CHAPTER 10

Rehabilitation of Sick Units

10.1 GENERAL

Industries that have gone sick have far-reaching consequences on the economy of the nation. The following are the bad effects of industrial sickness.

- There is under utilisation of capital assets. Though under utilisation of capital assets is a drain on the capital of any nation, it very much affects the capital formation process of less developed and developing countries.
- The entrepreneurship level declines. In economics land, labour and capital are referred to as the factors of production. It is only entrepreneurship of project promoters that brings together the factors of production for accomplishing the task of nation building. Increase in industrial sickness discourages entrepreneurship.
- The investor confidence reaches a lower ebb. Thus, capital is not put to productive use.
- Industrial sickness results in large scale unemployment and industrial unrest.
- Profitability of banks and financial institutions gets affected since they don’t get back their funds invested in projects that have gone sick. Nor do they earn interest on their invested funds. Since their funds get blocked in sick units banks/financial institutions could not recycle their funds with the result that even a good project can not be funded by them.

Therefore, prevention of sickness and rehabilitating sick projects assume greater importance.

10.2 DEFINITION OF SICKNESS

The sick industrial companies (Special provisions) Act, 1985, as amended in 1993 defines sick industrial company as an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire networth.

Section 3 (1) (ga) of the amendment act, 1993 defines ‘Net worth’ as the sum of the paid-up capital and free reserves, while the term ‘free reserves’ means all reserves credited out of the profits and share premium account, but does not include reserve out of re-valuation of assets, write back of depreciation provisions and reserves created out of amalgamations.

Government companies having State or Central Government share holdings of 51% or more are kept outside the purview of the Act. Also small scale industrial units and Ancillary units are kept outside the purview of the Act.

10.3 BOARD OF INDUSTRIAL AND FINANCIAL RECONSTRUCTION (BIFR)

Board of industrial and Financial Reconstruction (BIFR) was established by the Central Government, under section 3 of the Sick Industrial Companies (Special provisions) Act, 1985 and it became fully
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operational in May, 1987. BIFR deals with issues like revival and rehabilitation on sick companies, winding up of sick companies, institutional finance to sick companies, amalgamation of companies etc. BIFR is a quasi judicial body.

The role of BIFR as envisaged in the SICA (Sick Industrial Companies Act) is:

(a) Securing the timely detection of sick and potentially sick companies

(b) Speedy determination by a group of experts of the various measures to be taken in respect of the sick company

(c) Expeditious enforcement of such measures

BIFR has a chairman and may have a maximum of 14 members, drawn from various fields including banking, labour, accountancy, economics etc. It functions like a court and has constituted four benches.

10.3.1 Reporting to the BIFR

The Board of Directors of a sick industrial company is required, by law, to report the sickness to the BIFR within 60 days of finalisation of audited accounts, for the financial year at the end of which the company has become sick. BIFR has prescribed a format for this report. While reporting by a company of its sickness to the BIFR is mandatory as per the provisions of law, any other interested person/party can also report the fact of sickness of a company to the BIFR. Such interested parties may be the financial institution/bank that has lent loan to the company, the RBI, the Central/State Governments. The BIFR has prescribed a different format for the report to be submitted by such interested parties. When a company has been financed by a consortium of banks, it is the Lead Bank that should report to the BIFR about the sickness under advice to other participating banks in the consortium.

10.3.2 Enquiry by the BIFR

When a case is referred to the BIFR, it is verified by the Registrar of the BIFR as to whether the facts of the case falls within the provisions of the Sick Industrial (Special provisions) Act, 1985. If so, the BIFR accepts the case and notifies a date for hearing the case. For rehabilitating a sick unit, co-operation of various connected agencies is a must. This co-ordination is achieved by the BIFR. The BIFR invites the representatives of the informant sick company, the representatives of concerned financial institutions and commercial banks, representatives of the Central/State Governments, trade union representatives etc., to the hearing and inquiry is made under section 16 of the Act.

After the hearing, the BIFR itself may conduct a study or entrust the work to an ‘operating agency’ appointed by it to determine whether the company is in fact sick. Normally, the lead financial institution (IDBI, ICICI, IFCI, SFC) or the lead public sector bank that has financed the company is nominated as the operating agency. Lead institution is one that has major financial stake in the sick company. The enquiry is to be completed within 60 days. On completion of the enquiry, the BIFR will declare whether the company is sick or not.

