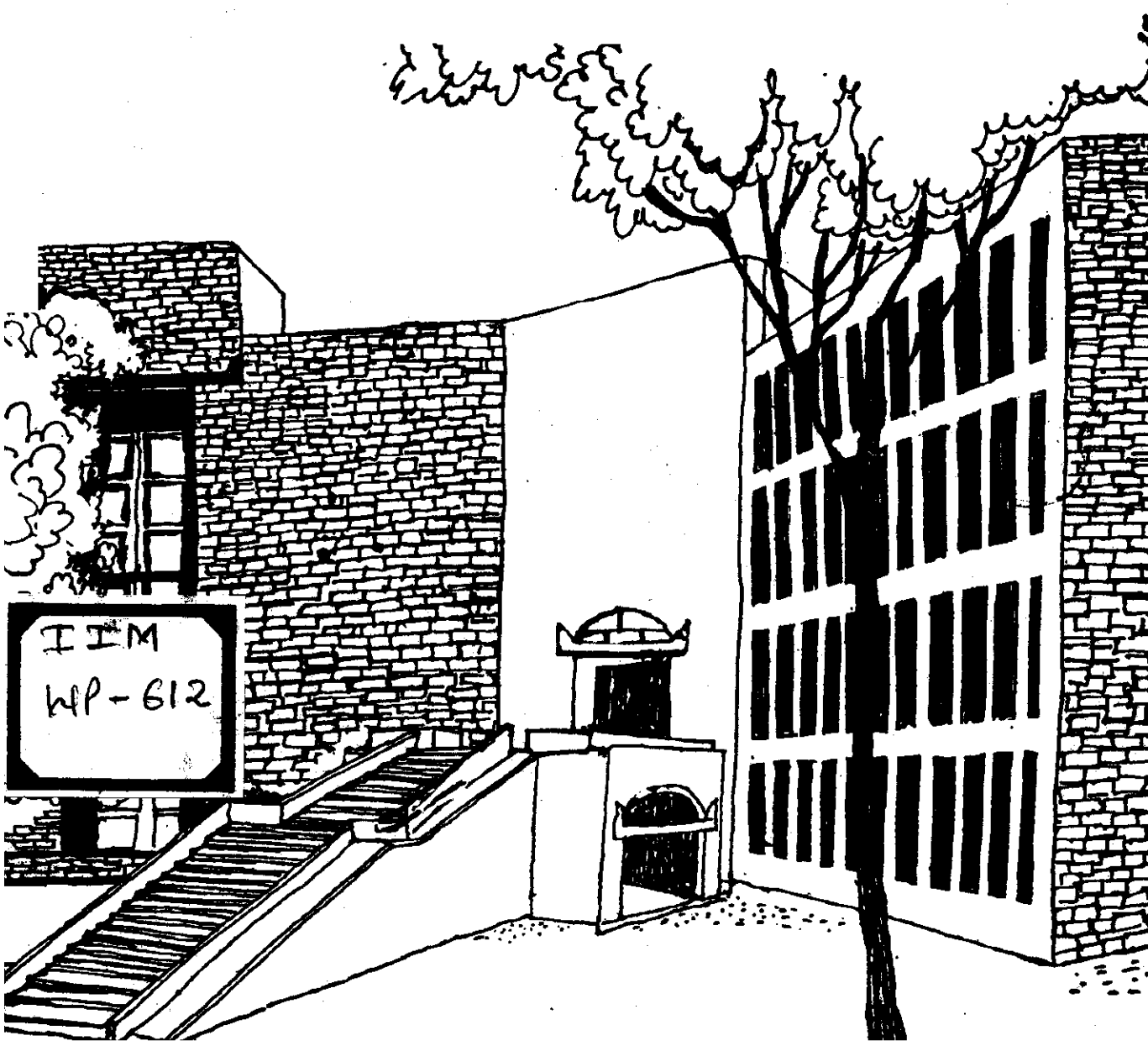
Working Paper



CORPORATE SICKNESS AND ITS PREVENTION BY FINANCIAL INSTITUTIONS

By

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Abstract

Growing corporate sickness seems to be a global phenomenon, at least is the world's market-orinted economies. But the causes of sickness may differ as between Third World countries like India and the developed Western economies. After reviewing Western and Indian work on sickness, the paper presents data on a questionnaire and interviews based study of the major causes of sickness in India, and the mechanisms available to the financial institutions to prevent sickness. The respondents were 36 rehabilitation officers of various Indian banks and financial institutions. A multi-pronged model for preventing sickness is proposed.

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Introduction

Corporate sickness is a significant problem in many market economies. In the U.K., over 10000 units fail each year, and in the U.S. the figure may be much higher. In the U.K., one in five firms listed on the stock exchanges turns sick, and of these, only one in four manages a successful turnaround.[1] A recent study indicates that during the decade 1967-1976, one in four companies listed on the U.S. stock exchanges had turned sick, and only a third of those that got sick recovered.[2] In India, it has been estimated that currently over 550 large units and over 90000 small units are sick,[3] with four thousand crore rupees (40 billions) of the funds of financial institutions and banks tied up in these sick units. Besides these, nearly 20% of central government public enterprises are loss making[4] (the estimated total investment in central government public enterprises is around Rs.350 billion, that is, Rs.35000 crores). Not only has sickness assumed the proportions of an epidemic, it may be growing. In the U.K., business failures quadrupled between 1972 and 1982.[5] In India, the amount of funds of financial institutions tied up in defaulting accounts may be growing at over 10% per annum,[6] and therefore, may double every seven years. In fact, the rate may have gone up in the past few years. According to a Reserve Bank survey, outstanding bank credit to some 450 large sick units went up from Rs.1729 crores in 1981-82 to Rs.1913 crores in 1982-83 (an increase of nearly 11%) and to over 60000 sick small-scale units it went up from Rs.394 crores in 1981-82 to Rs.627 crores in 1982-83 (an increase of nearly 60%), for an overall increase of around 20%.[7]

In India the problem of sickness is likely to grow worse. The number of new units coming up in the country every year is growing.

