

# Executive Summary

## Background

Industrial sickness has far-reaching consequences on the economy of the nation which generally results in substantial loss of revenue to the Government, loss of production and productivity, large-scale unemployment and industrial unrest, undermining public confidence in the functioning of organised sector which in turn affects the overall investment climate of the country and increase of the non-performing assets (NPAs) of banks and financial institutions (FIs). Since funds get blocked in sick units, funding may not be available even for other good projects.

Central Public Sector Enterprises (CPSEs) were set up as the instrumentalities of the Government of India (GOI) to serve broad macro-economic objectives of state policy.

As on 31st March 2011<sup>1</sup>, out of a total of 406 CPSEs, 378 CPSEs were in operation, of which, 251 CPSEs earned a net profit of ₹ 1,27,141 crore whereas 127 CPSEs registered loss of ₹ 23,264 crore during 2010-11.

As per the Public Enterprises Survey of Department of Public Enterprises (DPE), 45 CPSEs with accumulated losses of ₹ 63,828 crore were sick as of March 2010<sup>2</sup>.

Keeping in view the inherent potential of the public sector, Government of India (GOI) has been making persistent attempts to overcome sickness through revival schemes for sick CPSEs. In fact, up to March 2010, GOI had approved revival schemes of 35 CPSEs at a cost of ₹ 39,658.72 crore.

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 enterprises.

## Why we took up this audit ?

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

As on 31.03.2011<sup>1</sup>, out of a total of 406 CPSEs, 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.

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<sup>1</sup> As per data available with Audit.

<sup>2</sup> Data for 2010-11 under preparation by DPE, GOI.

- Despite providing assistance of ₹ 39,658.72 crore (cash and non-cash) for their revival, the CPSEs could not realize the intended benefits of the schemes as the success rate of revival of sick CPSEs was not satisfactory.
- While many financial sector laws have undergone significant transformation after the liberalisation of the Indian economy, the insolvency law remains outdated. There is no single legislation in India providing for a systematic and cohesive system for rehabilitation and liquidation of enterprises including CPSEs.
- In fact, both the restructuring and the winding up of companies under the existing laws remain a cumbersome and long-drawn process which is a deterrent factor for attracting foreign investors due to locking up of huge national resources.

**An effective exit law enhances the confidence of investors including foreign investors for whom the state of exit law is an important criteria for making investment decision.**

In the backdrop of the above, it was felt that an in-depth examination of the legislative framework and the procedures followed for revival and rehabilitation of sick CPSEs was needed to be done.

### ***What does our audit cover?***

The Audit was undertaken to assess

- Whether the existing legislative, institutional and operational framework for insolvency facilitate efficient, speedy and cohesive interventions for rehabilitation and liquidation of sick enterprises in the backdrop of economic developments and international standards and best practices.
- The adequacy of existing insolvency framework and its impact on the revival of sick CPSEs.
- The process of designing, approval and implementation of revival schemes with a view to analyse their impact on the operations of sick CPSEs and

To also recommend measures to address the gaps identified in the insolvency system and improve the regime for revival of sick and potentially sick CPSEs.

A sample of nine<sup>3</sup> revival schemes was selected with a view to cover major schemes under varied sectors. These were sanctioned at a cost of ₹ 27,845.14 crore and constituted 70 per cent of the total cost of all the revival schemes. In

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<sup>3</sup> *National Textile Corporation Limited (NTC), Cement Corporation of India Limited (CCI), Eastern Coalfields Limited (ECL), Fertilisers and Chemicals (Travancore) Limited (FACT), Hindustan Organic Chemicals Limited (HOCL), Heavy Engineering Corporation Limited (HEC), Braithwaite and Company Limited (BCL), National Projects Construction Corporation Limited (NPCC) and HMT Machine Tools Limited.*

addition, one more revival scheme which was yet to be approved by GOI (October 2011) was also selected for audit.

## **Our Major Audit Findings:**

### **(i) Legislative framework and its impact on revival of sick CPSEs**

#### **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. A number of legislations and regulations comprise the insolvency framework for commercial enterprises.

