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**INDUSTRIAL SICKNESS : AN EMPIRICAL STUDY ON SMALL
SCALE INDUSTRIES**

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Industrial Sickness is a global phenomenon though its incidence in the developed countries of the world may be low as compared to the less developed nations where industrialization, as a result of low capital base and low level of technological and managerial know-how, has not been an exhilarating experience. India, in particular, has suffered from this malady and during the last decade, industrial sickness has assumed unmanageable dimensions and there is no sign of abatement.

Industrial sickness is the key event of modern industrial age; and incidence of sickness has been growing in such large proportions that in the wake of industrial development, a large number of new units (covering all types of units in small, medium and large sectors) have been added in this category. The rapid growth and magnitude to industrial sickness is posing issue

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not only for present time but also for all time to come; especially for India during the next century. It has become a matter of grave concern for all; concerned directly or indirectly as not only, crores of rupees blocked up in several of sick units but also affected the national growth.

This phenomenon of industrial sickness also effects in terms of unemployment, none availability of goods and services and the prices soaring up. The shareholders lose their hard-earned savings, creditors lose their cash and future prospects of business become completely dark.

The growing industrial sickness in the country is causing great concern to the government and financial institutions because it is sucking the blood of the industry gradually and sapping economic vitality and thereby baffling all the useful programme of economic development. In fact industrial sickness pervades all around and is posing a very serious problem to different sectors of the economy.

Sickness is an organic process in the life of industrial units, and so the phenomenon of sickness does not develop in a single day or "Industrial units does not burst overnight as many people think". The process may take several years, but the seeds of sickness can be visualized at a very early stage in the life cycle of an industrial unit. It passes generally through various stages before it becomes sick, and later on liquidated. The complete process of sickness depicts the various stages of an industrial unit from normal to sick. "If sickness continues for a long period it may become chronic." At the initial stage, if no treatment is launched, it may go beyond the control to an advanced stage, and as a result, there will be annihilation/death of an organism in case of human sickness or closure of a unit in case of industrial sickness.

It is generally, found that a healthy unit may become sick temporarily and may recover its healthy stage or may become permanently sick. The factors that cause sickness could be:-

1. Internal or
2. External or
3. Mixture of the both.

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The external factors usually affect all the units of the same industrial group simultaneously and may be beyond the control of the management, while the internal factors may affect a particular unit only and mostly are within control of management. In most of the cases, sickness is bred within the unit itself. The event of sickness may have origin followed by several stages i.e., healthy stage to sickness stages.

The sickness process is as illustrated below:-

Healthy Unit Criteria →	Tending towards Sickness Criteria →	Incipient of Sickness →	Sick →
1. Cash Profit + 2. Networking Capital+ 3. Net Worth	1. Cash Profit/Loose 2. Net Working Capital + 3. Net Worth	Or more negative	All negative

Initially a healthy unit may show good cash profit and may have positive values of net working capital and net worth. As it tends towards sickness, at first cash profit may become negative although the unit may continue to pay its installments to the term lending institution. As sickness grows more and more through other stage, two or more financial parameters may become negative. The negative values do signal sickness. These initial stages require careful monitoring. For such purpose, a forewarning system which signals the probable sickness of industrial concerns before any loss is inflicted upon the concerned parties would prove to be of great utility. It would provide a warning to all the concerned parties to reconsider their situation and take prompt and appropriate action.

It is a well-established fact that earlier the trouble is detected, more easily and economically it may be countered. Early detection of sickness possibly may enable the management to take timely action to avert the crisis of such an occurrence. If there exists a forewarning system which helps in predicting corporate sickness, the attention can be focused on those concerns

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which are trudging towards sickness. The Chairman of the Industrial Finance Corporation of India (IFCI) mentioned on 33rd Annual General Meeting about the importance of an effective monitoring system, "One is well aware of the sickness in industry. While it is not possible to avoid sickness in the industry entirely, it has come to be clearly recognized that:-

- a. This process can be considerably controlled with effective monitoring, and timely steps to ensure prevention of sickness, and
- b. By rehabilitation of some of the units which have become sick, but which are potentially viable. This can be feasible only when some monitoring system is in force.

Companies do not go burst "overnight" as many people think. The process of sickness can take years and thus the seeds of sickness may be discernible very early in the story of a company's rise and decline. The forewarning system would help in reducing, if not completely eliminating, the irreparable loss to the interested parties caused by corporate collapse. The importance of such a forewarning system can be described in the word of more clearly: "An early warning signal or probable failure will enable both management and investors to take preventive measures; operating policy changes, reorganization of financial structure, and even voluntary liquidation will usually shorten the length of time losses are incurred and thereby improve both private and social resource allocation."

