International Journal of Application or Innovation in Engineering & Management (IJAIEM)
Web Site: www.ijaiem.org Email: editor@ijaiem.org
Volume 5, Issue 8, August 2016 **ISSN 2319 - 4847**

INDUSTRIAL SICKNESS OF MSMEs UNITS

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Abstract

Sickness in industrial units is a gradual process and does not develop suddenly. In the initial stages, it gets reflected in the form of defects and mistakes in the unit's functional areas like production, finance and management. Later it is observed in the form of symptoms like irregular or unsatisfactory turnover in the account, slow and unsatisfactory movement of stocks, decline in production, sales and profitability, frequent violation of terms and conditions and asking for additional grants. The other common problems faced by MSME towards the creation of excess capacity: absence of comprehensive data. Under-utilization of installed capacity, inadequate planning production, persistent recessionary condition, shortage of raw material. In this chapter an attempt is made to review the sickness in MSMEunits at all India level and Andhra Pradesh state level.

4.1INDUSTRIAL SICKNESS

Industrial sickness is a significant problem in many market economies. In the Indian private sector, it has been estimated that currently over 450 large manufacturing units end over 125,000 small units are sick, with more than rupees four thousand crores (over $3 billion) of the funds of financial institutions and banks tied up in these sick units. In India, the amount of funds of financial institutions tied up in defaulting accounts may be growing at over 10 percent per annum, and therefore, may double every seven years.

In India and elsewhere in the Third World, the problem of sickness is likely to grow worse. The number of new units coming up in India every year has grown over ten times since independence to around 60,000 registered new manufacturing units a 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, literalisation of the economy is likely to accelerate the pace of entrepreneurship.

A Reserve Bank of India study indicated that 84 percent of sick large firms for which viability studies were conducted were considered to be potentially viable, though only about 10 percent of the small units were so considered.

The sick industrial companies (special provision) Act 1985 identifies sickness in terms of cash losses for two consecutive financial years and accumulated losses equaling or exceeding the net worth of the company at the end of the second financial year.

The identification of sick units has been modified as under: "A MSME unit should be considered as sick if it has, at the end of any accounting year, accumulated losses equal to or exceeding 50 percent of its peak net worth in the immediately preceding five accounting years" (Bihar Chambers of Commerce, Sep. 1989).

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). 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 for two consecutive years, or has lost its net worth by 60 percent, and has mounting arrears of statutory and other liabilities.

A unit is sick if its financial performance is well below its performance potential. An operational way of judging this is to compare the unit's current financial 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 units is operating below its performance potential. Thus, a unit may be considered sick if it is operating way below its or defaulting) and the prospects are that it will continue to operate below its performance potential.

4.2 REASONS OF INDUSTRIAL SICKNESS

Units satisfying one or more of the above criteria were treated by enumerators as not being run satisfactorily and the reasons for the same were elicited. Table 4.1 indicates the reasons as given by the units suffering from sickness/ incipient sickness. Lack of demand and shortage of working capital are the main reasons for sickness/incipient sickness in the MSME sector. It can be observed from the table that the reason lack of demand as accounted for 71.6 percent and 84.1 percent in the registered and unregistered MSME sectors respectively followed by shortage of working capital with 48 percent and 47.1 percent against the reason managerial problem with a low response of 5.5 percent and 5.1 percent in registered and unregistered respectively.

TABLE 4.1 Reason for Sickness/incipient Sickness in MSME sector

Reason for sickness/ incipient sickness	**Percent of sickness/incipient sick units**	
	Registered MSME sector	**Unregistered MSME sector**
Lack of demand	71.6	84.1
Shortage of working capital	48.0	47.1
Non-availability of raw material	15.1	15.2
Power shortage	21.4	14.8
Labour problems	7.4	5.1
Marketing problems	44.5	41.2
Equipment problems	10.6	12.9
Management problems	5.5	5.1

The states of Kerala, Karnataka, Chandigarh (UT), Maharashtra and Tamil Nadu had the maximum share of sick units in the registered MSME sector.

As per the data compiled by the Reserve Bank of India from the scheduled commercial banks, the sickness in the MSME has decreased in the recent years. The number of sick MSME from March 2003 to March 2010 is given in Table 4.2 in the table exhibits the tendency of sickness in MSME sector during March 2003 and 2010 at all India levels in. It is encouraging to note from the table that except during March 2011-12, sickness in MSME has shown declining trend as the annual growth rate is climbed up from 5.74 percent in March 2011 to as high as 28.9 percent and 5.27 percent during March 2014 and March 2015. Constituting to the above analysis, the amount outstanding with sick units has increased tremendously from Rs. 3,609.20 crores in 2010 to as much as Rs. 5,706.35 crores with exceptional fluctuations during March 2012 and 2013 as the amount decreased from Rs. 4,608.43 crores to 4,505.4 crores. Another dimension of the sick units in MSME sector is that a good potentiality viable units have been found among the sickness units though their share stood at a minuscule level. It can be observed from the table that the growth in potentiality viable units has fluctuations as it was 6.9 percent of the total in 2010 increased to 8.43 percent in 2011.

