Case Studies and Inferences

As part of the FNST sponsored study, RGF and Indicus Analytics in cooperation with FISME (and its associated associations) analyzed a few cases. The aim of the case studies was to obtain insights into the experiences of entrepreneurs when their firms became bankrupt or insolvent. In the process we found that what separates a sick enterprise from a successful are just one or two negative shocks. Successful enterprises become insolvent within a span of a few months merely because of the loss of an order, a strike, delayed payment, personal tragedy, etc. We find that the current system is highly structured and fraught with delays – both of which actually contribute to increasing sickness.

Five case studies of sick small-scale enterprises in different states of India were carried out. In depth interviews were conducted of the entrepreneurs involved with the functioning of the units. Information on the performance of the units over time, relations with financial institutions and other creditors, capital requirements, debt status, reasons for sickness, response of government functionaries and financial institutions etc were gathered. Based on this a brief description of the five units has been presented below. (See Appendix 3 and 6 for the questionnaire and the case studies).

Section 2.1: Brief description of case studies

Case 1: The Case of Mr. Jain

Mr. Jain comes from a family, whose many members are involved in trading. Mr. Jain is not a graduate, he did not have any set of skills that would have rated him either as skilled technically or a 'professional' entrepreneur. He had worked in various capacities in the private sector, and had also spent some time in government (defense) services before he started off on his business.

In 1973 he started off on setting up a business manufacturing industrial textiles. Specifically, based on a chance meeting with a senior Department of Telecommunications (DoT) employee on a train, he got to know of 'moleskin' cloth that was in great demand. The cloth was not manufactured in India and was being imported. Given that import was channeled in those days it was in short supply, and DoT required much more than was available.

The entrepreneur in Mr. Jain set about trying to find the specialized machinery required to make that cloth. He could not get it in India. Consequently, Mr. Jain's father-in-law who was a Professor of Textile Engineering stepped in to help. For almost eight months Mr. Jain and his father-in-law worked together to develop the specialized machinery themselves. Mr. Jain put in his own money for this informal R&D. Eventually, the machinery was developed, and a firm in Patna, Bihar, set up by former students of Mr. Jain's father-in-law were given the task of building the machinery once the finances were arranged.

Since the cloth was in short supply and was imported, Mr. Jain's unit fell in the import substitution category, and he did not have too much difficulty is obtaining both term loan from the state financial corporation (SFC) and the working capital loan credit facilities from the Bank. He obtained all these in about a year. But to avail these facilities he had to give his personal guarantee over assets that he did not have. Consequently, his father-in-law as well as other relatives put in their guarantees.

Despite delayed set up of the plant, Mr. Jain achieved high success levels in his moleskin unit. He set up eight looms initially in 1975. These were increased by another eight two years later. By 1978 these were further increased to sixteen looms. In the first three years of operations he was able to increase the capacity of his plant by 300 per cent.

His was a success story. Senior managers of financial institutions visited his facilities on repeated occasions. His unit was considered to be a model unit. On many occasions these mangers would ask him to increase the scale and scope of his activities. Promising no hindrance in the 'release' of funds.

And Mr. Jain did expand. His next unit was to manufacture industrial rubber cloth. Unlike the previous item, this was not to be sold to DoT, but to producers of rubber belting – predominantly in the private sector. Like his other unit making moleskin cloth, this unit was also successful.

With repeated successes under his belt, Mr. Jain started thinking bigger. The industrial rubber cloth was used in rubber belting. He found that a particular kind of belt that was purchased predominantly by the railways was in short supply. For the larger manufacturers of this item, the railways were not an important enough market to focus their efforts on. But given his confidence in his technical abilities, and the fact that he was vertically integrating from the rubber cloth to the rubber belt, this made business sense. The term loan was available based on the project viability and Mr. Jain's bank also promised working capital for the unit.

Mr. Jain was unaware that technical changes were soon going to reduce the demand for moleskin cloth. New types of communication cables had now become the norm abroad, and these did not require moleskin. By the early eighties, his first unit would start to suffer from the demand growth slowdown in India as well.

Also in 1980 Mr. Jain could not foresee that labor troubles in larger units in his area were going to spread to the whole region. He was ready to start production. He had also obtained orders from the railways for rubber belts.

But labor troubles soon appeared and they spread to all units in the region. Mr. Jain's units also were severely affected. They became 'sick' in no time. From a successful entrepreneur, Mr. Jain became the owner of two sick units in no time.

The viability of the third unit was never in question (and is not today either). However, since Mr. Jain had two other sick units, the Bank was unwilling to give him credit facilities for the third one either. Meanwhile the SFC and other claimants were demanding payments for that as well. The third unit also became sick.

The labor unrest took almost three years to settle down. But by now, Mr. Jain was heading three sick units. From being at the top of the league of SSI entrepreneurs, Mr. Jain had reached the bottom. Since his units were not functioning, he had been unable to service the loans that he had taken. To be able to do that the Bank would have to release credit facilities so that he could start operations. But the Bank could or would not do that. From the Bank's point of view – Why throw good money after bad?

As mentioned before, rules and regulations, for the right reasons or wrong, do not allow the entrepreneur of a sick unit to access any other bank for credit facilities. This is not only true of the sick unit, but also a new unit set up by the entrepreneur. Mr. Jain had made a mistake, when he had set up his second unit, he had continued with his original banker. Now that both his units were sick, he did not have a choice to approach any other bank.

Mr. Jain was locked-in with his bank. The market for credit does not exist for a sick unit's entrepreneur. Even if other banks find his unit viable, and creditworthy, an entrepreneur has to approach his original banker only. Assets of sick units cannot be transferred to another bank.

This is not to say that rehabilitation procedures do not exist in India. They do. And Mr. Jain approached the same. On repeated occasions, representatives of banks, bureaucracy, RBI (the regulator), national development financial institutions, put down on paper that the unit was viable and the reason for its sickness was lack of adequate working capital. In some cases such recommendations lead to the release of funds, but in Mr. Jain's case somehow that did not occur. This was because the bank still has the final say in the matter, and the bank refused to on many occasions.

Unlike in the case of larger businesses, he could not approach BIFR, unlike small entrepreneurs in USA, he could not approach the government for a Chapter 11 like rehabilitation package. Rules and procedures prevented him from going to other banks for a rehabilitation package, and his own bank would not give him one.