10.3.3 Revival Package

Once a company has been found sick, the BIFR may grant time to the sick company to enable it to make its networth positive and bring the company out of sickness, without any external financial assistance. If it is found infeasible for company to make its networth positive with out any external financial assistance, or if the BIFR decides that the company can not make its networth positive
within a reasonable time, the BIFR will direct the operating agency to prepare a suitable revival package for the restoration of the health of the company.

The operating agency prepares a suitable revival package. The revival package may vary from case to case depending on the nature of the problem and may include additional financial assistance, postponement of recovery of loan already lent by banks and financial institutions, change in management, amalgamation, sale of redundant assets, lease of assets or any other suitable measure. The revival package should be submitted to the BIFR within a time limit of 90 days or such extended period as may be granted by the BIFR.

On submission of the revival package by the operating agency, the BIFR sends the revival package in a draft form to all the interested parties (i.e., the sick industrial company, the banks/financial institutions who have given financial assistance to the sick company, the operating agency, the transferee company (if there is a recommendation in the revival package for amalgamation) etc., eliciting their views/suggestions on the revival package. The BIFR will also publish particulars of the draft revival package in newspapers inviting suggestions/objections, if any, from the shareholders of the sick company, creditors and employees of the sick company, transferee company and any other interested party. On receipt of views/suggestions/objections on the draft revival scheme, the BIFR may, if deemed fit, afford an opportunity to the interested parties to be heard. After careful examination of all the aspects, the BIFR will sanction the revival scheme with or without any modifications. The scheme, as sanctioned, will come into force from the specified date and all the concerned parties are required to abide by the provisions of the revival scheme. The BIFR may also order the operating agency to implement the sanctioned revival scheme.

When the revival package as finalized by the BIFR contains further financial assistance or reliefs, concessions, sacrifices etc. (for example, sanctioning of additional financial assistance for the purchase of certain balancing equipments, waiving of penal interest/compound interest charged, waiving of interest in part or full, waiver from sales tax etc.) the scheme will be circulated to the concerned agencies for their consent to be received within a period of 60 days. Once the various agencies involved in the revival scheme give their consent to the scheme, it will become binding on the consenting parties to implement the recommendations contained in the revival scheme. However, when any of the involved agency does not give its consent to the scheme, the BIFR has no powers to force the agency to accord its consent. If in the opinion of the BIFR, the revival package can not be successful with out the consent from one or more of the agencies involved, the BIFR has no other option but to recommend for winding up of the company. In fact, the threat of actual winding up of the company is the only weapon in the hands of the BIFR to make the various agencies to extend suitable reliefs and concessions as may be deemed necessary by the BIFR. BIFR itself cannot initiate the winding up proceedings. It can only forward its opinion to the concerned High Court and the High Court will initiate the winding up proceedings.

10.4 CAUSES OF SICKNESS

‘Prevention is better than cure’ is the proverb that reflects the need for knowing the likely causes of industrial sickness so that one can plan to avoid the same. Just as human beings fall sick by two ways, viz., either born sick or acquiring sickness during growth, an industry can either run into trouble even during the implementation stage itself or develop sickness during its lifetime.

The causes of sickness can be categorized into two viz., internal causes and external causes. Internal causes are those that are internal to the organization over which the management of the organization has control. Sickness due to internal causes can be avoided if the management is
shrewd enough to identify the causes and eliminate them at their initial stage itself. External causes are those that are external to the organization over which the management of the organization has little control. Government’s plans and actions, failure of monsoon which affects agriculture and allied industries, emergence of strong competitors etc., are some of the external factors. Though sickness may be caused either by internal or external factors, sometimes, the management may be able to revamp its organization, plan suitable strategies and take on the external factors to reduce their impact.

The areas/stages in which these causes may exist and their effects can be studied under the following heads.

- Project formulation.
- Project implementation.
- Production.
- Marketing.
- Finance.
- General and personnel administration.