TABLE 4.2 SICKNESS IN MSME SECTOR DURING MARCH 2009 – MARCH 2015

As at the end of	**Total sick units**		**Potentially viable**	
	Number	**Amount outstanding (Rs crore)**	*Number*	**Amount outstanding (Rs crore)**
March 2009	235,032	3,609.20	16,220	470.31
March 2010	221,536	3,856.64	18,686	455.98
March 2011	306,221	4,313.48	18,692	376.96
March 2012	304,235	4,608.43	14,373	369.45

March 2013	249,630	4,505.54	13,076	399.17
March 2014	177,336	4,818.92	4,493	416.39
March 2015	167,980	5,706.35	3,626	624.71

As a follow-up to the measures announced by the government in the Comprehensive Policy Package for the MSME on August 30, 2012, the Reserve Bank of India constituted a working group under the chairmanship of the then chairman, Indian Bank Association, Mumbai, to review the existing guidelines and recommend the revision of guidelines, making them transparent and non-discretionary for the rehabilitation of currently sick and potentially viable MSME units. The working group has submitted its report to RBI.

All the major recommendations of the working group have been accepted by the RBI including a change in the definition of sick MSME units, norms for deciding on the viability of sick units, etc. The revised definition would enable banks to take action at an early stage for revival of the units.

Based on the accepted recommendations of the working group, RBI drew up the revised guidelines for rehabilitation of sick MSME units, which were circulated to the banks on January 16, 2014 for implementation. A view of industrial sickness is useful for many reasons.

I) There is no confusion between sickness and poor performance beyond the control of the unit. 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.

II) Revival efforts are likely to yield good dividends when the unit is performing well below its potential, as several case studies have shown.

III) 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.

IV) 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.

CAUSES OF SICKNESS

Internal Causes

1. Inadequate management. Excessively cautions, bureaucratic permissive, or authoritarian management. Weak board and watchdog function. Lack of management depth.
2. Unprofitable acquisitions, expansions, poor choice of plant of 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.

4.4 PREVENTION OF SICKNESS

Prevention of Sickness by Owners and Management

The primary responsibility for preventing sickness lies with the owners and management of the organisation. Owners and management are not always identical, however, although they tend to be identical for small and medium sized units. In widely held larger companies, in subsidiaries of multinationals, in companies belonging to business houses, and in government owned enterprises there can be a substantial separation between ownership and management. In such companies, where the management is competent and honest, the primary responsibility for prevention rests with the management. Where it is incompetent or dishonest (these are the primary causes of sickness) the primary responsibility rests with the owners.

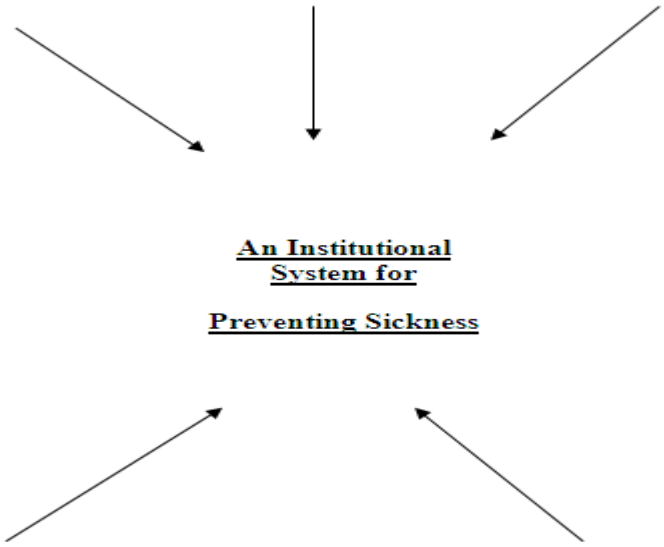
As far as prevention of sickness is concerned, the essentials are obvious: competent management of various functions like general management, marketing, operations, personnel, and finance; and a good performance reporting system designed to provide top management/owners timely information on critical parameters such as sales, production, profits, cost variance, profit variance, etc .

Prevention of Sickness by Government

In the Third World, the government is often a dominant stakeholder even in privately owned enterprises. The various tax reliefs and subsidies it provides, its ownership or control of the institutions that finance organisations, its enterprises related policies stemming from its overriding concern with industrial development, etc., make it a major stakeholder even in minor enterprises. Its actions often affect the health of whole enterprises. Like magic new industries arise though appropriate policies, tax incentives, subsidies, infrastructural facilities, etc., and like magic they disappear also, or get sick. The policies and financial and infrastructural support provided – or withheld – by the government is an important determinant of health and sickness. Frequent changes in government policies need to be avoided to reduce industrial sickness.