PHASES OF SICKNESS:

The process of sickness can be discussed in following different Phase of Sickness:

Phase I (Normal/Healthy):

"A unit is called normal when all its functional areas like production, marketing, finance and personnel are functioning efficiently". Initially, a healthy unit may show good cash profit and positive value of net working capital and net worth as well. To sum up, a normal or healthy unit may have the followings features:

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1. All functional areas viz, production, marketing, finance and personnel are normal and efficient.
2. Generating good cash profit.
3. Positive value of net working capital or current ratio more than one.
4. Positive value of net worth.
5. Satisfactory debt equity ratio.

Phase II (Tending Towards Sickness):

As the industrial unit tends towards the stage of sickness, initial aberration in any functional area begins, or may face external constraints. Due to this reason, the cash profit begins to decline in comparison to last year's, and may firms estimate cash loss, too, in the current year. Although, the unit may have positive values of net working capital and net worth and may not have listed as defaulter in the records of banks and financial institution. This stage conveys first warning signal which should be taken cautiously, and preventive measures with close monitoring and follow up actions should be launched promptly by the management and the other associated agencies, this stage may have the following features:-

1. Decline in profit during last year.
2. Losses estimated in the current year.

Phase III (Incipient Sickness)

As sickness grows gradually it enters into incipient stage of sickness for a very short period. Incipient stage of sickness comes when an industrial unit incurs cash loss but imbalance in financial structure may or may not appear. In other words, two or more financial indicators may become negative and its value may show warning signal of sickness. At this stage, major financing and other agencies along with the management should collectively review the overall

performance, and with joint concentration take suitable remedial measures to prevent the unit from becoming sick. This stage may have following features:

1. Cash losses incurred in last year are expected in current year also.
2. Deterioration anticipated in current year although current ratio was more than 1 during last year.
3. Deterioration anticipated in debt equity ratio during current year.

Phase IV (Final Stage)

When the suitable remedial measures are either not taken or are inadequate at the incipient stage of sickness and adverse factors continuously effect the production, finance, marketing and personal areas, the unit, finally, become sick. At this stage all the financial indicators, such as cash profit/loss, net working capital, net worth depict negative results. The industrial unit may work below 20% utilization of its installed capacity or below its B.E.P. level. As per Diagnostic Survey Report of Development Commissioner (Small Scale Industries)⁴, "A unit is categorized actually sick on the basis of the following criteria:-

1. Erosion of net worth by 50% and more.
2. Units being closed for a total period of 6 months and more during the past year.
3. Default in payment of loan installment.

Such a unit will require a comprehensive rehabilitation programme for revival and intensive care for a certain period of time in case it is potentially viable. It is generally, observed that the remedial measures are taken too late. Consequently, it becomes as expensive affair to bring the sick unit back to a healthy state. If the sickness is not arrested timely, incidence of sickness leads to incidence of closure ultimately.

CRITERIA FOR IDENTIFICATION OF SICK UNITS

The Reserve Bank of India identifies sick industrial units on the basis of a mix of criteria including continued cash losses, imbalances in the financial structure, and deterioration in liquidity. "A unit may be considered sick if it has incurred cash losses for one year and, in the judgement of the Bank (RBI), it is likely to continue to incur cash losses for the current year as well as the following year and the unit has an imbalance in its financial structure such as current ratio of less than 1:1 and worsening debt equity ratio" (RBI, 1978).

Term lending institutions identify sickness on the following criteria:

- continuous defaults in meeting four consecutive half-yearly instalments of interest or principal of institutional loans
- continuous cash losses for a period of two years or continued erosion in the net worth by 50 per cent or more
- Mounting arrears on account of statutory or other liabilities for a period of one or two years (Bidani and Mitra, 1983).

The most stringent definition is given in the Sick Industrial Companies (Special Provisions) Act of 1985, which defined a sick unit as "An industrial company (being a company registered for not less than seven years), which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth and has also suffered cash losses in such financial year and the financial year immediately preceding such financial year,"

These definitions view sickness in terms of extreme deterioration in the financial health of the unit. However, the criteria do not warn sufficiently well in advance about the impending closure of a unit. For instance, the wiping out of the entire net worth of a unit accompanied by at least two consecutive years of cash loss clearly signals extreme form of sickness which would in fact take the enterprise to the brink of closure. Similarly, severe cash losses with persistent defaults in institutional debt servicing also indicate fairly advanced stage of sickness on the part of the industrial unit, though this stage would certainly precede the stage of complete erosion of the

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net worth of the unit. The criteria, in fact, delay the identification process by at least a couple of years or more.