**Project formulation:** Most of sickness is attributed to ill-conceived projects. A project that may, prima-facie present a rosy picture may have many hidden pitfalls. Irrational, hasty, over-optimistic decisions may result in choosing projects that may have inherent weaknesses. A project that has an inherent weakness is very unlikely to be a successful project. The existence of a few players in the chosen field who are doing well, is not always a sound proof that the project will be a success. The existing players may have their own special advantages due to which they could have overcome the hurdles and pitfalls that are present in the project.

A thorough investigation of the project during the identification and formulation stage is the sinequa-non of any project proposal. “Think before you act”—is the proverb that is worth practising. Any amount of time and efforts spent at this stage is worth it as any hasty decision made at this stage will be very costly.

External factors play a major role in project formulation stage. The present stage of and the future course of the external environment are to be carefully studied for their influence on the project.

**Project implementation:** Delayed implementation gives a project a difficult start. Unduly long time taken for project implementation results in time-overrun which is invariably followed by cost-overrun. Cost-overrun has the ill effect of affecting the financial viability of the project since a project that is viable at a capital cost of say Rs. 100.00 lakhs may prove to be unviable when the cost raises to, say Rs. 150.00 lakhs due to cost-overrun. The problem of cost-overrun will get more compounded if the finance necessary to meet the increased cost can not be arranged in time. Any delay in arranging for the finance needed to meet the cost overrun will only further tend to increase the cost and this may land the project in trouble leading eventually to the death of the project and the project may not take off.

The following are some of the problem areas in implementation stage.

- The promoters may not be in a position to bring in funds to the required extent in time. In general, Banks/Financial institutions, of late, insist that the promoters shall bring in their capital contribution to the project upfront before release of loan. Any delay in bringing the stipulated capital by the promoters will delay the drawal of loan, which will lead to delay in implementation.
The loan disbursement may be delayed if the promoters are not able to comply with major
terms and conditions of the loan agreement. For example, the loan agreement, inter-alia, may
stipulate that collateral security to cover, say 25% of the loan amount shall be offered. The
value of the property that the promoters offer as collateral security to the bank/financial institution
may be short of the requirement. Or, when the value of the property meets the requirement,
there may be other impediments like legal hurdles for clear, unencumbered title to the property
e tc.

The cost of different components of project-cost may increase due to price escalation. The cost
provided for some of the elements of project-cost might have been underestimated. It is also
likely that some elements which are essential might have been left out. These factors lead to
cost-overrun which may delay the project implementation.

There may be delay in getting power connection, water connection, approval from local bodies,
approval from pollution control authorities etc., which may postpone project implementation/
commencement of production.

When more than one institution are involved in funding a project, there may be delay in tying
up the financial arrangements with the different institutions. This is more so when term loan
and working capital loan are provided by two different institutions. The institution that is to
lend working capital loan may wish to see that the project comes through successfully and
reaches a ready-to-start stage before committing sanction of working capital finance. There is
likelihood of the capital investment on the project having been fully made and the project
waiting for sanction/release of working capital finance to commence commercial operations.
Any delay in release of working capital finance due to procedural formalities involved will
harm the project heavily, as the capital investment will be lying idle, without earning any
return.

‘Rethinking’ of the project during the course of implementation, like changes in production
process, use of alternate raw material, changes in technology etc., may hold up project imple-
mentation.

Over spending on travel, entertainment and non-productive assets like guest houses, compound
walls, staff quarters etc., may result in cost-overrun, which in turn may delay project imple-
mentation.

Adverse foreign currency exchange rate fluctuations may affect projects involving imported
plant and machinery and may result in cost-overrun. This is an external factor over which the
management has no control. However, a prudent management can guard against adverse for-
eign currency movement by entering into forward contracts etc.,

Production: The major aspects of production that may lead to sickness are

- Increase in the cost of production.
- Decrease in the quantity of production.
- Quality of product not meeting the standards/customer expectation.
- Producing more quantity than can be sold, leading to accumulation of stock.

The increase in cost of production may be due to external factors like increase in the cost of raw
materials, increase in the cost of consumables, power, etc., or due to internal factors like improper
choice of raw material/raw material-source, wrong choice of production process etc.
Decrease in quantity of production may be due to defects/under performance of plant and machinery, defects in production process etc.,

Defects in quality of products may be due to defects in raw material used, or due to unsatisfactory performance of machinery or due to ineffective supervision. Inspite of the raw material, machinery and supervision being good, the advent of new technology may bring in product-obsolescence and the product may loose customer preference.