Given the viability of the project, Mr. Jain could have approached private creditors for the same. Perhaps he could have taken other partners to help him rehabilitate it. But another set of factors would prevent him from doing that as well.

The domino effect now started working. He was still liable to pay all other dues. These included:
Term loan repayments
Provident Fund payments
Electricity dues

Land dues
Sales and income tax, etc.

Mr. Jain’s Calendar 15 years after Sickness:
Court Appearances, Meetings with Government Functionaries and Creditors

	Mon	Tue	Wed	Thur	Fri	Sat	Sun
January, 2001	1	2	3	4	5	6	7
	8	9	10	11	12	13	14
	15	16	17	18	19	20	21
	22	23	24	25	26	27	28
	29	30	31				
February 2001				1	2	3	4
	5	6	7	8	9	10	11
	12	13	14	15	16	17	18
	19	20	21	22	23	24	25
	26	27	28				
March, 2001				1	2	3	4
	5	6	7	8	9	10	11
	12	13	14	15	16	17	18
	19	20	21	22	23	24	25
	26	27	28	29	30	31	
April, 2001							1
	2	3	4	5	6	7	8
	9	10	11	12	13	14	15
	16	17	18	19	20	21	22
	23	24	25	26	27	28	29
	30						
May, 2001		1	2	3	4	5	6
	7	8	9	10	11	12	13
	14	15	16	17	18	19	20
	21	22	23	24	25	26	27
	28	29	30	31			
June, 2001					1	2	3
	4	5	6	7	8	9	10
	11	12	13	14	15	16	17
	18	19	20	21	22	23	24
	25	26	27	28	29	30	
July, 2001	1	2	3	4	5	6	7
	8	9	10	11	12	13	14
	15	16	17	18	19	20	21
	22	23	24	25	26	27	28
	29	30	31				

Mr. Jain’s Calendar 15 years after Sickness:
Court Appearances, Meetings with Government Functionaries and Creditors

	Mon	Tue	Wed	Thur	Fri	Sat	Sun
August, 2001			1	2	3	4	5
	6	7	8	9	10	11	12
	13	14	15	16	17	18	19
	20	21	22	23	24	25	26
	27	28	29				
September, 2001						1	2
	3	4	5	6	7	8	9
	10	11	12	13	14	15	16
	17	18	19	20	21	22	23
	24	25	26	27	28	29	30
October, 2001	1	2	3	4	5	6	7
	8	9	10	11	12	13	14
	15	16	17	18	19	20	21
	22	23	24	25	26	27	28
	29	30	31				
November, 2001				1	2	3	4
	5	6	7	8	9	10	11
	12	13	14	15	16	17	18
	19	20	21	22	23	24	25
	26	27	28	29	30		
December, 2001				1	2	3	4
	5	6	7	8	9	10	11
	12	13	14	15	16	17	18
	19	20	21	22	23	24	25
	26	27	28	29	30		

Days spent in Meetings, Court Appearances, Other Insolvency related Matters

Year	No. of Days
1999	83
2000	105
2001	101

Mr. Jain has since suffered repeatedly on this basis due to one such act – The UP Land revenue Act, 1901, and more than may have been envisaged by the framers of this law.

Take for instance, repeated imprisonment. As dues add up, additions are dealt with as is separate dues. As a result, for a sick industry, even if imprisoned once, for the new dues another term in prison is possible. Moreover, some unpaid dues are treated not as a single entity but as multiple ones. For instance, in the case of unpaid PF dues, there are 72 cases against Mr. Jain (1 case for every three months, 4 per year for 18 years). Further, though the law states that women cannot be imprisoned, in his case his wife (a director in his firm) has been.

Take another example of how some of these function. In one case the *tehsildar* (a functionary in the District Government Administration) arrested both Mr. Jain and his wife for non-payment of electricity dues. While imprisoned (for 14 days) the *tehsildar* impounded all machinery in a unit and auctioned it for Rs. 46,000. The book value of the machinery was in the region of Rs. 64,00,000. Later it was found that there was a mistake in the electricity billing and that the imprisonment and auction was unwarranted.

Meanwhile on the promise of release of funds, all his property has been mortgaged but funds have not been released. He has no assets left. He has no wealth left to fight the more than 60 cases going on against him, and he has no ability to generate income from any other source. Since there are cases going on against him, he cannot even start afresh. He has four school and college going children, he cannot even go 'underground', and start afresh (as many have advised him to do).

The Case of Mrs. Bina Sheriff

A science graduate Mrs. Sheriff started on the entrepreneurial path by setting up "Indian Leather Industries" in 1980. A diploma in Industrial management and a one-year training at Bhopal conducted by SIET Institute, Hyderabad gave her that professional touch. Her husband Mr. Feroz Sheriff was the key person aiding her in the process.

Dewas, an industrial town near Indore was the site where she decided to set up the unit that would manufacture leather shoe uppers. Indian Leather Industries was conceived as an ancillary unit to the leading export house "Tata Exports Ltd". There were not many units that were involved in the manufacture of leather shoe uppers in and around Dewas, ample opportunity existed.

In the 1980's the Indian government shifted from an Import substitution policy to an export promotion policy with the leather sector being identified as the major thrust sector. Thus it was an ideal time to set up a unit that would be involved in the export of leather products.

Indian Leather Industries was set up in 1980 with an initial investment of approx. -- Lakhs and an annual working capital requirement of -- lakhs. The capital investments made were mainly in the leasing of a shed and the import of production line machines from Germany. The unit was registered with the M.P. State Industries Deptartment (Dewas and Bhopal unit), Sales Tax Deptartment, Dewas, and with Tata Exports Ltd as an ancillary unit.

The idea to set up came from an advertisement by Tata Exports inviting entrepreneurs to set up ancillary units. On being selected by Tata Exports, the proprietor entered into an agreement with Tata Exports and the Industries Deptt. Dewas to set up a unit that would act as an ancillary unit to the Tata plant. The unit would cater exclusively to Tata exports need for high-end fashion shoe uppers.

Under this agreement the proprietor also went trough a one-year crash-course in various aspects of managing a small-scale unit. The course was conducted by SIET Institute, Hyderabad and sponsored by the government of Madhya Pradesh.