Currently some 60000 new units come up every year, thanks to various incentives offered by the government, the financial support provided by the apex and state level financial institutions, and the facilities provided in industrial estates. The percentage of entrepreneurs receiving any sort of training in setting up and managing units is miniscule. Inadequate capacity to manage units may mean more and more units turning sick. Besides, liberalisation of the economy and the advent of "sunrise" industries are likely to accelerate the pace of entrepreneurship. Equally, the liberalisation of the licensing policy and of imports is likely to intensify competition, and so the incidence of sickness may well rise.

Economic development probably implies some industrial sickness. But its ravages could be reduced. An officer of Gujarat Industrial Development Corporation recently told the author that of around 8000 units in GIDC sheds, some 25% were sick. But of these, as many as 60% were, in his opinion, salvageable with better management. A Reserve Bank of India study indicates that 84% of sick large firms for which viability studies were conducted were considered to be potentially viable, though only about 10% of the small units were so considered.[8] These figures provide some idea of the potential for reducing sickness. The potential may be even greater. If effective steps can be taken to prevent sickness in the first place, the incidence of sickness could be potentially lowered even more. For the next decade, it may not be an impossible goal to cut down the incidence of sickness to half of what it may otherwise be (a) by devising steps to prevent sickness in the first place, and (b) by strengthening the machinery to turnaround expeditiously those units that do fall sick but are salvageable.

Definitions of Sickness

There have been numerous definitions of sickness. One Western scholar equates sickness with a lose situation or 80% or more decline in profits in a year.[9] Another equates it with several years of successively lower profits culminating in a loss situation and a cash flow crisis.[10] The Reserve Bank of India considers a unit as sick if it has incurred a cash loss for a year and is likely to incur a cash loss in the current and coming years, along with a poor financial structure (current ratio less than 1:1, worsening debt-equity ratio).[11] 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 instalments due to the financial institutions, has made cash losses for two consecutive years, or has lost its net worth by 50%, and has mounting arrears of statutory and other liabilities.[12] Bidani and Mitra compare corporate sickness with bodily sickness, and indicate that abnormal functioning of a unit or any of its areas of management (production, marketing, finance, personnel, or general management) would amount to corporate sickness.[13] These definitions cumulatively suggest a systems view of corporate sickness: a unit is sick if its management is deficient and/or the result of operating the unit is a loss with the prospect of further losses.

An operational way of judging whether there is any deficiency in the management of the unit or not is to compare its current performance with its performance in the past during comparable business conditions, and to compare its current performance with other comparable units in the industry known to be efficiently managed. These two comparisons should provide a rough indication of how far the unit is operating below its performance potential. Thus, a unit may be considered sick

if it is operating way below its performance potential (even if it is not making cash losses or defaulting) and the prospects are for continuing operations below performance potential.[14]

Such a view of corporate sickness is useful for many reasons. First, there is no confusion between sickness and poor performance beyond the control of the unit's management. After all, a unit may be making cash losses because the industry it is in is in a deep recession, not because of poor management. In such a case the industry is sick, not the unit, and any revival actions need to be industry-oriented rather than unit - oriented. Secondly, revival efforts are likely to yield good dividends when the unit is performing well below its potential, as several case studies have shown.[15] Thirdly, identification of relatively poor performance can cue a unit or the financial institutions to earlier revival efforts than waiting for the unit to make losses - and the earlier the revival efforts, the faster, more effective, and less expensive may be the turnaround. Finally, from a social viewpoint, the closer enterprises operate to their performance potential the better generally would be resource utilisation, and so any efforts of stakeholders (including the management, the government, and the financial institutions) to keep enterprises operating at or near their performance potential should yield good dividends for the economy.

Empirical Work on Causes of Corporate Sickness

There has been substantial empirical work on the causes of corporate sickness in the West. These findings are worth considering because though the Western economies are far less regulated and far more developed than the Indian economy, both are, to a substantial

degree, market economies, and given the prospects for liberalisation and development of the Indian economy, Western experience in the area of corporate sickness may become increasingly relevant in India. There has also been some important work in India. The findings are summarised below.

Western work on corporate sickness

1. Most studies agree that sickness can be caused by a wide variety of factors.[16] Broadly speaking, sickness can be caused by factors internal to the organization, such as inadequate management or a sub-optimal plant, and/or by factors external to the organization, such as increased competitive pressure, recession, or strike. Table 1 summarises the causes as identified in a number of studies.