INSTITUTIONAL SYSTEM FOR PREVENTING SICKNESS

Continuous Monitoring of Unit	Careful Project Appraisal	Professional Institutional response to Unit's Problems
Periodic financial reports Desk officer for client unit	Independent verification of sales, profits, etc., projections of the client	Training of desk officers and deputed advisers in professional industrial and financial management
Institutional nominee(s) on the board Periodic inspections	Careful scrutiny of technology and plant size choices, location, government-related contingencies, and quality of management	Discretionary authority to monitoring desk officer to commit the institutions (up to some limits) to immediate contingency reliefs
Institutional adviser deputed to unit, especially to monitor project implementation in "risky" ventures	Use of external consultants for appraising large or "risky" projects	Better co-ordinations and faster response by financial institutions through a smaller consortium
Inter-institutional reviews of unit		
Market intelligence and industry cells		Lead agency concept



Required systems at client units	Incentives to units to remain healthy
Approval of financial institutions for appointing (or removing) internal and statutory auditors, etc.	Interest relief if no sickness
Professional management training for promoters	Penal interest for avoidable project cost escalations, careless or false sales and profit projections

Source: ETOE (Indian Experiences) 2010.

4.5 REHABILITATION OF SICK UNITS

Growing incidence of sickness of SSIs is yet another area of concern. Mortality of SSI unit has been showing an increasing trend because of internal and external factors including international competitive environment. This has wider implications including the locking up of funds of the lending institutions, loss of scarce material resources, and a large number of workers and other employees becoming jobless.

With a view to ensuring that potentially viable sick MSME units are provided with timely and adequate assistance by all agencies concerned, there are State Level Inter-Institutional Committees (SLIICs) involving State Government, Financial Institutions, Commercial Banks and SIDBI. SSI associations are also represented on these committees. A sub-committee of the SLIIC has also been set up in each state to examine the individual cases referred to it for rehabilitation. It is suggested that the SLIIC may be given statutory backing to ensure its effectiveness. To arrest the

incidence of growing sickness, the RBI has issued a complete set of revised guidelines to commercial banks in January 2002, which supersedes the guidelines issued in 1993, on the basis of the recommendations of the Working Group constituted for the purpose.

The guidelines also cover aspects relating to monitoring, viability, incipient sickness, relief and concessions that can be extended by banks. The revised criteria will enable banks to detect sickness at an early stage, and facilitate corrective action for the revival of the unit. The revised guidelines also stipulate that the rehabilitation package should be fully implemented within six months from the date of the unit is declared potentially viable/viable. During this interim period, banks/financial institutions are required to do 'holding operation' allowing the sick unit to draw funds from the cash credit account, up to the extent of the deposited sale proceeds. The RBI package should be supplemented by a package from the State Governments.

4.6 MARKETING SICKNESS

The marketing is the major area of operation in MSME sector, which is neglected in many cases. The factors responsible for marketing sickness, which results in SSI maladies, are grouped on the basis of key elements of marketing. The factors are ranked with the help of Garrets Ranking principles.

This reveals that the following factors have vibrant and more influence on marketing sickness of SSIs.

- Problem of delay in payment
- Lack of finance resources
- Lack of entrepreneurial background
- Lack of support from the government
- Problem of price variation
- Acute competition
- Poor quality of the product
- Giving long credit period

These factors, ranked first in each group, are the most influential factors responsible for the severe marketing sickness.

4.7 SICKNESS OF MSME IN ANDHRA PRADESH

Sickness among MSME is rather high in Andhra Pradesh. Among the registered MSME units, the percentage of closed industries is as high as 38 percent.

The closed MSME units are a whooping 38,788 out of the total registered number of 1,02,761 and the working SSIs number 63,973, accounting for 62.29 percent.

In efforts to receive and rehabilitate the closed units, the State Government has appointed five institutes to go into the issues of economic viability and work out a package.

The National Institute for Small Industries Extension & Training (NISIET), the Small Industries Services Institute (SISI), the Andhra Pradesh Industrial Technology Consultancy Organisation (APITCO), the AP Productivity Council and the Federation of Andhra Pradesh Small Industries Association AP SSI Centre. These organizations have undertaken a district-wise study of the closed MSME units, inclusive of the economic viability of their revival and rehabilitation and had submitted the report based on their recommendations a strategy would be devised.

It is not out of place to mention that the national percentage of closed units is 37.65 percent or 8,68,021 units out of the total of 23,05,725 registered units surveyed under the Third All-India Census of MSME by the Development Commissioner, Union Ministry of MSME .

The Andhra Pradesh state, which has lagged higher than the national percentage of units closed, the gratifying feature is that it does not find itself among the top five. These States are Tamil Nadu (16.2 per cent), Uttar Pradesh (13.4 per cent), Kerala (8.4 per cent), Madhya Pradesh (7.4 per cent) and Maharastra (7.1 per cent), in Andhra Pradesh, the percentage of closed units stood.

4.8 CONCLUSION

Industrial sickness is a significant problem in many market economies, more so even in the case of Indian economy. The sickness in small scale enterprises is very much looming and large as compared to medium and big industries. The evidence reveals that lack of demand and shortage of working capital were responsible for the magnitude of sickness in both registered MSME sector and unregistered MSME sector. Further, analysis also reveals that the tendency of sickness is at declining end over the years, however, the amount involved or locked up in the units is on the increasing end. In Andhra Pradesh State, the magnitude of sickness is extreme and 10 districts have accounted for the closure of the units ranging from 40 percent to 50 units percent of the total units Hyderabad and Cuddapah districts topped the list.

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