# Chapter 1
# Introduction

## 1.1 Industrial framework in India – Role of Central Public Sector Enterprises

As per World Bank's Doing Business Report, 2012, India ranks 128 among 183 economies surveyed in the area of Resolving Insolvency and it takes 7 years on an average to resolve insolvency and the recovery rate[5] is a mere 20.1 cents of the dollar. The results of 2012 survey are only a marginal improvement from Doing Business 2007 survey in which India ranked at 133, it took 10 years on an average to close the business and recovery rate was 13 cents to a dollar. This is evident in the cases of CPSEs taken up for assessment.

There is no single legislation in India providing for a systematic and cohesive system for rehabilitation and liquidation of enterprises including CPSEs. Both, the winding up of companies under the Companies Act and rehabilitation under Sick Industrial Companies (Special Provisions) Act (SICA)[6] remain cumbersome and long-drawn resulting in locking of huge national resources in these proceedings.

In more developed economies, the discipline of insolvency professionals is highly sophisticated. In countries like United Kingdom, Australia, Canada and United States, and in most European countries, the insolvency professionals play an important role in resolution of insolvency. China introduced the concept of insolvency practitioners under the Enterprise Insolvency Law of China which came into force in 2007. Insolvency practitioners are licensed in UK, Australia, Canada, China and other jurisdictions. However, there is no such discipline in India.

### Role of Central Public Sector Enterprises in India

The CPSEs perform an active role in the country's economic system. At the time of independence, India was an agrarian economy with a weak industrial base, low level of savings, inadequate investment and lack of infrastructural facilities. There also existed considerable inequalities in income and levels of employment, and glaring regional imbalances in economic development. In view of the manifold problems faced by the country on the economic, social and strategic fronts, Central Public Sector Enterprises (CPSEs) were set up as the instrumentalities of the Government of India (GOI) to serve as crusader of socio-economic objectives, spearheading planned development in India, promoting rapid industrial development, balancing regional development, generating employment and creating basic infrastructure network. Public sector was made to provide a leading role in moulding and accelerating the process of industrialisation

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*[5] Recovery rate is a function of time, cost and other factors such as lending rates and the likelihood of the company continuing to operate. The ranking on the ease of resolving insolvency is based on the recovery rates.*

*[6] Sick Industrial Companies (Special Provisions) Act, 1985(SICA) discussed in Chapter 3.*

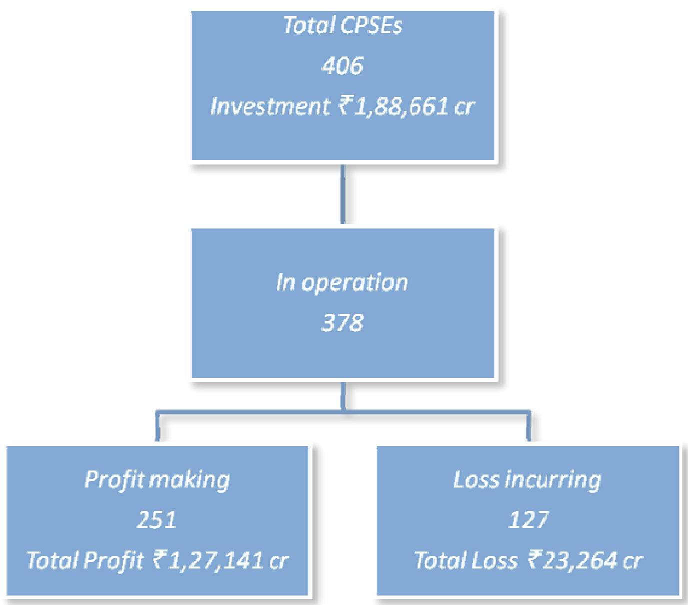
within the framework of a 'mixed economy'. They assumed a strategic role in the economy over years.

While a large number of CPSEs were set up as Greenfield projects, some were taken over from the private sector. Many of these enterprises successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas, and emerged as important players in the market. Others turned sick while a few were struggling and some have since been privatized.