(Table 1 about here)

2. The major cause of corporate sickness seems to be poor quality of top management. This may take one of several forms : excessive conservatism, excessive complacency, growth mania, poor financial control, excessive centralization and authoritarianism, weak board and a weak watchdog function, excessive commitment to policies that worked well once but are no longer appropriate, poor financial or marketing management, etc.[17] (see Table 1). Although such contextual factors as price competition and recession are significant causes, these are more often than not contributory factors rather than main factors. In an American study it was found that external factors (slumps, exchange rate changes, credit squeezes, inflation, etc.) may have been mainly responsible for only about 10% of corporate declines. On the other hand internal causes of decline, such as one man rule, lack of management depth, management succession problems, inbred, bureaucratic management, weak financial control, an unbalanced top management,

a weak board, etc., accounted for about 70% of declines (the remaining 20% declines were caused by a mix of external and internal factors).[18] As a British researcher put it, "..... a crisis situation is likely to occur most frequently when a firm, already weakened by poor management, lack of control and inefficiency, is subjected to adverse movements in market demand and commodity prices, price competition and ..... problems resulting from the so-called big project."[19]

The two vital errors of omission on the part of management may be failure to respond adequately to market place changes, and inadequate control of operations. Some significant errors of commission seem to be overexpansion and excessive leverage (i.e. debt).[20]

3. Many declines tend to take place during organizational transitions.[21] For instance, once an entrepreneurial venture has been established, the failure to induct a professional manager to set up appropriate financial control, production planning, etc., systems may lead to sickness; if a professional manager is hired, and the organization grows, excessive centralization may lead to sickness; if decentralization does take place, accompanied by a sound management control system, the resulting depersonalization may cause sickness unless the management communicates some core values to the rank and file that act as a binding force.

4. Organizational size, and the bureaucratisation of the organization a growth in size often implies, may be an important cause of sickness. Large size implies growing reliance on rules and regulations, hierarchy, and specialization of functions. These, in turn, can lead to staff alienation, distorted communications, administrative rigidity, interdepartmental conflicts, and sub-optimisation, and result in organizational sickness.[22]

5. The major causes of sickness are not necessarily the major inhibitors of revival. For instance, in a British study of 40 turnaround cases, the four major causes of sickness were found to be lack of financial control on the part of management, an inadequate chief executive, price competition, and operating inefficiency.[23] However, of the four, only price competition was found to be a major inhibitor of recovery (see Table 2). In other words, not only was price competition a common cause of sickness, the chances of recovery of units falling sick because of competition tended to be slim. Three other major inhibitors of recovery were a sub-optimal plant, high overheads, and weak marketing. Thus, the more of these four factors are present in a sickness situation, the less salvageable may the unit be. On the other hand, though poor financial control, an inappropriate chief executive, and operating inefficiency may be major causes of sickness, they seem to be far easier to remedy, and, therefore, they do not render a unit unsalvageable.

(Table 2 about here)

6. Western experts have suggested that for revival purposes it may be useful to consider three types of sickness situations.[24] The first is the hopeless case. The hopeless case is characterised by such factors as a severe decline in the unit's core business area; a single product, single plant operation that makes divestiture difficult; and relatively high fixed costs in relation to value added, which makes the unit highly vulnerable to even modest business declines. The second suggested category is that of short-term survivors, who can break even for a while but have no long-term competitive advantage and therefore, may survive in a boom but are likely to go under in a recession. The third category consists of those with potential for

sustainable recovery because of a good product or process base but sickness due primarily to poor management. Obviously, the clear policy implication for financial institutions would be to stop further assistance to the hopeless cases and give full but conditional assistance to those with potential for sustainable recovery, with some ambiguity about what to do vis-a-vis the short-term survivors. The earlier (and better) the diagnosis the lower may be the costs of effective action.

Indian work on sickness

A Reserve Bank of India study published in 1981 sought to identify various causes of sickness.[25] The study covered 378 units. According to this study, 52% of the units had become sick due to mismanagement, including diversion of funds, infighting, and lack of marketing strategies. About 14% had gone sick because of faulty planning and other technical drawbacks (indicative of faulty management), 23% due to market recession, 2% due to labour trouble, and 9% due to power cuts, shortage of raw materials, etc. Thus, the predominant cause of sickness appeared to be poor quality of management.

A study by the Economic and Scientific Research Foundation indicated that project cost escalation may be a significant promoter of sickness.[26] In many industries, project costs have doubled or tripled over a decade. The problem is aggravated by cost overruns. Thus, delays in taking on or commissioning projects may seriously inflate costs and render a unit non-viable. Besides, cost per ton of capacity can vary widely - sometimes by a factor of 2 - depending on the size of the plant. Thus, wrong choices of plant size and technology can also be a significant cause of sickness.

In another comparative study of sick and successful projects, it was found that sick projects were characterised by long delays in project implementation and large cost escalations, while successful projects mostly escaped both these problems.[27]

In a study that attempted to identify the lead indicators of sickness, discriminant analysis was applied to the financial indicators of a sample of about 40 cotton textiles companies.[28] The financial data for the 13 year period 1962-74 were collected, and the attempt was to find financial ratios that correctly identified sick companies before they turned sick. The study found that the ratios of earnings before interest, taxes, and depreciation and earnings after interest and taxes but before depreciation to sales and gross assets respectively gave the best results. The study also found that net worth related and liquidity ratios were not very reliable. Although balance sheet ratios were not as good as profitability ratios, two ratios were found to be useable : net worth/short and long term debt, and all outside liabilities/tangible assets.