On completion of the project the proprietor prepared a project report in collaboration with the SIET Institute and MPAVN for the setting up of the ancillary unit. On approval of this by the MPAVN, the proprietor went ahead to set up ILI. As per the proposal, MPAVN was only ready to finance the procurement of machines, while the proprietor was to invest the rest. The machines required were meant exclusively for the design of high-end fashion shoes and were identified by TEL.

The machines could only be procured under an end users license. The proprietor duly applied for the same with the concerned agencies. The license was granted after three months of filing for application. After the granting of the license, the proprietor applied to MPAVN for the procurement of the required machines. The application was made in November 1979. As mentioned earlier, under the agreement with MPAVN, it was decided that MPAVN would procure the machines on behalf of the proprietor from the company/ or agent. It took almost a year from the time of applying to MPAVN till the final delivery of machines. Even though the proprietor continuously kept on reminding the concerned officials, the machines were only offloaded at Chennai in the return journey of the ship. This delayed the setting up of the unit by six months.

The proprietor was also entitled for a subsidy of 15% on the procurement of capital goods. But this was to be availed through the procuring authority, in this case the MPAVN. Again a lax attitude on the part of MPAVN, this subsidy could not be availed by the proprietor. This would have clearly reduced the loan burden of the proprietor and also the outstanding of MPAVN.

The machines were finally delivered on in Nov. 1980. The proprietor had in the meantime got on lease a shed from the industries department. The shed was leased on priority basis by the Dewas district unit of the Industries Department.

Since Dewas did not have any untis specializing in leather products, skilled labour for ILI were sparse. Most of the workforce was thus got from Chennai at a much higher cost.

The unit was registered with TEL as an ancillary unit. After approval of the manufacturing unit by the officers at TEL, the first job was to prepare samples of various designs provided by TEL. For this the finished leather was procured from TEL itself.

While other accessories were got from Mumbai. The accessories were not manufactured in India and were imported.

The samples were to be used by TEL to procure orders. Unfortunately TEL could not procure any orders from the two identified markets- USA and Europe- for their product. It tried to get orders from other markets, but these also did not materialize. Subsequently TEL dropped the idea of manufacturing high-end fashion shoe uppers and decided to concentrate on exporting finished leather only. Further the management at TEL decided to promote the formation of ancillary units to be run by employee as co-operatives. It then outsourced all its requirements from these units, giving a cold shoulder to ILI and similar units.

This was a blow to ILI as it was wholly dependent on TEL. During this period, ILI had provided almost Rs. 3 Lakh worth of samples. Neither the proprietor, nor TEL nor the FI's involved had visualized such a scenario.

The proprietor thus tried to look for other option to utilize the manufacturing base. Even though a demand for such shoe uppers was prevalent but only in Chennai. But it was not economically feasible for ILI to market the product in Chennai as the transaction costs were very high.

Also not many products could be manufactured using the machines. The proprietor also mooted the idea to move the unit to Chennai, where it will be much more economical for ILI. This request was turned down by the both the MPAVN and PNB.

The proprietor finally decided to diversify into making leather Jackets for the domestic market. The proprietor approached MPAVN for financial help to fund the purchasing of additional machinery. The request was turned down by the MPAVN. The proprietor was forced to invest more to procure the additional machines that were required.

Only TEL was the local manufacturer of the raw material required by ILI. Earlier being an ancillary unit, good quality of leather was made available to ILI for manufacturing the samples. But once it tried to get raw materials for itself, poor quality leather, reject pieces and that also untimely delivery was maintained by TEL. This forced the proprietor to also source raw material from Chennai. Also now it had to maintain a higher inventory. From stocking materials for two-days now it had to maintain an inventory for over a month. This increased the total working capital requirement of the unit. To meet this need the proprietor approached PNB. This request to increase the w/c limit from 50,000 to 1,50,000 was also turned down. The proprietor tried to manage within the constraints, but could only utilize 5% of the installed capacity. Making this whole process uneconomical.

Left with no choice, the proprietor decided to wind up the unit. In 1986, after six years of desperately trying to somehow make the unit functional, the proprietor called it a day. But the winding up was even tougher. The main creditors to which the unit owned liabilities were:

- The MPAVN
- The Punjab National Bank, Dewas Branch
- The Industries department
- MP State Electricity Board
- Other sundry creditors

Of these the highest outstanding were with The MPAVN. In 1986 the liability included the principal amount of Rs. 2 Lakhs plus the interest. The proprietor repeatedly sent notices to the MPAVN offices and even spoke to them for a one-time settlement of all the dues. No action was taken by MPAVN while the interest on the claim kept on mounting. Finally in 1996 ten years after initiating the process the proprietor managed to reach an agreement with the MPAVN. While MPAVN was claiming Rs 15 Lakhs as the outstanding, it agreed to settle the claims for Rs 3.5 lakhs. This was also on the behest of the chairman of MPAVN.

The proprietor settled the other claims at the time of winding up in 1986. These included the lease amount for the shed, the working capital from PNB, the other utilities including electricity and the wages and provident fund etc. This was all done from personal savings and borrowing from friends and family.

The Case of Mr. C.L.S. Rosario

Mr Rosario started TICO Tools & Gauges (TTG) in 1972. The unit was based in Chennai and was aimed at producing boring tools. With a mechanical engineering diploma, Mr. Rosario had the required technical expertise, and was quite confident of the success of the venture. To set up the unit he took a medium term loan from Indian Bank for Rs 83,000. Though the first two years were not very fruitful, but from the third year the unit managed to get good orders and thus was able to service the loan.

TTG slowly diversified into making bars for holding boring tools. It kept on continuously developing new methods for value addition. During this period it also imparted training and helped six more entrepreneurs to set up small-scale units. The proprietor had managed to build a good rapport with the chairman and other officers of the Indian bank. This led to an active involvement of the chairman in considering the application of TTG for funds.

TTG faced some labour unrest in 1990, which left some stocks and goods damaged. The company was unable to claim for the damages through the insurance done by the Indian Bank. The OCC based on this stock could not be serviced. The outstanding for this was in 1990 was Rs 7 lakhs.

In 1990 the company decided to diversify into material handling and inventory equipment. There were no Indian manufacturers of such systems. TTG decided to develop its own equipment. It had a customer in HVF Avadi, which was keen to install the equipment at its warehouse. TTG undertook extensive development work for this.