## 1.2 Snapshot of Performance of CPSEs

As on 31st March 2011, there were 406 CPSEs (including 131 deemed Government Companies) out of which 378 CPSEs were in operation with a total Government equity investment of about ₹ 1,88,661 crore[7], of which 251 CPSEs earned net profit of ₹ 1,27,141 crore whereas 127 CPSEs registered loss of ₹ 23,264 crore.

***Chart 1.1 -Status of CPSEs***




The aggregate turnover[8] of CPSEs has increased to ₹ 15,44,897 crore in 2010-11 from ₹13,56,974 crore in 2009-10. Contributions (Income tax and dividend) of CPSEs to Government exchequer also increased from ₹ 73,126 crore in 2009-10 to ₹ 81,423 crore in 2010-11.

In brief, with a total equity investment of ₹ 181,661 crore in 406 CPSEs by GOI, the total contributions to the Government was ₹ 81,423 crore, which was about 43 per cent of the equity investment.

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*[7]Figures for 298 CPSEs only. For other CPSEs, data not available as these CPSEs were defunct/ under liquidation/ accounts not submitted/ accounts not due or deemed government Companies*
*[8]Data for 298 CPSEs.*

As on 31.03.2011, equity capital of 67 CPSEs had been completely eroded by their accumulated losses. The accumulated losses in these 67 companies were ₹ 82,477 crore against equity investment of ₹ 14,660 crore.

## 1.3 Sickness in Central Public Sector Enterprises

**Sickness as defined under SICA:**

A company is sick if it is registered for not less than five years and has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

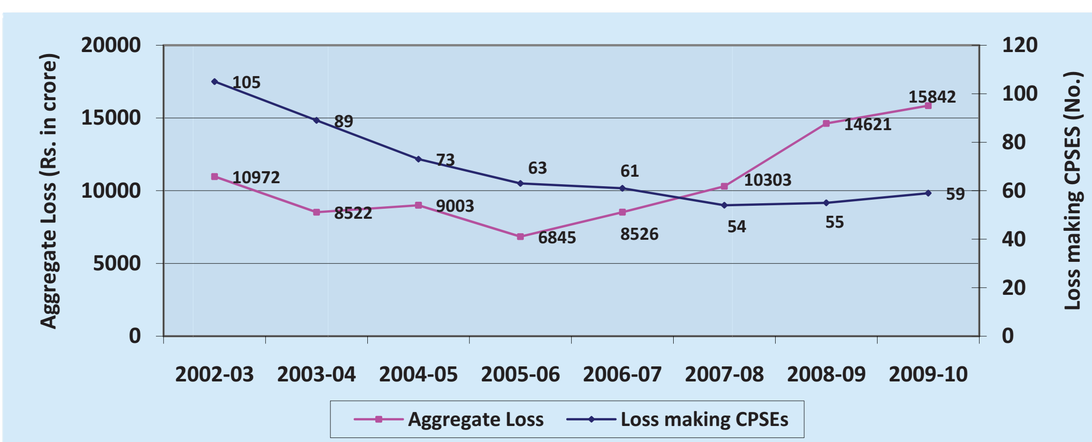
Sickness in CPSEs has been a continuing concern. Public Enterprise Survey 2009-2010[9] indicated that though the number of loss making CPSEs has reduced from 63 in 2005-06 to 59 in 2009-10, the aggregate loss of the loss making CPSEs has been mounting steadily since 2005-06 i.e. from ₹ 6,845 crore to ₹ 15,842 crore.

*Table 1.1 – Number of sick CPSEs and accumulated losses*

| Year | No. of loss making CPSEs during the year | Aggregate loss, during the year (₹ in crore) | No. of sick CPSEs as per BRPSE definition | No. of sick CPSE as per BIFR definition | Accumulated losses of sick CPSEs (₹ in crore) |
|---|---|---|---|---|---|
| **2002-03** | 105 | 10972 | - | 111 | 76721 |
| **2003-04** | 89 | 8522 | - | 100 | 73487 |
| **2004-05** | 73 | 9003 | 81 | 90 | 82352 |
| **2005-06** | 63 | 6845 | 75 | 81 | 83554 |
| **2006-07** | 61 | 8526 | 83 | 74 | 89064 |
| **2007-08** | 54 | 10303 | 78 | 46 | 72820 |
| **2008-09** | 55 | 14621 | 73 | 46 | 68577 |
| **2009-10** | 59 | 15842 | - | 45 | 63828 |