There is evidence that corporate sickness is concentrated in some regions, industries, and sectors. A 1983 Reserve Bank of India survey indicates that corporate sickness is in part a regional phenomenon.[29] For instance, West Bengal accounted for 23% of the 463 large sick units and 19% of the small sick units. Other states with many sick large and small units in 1983 were Maharashtra, U.P., Tamil Nadu, and Karnataka. Sickness may also be partly an industry phenomenon.[30] For instance, upto 1982, textiles, rubber products, transport equipment, and metal products accounted for respectively 23%, 19%, 16%, and 14% of the assistance sanctioned by the Industrial Reconstruction

Corporation of India. Sickness may in part be a sectoral phenomenon. A study in the mid-seventies indicated that the profitability of large private sector companies was generally far higher than that of central public sector enterprises in the same industries.[31] Also, while less than 15% of large private sector companies are sick, nearly 20% of central public sector units in any year may be loss making.[32]

Bidani and Mitra, using a clinical model of corporate sickness, identified a large variety of causes of sickness.[33] They first categorised these causes into external and internal causes, and further into causes relating to finance, production, personnel, marketing, and corporate management. Somewhat modified, the Bidani and Mitra list of causes is summarised in Table 3. Bidani and Mitra do not, however, report the empirical basis for their list nor data bearing on the relative importance of these causes.

(Table 3 about here)

An Interview and Questionnaire Study of Sickness Causes

Several officers of the apex Indian financial institutions and banks were interviewed to identify major causes of corporate sickness. By and large the following categories of causes were identified:

1. External industry-specific factors, such as stagnation or recession in the industry (e.g. the textile industry), competition faced by the unit (e.g. small units, rayon grade pulp units), excess capacity in the industry (e.g. the tyre industry), etc.

2. External, government - related factors, such as tax burden on the unit, especially import duties, excise duties, and sales tax; legal

restrictions on the unit's expansion/diversification (as with FERA and MRTP companies); government price control (as in the case of newsprint and sugar industries); frequent changes in government policies affecting the unit; liberal imports that compete with the unit's products; the government or its agencies going back on promises made to the unit (such as promised price preference to joint sector units); poor law and order situation (as in parts of eastern India); political interference in the unit's affairs (as in public sector units, agro-based industries); unhelpful governmental machinery (e.g. in supplying power or in clearing a project), etc.

3. Financial institutions related factors, such as their harshness in dealing with the unit, delay in providing finance to the unit, inadequate working and/or long term capital provided by them, their inexpert assessment of the client's project finance proposal, etc.

4. Other external factors, such as customer resistance to the unit's products, erratic availability of raw materials/components/power/fuel to the unit (e.g. paper and sugar industries, aluminium units), inadequate transport facilities available to the unit for transporting coal).

5. Internal management deficiencies, such as excessive conservatism, bureaucratic orientation, lack of commitment to professional management (as with some family-management units), in-fighting at the top, too much centralisation, harsh treatment of staff, recklessness, corrupt management, poor financial, marketing, personnel, and manufacturing management, wrong choice of technology, weak board, etc.

A questionnaire was developed for assessing the importance of some 40 identified causes of sickness. For the items a four-point scale was used for rating the importance of each item in causing sickness. The questionnaire was administered to officers of two apex financial institutions (IDBI and ICICI) dealing with sick accounts, and officers of banks looking after such accounts. In all, 36 officers provided the data. These officers had been with their respective financial institutions for an average of about 16 years, and they had been involved in monitoring/assisting sick units for an average of nearly 3 years. Based on their averaged scores, each cause was classified into a major cause or a moderate cause or a minor cause. Those causes with mean scores of 2.8 and above were considered major causes; with means of 2.3 to 2.7 were considered moderate causes; and those with means below 2.3 were considered minor causes (see Table 4). As many as ten out of 13 major causes of sickness were seen to relate to the competence and nature of the unit's management. Major causes of sickness included corrupt management of the unit, inadequacies in functional management (finance, manufacturing, marketing), poor general management (too much centralization in decision making, low commitment to tools of professional management, weak control of the board, lack of cohesion due to infighting), and poor initial choices of technology and investment. Two other major causes were seen to relate to the government frequent policy changes, and inadequate power/fuel supply. Finally, disturbed industrial relations was also seen to be a major cause.

(Table 4 about here)

The moderate causes of sickness included four groups of factors. The first group related to adverse industry conditions (excess capacity, competition, stagnation or recession); adverse government behaviour

(price control, erratic availability of inputs, liberalised imports of competing products); adverse behaviour of financial institutions (delay in providing finance, inadequate provision of working capital and investment finance, and poor assessment of project finance proposals); and poor unit management (conservatism, bureaucratic functioning, slackness, nepotism, poor image management).

The so-called minor causes may sometimes well be major causes in particular situations. However, they were seen to be minor overall. These included political interference, interference by financial institutions in the management of the unit, poor law and order situation, and unhelpful governmental machinery.