An effective exit law promotes responsible corporate behaviour by encouraging higher standards of corporate governance, including financial discipline and mitigates the consequences of insolvency. This also enhances the confidence of investors including foreign investors for whom the state of exit law is an important criterion for making investment decisions. But both the winding up of companies under the Companies Act and rehabilitation under SICA remain cumbersome and long-drawn resulting in locking of huge national resources in these proceedings.

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 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<sup>4</sup> was 13 cents to a dollar. This is evident in the cases of CPSEs taken up for assessment.

#### **Sick Industrial Companies (Special Provisions) Act (SICA)**

SICA was enacted in 1985 to provide a statutory definition of sickness and expedite revival of potentially viable units and closure of unviable units. Under SICA, Board of 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 to recommend liquidation of non-viable companies.

However, SICA did not achieve its objectives on account of inherent weaknesses like:

- Legislative deficiencies

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<sup>4</sup> 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 rate.

- time consuming approval procedure due to involvement of multiple agencies, lack of engagement of insolvency experts in the process,
- perfunctory engagement of experts,
- absence of time-frame for sanction of revival schemes.

The Companies Act, 1956, which contains provisions for liquidation of companies, takes upto 10 years for winding up a company.

In view of the sub-optimal procedures and processes of BIFR, SICA was repealed in December 2003 and the function of revival and rehabilitation was proposed to be entrusted to National Company Law Tribunal (NCLT) established under the Companies (Second Amendment) Act 2002. However, NCLT has not yet been constituted till date (January, 2012).

*The provisions and process of detection of sickness, formulation/ sanction and implementation of revival proposals of sick CPSEs under BIFR framework were found to have several inadequacies as discussed below:*

- The loss making CPSEs can make a reference to BIFR only after their net worth is completely eroded. This restricts early reference to BIFR for checking their incipient sickness.
- The process of determination, finalisation and sanction of schemes for revival of sick CPSEs was found to be time consuming and slow.
- Mostly a secured creditor, which is an interested party, is appointed as the (Operating Agency) to prepare the revival scheme as against an independent restructuring expert.
- There is no provision for constituting creditors committee for coordinated and timely resolution as is the established best practice in more sophisticated economies,
- Although SICA provides for preparation of the revival scheme within 90 days from the date of orders of the Board, no predictable and certain timeline has been prescribed for sanction of the scheme. This is therefore, fraught with the risk of uncertainty in timely sanction which in turn has an adverse cascading impact on the revival of the companies.

In addition, GOI established the **Board for Reconstruction of Public Sector Enterprises (BRPSE)** in the Department of Public Enterprises, as an advisory body to address the task of strengthening, modernisation, revival and restructuring of sick CPSEs. The recommendations of BRPSE are advisory in nature and are communicated to the concerned Administrative Ministry of the sick CPSE for implementation.

***Several deficiencies in formulation and sanction of revival scheme by BRPSE were noticed as detailed below:***

- The process involves prolonged deliberations and protracted correspondence, consultations at multiple layers, viz., Administrative Ministries, Department of Public Enterprises, relevant authorities and the BRPSE which examines and recommends the proposals.
- Though two months time is prescribed for the BRPSE to finalise its recommendations from the date of receipt of the proposal, no specific time frame has been prescribed for the sick CPSEs/ Administrative Ministries to submit a revival proposal for the consideration of BRPSE.
- The terms of reference of BRPSE do not specify the timeline for implementation of revival schemes, nor modalities for review and monitoring of the schemes are prescribed.

In essence, the existing legislative and operational framework was found to be inadequate to effectively address the problem of sickness in CPSEs. Although SICA has been repealed since December 2003 due to its inherent weaknesses, the repeal has not been given effect as no alternative framework has yet been constituted in its place. Under NCLT, which is yet to be set-up after SICA Repeal Act of 2003, reference of loss making or sick CPSEs to NCLT is no longer automatic and requires prior approval of the Government.

This would result in accumulation of sick CPSEs falling outside the purview of NCLT. At the same time, many sick companies may not get referred to BRPSE since their reference is not a legal requirement under the existing framework. In the absence of a clear cut policy framework, many loss making and potentially sick CPSEs would fail to receive timely intervention of the Government. Under the circumstances, non-revivable or chronically sick CPSEs will continue to receive non-plan budgetary support which will increase the burden on the national exchequer.