Lack of proper planning of product mix and lack of co-ordination between production and marketing departments may lead to piling up of inventory, which will only add to the cost of the product.

**Marketing:** Marketing occupies an important position in the organization of any business unit. The prime objective of marketing, is the satisfaction of customer’s needs. Marketing functions include all functions necessary to satisfy the customers. Marketing includes all activities starting with the idea of producing a product to satisfy the needs of the consumers and ending with the satisfaction of the consumer even after the product is sold. Thus, it involves planning and producing to meet the customer needs and also servicing the customers after selling the product.

In the present day situation where buyer’s market has come to stay almost for all products, any organization that does not give due importance to marketing is bound to find its sales turnover taking a downward trend.

The problem areas may be summarized as under.

- Introduction of better substitute products by competitors.
- Absence of product innovation and new product development.
- Failure to maximize the potential of existing products.
- Poor and inadequate distribution system.
- Failure to meet the agreed delivery schedules.
- Absence of correct costing and correct pricing system for the products.

**Finance:** Finance is the lifeblood of business. It links and passes through all areas of a business unit. The problem areas may be summarized as under

- The promoters might have chosen a project which is beyond their financial capacity. This often happens due to over ambitious approach of entrepreneurs. A bigger project needs a bigger investment and accordingly a higher promoter’s contribution in absolute terms. If the promoters are not able to mobilize their contribution, with the sole idea of implementing the project, they often resort to borrowings, invariably at higher interest rates with the hope of clearing the high-cost borrowings once the project takes off (a hope that rarely comes through!).
- Funding a project with a higher debt component than that it can safety bear is another reason for sickness, since such projects will not be able to service the high interest charges. On the other hand, inadequate long-term debt component will also be detrimental since the project will either not take off due to the promoter’s inability to raise the required capital or will be funded by high cost short term borrowings which is harmful.
- Using shorterm funds for acquiring fixed assets is an area of concern. This will put the liquidity position of the business in strain when the shorterm obligations become due for repayment.
- Improper inventory management policy will lead to holding huge stock of finished products, late realization of debts from sundry debtors, lack of proper planning to pay to creditors of raw materials, etc., which will all have telling effects on the operation of a business unit.
General and personnel administration: The problem areas are summarized as under:

- Dispute/difference of opinion among the promoters/directors.
- Poor industrial relations leading to labour unrest.
- Lack of motivation and co-ordination.
- Lack of manpower planning.
- Lack of assigning equal importance to all areas of business. It is generally observed that the main promoter takes more interest in the area of his specialisation and ignores other aspects of the business. For example, technocrat entrepreneurs, by their nature are more inclined to improving the technical aspects of the product. The result may be that the product will not be a commercial success though it may have technical excellence.
- Projects that solely depend upon the skills of a key promoter may find it difficult to sail through in the event of death or ill-health of the key person.

Leading indicators of sickness: Just as diseases are identified by certain symptoms, industrial sickness can be identified by the following symptoms. These symptoms act as leading indicators of sickness, and if immediate remedial actions are not taken, the sickness will grow to the extent that the organization will find its natural death.

- Continuous reduction in turnover.
- Piling up of inventory.
- Continuous reduction of net profit to sales ratio.
- Short term borrowings at high interest rate.
- Continuous cash losses leading to erosion of tangible net worth.
- Default in payment of interest on borrowings and default in repayment of term loan instalments.
- The ‘sundry debtors’ as well as the ‘sundry creditors’ keep growing and reaching a disproportionately high level.
- Approaching the banker for temporary over draft at frequent intervals.
- High turnover of personnel, especially at senior levels.
- Change in accounting procedure with to view to window dressing.
- Delay in finalization of accounts.