Overall, it would seem that in the judgement of rehabilitation officers, the number one contributor to sickness is the unit's management, although the conditions in the unit's industry and the errors of omission and commission by the government and the financial institutions may be significant contributory factors. Of course, each sickness is more or less unique, with a unique constellation of factors making the unit sick. Also, sickness factors may vary by industry and region also. And yet, it is important, for designing a general sickness prevention and recovery aiding system, to know which causes are considered the most important causes of sickness, and which the least.

In order to identify constellations of sickness causing factors that tend to occur together, with the possibility that within each constellation the factors reinforce one another, the data were subjected to a factor analysis (varimax rotation of principal components). Several significant and relatively independent constellations were

identified (these explained 80% of the total variance). In order of importance, these were:

1. Management, especially excessive nepotism and family domination of company, weak board, and too much centralisation, aggravated by low results orientation, low commitment to professional management, harsh treatment of staff, and slackness in enforcing the performance accountability of managers. This constellation seems typical of "traditional management".

2. Poor support of financial institutions to the unit, especially insufficient provision of working capital and long term capital, delay in providing finance, interference in the unit's affairs, and general harshness in dealing with the unit, in the context of industry stagnation, credit squeeze, and inexpert assessment of the client unit's investment proposal by the financial institutions. This constellation may well characterise institutional behaviour when the case is a hopeless one, or when the financial institutions have no confidence in the management of the unit.

3. Negative government behaviour, especially interference in the affairs of the unit, bad law and order situation, unhelpful governmental machinery, and also poor transport facilities, power/fuel shortages, etc. This constellation may be fairly local, and may operate mostly in the so-called "difficult" states and regions.

4. Operations management involving poor marketing capability of the unit, combined with overly optimistic expectations (by management) of returns from the project, and poor manufacturing management and cost control. In short, poor operations management, often characteristic of novice promoters.

5. Hostile operating environment covering competition faced by the unit, restriction on its expansion/diversification, and customer resistance to the unit's products, fairly typical in mature industries.

6. A wheeler-dealer management - corrupt and reckless management, with a poor market image, in the context of frequent changes in government policies affecting the unit.

7. Liberal imports that compete with the unit's products.

8. Tax burden on the unit.

9. Excess capacity in the industry in the context of erratic availability of various inputs.

10. Price control by government.

11. Disturbed industrial relations.

In the questionnaire, the respondents were encouraged to list sickness producing factors not covered by the 40 items rated by the respondents. Table 5 lists these additional causes of sickness.

(Table 5 about here)

Some of the causes of sickness listed in Table 5 are interesting : the softness of financial institutions in dealing with incompetent managements; the lack of coordination and information - sharing between the financial institutions, banks, and relevant government agencies; weak control of the financial institutions over project implementation; reliefs and concessions that seem to reward sickness; difficulties for units locating projects in backward areas; the

inability of financial institutions to detect sickness early; diversion of short term funds for long term uses (and, possibly, vice versa); lack of cooperation of state financial corporations; and delays in obtaining payments from government agencies. Many of these indicate serious, but remediable, shortcomings of the financial institutions, and their relationship with the unit, the banks, and the government. Especially critical seem to be better project appraisal and monitoring of project implementation, timely detection of, and quick, coordinated response to, sickness, and reliefs and concessions only to a unit with a competent and ethical management.

Prevention of Sickness by Financial Institutions

Interviews with officers of apex and other financial institutions indicated several mechanisms that the financial institutions do, or can, use to prevent sickness. These included receiving monthly or quarterly financial reports from the assisted units, putting nominees of financial institution on the boards of clients, periodic inspections of units by officers of financial institutions, designation of desk officers within financial institutions to monitor groups of clients, industry cells in the financial institutions that specialize in keeping abreast of developments in specific industries, market intelligence cells that keep in touch with informative contacts (sharebrokers, bankers, dalals, etc.) for gathering market information on clients, inter-institutional meetings, independent assessment of sales and profit projections vis-a-vis project finance requests submitted by clients, appointment of internal/statutory auditors with the approval of financial institutions, the identification of the lead agency among the financial institutions to deal with each client, use of external consultants by the financial institutions to evaluate sizeable project

finance requests, good character certificates from banks, etc., to be obtained by clients desiring project finance, required management training for the top managers of units seeking project assistance, formal training for those officers of the financial institutions that have client monitoring roles, etc.

A questionnaire was developed to assess the usefulness of fifteen sickness prevention mechanisms. The sample of 36 rehabilitation officers of various apex financial institutions and banks was asked to rate the usefulness of each mechanism on a 4-point scale. Table 6 presents these mechanisms in the order of their perceived usefulness. The periodic financial report from the unit was seen as the most useful sickness prevention mechanism, followed by periodic inspection visits to the unit, inter-institutional meetings, independent assessment by financial institutions of the projections made by the unit for getting project finance, formal training for financial institution officers playing a monitoring role vis-a-vis units, market intelligence cells within financial institutions, etc. Good character certificates for chief executives of units seeking project finance, outsider nominees of financial institutions on the boards of borrowing units, the use of external consultants to evaluate funding requests, compulsory management training requirement for the top executives of borrowing units, insider (to financial institutions) nominees on the client's board, etc., were seen as much less useful.

The combined wisdom of rehabilitation officers usefully points to the efficacy of (a) continuous monitoring of the unit right from the project finance proposal stage, and (b) a professional response to the needs and problems of the client unit.