*(Source: Public Enterprises Survey 2009-10)*

*Chart 1.2 – Loss making CPSEs and aggregate loss*




9 *Most recent Public Enterprises Survey available.*

> ***Main reasons for sickness***
>
> - *High manpower cost;*
> - *Technological obsolescence;*
> - *Competition from the private sector;*
> - *Problem of lopsided debt-equity structure;*
> - *Weak marketing strategies; and*
> - *Slow decision-making process.*
>
> *# as identified by DPE*

The reasons for sickness of CPSEs vary from enterprise to enterprise, ranging from obsolete technology, high input cost, high overhead cost and the administrative price mechanism, adverse market/ administrative prices, stiff competition from private sector, weak marketing strategies, low capacity utilization and high interest rates. The problem of sickness has aggravated on account of reasons identified in the report.

## 1.4 Impact of Industrial Sickness on the Economy

Industrial sickness has far-reaching consequences on the economy of a nation and results in:

(a) Substantial loss of revenue to the Government and enhances its public expenditure.

(b) Loss of production and productivity in the economy. There is underutilization of capital assets which affects the capital formation process of the economy.

(c) Default in payment of dues including those of workers. As a result of accumulating losses and liquidity constraints, the workers are called upon to make sacrifices in order to improve the viability and financial health of the enterprise. These sacrifices can be in the form of exemption from existing as well as prospective wage awards, non-payment of bonus, reduction in wages, postponement of annual increments, modification of service conditions, retrenchment and lock-out of units. Industrial sickness as a consequence results in large-scale unemployment and industrial unrest.

(d) Undermining public confidence in the functioning of organised sector which in turn affects the overall investment climate of the country.

(e) Increase of the non-performing assets (NPAs) of banks and financial institutions (FIs). Profitability of banks and FIs, thus, gets affected as they do not get back their funds invested in projects that have gone sick. Since funds get blocked in sick units, funding may not be available even for a good project.

Specific impact of sickness on the CPSEs selected for audit is discussed in ***Annexure 1***.

## 1.5 Need for a robust insolvency system

While financial sector has witnessed transformation and reforms after the liberalisation of the Indian economy, the insolvency system has not undergone the much needed reform. A sound insolvency system assists in efficient resolution of restructuring and liquidation of commercial enterprises and cushions the impact of insolvency. Therefore, a good insolvency system is considered as an essential part of the financial architecture of any country. It is fundamental to economic growth, wealth creation and encouraging both enterprise and investment. It is vital to stability in commercial relationships and financial systems, advance important social objectives of maintaining public confidence in the corporate and financial sectors and investment, enable market participants to more accurately price, manage and control default risks and corporate failure, and encourage sound credit practice.

According to the United Nations Commission on International Trade Law (UNCITRAL)[10] Legislative Guide, the underlying goal of insolvency law is to maximize returns for stakeholders by promoting through a timely and efficient process;

- revival of viable businesses and;
- liquidation of enterprises whose resources can no longer be utilized.

A robust insolvency system seeks to achieve the appropriate balance between the debtor and its creditors, rehabilitation and liquidation, as amongst creditors while preserving their negotiated rights and ensuring that preferential transactions are appropriately addressed and misfeasance is effectively addressed.

Another fundamental objective is to preserve employment through an effective system of rehabilitating. They enhance certainty in the market and promote economic growth and stability. They are critical to enabling countries to avoid the pitfalls of integration of national financial systems with the international financial systems. An effective exit law promotes responsible corporate behaviour by encouraging higher standards of corporate governance, including financial discipline and to avoid consequences of insolvency. This also enhances the confidence of investors including foreign investors for whom state of exit law is an important criterion for making investment decisions.