The development was partially funded by the Indian Bank. Out of the total expenditure of 40 Lakhs, 15 lakhs were provided by Indian Bank while the proprietor invested the rest.

In 1993 the equipment was tested and delivered to HVF Avadi. The payment was received in 1994 and part of the loan was serviced. The equipment was also showcased to a number of organizations including the RBI currency division. The Ministry of Defence showed considerable interest and in 1995/96 it commissioned a study for warehousing equipments. TTG conducted a part of a study for which they received Rs 11 Lakhs. This was used to service part of the outstanding with Indian Bank. This study also opened up a new avenue for TTG to expand.

In 1996 RBI also floated a global tender for procurement of the warehousing equipment similar to that developed by TTG. The tender required that the company have a tie up with a foreign firm. TTG tied up with Electrolux, Holland for this venture. The tender also required a sanction from the bankers to meet the working capital requirements to the tune of Rs 80 Lakhs. TTG approached its bankers with a request. But by this time Indian Bank, had a new chairman and a new policy in place. They refused to give any credit. The troubles for TTG started from this point.

The unit had already stopped the production of boring tools and bars or CNC machine tools. The proprietor's decision to shift into development had already exhausted all the other resources of availing finance. At this point it did not have any customer and the RBI project would have been its only source of revenue.

The proprietor again tried to set up the production of CNC machine tools and had managed to book orders from two customers. But the production required around Rs 3 Lakhs of working capital. The Indian Bank refused to even provide this capital. Further major portions of payments made to the TTG account were diverted to service the medium term loan of the bank.

The proprietor tried to get access to working capital through other banks and financial institutions. Having already some outstanding with the Indian Bank no other financial institution was ready to provide the necessary financial support. The time spent looking for resources further increased the proprietor’s liabilities.

The refusal to give any working capital left the proprietor with no option but to close down the unit. The winding up process was started in 1999 when the proprietors had exhausted all avenues of funding. The Indian Bank on the other hand asked the proprietor to furnish a plan for one time settlement.

In 1996 the liabilities included were

1. Medium term loan from Indian Bank
2. Development loan from Indian Bank
3. OCC
4. Machinery supplier

5. Utility charges
6. Employee Wages, provident fun and insurance
7. Private creditors

The proprietor managed to pay back most of the liabilities after borrowing money from the market. This was also only possible when they borrowed in the name of a new firm set up by his son. Settling the claims of the Indian Bank was difficult. The Bank had claimed an amount of Rs 1.2 Crores. This included the principal, compounded interest and the penal interest. After a number of meetings, the bank finally settled for an amount of Rs. 52 lakhs.

Two liabilities have still not been cleared by TTG. A supplier who sold a machine on hire purchase terms. The other is the provident fund for an employee. The proprietor claims that the employee had stolen a piece of equipment and thus has refused to clear the provident fund liabilities for the employee. The proprietor managed to sell the unit and recovered some salvage value, which were used to settle the claims of private creditors.

The Case of Mr Singhania

Mr Singhania came from a family with a business background. Even though just a high school pass out, he was able to spot an opportunity to start his own entrepreneurial venture. He had already been involved in trading of engineering goods in the eastern parts of India. Having witnessed the operations of business of engineering goods, in the year 1958-59, the promoter was searching for new avenues.

He came to know about Bharat Heavy Electricals Limited's (BHEL) need for substituting import of gas purifiers with indigenous product. Many other public sector units were importing the same product. Mr Singhania managed to convince the BHEL officials to let him manufacture and supply on a trial basis. This led to the establishment of IEC in 1960. The promoter managed to deliver to the expectations of BHEL and became a regular supplier of gas purifiers.

Satisfied with the performance of IEC, BHEL requested it to develop a number of other engineering components. All these were being imported from England and their indigenous development would considerably reduce the import burden. The promoter was keen to utilize this opportunity and slowly became a regular supplier of engineering components to BHEL and allied Industries.

IEC was started with an initial investment of Rs. 5000 in 1959-60. Started as a proprietorship, with Mr. B.P.Singhania managing the affairs. It was later converted into a partnership in order to meet the growing demand. In 1960 the unit was registered with the Director of Industries – SSI, the National Small Industries Corporation and BHEL. It was later on registered with the Railways and the Defence departments to enable it to supply the various components to these departments also.

IEC was the exclusive manufacturer of certain engineering components and catering mainly to BHEL. The unit maintained regular supplies to BHEL till 1972. But with increasing financial constraints the supplies became erratic. Even though the unit remained the exclusive supplier to BHEL till 1977-78 it was facing difficulties in maintaining it. During this time a couple of more manufacturers had also started manufacturing the same products and were gaining a foothold in BHEL.

The unit had been operating within limited financial resources and it was extremely difficult to maintain supply lines and meet wage requirements. In order to overcome these limitations the unit approached its bankers to increase the working capital limit. The unit applied for a working capital loan limit of Rs 8-10 Lakhs. The bank on the other hand agreed to give a loan of just 25% of the requested amount. This ad-hoc limit was set without a proper appraisal of the unit.

The promoters made repeated requests to the bank to increase the limit and conduct a proper appraisal of the unit, but to no avail. The promoters were forced to arrange the capital from the private sources at much higher rates of interest.

The financial situation further worsened when the raw material prices suddenly surged. The main raw materials included non-ferrous metals, which were being supplied by Mineral and Metal Trading Corporation (MMTC). MMTC was the sole supplier of the non-ferrous metals and IEC was thus solely dependent on it. This adversely affected the timely completion of orders and payment of wages. This started the familiar domino affect. There was labor trouble, the supplier refusing to increase credit period, the utility bills started mounting, and the capacity utilization fell reducing the profit margins.

The promoters approached various banks and financial institutions for support. But none of the FI's offered to help. To sustain the production, the promoter borrowed from the market at higher rate of interest. The suppliers were also requested to increase the credit period. But this was not viable all the time. By December 1978 the situation had worsened. While approximately Rs 28 lakhs were owed to the various creditors. The major creditor was the UCO bank to which IEC owed Rs 12 lakhs. The suppliers were the next major creditors. The list of creditors with their outstandings is been given below.