EARLY IDENTIFICATION HELPS

Timely action to help sick units requires early identification of sickness and for this purpose, it is necessary to identify other symptoms. In the case of large units whose shares are quoted in stock exchanges, a signal of sickness is sent when dividends are skipped and share price sharply declines. It is not uncommon to come across cases where despite dividends being skipped, shares continue to be quoted above par. This measure, therefore, will have to be used very cautiously with other identifiable symptoms to judge whether skipping dividends indicates sickness or represents a temporary downward slide in financial performance.

USE OF CASH LOSS CRITERION

The cash loss criterion adopted by the official agencies does not involve any attempt to evaluate the normal profitability of a representative unit in a given industry. Subnormal profit may either indicate the onset of sickness or serve as an early warning signal for sickness. In this context, another relevant criterion to identify sickness is the relative performance of a unit vis-a-vis other firms in the industry. Business fluctuations and changes in the economic environment do not affect the profitability of different firms in the same manner. A pronounced downswing in business conditions or a recession in a given industry would bring about a general decline in the average profitability of that industry.

However, it is likely that some units would be affected by these fluctuations far more seriously than others. In favorable conditions, almost all firms in industry, including newcomers, earn fairly high profits. Even marginal or inefficient firms with relatively high cost of production also make profits. When the boom is over, marginal or relatively inefficient firms are the first ones to show

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a sharp decline in profitability, the decline far exceeding the general decline in the industry. Eventually, these firms are likely to become sick.

Recent studies have shown that cash loss is not a sudden occurrence and actually represents only a continuation and aggravation of a trend already in evidence. Gupta (1983) has shown that in the early stages (i.e. up to six years preceding the cash loss period), the profitability index shows a marginal decline, and followed by sustained decline during three years preceding the cash loss period and continuous cash loss during the subsequent period.

CONCEPT OF WEAK UNITS

The recent RBI guidelines facilitate the detection of sickness at the incipient stage but only for large and medium units. An industrial unit will be termed as "weak," if at the end of any accounting year it has:

- Accumulated losses equal to or exceeding 50 per cent of its peak net worth in the immediately preceding five accounting years
- a current ratio of less than 1:1
- Suffered a cash loss in the immediately preceding accounting year (Ojha, 1987).

On the other hand, a small scale industry (SSI) unit should be considered sick if it has:

- incurred cash loss in the previous accounting year and is likely to continue to incur cash loss in the current accounting year and has an erosion of 50 per cent or more of its net worth
- continuously defaulted in meeting four consecutive quarterly instalments of interest or two half yearly instalments of principal on term loans with persistent irregularities in the operation of its credit limits with the bank (Ojha, 1987).

CAUSES OF SICKNESS

Undoubtedly, the nature and causes of sickness differs from industry to industry, area to area, size to size – small, medium and large units, and because of a host of other factors.

Sickness of an industry, generally, starts with the gradual erosion of its liquidity due to cash losses on continuing basis, and thereby deterioration in debt, equity and current ratios. The root cause is poor management and the resultant cause in finance. The worsening liquidity position and deteriorating standards of maintenance accelerate the wear and tear of the existing assets, leading the unit to a state of operational thrombosis. The unit is then considered sick. If this process is allowed to continue, it may take the unit to ultimate death, i.e., insolvency and liquidation. A successful entrepreneur has to keep his eye open on the entire gamut of the unit operation so that a tiny rash may not grow into a tumor. So long as sickness is sporadic, it does not cause any social concern. However, its widespread incidence of an epidemic nature becomes a threat to the national economic health.

As per nature of sick unit, it can be categorized under three groups viz., Born Sick, Become Sick and Made Sick.

1. Born Sick

Sickness is not always a post-implementation feature. Some industrial projects are born sick from the very inception owing to ill-conceived projects, bad planning and poor appraisal, wrong choice of location and product selection, inadequate market surveys, false fixed investment decisions and one customer – one product, type situation etc. Mostly the units established by the government under social welfare scheme come in this category.

2. Become Sick

Some industrial projects may become sick due to internal causes. In such circumstances, sickness starts at last stage of project implementation as a result of poor management and deliberate diversion of funds. The factors like wrong recruitment and faulty management policies are responsible for this.

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3. Made Sick

In this category, sickness is thrust upon them due to external causes beyond the control of the management, mostly attributed to environmental factors such as sudden changes in government policies, technological changes, macro – political, social and economic problems. It is a product of malafide inheritor or weak management policy of entrepreneur.

The causes responsible for the sickness in any unit can be termed as:

- Internal, i.e., Avoidable (Mostly, under control)
- External, i.e., Unavoidable (Mostly, not under control)

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