(Table 6 about here)

In the questionnaire, the respondents were asked to list any additional sickness preventing mechanisms. Table 7 lists these additional mechanisms. A smaller project finance consortium to facilitate quicker response to sickness, greater autonomy to monitoring officers in the financial institutions to act to prevent sickness, and better liaison with the assisted units through, for example, officers of financial institutions being sent on deputation, are interesting suggestions. Greater autonomy for monitoring officers, and officers being sent as advisers, could be effective sickness preventive mechanisms provided these officers are well-trained in professional industrial and financial management. Otherwise they may aggravate sickness through uninformed interference. Reducing the size of the consortium also makes sense, especially for relatively modest project finance proposals that do not involve a large risk to any financial institution. Besides these possibilities, the "premium rebate for no claim" idea in insurance is worth considering, that is, there could be incentives for remaining healthy, by way of modest interest rebates on project finance that increase with the period of health. Equally, of course, avoidable project cost escalations, due, for example, to avoidable delay in project implementation, and amateurish sales and profit projections that subsequently go haywire, could be penalised by increasing the rate of interest on additional project finance required (provided, of course, that this additional interest burden does not push a unit into sickness).

(Table 7 about here)

The data suggest a model sickness prevention system at the financial institutions, whose main elements are (a) careful project appraisal; (b) continuous monitoring of the units, especially during the

project implementation stage; (c) a professional, speedy, and coordinated institutional response to the problems of units; (d) required systems at the units; and (e) incentives for remaining healthy and disincentives for actions contributing to sickness (see Exhibit 1 for details).

EXHIBIT 1

A MODEL INSTITUTIONAL SYSTEM FOR PREVENTING SICKNESS

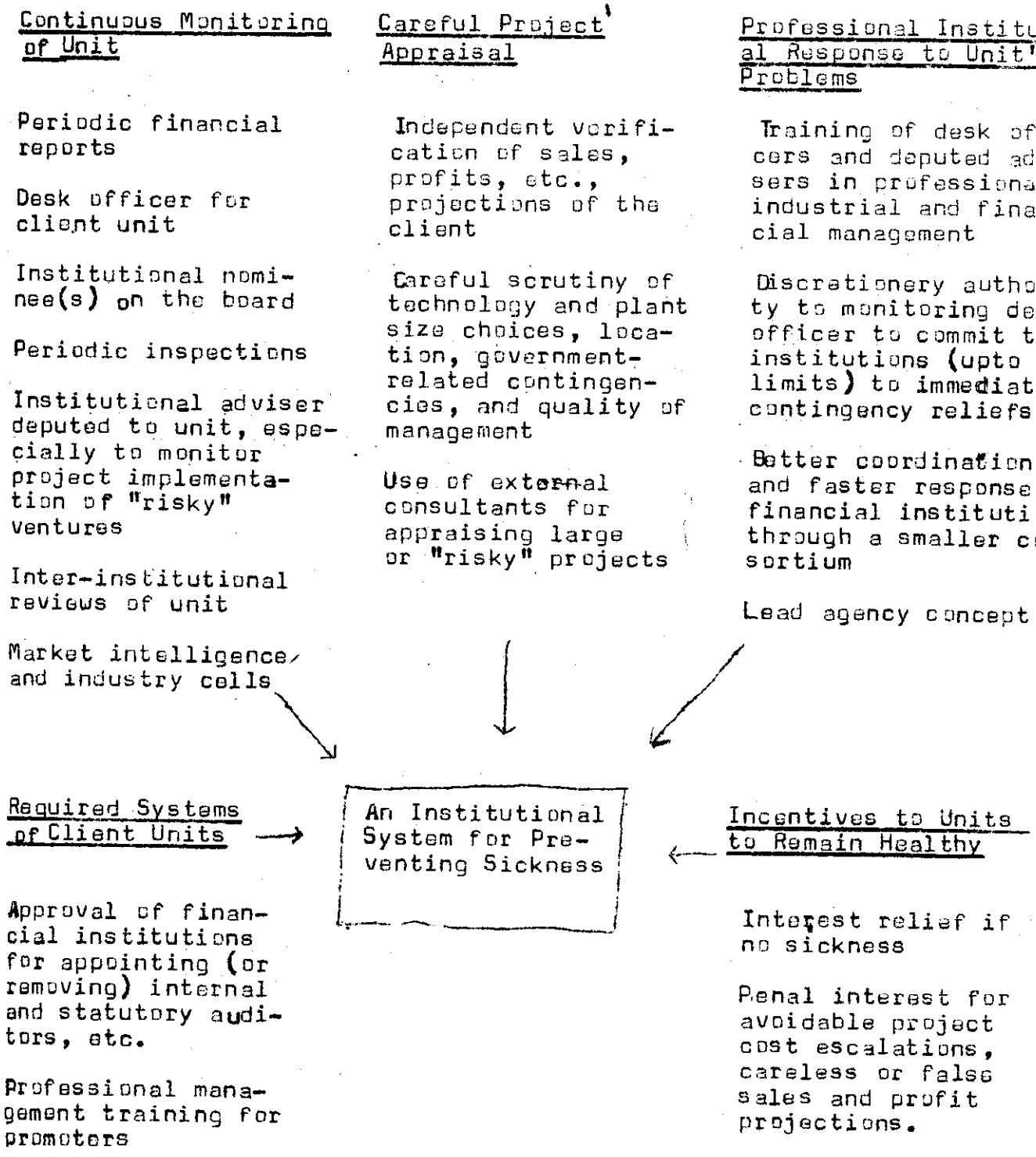

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TABLE 1

CAUSES OF SICKNESS ACCORDING TO WESTERN STUDIES

Internal Causes

1. Inadequate management. Excessively cautious, bureaucratic, permissive, or authoritarian management. Weak board and watchdog function. Lack of management depth.