UCO Bank	12.57 (Disputed)
Money Lenders	1.37
Relatives & Friends	0.53
Suppliers of raw materials	7.08
Outstanding Expenses	5.24
Income Tax – (TDS & Int.)	0.04
Sales Tax	1.16
Provident Fund	0.12
Pension & SSI	0.07
Total	***28.18***

UCO Bank initiated the process of recovery and filed a suit in 1979 against Industrial Equipment (Manufacturing) Corporation and others, at High Court (Original Side) at Kolkatta for recovery of Rs. 19,88,515.36. The Hon'ble High Court passed a judgement on 24th March 1998. In the meantime, "*The Recovery of Debts due to Bank and Financial Institutions Act 1993*" came into being and pursuant to section 31 of the said Act, the suit was transferred to **The Debt Recovery Tribunal**. The Tribunal upon prayer of the respondent Bank (UCO) issued certificate under Sub-Section 7 of Section 9 of the Recovery of Debts due to the Banks and Financial Institutions Act, 1993 on 3.7.2000.

There is discordance regarding the amount to be recovered as per the High Court order and the DRT certificate. The promoter has filed for reexamination. The decision is still pending. The bank also applied for appointment of a receiver to take charge of the assets and inventories. The receiver in the subsequent hearings has not been able to produce all the goods received further complicating the matters. This effectively rules out any other means of liquidation.

The suppliers on the other hand resorted to private means of recovery. Apart from notices, the promoters were repeatedly threatened through musclemen. The family members of the partners have also met this fate. Further the partners also felt that the process has damaged their reputation.

The promoter Mr. Singhania expired in 1985, leaving behind his family members to fight the case. His son had been included as a partner and was overlooking the sales and marketing aspects. He has since then been fighting the case.

The Case of Mr. Sridhar

The case is of Mr. Sridhar a Chennai based entrepreneur. A technocrat Mr Sridhar had also the experience of working in a SSI. Prior to starting his own unit, he had been the executive director of the SSI unit. In this capacity he had the exposure to manufacturing, marketing as well as finance. Further he also undertook entrepreneur training at SISI, Chennai. He established Pyrosystems Private Limited (PPL) in 1977. The unit was established to manufacture process control instruments and industrial heating elements.

The unit commenced commercial production in 1977. Since then the unit has been continuously growing. PPL was started with an initial investment of Rupees two lakhs and a working capital requirement of Rupees five lakhs. The unit was utilizing almost 90%of its production capacity and there were no dearth of orders. Further PPL also won number of national and international awards. It also had 10 ISI licenses to its credit. These point to the fact that the company was performing considerably well.

The banker for PPL had been the Indian Overseas Bank since the inception of the firm. The units did not initially face any problem with the bank. The finances were released generally in time. But in 1984 the IOB (Secundrabad) released a documentary bill without taking payment from a drawee for Rs 7.2 Lakhs. Further the bank debited this amount and interest from the company's OCC account after 18 months. This made the company's account irregular adversely affecting its functioning.

The bank took 4 years to sort out the matter and extend a rehabilitation package. The package included a write off of Rs. 7.2 Lakhs, and charging of concessionary interest of 13.5 %. But the implementation took another 3 months and that also partially. The bank kept on charging interest at a higher rate than the 13.5 % agreed upon. It took another four years for the Zonal office to issue an order to implement the package fully. But the local branch did not still implement the package.

In 1995 the bank appropriated an amount of Rs 104 Lakhs from the bills realized account of the firm. This increased the financial constraints. To make matters worse the bank started to maintain a 50 to 100% margin of the bill amount at the time of purchasing bills. Further in 1997 the central bank ordered the release of working capital to the PPL. The local branch again did not implement this. Even though the company had orders, it could not provide supplies in time. The clients stopped the payment of outstanding bills.

In 1998 the chief general manager also issued an order for the reconciling of accounts, and releasing of regular credit facilities. This order was also not implemented instead in August the bank filed a case against the company with the DRT (Debt Recovery Tribunal). The promoters tried to sort the issue with the CMD as well as the customer care department of the bank but the bank was not ready to even have a discussion. The Company then lodged a complaint with the Banking Ombudsman at Chennai. The BO ordered the bank to reply to the deficiencies by it. The bank again failed to set right the issues. The company has also taken up the case in the SLIIC forum but it has not yet resulted in an amicable solution.

The company has been declared sick as per the guidelines of RBI by the IOB. Even though the cause for sickness has been the deficiencies in providing service by IOB itself. The domino effect is visible. Once the bank put in the restrictions, the debtors have stopped payments, the suppliers cut off the credit limit. The unit has stopped production. At that time the company outstanding dues

Private	Rs. 3.00 Million
Supply of raw materials	Rs. 1.00 Million
Company tax & water charges	Rs. 0.08 Million
PF dues and due of laborers	Rs. 0.55 Million

While the company's receivables stood at Rs 15.7 Million. These included:

Debtors	Rs. 15.00 Million
Advances made to suppliers	Rs. 0.45 Million
Others	Rs. 0.25 Million

The major unsecured creditors filed for the winding up of the company. On explaining the position they agreed to give some time. The promoters subsequently settled most of their claims. The provident fund organization filed criminal cases against the company and its directors. The provident fund claims were also settled from the payment received from the debtors. Some of the remaining unsecured creditors filed criminal cases against the company under section 138 of the Negotiable Instruments Act. These claims were settled and most of the cases withdrawn. Some of the cases are still pending as payment could not be made.

The company has also filed cases against the debtors for recovery under The Payment of SSI (Central) Act. The company can settle most claims on recovery of its dues and interest. The company is still technically and commercially viable. Given support it can be easily turned around.

Section 2.2: Inferences from the case studies

This section details out certain essential facts about the SSI units and their functioning. These facts are inferences that one draws in general about the SSI's in India from the five case studies. Even though the cases belong to different States, their functioning is considerably uniform and so are their problems. Specific instances from the case studies that reveal the characteristics have been given alongside.

Though the specific cases might be different they all lead us to the same set of conclusions. What we gather from them are simple but essential facts about small business and their role in the economy.

Entrepreneurship – Small businesses reflect high levels of entrepreneurship. The role of an entrepreneur is to find opportunities that can be exploited for personal gain. The efficiency or growth of the economy does not figure in the entrepreneurs' main objectives. However, an economy that allows the entrepreneur to carry on his or her main role, is well on its way towards efficiency and high growth.