10.5 PREDICTION OF SICKNESS

Though symptoms of sickness can be observed from the leading indicators, such indicators may only suggest that the unit is a potentially sick unit. However, it is not easy to arrive at a definite conclusion about the impending sickness on the basis of the leading indicators of sickness. Considerable research work has been done to identify other measurable parameters that can be used for predicting sickness. The research, in general has been done by two different methods of analysis. They are,

Univariate Analysis

and

Multivariate Analysis
10.5.1 Univariate Analysis

Univariate analysis aims to predict sickness on the basis of a single financial ratio. Though many financial ratios were used by analysts for predicting sickness, there was no consensus as to what the most appropriate ratio is for the prediction of sickness. Such a situation prevailed till William H. Beaver published his study on univariate analysis in the year 1966. Beaver examined the predicative power of 30 different financial ratios by choosing a sample of 79 firms that had become sick and 79 firms that were healthy for the same period of time. The sample was so chosen that for each failed (sick) firm, a healthy firm operating in the same industry and having comparative size was included in the sample set. For both the set of samples of 79 firms each, Beaver examined the behaviour of 30 different financial ratios during the period of 5 years prior to the failure. The main finding of Beaver was that the ratio that is most useful in predicting impending sickness is the ‘ratio of cash flow to total debt’, since this ratio showed the minimum error in his prediction.

10.5.2 Multivariate Analysis

Univariate analysis examines the predictive power of individual financial ratios. The joint effect of more than one financial ratio in predicting sickness is not studied in univariate analysis. Multivariate analysis, on the other hand, aims to predict industrial sickness by studying the combined influence of several financial ratios.

Altman, E.I. presented his model of multivariate analysis for predicting industrial sickness in the year 1966. In his model, Altman combined several financial ratios into a single index. He named this index as ‘Z-score’. His analysis was based on a statistical procedure known as ‘multiple discriminate analysis’ (MDA). Altman studied a sample of 33 bankrupt firms along with a paired sample of 33 non-bankrupt firms. He examined 22 financial ratios to identify their combined influence on sickness and selected five ratios, which in his opinion jointly possess the maximum power to predict bankruptcy.

Altman derived a discriminant function (‘Z’) that contains five financial ratios. The discriminant function derived by Altman is as under:

\[ Z = 1.20x_1 + 1.40x_2 + 3.30x_3 + 0.60x_4 + 0.999x_5 \]

Where,

- \( Z \) = discriminant score
- \( x_1 \) = (working capital) \( \div \) (total assets)
- \( x_2 \) = (retained earnings) \( \div \) (total assets)
- \( x_3 \) = (earnings before interest and tax) \( \div \) (total assets)
- \( x_4 \) = (market value of equity) \( \div \) (book value of total debt)
- \( x_5 \) = (sales) \( \div \) (total assets)

A cut-off point for the ‘Z’ score was determined by Altman in such a way that it minimized the overlap between bankrupt and non-bankrupt groups. Altman found that a cut off value of 2.675 for ‘Z’ minimized the possibility of misclassification. Thus, as per Altman’s analysis, firms with ‘Z’ score less than 2.675 are prone to become bankrupt and firms with ‘Z’ score more than 2.675 are free from the threat of bankruptcy.

10.5.3 An Evaluation of Altman’s Model

Altman propounded that his sickness prediction model was highly reliable and gave a low percentage of error (of the order of only 5%) when the data for one year before bankruptcy was employed. In other words, Altman’s model could predict bankruptcy one year before the firm becomes bankrupt.
The percentage of error in Altman’s model raises from 5% to 28% when prediction is made two years prior to bankruptcy. It further raises to 71% when the study is made four years prior to bankruptcy. Such high level of errors in the preceding years lead one to believe that the lower percentage of error of 5% when the study is made one year prior to bankruptcy could have been accidental. Thus, the reliability of Altman’s model is not established beyond doubt. Assuming that Altman’s model works well when prediction is made one year before bankruptcy, one year is too short a period to take any remedial action. It is like predicting that the tree would fall when the tree has already started falling.

Another disadvantage of Altman’s model is that it predicts only ‘bankruptcy’. A firm becomes sick well before it becomes bankrupt. Hence, any sickness prediction model will be of use only when it predicts the starting symptoms of sickness so that suitable remedial measures can be taken to bring back the sick unit to life.