2. Unprofitable acquisitions, expansions, poor choice of plant or technology. Growth mania. Neglect of core business in the drive for diversification. Poor post - acquisition management.

3. Lack of financial control and proper accounting information. Inability to pinpoint which products and customers are profit yielding, which loss making.

4. Poor marketing and distribution. Poorly motivated or trained sales force. Ineffective advertising and promotion. Poor after sales service. Lack of focus on key products and customers. No new product development.

5. Overtrading; inadequate working capital to finance sales growth. Proliferation of low margin or loss making sales.

6. Poor financial policies - excessive leverage, low profit retention for reinvestment, short term borrowing for long term needs, etc.

7. Big projects with long gestation periods, start-up difficulties, poor timing, under-estimated costs and over-estimated returns, high market entry costs.

8. The unresponsiveness of the firm to market and technological changes.

9. High unit costs relative to competitors due to unfamiliarity with business, or inability to take advantage of economies of scale, or lower market share or vertical integration compared to rivals, or government-imposed pollution control, social welfare, or other costs, or high overheads because of technology or plant choice, etc.

External Causes

10. Increased competitive pressure on the firm.

11. Decline of market demand.

12. Adverse movement in input prices and interest rates, combined with price stagnation or decline in marketed products.

13. Strikes.

TABLE 2

FOUR MAJOR CAUSES OF DECLINE AND FOUR MAJOR INHIBITORS OF RECOVERY IDENTIFIED IN A BRITISH STUDY

Major Causes of Decline	Major Inhibitors of Recovery
1. Lack of financial control	1. Price competition
2. Inadequate chief executive	2. Smaller than optimal plant in an industry with large economies of scale
3. Price competition	3. High overheads
4. Operating inefficiency	4. Lack of marketing effort

TABLE 3

BIDANI AND MITRA BASED LIST OF SICKNESS CAUSES

	Finance - related	Production - related	Marketing - related	Personnel - related	Corporate management related
External causes	-Insufficient assistance from financial institutions -Unfavourable investment climate, fear of nationalisation, etc.	-Input and power/ fuel shortages -Restraint on expansion/diversification -Excess capacity in industry	-Government restrictions on selling, pricing, purchasing -Recession or deterioration in the national or international markets -Excessive export duties	-General labour unrest and inter-union rivalry -Poor availability of skilled manpower -Low work ethic in the workforce -High absenteeism due to local regional, cultural, etc., factors	-Political interference or bureaucratic interference or nepotism in the appointment of top managers -Artificial restrictions on pay and perks of top managers.
Internal causes	-Poor debt-equity mix -Poor asset utilisation -Bad working capital management -Absence of proper costing and pricing -Absence of proper budgeting and financial planning -Siphoning off of company funds	-Improper selection of site, plant, technology, etc. -Inadequate materials management -Poor plant maintenance -Lack of production and quality control -Lack of emphasis on R and D	-Poor demand forecasts -Bad product-mix -Poor marketing planning -Excessive dependence on a few customers -Lack of market research -Poor advertising, promotion, after sales service, etc. -Wrong pricing methods -Poorly used distribution channels	-Poor wage and salary administration -Bad labour relations -Low human relations skills of managers -Absence of manpower planning -Overstaffing -Absence of managerial and staff training	-Improper corporate planning -Poor top level coordination and control -Excessive conservatism and resistance to change -Discord in the ranks of top management -Corrupt top management -Bureaucratic orientation of top management -Top management recklessness -Weak board

TABLE 4

PERCEIVED IMPORTANCE OF FORTY CAUSES OF SICKNESS

Sample : 36 Rehabilitation Officers of Financial Institutions and Banks

Major Causes of Sickness

1. Corrupt management of unit
2. Lack of commitment of unit's management to tools of professional management
3. In-fighting within unit's management
4. Weak board of directors
5. Too much centralization in management
6. Choice of wrong technology
7. Excessively rosy assessment of investment by management
8. Poor financial management of unit
9. Poor cost control and manufacturing management
10. Inadequate marketing
11. Inadequate power/fuel supply
12. Frequent changes in government policies affecting unit
13. Disturbed industrial relations

Moderate Causes

1. Stagnation in industry
2. Competition in industry
3. Excess capacity in industry
4. Government price control
5. Erratic availability of inputs
6. Liberal imports
7. Delay in finance provided by financial institutions
8. Inadequate working capital provided by financial institutions
9. Poor assessment of investment proposal by financial institutions
10. Inadequate long term finance provided by financial institutions
11. Conservative management of unit
12. Bureaucratic management of unit
13. Slackness in enforcing the accountability for performance of unit's managers
14. Poor image of management in the market
15. Too much nepotism and family domination of unit

Minor Causes

1. Interference of financial institutions in unit's management
2. Restrictions under FERA, MRTP, etc.
3. Tax burden on unit
4. Inadequate transport facilities
5. Harshness of financial institutions
6. Poor law and order
7. The government going back on promises to unit
8. Customer resistance to unit's product
9. Harsh treatment of staff by management
10. Political interference
11. Unhelpful government machinery
12. Credit squeeze on unit.