All Cases

Family involvement – Most small businesses have a very high level of family and friends' involvement. This is not idiosyncratic to India. Everywhere in the world, be they developed or developing countries, in most small businesses family and friends are involved in many ways. They give credit, they stand as guarantors, they may provide general advice, etc. In most cases, unless required by law, there are no contracts, no paperwork that accompany this help. It is based on a general understanding of mutual dependence and informally shared benefits. The key point here is that, transaction costs are minimal in such interactions.

Mrs Sheriff's case: Her husband managed the affairs. Mr. Jain's case: His father-in-law provided technical advice. Mr. Singhania's case: Family background helped him in setting up the business.

Financial constraints – Entrepreneurs tend to set up a small business because they do not have high level of funds. As a result, when for any reason personal guarantees have to be given, the entrepreneur's personal assets are rarely adequate. Family and friends have to step in to stand as guarantors.

Small businesses in India tend to be owned by a group of people from families with a business background. That is not surprising, since it would be difficult to obtain personal guarantees from a person from another (less risk taking) background. It is difficult for any rational and risk averse individual to stand as a guarantor for another's small business (that later sections on post sickness experiences of small firms further highlight).

Mr Singhania started with an investment of Rs 5000 in 1968.

Flexibility – The tacit dimension, or the informality, is extremely important in setting up a business. That saves time, reduces costs, and makes the businesses highly flexible. At the same time, interactions in the formal dimension are highly time intensive. This, of course, goes against the major advantage of small businesses – that of rapid responses to temporary opportunities.

Mr. Rosario shifted from making boring tools, to bars, to CNC machine tools, and finally to developing warehouse equipment.

Single credit provider – As things stand today, none of the financial institutions are ready to finance an enterprise having a liability with some other financial institution. Once an entrepreneur takes a loan from an institution he is tied with him for all his future financial requirements. Not because the other institutions are not willing, the regulations do not let them. This reduces the options for the entrepreneur. He has to function within the credit limits set by this institution, stifling his risk taking ability.

Mr. Rosario could not access funds from other banks. Mr. Singhania had to work within 25% of his working capital requirement, as his bankers were not willing to provide more than this limit.

Lack of professionals – Small businesses can rarely afford experts and professionals. This is not only true of technical experts, but also legal experts, financial experts, management consultants, project consultants, etc. Such business and engineering services are too costly for a small business. Their scales do not justify such costs. Even if some were available, because of their low ability to pay, good quality professionals cannot be accessed. That market is missing. As a consequence small business in India depends only on the experiences of those personally networked with the entrepreneur.

Mr Jain 's father-in-law helped him with the technicalities. Mrs Sherif was unable to market her product after TEL stopped purchasing from ILL.

Personal Networking – The importance of personal networking either through relations or side-payments is visible at each step the entrepreneur takes. Their success is thus highly dependent on the extent to which they are successful in tackling this tacit dimension. The following illustrative points bring out this characteristic of small sector industries.

(All Cases)

First, small businesses are highly flexible; they have the ability to quickly gauge new opportunities and to meet them. This however requires that the rules and permissions *raj* allow them to do so.

Second, credit facilities from financial institutions are availed by any business on the basis of the project viability. However, that is not the only criteria. Though funds are granted on the basis of the viability of the project, they are almost always backed with personal relations of the entrepreneur with the fund giving staff.

Mr Rosario's got funds for development purposes and the CMD of the bank took keen interest in TTGL's work.

These personal relations may or may not involve side payments. Lets first take up the case where they do not. Given that a project is found to be financially viable by the financial institution, the entrepreneur may still not be able to access the funds. This is because the 'character' of the entrepreneur plays an important albeit implicit role in credit transactions. The FIs staff has to be comfortable with the entrepreneur. This happens simply because the entrepreneur is very good at selling her idea to the staff of the financial institution.

This is a general occurrence that is true not only in India but in other countries as well. In India however, in cases where this degree of trust is not strong enough, a side payment to the staff helps. In many cases it is a combination of both these forces (personal relations plus side payments) that precede the release of funds.

Third, the tacit dimension need not only be a facilitator, but may also cause hindrances. For instance, if for some reason the PR is not good, or some adequate arrangement of side payments is not reached then even viable projects may not receive funds. The errors occur on both sides – good projects not getting adequate credit and bad ones obtaining it.

Mr Jain's experience in accessing funds from Syndicate Bank, after his relations soured.

Vagaries of Government Policy – Since 1980 the small-scale sector in India has witnessed high levels of growth. This has been because of many policy measures. The Small Scale Policy Statement of 1980 emphasized the role of the SSIs, gave them greater flexibility in exporting, setting up units, accessing international technology, etc. At the same time the government increased the pressure on the public sector bank to provide funds to SSIs. This shows up in the table below.

Scheduled Commercial Banks' Advances to SSIs

Year Ending	Balance Outstanding (Rs. Crores)	Annualized growth (%)
1971	493	-
1975	1,040	21
1980	2,695	21
1985	7,829	24
1990	15,969	15
1995	29,175	13
2000	57,035	14

Ending March 31st
Source: RBI Handbook of Statistics, 2001

This rapid increase in the seventies and early eighties was in great part because of a push from the supply side. The banks however were short of good supply of entrepreneurs. This in turn made them push many of the better performing units to expand.

Mr Rosario's Case: Medium term loan easily available in 1972, future development loans also made available. But later on even working capital limit was not sanctioned. Mr Jain's Case: Helped in the financing of three units.

The Scope for Corruption – Complicated rules and procedures only increase the intellectual burden of the entrepreneur. They take away from her ability to look for the best opportunities, and to concentrate on improvements and innovation. In other words, since it becomes difficult for an entrepreneur to access experts, and since a large part of her time is consumed in non-productive activities, opportunities are lost.[1]

The problem does not end there. The entrepreneur is aware of the constraints on her ability to constantly find new and better opportunities in the productive sphere of her activities. Consequently she searches for opportunities in the non-productive sphere. And complicated rules and procedures ensure that the main area of expertise that an entrepreneur develops is maneuvering through this maze. The 'demand' for corruption is the natural result.

