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ORIGINAL ARTICLE

INDUSTRIAL SICKNESS HAMPERS ECONOMIC DEVELOPMENT

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Abstract

The industrial sickness has been growing in India year after year and hampering the growth of industrial development. The growing sickness among the large and medium industries has been one of the most persisting problems faced by the industrial sectors of the country. The sixth plan after making a careful analysis of the factors leading to sickness concludes, "however, perhaps the most important of all causes of sickness is the incompetence or the cupidity of the management. The reserve bank of India identifies sick industrial units on the basis of mix of criteria including continued cash losses, imbalances in the financial structure and deterioration in liquidity.

Key words : Industrial sickness, Hampers economic developments, large and medium scale industries.

INTRODUCTION

The industrial sickness has been growing in India year after year and hampering the growth of industrial development. This would be seen in most of the important industries like, cotton textiles, engineering, chemicals, agro based industries, cement and paper industries. The growing sickness among the large and medium industries has been one of the most persisting problems faced by the industrial sectors of the country. In 1985 the sick industrial industries (special provision) act 1985 was enacted. This act offered a definition of sickness.

According to this act, "Sick industrial companies indicates an industrial company (registered for not less than seven years) which is showing accumulated losses equal to or exceeding its not work at the end of any financial year and has suffered cash losses also during the financial year and immediately preceding year. Here the cash loss indicates computer loss without making provision for depreciation and net worth means the total amount of capital and free reserves.

The sixth plan after making a careful analysis of the factors leading to sickness concludes, "however, perhaps the most important of all causes of sickness is the incompetence or the cupidity of the management.". Jayathi Ghosh has rightly pointed "the implications of such a policy in terms of building up reserves for further involvement and expansion of production or over hauling of machinery and technicians are obvious. The main gainers from such dividend policy were the primary share holders, the large houses with the majority interest."

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It is therefore, incorrect to the state that in all cases, government policies or high wages demanded by the workers are responsible for sickness. In a majority of undertakings, however, mismanagement and misconduct have been the factors responsible for the situation. Prem Shankar Jha mentioned "in fact as the takeover of a sick engineering units and textile mills has shown in every case that the government has inherited is a load of worn out machinery, mountain of debts and distraught work force. Nationalization in such circumstances has been a means of indemnifying the entrepreneur against the consequences of his misdeeds instead of punishing him- first he milks an enterprise dry, then hands it over to the government for salvage".

Closure of business units and corporate failures resulting in bankruptcies have become a normal feature in market economies the world over. Growing competition and the ever changing international economic environment often lead to high incidence of corporate failure in develop market companies. However, these economies have the resilience to absorb the economic disturbances brought about by the closure of industrial units. In recent years industrial sickness in India has reached alarming proportions. In order to combat the problem of industrial sickness, a comprehensive assessment of the magnitude of industrial sickness and an analysis of the main factors which bring about sickness are necessary. Both prevention and cure of industrial sickness would depend on our ability to identify sickness as early as possible and analyze its causes. Faulty or delayed identification would reduce the effectiveness of the remedial action such as restoring the financial viability of sick units and protecting units which would become sick.

1. CRITERIA FOR IDENTIFICATION OF SICK UNITS

The reserve bank of India identifies sick industrial units on the basis of mix of criteria including continued cash losses, imbalances in the financial structure and deterioration in liquidity. A unit may b considered sick if it has incurred cash losses for one year and, in the judgment of 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 ration of less than 1:1 and worsening debt equity ratio " RBI, 1978".

The term lending institutions identify sickness on the following criteria:

Continuous defaults in meeting four consecutive half yearly installments of interest or principle of institutional loans. Continuous cash losses for a period of two years or continued erosion in the net worth by 50% or more. Mounting arrears on account of statutory or other liabilities for a period of one or two years.

The above 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 infact take the enterprise to the brink of closure. Similarly, severe cash losses with persistent defaults in institutional debts servicing also indicate fairly advanced stage of sickness on the part of industrial unit, though this stage would certainly precede the stage of complete erosion of the net worth of the unit. The criteria, infact delay the identification by at least a couple of years or more.

2.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 shared price sharply declines. It is not uncommon to come across cases where despite dividends being skipped, shares continued to be quoted above par. This measure, therefore will have to be used very consciously with other identifiable symptoms to judge whether skipping dividends indicates sickness or represents a temporary downward slide in financial performance.

3. USE OF CASH LOSS CRITERION:

The cash loss criterion adapted 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-à-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 the 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 the firms in the industry, including new comers, earn fairly high profits. Even marginal or efficient 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 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.

4. CAUSES OF INDUSTRIAL SICKNESS:

The causes which are mostly responsible for industrial sickness in India are broadly classified into a) external and b) internal causes. The following are some of the external and internal causes of industrial sickness.

External causes : the external causes of sickness include

a) power cuts imposed by the states government

b) Scarcity of raw materials and other inputs due to its erratic supply.

c) Recession in the markets resulting from steep fall in the quantum of demand for industrial products aggravated by credit restrains and resulting in unsold stocks and losses to industrial units and

d) Frequent changes in the government policy in connection with industrial licensing, taxation, power tariff, imports, exports all theses external factors are equally responsible for growing sickness among the industrial units of the country.

Internal causes: the internal causes which include various factors related to the industrial units itself include.

a) Faulty location of industrial unit.

b) Faulty planning of the production in the absence of market analysis

c) Defective selection of plants and machineries and adoption of absolute technology.

d) Acute financial problems due to weak equity base and lack of adequate support from banks.

e) Incompetent entrepreneurs having no knowledge about costing, marketing, accounts etc.

f) Labor problems like strikes and lockouts arising from strained industrial relation over the issues like wages, bonus, industrial discipline.

g) Management problems resulting from managerial decisions in connection with production, marketing, finance, materials, maintenance, personnel management etc.

5. CONSEQUENCES OF INDUSTRIAL SICKNESS:

Industrial sickness has been resulting serious consequences under developed labor – surplus economy like India.

These consequences of industrial sickness includes

a) Aggravating unemployment problem through the closure of industrial units.

b) Wide spread labor unrest due to closure, threatening industrial environment of the country.

c) Wastage of huge resources invested in these sick units

d) Creating disincentive among the entrepreneurs and investors due to wide spread closure of units

e) Creating adverse impact on the other related units through backward and forward linkages

f) Causing huge financial losses to banks and other term ending institutions and locking of huge funds into these sick industrial units and

g) Resulting huge loss of centre, state and local governments.

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