TABLE 5

ADDITIONAL SICKNESS CAUSES INDICATED BY REHABILITATION OFFICERS

Sample : 36 Rehabilitation Officers of Financial Institutions and Banks

1. Very soft treatment by financial institutions of incompetent management.
2. Excessive investment in unproductive assets.
3. Project implemented purely on a developmental angle in a backward area lacking infrastructural facilities. Fails to attract and retain good professional managers due to locational disadvantages.
4. Enamoured by the incentives for setting up units in backward areas, the company is unable to cope with lack of infrastructural facilities. This results in low capacity utilisation, long gestation period, and sickness.
5. Lack of coordination between the financial institutions/banks.
6. Inadequate exchange of information among institutions, banks, and concerned government departments.
7. Delay in extending temporary credit to tide over certain contingencies.
8. Lack of coordination between unit, financial institutions, and banks.
9. Lack of control on project implementation.
10. Delayed project implementation and unwanted capacity expansion.
11. Inability of institutions and companies concerned to detect symptoms of sickness in time.
12. Lack of timely detection of sickness, of prompt reporting, of remedial measures, and delay in financial assistance leads to sickness.
13. Availability of many reliefs and concessions encourage many units to go sick.
14. The government policy of providing many reliefs and concessions to sick units.
15. Siphoning off of funds for investment in other units.
16. Lack of interest and integrity of the borrower.
17. Diversion of funds of current finance for long term finance.
18. No proper delegation of authority at the management level and concentration of powers in the Managing Director.
19. Lack of experience.
20. Generally, due to lack of business capacity and instinct in the entrepreneur the unit becomes sick. The entrepreneur whose stake is less has no involvement in the enterprise.

21. Weak capital base.

22. Lack of compulsion to contain costs and ensure quality owing to the ill-effects of a protected market.

23. Too high a rate of interest on borrowed capital.

24. Irregular and low voltage power supply, sudden increase in power tariff.

25. Long procedural system of inspections by government undertakings.

26. Delayed payments by government departments and undertakings.

27. Ineffectiveness of cash credit system of advances of banks.

28. Non-cooperative attitude of state financial corporations in the revival of sick units.

29. Lack of facilities for establishing appropriateness of technology.

30. There is disharmony between the Bureau of Industrial Costs and Prices and wage boards - the result is obvious.

TABLE 6

USEFULNESS OF INSTITUTIONAL MECHANISMS FOR PREVENTING SICKNESS

Sample : 36 Rehabilitation Officers of Financial Institutions and Banks

	Usefulness Rank
1. Monthly or quarterly financial statements submitted by the company to the financial institutions	1
2. Periodic inspection visits by individuals or teams from financial institutions	2
3. Periodic meetings of the representatives of the financial institutions to exchange information about industries, common clients etc.	3
4. Independent assessment by financial institutions, through market research methods, of the appropriateness of sales projections, profitability, etc., submitted in funding requests by clients	4
5. Programmes to train persons within financial institutions for monitoring and client assessment roles	5
6. Market intelligence cells that keep in touch with informative contacts (bankers, shareholders, dalals, merchants, industrialists), etc., for monitoring the problems, prospects, etc., of client units	6
7. Appointment of internal and/or statutory auditors of the clients with the approval of financial institutions	8
8. The lead agency concept among financial institutions (i.e. coordination of assistance, etc., to client by an agreed upon lead financial institution)	8
9. Desk officers or contact persons in the financial institutions, each of whom specialises in the affairs of a few designated units	9
10. Industry cells in financial institutions that keep in touch with the developments in the industry, its problems, short and long term prospects, etc.	10
11. Nominees from within financial institutions on the company's Board	11
12. Requirement that top managers of client undergo at least a short duration course in project management and general management before the client organization makes a funding request	12

	Usefulness Rank
13. Use of external consultants to evaluate sizeable funding requests from clients	13
14. Nominees of financial institutions on client's Board from outside financial institutions	14
15. Good character certificates from bankers, reputed industrialists, trade or industry association, etc., required to be furnished by chief executive of client at the time of loan application.	15

TABLE 7

ADDITIONAL SICKNESS PREVENTION MECHANISMS SUGGESTED BY REHABILITATION OFFICERS

Sample: 36 Rehabilitation Officers of Financial Institutions and Banks

1. Deputing an officer of financial institution on whole-time basis, not as a substitute for, but as an adviser to, existing management.
2. Deputation of officers of financial institutions to industry and vice versa.
3. Individual officers should be designated to be in charge of one or two problem prone units and given independence, discretion, and accountability.
4. Financial institutions should organize themselves and establish a system of communication with the assisted units to be in a position to anticipate problems.
5. Concentrate on areas of weakness and trends in operational spheres which are likely to adversely affect the health of the unit, with discretion to the agencies to take prompt and appropriate action.
6. Reduction in the number of institutions/banks assisting each project to have speedy consortium decisions on the revival strategies of sick units.
7. Quick and prompt payment of bills drawn by units.
8. Training about procedures and formalities of sales tax, ESI, central excise, and other statutory obligations should be given to managers of units.