***(ii) Design and Approval of Revival Schemes***

***(a) Inadequate structuring of revival schemes***

The schemes were not adequately structured as these primarily involved financial restructuring. Major portion of the funds ₹ 20160.68 crore (about 72 percent) were marked for financial restructuring such as waiver of loans and interests, conversion of loans into equity and settlement of dues. In fact, a very small proportion ₹ 4174.03 crore (15 per cent) of the package was allocated for modernization and diversification for long term sustainability of the operations of these CPSEs.

Further, the report of the consultants in two cases either did not address the core issue of reducing the cost of production to make the products competitive and self-sustaining or were based on obsolete technology which resulted in delay in implementation of schemes with cost escalation.

Thus, the schemes did not address the core issues of sickness which would have yielded sustainable revival of these companies.

#### ***(b) Inordinate delays in approval of Revival schemes***

The revival schemes analysed in audit revealed that there were inordinate delays in approval of the schemes as no time frame was fixed for approval. The delays ranged from one to 18 years. The revival scheme of NEPA Limited (one of the 10 companies selected under audit) could not be finalised even after a lapse of 14 years from its sickness.

There was lack of synergy amongst various agencies involved and the financial measures and commitments of various parties could not be effectively enforced under the existing operational framework. As a result, the sick CPSEs could not reap the full benefits from the scheme and the delayed finalisation of the revival schemes cost the sick CPSEs heavily as the accumulated losses of these CPSEs increased from ₹ 7342.93 crore (at the time of sickness) to ₹22,503.91 crore (at the time of approval of schemes).

#### ***(iii) Gaps in the Implementation of revival schemes***

There were delays in implementation of schemes in four CPSEs (NTC, CCI, ECL and HMT Machines Tools). In HOCL and NTC, the rationalization of manpower was yet to be completed. HOCL was facing working capital crunch as it failed to mobilize the required financial resources from sale of idle assets. Similarly, HEC also could not generate resources from sale of surplus land as envisaged in the scheme. The JVCs of NTC failed to generate employment and profit as envisaged in their business plans even after three years of their formation.

#### ***(iv) Non-achievement of targets of Revival schemes***

Out of the nine CPSEs, targets of sales and net profit as envisaged in the revival schemes could be achieved only by four CPSEs (BCL, CCI, ECL and HEC).

The remaining five CPSEs (HOCL, NTC, FACT, NPCC and HMT Machine Tools), could not achieve the targeted net profit from ordinary course of business indicating only a limited success of revival schemes in these cases. The revival schemes in respect of nine CPSEs reviewed in audit could only achieve ₹ 332.56 crore of profit as against the projected profit of ₹ 889.78 crore.

The GoI has recently introduced Companies Bill, 2011 in the Parliament which provides for rehabilitation and liquidation of Companies under the same roof. The Bill vests the jurisdiction to deal with the rehabilitation and liquidation of companies in a neutral independent forum, NCLT with appeal to NCLAT. Even though significant improvement is expected in the corporate restructuring and liquidation regime after the Companies Bill, 2011 is passed by the Parliament, many policy gaps and legislative deficiencies remain in the restructuring and liquidation framework. 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 needs of sick or potentially sick enterprises including CPSEs and other stakeholders operating in a fast modernizing economy.

***Based on the performance audit conducted, the following recommendations are made:***

- (i) GOI should consider formulating a new framework to address:
  - (a) Early identification of sickness in CPSEs;*
  - (b) Timely formulation of proposals for revival/closure*
  - (c) Better synergy between the various national agencies involved in the revival or closure exercise; and*
  - (d) Effective monitoring mechanism of scheme implementation.**
- (ii) GOI may consider formulating operational modalities for reference of sick/ loss making CPSEs to the NCLT for revival/ rehabilitation.*
- (iii) There is an urgent need for an appropriate mechanism with certain, predictable and transparent guidelines, operating in a timely manner, empowered with a single point decision-making authority to effectively deal with the problems of sick/loss-making CPSEs.*
- (iv) The existing framework for revival of sick CPSEs may be reviewed to ensure that formulation, approval and implementation of revival schemes are carried out in a time bound manner.*
- (v) There is a need to develop and institutionalize the discipline of insolvency profession. In most sophisticated economies, the profession of insolvency is highly sophisticated and well-developed.*
- (vi) The deficiencies identified in the Companies Bill may be suitably addressed.*