

## Rehabilitation of Sick Micro and Small Enterprises

---



Pooja Rawal

[pooja@vinodkothari.com](mailto:pooja@vinodkothari.com)

Vinod Kothari & Company

Date: November 10, 2012

**Check at:**

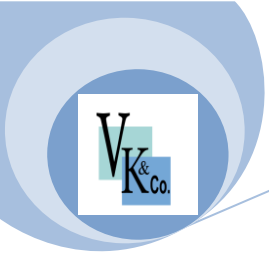
<http://india-financing.com/staff-publications.html>  
for more write ups.

**Copyright:**

This write up is the property of Vinod Kothari & Company and no part of it can be copied, reproduced or distributed in any manner.

**Disclaimer:**

This write up is intended to initiate academic debate on a pertinent question. It is not intended to be a professional advice and should not be relied upon for real life facts.



## REHABILITATION OF SICK MICRO AND SMALL ENTERPRISES

### Article

The Global Economic Crisis has left no stone unturned, with regards to its negative impact on India and on the rest of the world as well. Inflation is what the entire world is facing at present. Price hike in most of the commodities right from the daily household goods to petrol/LPG and even to the extent of the industrial products has brought our economy at a standstill. Having said this, individuals are the ones being affected most by this. However not neglecting the industrial sectors, even they are finding it difficult to cope up with global slowdown. When we talk about Global Economic Crisis it includes both large scale industries & Medium Small Enterprise (“MSE”) who strive hard to survive in this competitive world. By some or the other means the large scale industries try to manage their way out of this situation. But the MSEs, not having a very strong financial background eventually becomes sick and without having an option to revive, they tend to exit.

The Reserve Bank of India (“RBI”) has always been an active law maker when it comes to the development of the MSEs. This is not only because the financial position of these types of industries is low, however this is mainly to develop the Indian Economy. Having referred RBI as a law maker, it has made various amendments from time to time. But the one that has created a benchmark for the MSEs is the one that was initiated by the Working Group under the Chairmanship of Dr. K. C. Chakrabarty, then Chairman & Managing Director, Punjab National Bank.

RBI vide its circular RBI/2012-13/273 on November 01, 2012<sup>1</sup> came up with the new guidelines for Rehabilitation of Sick Micro and Small Enterprises (“**New Guidelines**”). Before we move to these guidelines let us know what do the existing guidelines for MSEs say:

#### Points from the Existing Guidelines

- 1) An MSE unit is considered sick when:
  - a) If any of the borrower accounts of the unit remain substandard for more than six months i.e. principal or interest, in respect of any of its borrower accounts has remained overdue for a period exceeding 1 year. The requirement of overdue period exceeding one year will remain unchanged even if the present period for classification of an account as sub-standard is reduced in due course;
  - OR
  - b) There is erosion in the net worth due to accumulated cash losses to the extent of 50 per cent of its net worth during the previous accounting year;
  - AND
  - c) The unit has been in commercial production for at least 2 years.

---

<sup>1</sup> <http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/CE273GR011112.pdf>



## REHABILITATION OF SICK MICRO AND SMALL ENTERPRISES

### Article

- 2) No stipulated time for deciding the viability of a unit.
- 3) The procedure for declaring a unit as unviable not specified.

#### Points from the New Guidelines

After analyzing the loopholes in the existing guidelines RBI came up with few revisions in its New Guidelines.

- 1) **Definition of a Sick Unit:** A Micro or Small Enterprise may be said to have become Sick, if
  - (a) Any of the borrower account of the enterprise remains NPA for three months or more
  - OR
  - (b) There is erosion in the net worth due to accumulated losses to the extent of 50% of its net worth during the previous accounting year.

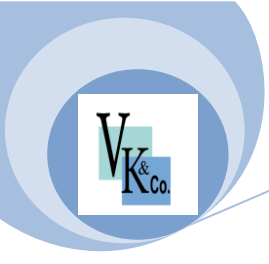
The above definition may be adopted for the purpose of reporting the data for the year ending March 31 2013, while for the purpose of formulating nursing programme; banks should go by the above definition with immediate effect.

- 2) **Handholding stage:** Precaution is better than cure. This is the whole logic behind the introduction of introducing the handholding stage. This is a very crucial stage as through this stage itself we can protect a MSE before declaring it as sick. Here, the bank intervenes after detecting early symptoms of sickness so that sickness can be arrested immediately.