Dependence on a single client – Many small businesses cater to the requirements of a single large organization. Many small firms have developed as a formal or informal ancillary unit of a large organization. This considerably reduces their bargaining power. Further any turbulence in the large organization gets reflected on the functioning of the small unit. The existence of the small business unit thus becomes a function of the larger organizations performance, the entrepreneurs relationship with functionaries in this organization, and of course the performance of the unit it self.

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[1] Are experts that important? We would argue that they are, and have become even more important in the post-1991 era. The fees charged by providers of business services are one indicator. Another indicator is the high rates of growth of business services in recent years. Currently, the bulk of these are being accessed by larger firms.

Mr Jain's unit was an informal ancillary unit of Department of Telecommunication. Mrs Sherif's unit was a formal ancillary unit of TATA exports. Mr. Singhania's was an informal ancillary unit of BHEL.

The domino effect – Small units are susceptible to a single small shock. And given the generic way of operations of all banks, there is not enough flexibility in the system; even a single shock is enough to drag a successful unit towards sickness.

Rules and regulations, for the right reasons or wrong, do not allow the entrepreneur of a sick unit to access any other bank for credit facilities. This is not only true of the sick unit, but also a new unit set up by the entrepreneur of a sick unit. The market for credit does not exist for a sick unit's entrepreneur. Even if other banks find his unit viable, and creditworthy, an entrepreneur has to approach his original banker only. Assets of sick units cannot be transferred to another bank.

This is not to say that rehabilitation procedures do not exist in India. They do. Representatives of banks, bureaucracy, RBI (the regulator), national development financial institutions, check the viability of the unit and also draw plans for it revival. In some cases such recommendations lead to the release of funds. But the original lender (bank) still has the final say in the matter, and our cases show that the banks refused on many occasions.

Unlike in the case of larger businesses, one cannot approach the BIFR. Unlike small entrepreneurs in USA, small firms in India cannot approach the government for a Chapter 11 like rehabilitation package. Rules and procedures prevent the entrepreneur from going to other banks for a rehabilitation package that his own bank does not offer.

The *domino effect* now starts working. The entrepreneur is still liable to pay all other dues. These included:

- Term loan repayments
- Provident Fund payments
- Electricity dues
- Land dues
- Sales and income tax, etc.

These are only some. The actual list is longer.

State laws hailing from pre-independence days allow imprisonment without trial of offenders who do not pay land dues. Later laws allow the government to treat unpaid dues such as those for PF, electricity, dues of SFCs etc. as those of land dues. As a result these economic offences are treated much like criminal offences.

In these cases the District Collector (working through the tehsildar) is empowered to collect dues in many ways:

- Serving writ of demand
- Arrest and detention
- Attachment and sale of property

However - no repeated imprisonment, no imprisonment of women, and no imprisonment greater than 15 days are allowed. (See Chapter 3 for greater details) What is much worse, and not only from the human rights angle, *an economic failure is treated as a crime*. As a consequence potential for value creation is eliminated.

There is some inherent flexibility in the system. However, the key issue has to do with the issue of *orientation*. The District Administration's job is to make sure that rules, regulations and laws are followed and taxes and other dues paid on time. Economic failure is difficult to identify and the district administration will tend to err on the side of caution.

The separation of insolvency related actions of the government and the day-to-day adminitration functions are essential. The former should to be handed over to specialized institutions more knowledgeable of business and economic conditions and with better ability to carry out economically efficient actions.

Lack of restructuring options

The government had incorporated a number of committees to look into this aspect, but most of these committees have passed the baton to the RBI. The RBI has issued guidelines to enable banks to go for restructuring of SSI. But again these guidelines are not mandatory and the decision rests with the concerned bank officials.

The government has tried to reduce this by introducing the concept of State Level Inter Institutional Committees (SLIIC). These are constituted from among the government, the RBI, the concerned financial institution and other financial institutions. Their function is to discuss the viability of various sick enterprises. But these committees play only an advisory function and their suggestions are also not mandatory. This leaves the entrepreneur at the mercy of the very (public sector) officials who have already turned down his petition for restructuring.

Declaring personal bankruptcy if settlement is not possible

In all the case studies an important point that emerged was the reluctance of the proprietor to declare personal bankruptcy and take protection under the Insolvency Act. The Insolvency Act provides protection to the individual from being prosecuted for recovery of debt while the case is being heard. This observation seems to be odd, as most of the promoters should ideally opt for a protection from creditors and undue harassment.

The possible reasons for this are that in some cases the proprietors have access to funds either in the form of land or loans from family and friends. They may be willing for a settlement of their dues with the creditors if given a few concessions. In many if not most cases they seek a waiver of penal interest and are ready to pay the principal amount and simple interest. This then does not harm them from taking credit again albeit not with the same set of creditors. On the other hand the set of entrepreneurs who do not have access to funds to settle claims are the ones that face the proceedings under various laws. They tend to buy time and hope that 'something' happens.

In two of the case studies the promoters were more willing to take loans from friends and family to settle their dues than seeking protection under the Insolvency Act. In both the cases the promoters had access to such funds. *(Mrs. Bina Sheriff & Mr. Rosario)* In two other cases the promoters are facing charges, their properties have been attached and are under a receiver. Both these promoters were not ready to declare personal bankruptcy. *(Mr. Jain & Mr. Singhania)*

The constraints in the Insolvency act are discussed in detail in Chapter 3.

Section 2.3: The specific culprit(s)/ issues

As mentioned before, Chapter 3 studies the legal regime of small firm insolvency. However, as is clear from the case studies and the resulting insights, mere legal reform will not solve matters. The institutions – both formal and informal, government functionaries, procedures and rules also play an important role. These are discussed in this section.

The Laws

What are these laws that eliminate the appearance of a market for NPAs and buying and selling of sick units? There are many, and most of them are at the state level. As a result these differ across the states. But there are many similarities between such laws in various states, as they have all evolved from a framework that was developed by the central government decades ago.

A financially unsuccessful SSI still has to repay all its creditors, workers, suppliers, FIs, government agencies, etc. Significantly the labor and government dues are including the interest charges on the unpaid dues (which keep on adding up through lengthy procedural battles) and are recovered as land dues. Penal action (imprisonment) can be undertaken for the following class of outstanding dues in all the state laws considered:

- Financial dues (from State Finance corporation, Bank, etc.)
- Utilities such as electricity, water etc.
- Tax related arrears like sales tax, income tax, etc.
- Social security arrears like wages, PF, bonus, etc.

