Resolution of failure

7.55 One major problem experienced in India, has been the resolution of failure. In a market economy, the failure of firms is an essential mechanism through which the resource allocation is guided into the most efficient uses. At the same time, there is a need for a sophisticated institutional framework through which the labour and capital embedded in failed firms is *rapidly* redeployed into productive uses. This question is closely linked up to the problem of creditors rights, which deals with the mechanisms through which creditors obtain the residual value of a failed firm. Efficient procedures for enforcing the rights of creditors are generally associated with a speedy recovery of distressed assets into productive use.

7.56 There are a large number of "sick firms" in India, where a resolution of failure is called for. According to information compiled by RBI from scheduled Commercial Banks, as on March 2001, there were 252,947 sick/ weak units consisting of 249,630 units in the SSI sector and 3,317 units in the non-SSI sector. Among these 3,317 non-SSI units, the private sector accounted for 2,942 units, 255 units and 106/14 units, respectively. The bank credit blocked in sick units rose from Rs. 23,656 crore (as on March 31, 2000) to Rs. 25,775 crore (as on March 31, 2001), the bulk of which was with non-SSI firms which accounted for 82.5 percent.

7.57 On 21st June 2002, the President of India promulgated *The Securitisation, Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance 2002*. The Ordinance gives powers to Banks and Financial Institutions to enforce their claims on collateral for delinquent secured credit, without going through a long and cumbersome judicial process. The Ordinance also provides a legal framework for securitisation of financial assets and asset reconstruction. Once the asset reconstruction company has acquired an asset, it has the same powers for enforcement of securities as the original lender. On 21 November 2002, it was passed in Parliament.

7.58 While this Bill addresses the narrow question of secured credit, the larger question of clarifying the relationship of debt and equity in a limited liability company remains. The modernisation of the Companies Act of 1956 is a key part of the process of improving institutional mechanisms for the resolution of failure. The Companies Bill 1997 was introduced in the Rajya Sabha on August 14, 1997, and referred to the Standing Parliamentary Committee. In the meantime, the urgent need to make progress on some of these questions, led to the introduction of two Bills in parliament. Both the Bills were passed by Parliament in December 2002:

1 *Companies (Amendment) Act, 2002.* This legislation will provide primary producers a new kind of organisation i.e. a producer company to produce and market the products in a modern and professional manner at par with other companies. It will enhance the efficiency and competitiveness of cooperatives, and enable them to compete and operate in today's liberalised, globalised market.

2 *Companies (Second Amendment) Act, 2002*. The Act provides for the constitution of a National Company Law Tribunal (NCLT). The functions that are presently being handled by the Company Law Board (CLB) (dispute resolution and compliance with certain provisions of the Companies Act, 1956), Board for Industrial & Financial Reconstruction (BIFR) (revival and rehabilitation of sick companies) and High Courts (winding up of companies) will now be handled by the NCLT, once the Sick Industrial Companies (Special Provision) Act, (SICA) is repealed. The new law has several advantages over SICA. Sickness has been redefined; a revival and rehabilitation fund has been set up; protection from creditors has been withdrawn.The NCLT will now be the single forum for companies replacing the existing three forums.

7.59 While these initiatives envision the replacement of Board for Industrial and Financial Reconstruction (BIFR) by the NCLT, the BIFR has been playing a major role in the resolution of failure. Since its inception in May 1987 till the end of October, 2002, BIFR has received 5,675 references under the Sick Industrial Companies (Special Provisions) Act 1985 (SICA) (Table 7.21). These references include 273 references from Central and State Public Sector Undertakings (CPSUs and SPSUs). Out of the references received, 4,204 were registered under Section 15 of SICA. While 988 references were dismissed as non-maintainable under the Act, 575 rehabilitation schemes, including 23 by AAIFR (Appellate Authority of Industrial and Financial Reconstruction)/Supreme Court, were sanctioned; and 1057 companies were recommended to be wound up. A small set of 321 companies have been declared "No longer Sick", and have been discharged from the purview of SICA, since their net worth turned positive after the implementation of the scheme.

Table 7.21 : Details of references received by BIFR as on Oct. 31, 2002

S.No.	Items	Total	Pvt.	Central	State	Total (PSEs)
1	References Received	5675	5402	98	175	273
2	Registration Declined	1359	1278	17	64	81
3	Under Scrutiny	104	100	1	3	4
A4	References Registered	**4204**	**4017**	**80**	**107**	**187**
	DISPOSALS					
5	Dismissed as N.M.	988	953	7	28	35
6	Rehabilitation Schemes approved/sanctioned*					
	(i) By BIFR	552	510	22	20	42
	(ii) By AAIFR/SC	23	23	0	0	0
7	Declared no longer sick out of S.No.6.	321	310	4	7	11
8	Winding up Recommended to the concerned H.C.	1057	1002	22	33	55
9	Dropped NW+	46	42	3	1	4
B	TOTAL (5+6+8+9)	2666	2530	54	82	136
C	PENDING					
10	Draft Schemes Circulated	67	62	4	1	5
11	Winding Up Notice Issued	128	113	12	3	15
12	Under Inquiry	1197	1176	9	12	21
13	Schemes failed and reopened	54	50	1	3	4
14	Pending Cases Remanded by AAIFR	25	23	0	2	2
15	Stayed ordered by Courts	45	43	0	2	2
	A-B=C	**1538**	**1487**	**26**	**25**	**51**

***91 Merger cases (87 Private Sector + 3 Central PSUs + 1 State PSU)**

Source : BIFR.

7.60 Among the 273 references for public sector undertakings, 187 (80 CPSUs and 107 SPSUs) were registered up to October 2002. Rehabilitation schemes were sanctioned for (42 PSUs) 22 CPSUs and 20 SPSUs. It was recommended that 22 CPSUs and 33 SPSUs be wound up. 4 CPSUs and 7 SPSUs were declared no longer sick.