10.5.4 Dr. L.C. Gupta's Sickness Prediction Model

Dr. L.C. Gupta made an attempt to distinguish between sick and non-sick companies on the basis of financial ratios. He used a simple non-parametric test for measuring the relative predicting power of different financial ratios. A mixed sample of sick and non-sick companies was made and the companies in the sample were arranged in a single ordered sequence from the smallest to the largest, according to the financial ratio that is tested for its predictive power. Let \([\text{profit after tax} + \text{Net worth}]\) is a financial ratio that is to be tested for its predictive power. The companies in the sample are arranged in increasing order of this particular ratio. Let the sick companies be denoted by the letter ‘S’ and the non-sick ones by the letter ‘N’. Let us assume that 8 sick companies and 8 non-sick companies are taken for building up the sample. When arranged in a sequential order as stated above, the sequence may result in any pattern as shown below:

(A) S-N-S-N-S-N-S-N-S-N-S-N
(B) S-S-S-S-S-S-S-S-N-N-N-N-N-N-N-N
(C) S-S-S-S-N-N-N-N-N-N-N-N-S-S-S-S
(D) S-S-S-N-S-N-S-N-S-N-N-S-N-N-N

Observing the pattern of occurrence of ‘S’ and ‘N’ a cut off point is chosen to separate the sick group from the non-sick group. Companies that fall to the left of the cut off point lie in the sick group while companies that fall to the right of the cut off point lie in the non-sick group. The cut off point is so chosen that the number of misclassifications are minimised. The ratio that showed the least percentage classification error at the earliest possible time is deemed to have the highest predicative power. Referring to the four patterns shown above, the pattern of sequence shown in (B) is the most accurate one since the cut off point will be located exactly midway in the sample group and the percentage of classification error will be zero since there are no misclassifications. Pattern shown in (C) is bound to have a higher error since the sick companies are concentrated on both the extreme ends.

Dr. L.C. Gupta used Indian data on a sample of 41 textile companies of which 20 were sick companies and 21 were non-sick companies. He studied the predictive power of 63 financial ratios and observed that the following two ratios have comparatively better predictive power.
(a) \( \frac{\text{Earnings before Interest and Taxes}}{\text{Sales}} \) and

(b) \( \frac{\text{Operating cash flow}}{\text{Sales}} \)

\[ \text{Note: Operating cash flow} = \text{profit after tax} + \text{depreciation} \]

Need for revival/rehabilitation programme: A project that has gone sick would have already swallowed huge scarce resources. In order to utilize the assets and infrastructure already created for the project, the project is to be revived from sickness.

There is no doubt that the project would have had some weak areas which could have been the cause for the sickness. Inspite of this, rehabilitating the sick project is worth considering since the cost of setting up a new unit might be substantially higher as compared to the cost of rehabilitating a viable sick unit. Of course, having known the factors that were responsible for leading the unit to sickness, they can be properly addressed in the revival package.

Revival of a sick unit may be necessitated or justified in view of the underlying socio-economic objectives such as the following.

(a) The project may be in a sector that is vital to the economy. Abandoning the project may lead to other socio-economic ill effects.

(b) Many ancillary units may be dependent on the unit that has gone sick. Unless the sick unit is revived, it will have a chain effect of all such dependent ancillary units becoming sick.

(c) Banks and financial institutions would have locked up their money in sick ventures.

In order to get back the investment of banks and financial institutions, the project is to be revived and made to work again and generate surpluses. Though banks and financial institutions that support a revival programme for the sick unit may be required to fund the project again, they will be prepared to implement revival packages if they are convinced that they will, apart from getting back their present investment with interest, also get back their earlier investments that are locked up.

Viability study for rehabilitation proposal: Once bitten, twice shy! - Before attempting to rehabilitate a sick unit, a detailed and thorough viability study is to be undertaken to ensure that the revival programme will really bear fruits. It is not advisable to venture upon any revival programme if there are gray areas that need further study.

The viability study shall enquire into the technical, commercial, managerial and financial aspects.

Technical Appraisal

(a) Study the manufacturing process used by the unit. Ascertaining if any new process has since been developed. Explore the necessity of switching over to the latest manufacturing process and study the cost, benefit aspects of such switchover.

(b) Study the production capacity of different production sections and checkup if the production capacity of different sections are perfectly balanced. If there is any production section, which has a lower capacity than that required for perfect balancing, the overall capacity of the plant can be significantly increased without huge investments, by adding the required balancing machinery.

(c) Explore the possibilities of adding additional/special features to the products that will add competitive edge to the product. Also examine the need for changing the product-mix that is in tune with the market requirement.
(d) Find out if any plant/equipment need major repair/overhauling to improve its operating efficiency.