In the following event a unit gets attracted to this stage:

- There is delay in commencement of commercial production by more than six months for reasons beyond the control of the promoters;
- The company incurs losses for two years or cash loss for one year, beyond the accepted timeframe;
- The capacity utilization is less than 50% of the projected level in terms of quantity or the sales are less than 50% of the projected level in terms of value during a year.

The question arising here is how efficiently and timely the banks can take a decision? The answer to this is, though such kind of an important responsibility is given to the banks, but the RBI has also set a time limit to take proper remedial action/measures in 'handholding stage'. The maximum time given is two months to identify whether an industry is a sick unit or not.



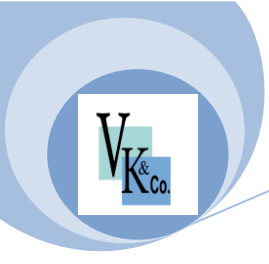
## REHABILITATION OF SICK MICRO AND SMALL ENTERPRISES

### Article

- 3) **Viability:** Viability in this case means capability of a unit for normal growth and development if given proper guidelines. Likewise when banks intervenes to decide whether a unit is sick or no it needs to take an early decision. However decision should not be later than 3 months of becoming sick.
- 4) **Procedure to be adopted by the Banks before declaring any Unit as Unviable:**

This is to ensure that before declaring a unit as sick, a proper procedure needs to be followed to give justice to the MSEs. Following points are covered by the RBI:

- (a) **Size of the Unit:** A unit should be declared unviable only if the viability status is evidenced by a viability study. However, it may not be feasible to conduct viability study in very small units and will only increase paperwork. As such for micro (manufacturing) enterprises, having investment in plant and machinery up to Rs.5 lakh and micro (service) enterprises having investment in equipment up to Rs. 2 lakh, the Branch Manager may take a decision on viability and record the same, along with the justification.
- (b) **Approval of the next higher authority:** The declaration of the unit as unviable, as evidenced by the viability study, should have the approval of the next higher authority/ present sanctioning authority for both micro and small units.
- (c) **Opportunity to be heard:** In case such a unit is declared unviable, an opportunity should be given to the unit to present the case before the next higher authority. The modalities for presenting the case to the next higher authority may be worked out by the banks in terms of their Board approved policies in this regard. The next higher authority should take such decision only after giving an opportunity to the promoters of the unit to present their case.
- (d) **Committee approach:** For sick units declared unviable, with credit facilities of Rs.1 crore and above, a Committee approach may be adopted. A Committee comprising of senior official of the bank may examine such proposals. A Committee approach will improve the quality of decision as collective wisdom of the members shall be utilized, especially while taking decision on rehabilitation proposals.



## REHABILITATION OF SICK MICRO AND SMALL ENTERPRISES

### Article

- (e) **Written Application:** Decision of the above higher authority should be informed to the promoters in writing. The above process should be completed in a time bound manner not later than 3 months.

#### Effects of this New Guidelines:

The New Guidelines will give a definite thrust to the MSME industry, a few bring provided below:

1. This special task being given only to Scheduled Commercial Banks (“SCBs”), it will help them to provide easy, speedy and transparent access to banking services in their day to day operations to its MSE customers.
2. In times of financial difficulties, banks can provide personalized services of the MSEs.
3. It will create positive thrust to MSE sector.
4. Hassle free credit will be available to MSE.
5. Proper appraisal and evaluation of MSE.
6. To achieve different parameters prescribed by RBI.
7. Cluster Based approach for financing MSE.
8. Generation of large number of youth entrepreneur will be attracted to invest in MSE.
9. The policy strives to ensure that the socio economic obligations cast on the bank are fully met.
10. With regard to guidelines issued from time to time by the authorities, the Bank would follow them in all their aspects. However, if these permit varying interpretations, the Bank will adopt a reasonable interpretation, as determined by the Credit Risk Management Committee without deviating from the spirit behind the guidelines.

#### Conclusion

Now that the RBI has laid down a structured process for the declaration of a sick unit, it clearly states that, in a developing country like India it is important to get problems solved before they become worse. Likewise, earlier detection of sickness in case of MSEs will surely improve the economics conditions. It will also give a second opportunity to MSEs to recovery back from their present situation. That is why it is said, “Precaution is better than cure.”