## 1.6 Overview of existing insolvency framework in India

There is no single legislation in India providing for a systematic and cohesive system for rehabilitation and liquidation of enterprises including CPSEs. The GOI has been making persistent attempts to overcome sickness of the CPSEs through various policy initiatives. A number of legislations and regulations comprise the insolvency framework for commercial enterprises:

[10] *UNCITRAL is the core legal body of the United Nations System in the field of international trade law with universal membership. Its role is the modernization and harmonization of rules on international business. India is a member of UNCITRAL.*

- **Companies Act 1956** - The winding up of companies is carried under the Companies Act, 1956. The winding up is a time consuming procedure and generally takes between six to ten years.

- **Sick industrial Companies (Special Provisions) Act of 1985 (SICA)** - enacted to determine sickness and expedite revival of potentially viable units or closure of unviable units. Under SICA**, Board for Industrial and Financial Reconstruction (BIFR)**, a quasi-judicial body, was set up in 1987, to take appropriate measures for revival and rehabilitation of potentially sick industrial undertakings and for liquidation of non-viable companies. Both the public and private sector companies owning industrial undertakings can make a reference to BIFR.

- **The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (SRFAESI)** - provides the framework for the setting up of asset reconstruction companies (ARCs) which can acquire NPAs from banks, financial institutions and housing finance companies, turn them around and resell them. SRFAESI also enables enforcement of security interest by banks and financial institutions without recourse to courts.

- **The Corporate Debt Restructuring (CDR) mechanism introduced by the Reserve Bank of India (RBI)** - a voluntary out of court workout procedure provides for restructuring of debt in multiple banking consortium accounts.

- **The Companies (Second Amendment) Act, 2002** – this amendment was made to establish National Companies Law Tribunal (NCLT), a single forum to deal with restructuring and liquidation. NCLT is yet to be set up (January 2012).

In addition, in December 2004, GOI established **Board for Reconstruction of Public Sector Enterprises (BRPSE)** in the Department of Public Enterprises (DPE) as an advisory body to address the task of strengthening, modernisation, revival and restructuring of CPSEs including disinvestment/ closure and sale of both industrial and non-industrial units. The recommendations of BRPSE are advisory in nature and are communicated to the concerned Administrative Ministry for implementation.

The insolvency framework and its impact on revival of sick CPSEs is discussed in detail in Chapter 3.

## 1.7 Status of sick CPSEs referred under BIFR and BRPSE

### (a) Status of sick CPSEs referred under BIFR

As many as 94 sick industrial CPSEs were registered with the Board for Industrial and Financial Reconstruction (BIFR) under the the Sick Industrial Companies (Special Provisions) Act, 1987 (SICA) upto 30.6.2011. The status of these cases is briefed in the table below:

*Table 1.2 – Status of CPSEs registered with BIFR*

| S.No. | Particulars | Number |
|---|---|---|
| **1.** | Revival scheme sanctioned | 30 |
| **2.** | Winding up recommended to the concerned High Court | 23 |
| **3.** | Dropped on net worth becoming positive | 11 |
| **4.** | Dismissed as non-maintainable | 12 |
| **5.** | Cases pending | 18 |
| | **TOTAL** | **94** |

Both the public and private sector companies owning industrial undertakings can make a reference to BIFR. As on 30 June 2011, BIFR sanctioned revival schemes in 758 cases out of which 497 cases were declared as "no longer sick". Thus, the overall success rate of revival schemes comes out to 65.57 per cent. The position of revival schemes sanctioned by BIFR in private sector companies and public sector enterprises is given in the table below:

*Table 1.3 – Success rate of revival schemes*

| S. No. | Particulars | Private Companies | Central PSEs | State PSEs | Total No. of companies |
|---|---|---|---|---|---|
| **1.** | Revival schemes sanctioned | 709 | 30 | 19 | 758 |
| **2.** | Declared no longer sick | 474 | 10 | 13 | 497 |
| **3.** | Success rate | 66.85 | 33.33 | 68.42 | 65.57 |

As may be seen, in comparison, the success rate in case of private companies was 66.85 per cent which was significantly higher than in CPSEs at 33.33 per cent. However, the success of revival schemes for sick companies depends upon various factors such as diversification of activities, level of implementation of schemes, government policy, effects of globalisation, co-operation of participating agencies, financial and business restructuring, change in management etc. These factors influence different sectors and industries in a different manner. As such, the success rate of revival schemes varies among companies of private sector and public sector as also amongst companies belonging to different industries.