Since land revenue was an integral part of the colonial rule, extreme penalties were included in them. The law was not traditionally meant for economic offenses. But somehow the laws and procedures that were put up after independence further increased the scope of the land recovery acts. As things stand, in the event of an SSI shutting due to any reason whatsoever, all the dues of the employees are recoverable from the employer. Similarly for utilities, finance institutions, tax, etc., the sole burden rests on the entrepreneur. These are listed in Appendix 1.

The Institutions

Most public sector institutions have been envisaged as avenues for collective development. Proponents further claim economies of scale coupled with smoother functioning as some of the major advantages associated with these institutions. Stricter control and regulation are some of the administrative advantages. What these though reflect is the concentration of economic forces, which generally undermine the free play among markets. Further they increase the importance of the tacit dimension by concentrating power to a few.

As is seen from the case studies, the major players in bankruptcies have been the financial institutions. Whether they are the cause or not is a debatable question but they are always the losers. This does in a way raise a question on their functioning as fund centers for SSI units. But being the only source of cheap capital available they cannot be avoided. The problem though is that all of these operate under the guidelines of the RBI, (See Appendix 2) which leaves very little room for flexibility. Thus most banks and financial institutions are forced to react in the same manner. More so in cases where there has been a default on payment.

Though RBI has issued guidelines for extending a helping hand to defaulting SSI units, these are hardly binding (unlike those for giving credit). On the other hand regulations like not financing defaulting SSI units of other banks, assessment of the performance of banks on basis of NPA's, etc are binding. What this inadvertently leads to is a risk-averse approach to banking. The losers of this are the markets for sick SSI units.

The Functionaries

Most of the entrepreneurs while dealing with banks and financial institutions feel that they are dealing with the individual and not the institution. If they are able to develop interest among the functionaries in these institutions, they are able to get their work done. This interest may be on any account but it underlines the presence of the tacit dimension.

The trouble with this though is their transitory nature. Once the functionary is transferred or moves from the job a new set of relationships have to be developed. Sometimes the situations are entirely different and the entrepreneur is unable to develop a relationship. This then stands in his way of accessing the best possible support from institutions. For sick units this at times is the decisive factor to choose between rehabilitation and liquidation.

If support for rehabilitation can not be obtained from the bank functionaries at the local or regional level, in most cases rehabilitation becomes next to impossible. This is because of the discretion that the bank officials are allowed in case of restructuring.

Most of the restructuring results are visible only after a year or two and the old debts are only fully realized after five to seven years. While the bank officials performance is judged every year and at times he may be transferred much before the dues are realized. Thus there is a clash of interest. This acts as a disincentive for the official from providing a rehabilitation package. Further in case of liquidation most functionaries tend to wash of their relationship in order to keep their jobs secured.

The Delays

The inherent time lags in the various procedures of rehabilitation, liquidation or recovery are the other culprits (See Appendix 4). The end result of all of this is the reduction in value of the assets and the inability of development of a market for sick units. Both the entrepreneur and his creditors try to utilize this delay to their advantage.

The entrepreneur tends to buy time and hence uses the law to his advantage. The aim being to somehow use the available time period in putting the unit back on track. But in a majority of cases this is not possible and the time is also sometimes used for asset stripping in order to pay up the informal creditors, friends and family.

The various functionaries on the other hand try to delay the decision making in order to avoid taking on the responsibility. This generally happens in the case of rehabilitation. Also the various creditors use the delays as a leverage to force the debtor to agree to a settlement.

Bankruptcy (*Diwala)* – Legal Death, Criminal Cases, and Social Stigma

Though failure of a small-scale industrial unit is an economic problem, it gets criminalized. The lenders frequently intitute criminal cases against the entrepreneurs for misrepresentation of facts. This is done to ‘arm-twist’ the borrower to pay the dues. This has contributed to the stigma associated with failure in social circles. Furthermore, as Chapter 3 shows, post bankruptcy it is difficult for a formerly insolvent entrepreneur to start another business.

Whether it is the laws or the accompanying rules and regulations or the mindset of the people, all are against the failed enterprises and entrepreneurs. With the many barriers against failure, the entrepreneur chooses to avoid insolvency.

However, this need not be so, an economic failure of a firm should at most be considered to be a legal death of the enterprise, not the entrepreneur. Later chapters delve into these matters.

Section 2.4: Conclusion

In this matrix, it is necessary to review how the system operates. Typically a small businessman seeks loan / credit from banks or other accredited institutions. There is little scope for negotiation of the terms of contract. Interest again has several variables, compounded, penal, liquidated etc. Then the creditor seeks security, as a mortgage or collateral, of property whose value is more than the credit amount. Both the creditor and debtor are aware that the valuation of such security, either in the balance-sheet of the debtor or otherwise, has little relation to it's actual market value! Then there are other documents – promissory notes, personal guarantees, other guarantees, board resolution, affidavits etc., which are executed. Anyway, the signatures are obtained and money changes hand. Off course, there are some creditors who additionally insist on post-dated cheques. Such cheques represent the equated monthly installments, principal amount (with and without penal interest) and such other amount that the creditor insists.

After sometime new default takes place. The loan is recalled. Negotiations fail. The post-dated cheques are deposited for collection; notices under section 138 of the Negotiable Instruments Act are issued. The hostilities further result in filing of Civil Suits under Order 37 of the Civil Procedure Code, 1908 (summary proceedings) for recovery of admitted liability and / or proceedings are initiated before the Debt Recovery Tribunal. The creditor gets interim injunctions restraining the debtor from selling his assets, and the case finds residence in the cause-list. Additionally, some creditor, when the debtor happens to be a corporate, upon notice, file winding-up petition before a High Court.

At this stage, the debtor is driven to the wall. Initiation of criminal and civil proceedings, all at the same time, can create substantial pressure. This either leads to settlement, where the debtor borrows from some other source (on equal or more onerous terms) and pays-off the aggressor. In case of a habitual defaulter, upon instructing a team of lawyers, the debtor either avoids court process or ensures that no adverse order is passed in the short term. Once the initial heat is contained, the urgency to settle / repay is lost.