(e) If the locational disadvantages outweigh all other factors, the scope for shifting the location to an advantageous place may be examined and the consequent cost-benefit analysis studied. This may be possible if the firm is functioning in a leased premises and owns only the plant and machinery. If the unit is located in own building, the proposal for shifting the plant and machinery to a leased building in an advantages location may also be studied. The building owned by the firm can be leased out to some other firms. The long-term cost-benefit analysis will give lead to the acceptability or otherwise of such a proposal.

(f) Study the modifications required, if any in the plant layout so that the material handling time can be reduced which may improve the efficiency of operations and improve the output.

(g) Examine if any of the manufacturing operations that are done in house can be entrusted to outside agencies, which may result in cost reduction.

Commercial Appraisal

(a) Commercial failure of a project will be mainly due to problems relating to the product itself viz., defects/imperfections in product design which may lead to consumer resistance. Such situations indicate that the products offered by competitors have better features that attract consumers. Hence, the scope for product improvement and the cost involved are to be studied.

(b) In spite of consumer acceptance of the product, if the project has gone sick, it is likely that the profit margins might be low. Minor modifications in designing and packing the product with upward revision in price may be accepted by the market which may bring better returns to the company. This aspect may be studied by carrying out test marketing for the improved product.

(c) Every product follows a life cycle which passes through four stages viz.,
   Introduction.
   Rapid expansion.
   Maturity.
   and Decline.

Profit margins shrink and signs of sickness appear when the product is in its ‘decline’ stage. Product innovation can only sustain the product at this stage. The decline once started can not be contained for long inspite of product innovations. Product diversification may prove to be a feasible solution. Hence for rehabilitating a unit whose product has already reached its ‘decline’ stage, the feasibility of switching over to diversified products making use of the existing production facilities is to be studied. The cost-benefit analysis of additional investments needed for product diversification and additional benefits that may accrue are to be analysed.

Management Appraisal: A good project in the hands of an ineffective management turns the project bad. Similarly a good management is capable making a not-so-good project, a success.

Hence the first thing under management appraisal is to study whether the sickness is due to reasons beyond the control of the present management or due to ineffective management.
If the sickness is due to reasons beyond the control of the management, for any revival package to come out successful, it should be first ascertained if the management is still committed to the project and is serious about reviving the unit. The management’s commitment and seriousness may be indicated by,

- Its readiness to inject additional funds to revive the unit.
- Its readiness to strengthen the existing management by agreeing to induct professionals as directors at various functional areas like technical/finance/marketing/research and development etc.

The managerial appraisal shall suggest the required changes in the existing organisational set up of the unit and also shall study the possible reduction in the man power that can be achieved without affecting the organisational efficiency, the likely compensation payable for retrenchment etc.

**Financial appraisal:** Since appraisal of all other areas have a financial commitment in one form or the other, financial appraisal assumes greater importance. All aspects of financial reconstruction need to be considered and analysed.

When a project that has long term debt component in its capital structure becomes sick, it becomes necessary to ease the burden of debt to enable the sick unit to recover from its sickness. This necessitates restructuring of the debts. In general, banks and financial institutions offer the following concessions in their package of rehabilitation assistance.

(a) Reduction in interest rate of existing loans.

(b) Conversion of short-term loans in to long-term loans. 
   (This gives the unit under revival the much-needed leeway to repay short term borrowings.)

(c) Conversion of part of long term loans into equity.

(d) Funding of the overdue interest (un-paid interest) and making it repayable in easy instalments. The funded interest component may carry concessional rate of interest or even at times bears no interest.

(e) Offering a revised schedule of repayment for the principal components of term loan.

(f) Sanction of additional loan to meet the additional capital expenditure.

(g) Enhancement of working capital limits and regularising the irregular portion of working capital finance already availed.

If any asset is found not useful, the wise choice would be to dispose off the asset and use the amount realised to support the rehabilitation programme.

**Monitoring of nursing programme:** For the growth of a healthy person it is enough if ordinary care is taken, while a sick person who is in convalescent stage needs critical attention. He is prone to getting sick again if proper care is not taken to monitor his health and to administer medicine at the required intervals.

A sick unit that is under a nursing programme is similar to a sick person who is in convalescent stage and needs continuous monitoring. A simple and practical monitoring mechanism shall be devised.