**(b) Status of sick CPSEs referred under BRPSE**

A total of 67 cases have been referred to BRPSE till September 2010.[11] During December 2004 to March 2010, 64 sick CPSEs were referred to BRPSE by the concerned Administrative Ministries. Out of these, BRPSE made recommendations in 58 cases

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[11] *BRPSE considers a company as sick if it has accumulated losses in any financial year equal to 50 per cent or more of its average net worth during 4 years immediately preceding such financial year and/or if a company is a sick company within the meaning of SICA. Besides, BRPSE has defined 'incipient sickness' as a situation when a company incurs losses for two consecutive years.*

while in 6 cases, the proposals were returned to the concerned Ministries for re-examination. The status of the 58 proposals recommended by BRPSE is detailed below:

***Table 1.4 – Status of proposals recommended by BRPSE***

| S.No. | Particulars | Number |
|---|---|---|
| **1.** | Revival proposals sanctioned by GOI | 35 |
| **2.** | Ordered for closure | 2 |
| **3.** | Under consideration of GOI | 21 |
| | **TOTAL** | **58** |

**Change of management and capital infusion are considered to be the most important factors contributing to the success of revival schemes.**

## 1.8 Revival strategies adopted by GOI for sick CPSEs

Keeping in view the inherent potential of the public sector and its performance over the years, GOI has been making persistent attempts to overcome industrial sickness through revival schemes for sick CPSEs. GOI's approach to loss making CPSEs basically focused on:

- Revival of potentially viable enterprises;
- Closing down of those that cannot be revived; and
- Reducing its equity in non-strategic units.

Revival of sick CPSEs may be necessitated or justified in view of the underlying socio-economic objectives such as the following:

- The sick CPSE may be in a sector that is vital to the economy.
- Closing of the sick CPSE may lead to other socio-economic ill effects.
- Many ancillary units may be dependent on the CPSE that has gone sick. Unless the sick CPSE is revived, it will have a chain effect on all such ancillary units

GOI adopted a combination of the following strategies for revival of sick CPSEs:

- **Financial restructuring**, which involves investment in CPSEs by the Government in the form of equity participation, providing loans/ grants, waiver of loans/ interest, conversion of loan into equity, conversion of interest into loan, moratorium on payment of loan/interest, offering of guarantee, sale of fixed assets including excess land, one-time settlement with banks/financial institutions, etc. are also taken to improve the financial strength of the CPSEs.

- **Business restructuring,** which involves change of management, closure of unviable units, modernization of viable units, formation of joint ventures by induction of partners capable of providing technical, financial and marketing inputs, change in product mix, improving marketing strategy etc.

- **Manpower rationalization**, which involves shedding of excess manpower by offering Voluntary Retirement Schemes (VRS) and introduction of Voluntary Separation Schemes (VSS) in cases where decision is taken to close the unviable units.

**Decision of the GOI may not always be based purely on commercial considerations. The protection of employee's interest and social and economic consequences to the places where the CPSEs are located may form key influencing factors.**

## 1.9 Recent initiative of GOI – Companies Bill, 2011

The Companies Bill, 2011 (Companies Bill) was introduced recently in the Parliament which seeks to foster an extensive insolvency code based largely on the latest principles recommended by the United Nations Commission on International Trade Law (UNCITRAL) in the UNCITRAL Legislative Guide on Insolvency Law. The Companies Bill contains a composite law for reorganisation and liquidation of companies.

Even though significant improvement is expected in the corporate restructuring and liquidation regime after the Companies Bill, 2011 is passed by the Parliament, some policy gaps and legislative deficiencies remain in the restructuring and liquidation framework as discussed subsequently at Para 3.2 of chapter 3.. It is important to address these gaps and weaknesses to capture the key objectives and provide a comprehensive insolvency framework which can function efficiently and meet the needs of sick or potentially sick enterprises including CPSEs and other stakeholders operating in a fast modernizing economy.