed that the borrowers may come forward and repay their loans in case fear of attachment, sale or winding up is shown to them. In the opinion of the author, the sale or winding up proceedings shall have

to be culminated in the form of the sale of assets or liquidation of such sick, delinquent companies which may not find ready buyers as has been envisaged in the aforesaid laws. It may be due to the weak investment climate, or the plant may have been set up on old technology or simply the buyer wants to purchase the assets at abysmally low price.

Despite changes in laws relating to the sickness of companies a number of times, changes are due in the provisions of the Industrial Disputes Act 1947, which deals with matters governing employees of a sick company. The exit option, discussed by especially foreign entrepreneurs or closing down of un-viable, loss making units without seeking permission from the concerned State Govts is still to be made applicable. Successive Central Governments have not been able to bring about changes in this Act due to opposition from the Trade Unions, and the various political parties.

## CONCLUSION

The country has witnessed a change in the approach

of the Govt in handling sickness of Companies. The Govt has switched the mode from a socialist approach, which aimed at preserving employment at every cost, towards a capitalist approach, where efficiency of the capital employed is of prime concern and the inefficient may be shown the door and the fittest allowed to survive.

In the opinion of the author, it is prudent to align ones economic order with the world's order of allowing only the efficient/fittest to survive. At the same time, a humane approach, to the problem of sickness of companies might be followed, keeping in view the fact that a fast track winding up of companies may also bring about miseries in the lives of people who would be affected by reason of the loss of their jobs. Our country has to still carry along such a population which does not have any education and may not have many avenues for employment, other than the industry. The Nobel Laureate Dr Amartya Sen, has also advocated following of the economic reforms with a human touch and this aspect should be given due regard by our country's planners. ■

## FOR ATTENTION OF THE MEMBERS

### "CHARTERED ACCOUNTANTS DAY"

In commemoration of the Chartered Accountants Day, a Special Address on "Reforms in Financial Sector - Way Forward" will be delivered by Dr. Bimal Jalan, Governor, Reserve Bank of India. The programme is scheduled to be held on Saturday, the 5th July, 2003 in Convention Hall, Hotel Ashok, New Delhi.

Dr. Bimal Jalan, Governor, Reserve Bank of India, will address the august gathering at about 10.30 A.M. on that day.

Members interested in further details of the programme may contact - Shri T. Karthikeyan, Additional Director at Headquarters. His contact numbers are: 2337 8402, 2337 8316, E-mail: karthik@icai.org

*(TCA/03)*