MANAGEMENT/ REHABILITATION OF SICK MSME UNITS

Incipient sickness

It is of utmost importance to take measures to ensure that sickness is arrested at the incipient stage itself. The respective branches shall keep a close watch on the operations in the account and take adequate measures to achieve this objective. The managements of the units financed shall be advised about their primary responsibility to inform the Bank if they face problems, which could lead to sickness and to restore the units to normal health. The organizational arrangements at branch level shall also be fully geared for early detection of sickness and prompt remedial action. Bank shall have to identify the units showing symptoms of sickness by effective monitoring and provide additional finance, if warranted, so as to bring back the units to a healthy track. An illustrative list of warning signals of incipient sickness that are thrown up during the scrutiny of borrowal accounts and other related records e.g. periodical financial data, stock statements, reports on inspection of factory premises and godowns, etc., is given in Appendix – 1 which will serve as a useful guide to the operating personnel.

When an advance slips into the sub-standard category, as per norms, the branch shall make full enquiry into the financial health of the unit, its operations, etc. and take remedial action. The branch officials who are familiar with the day-to-day operations in the borrowal accounts shall be under obligation to identify the early warning signals and initiate corrective steps promptly. Such steps may include providing timely financial assistance depending on established need, if it is within the powers of the branch manager and an early reference to the controlling office where the relief required are beyond his delegated powers. The branch manager may also help the unit in sorting out difficulties which are non-financial in nature and require assistance from outside agencies like Government Departments/ undertakings, Electricity Boards, etc. He shall also keep the term lending institutions informed about the position of the units wherever they are also involved.

In spite of their best efforts and intentions, sometimes borrowers find themselves in financial difficulty because of factors beyond their control. All assisted projects do not always operate on expected lines due to various reasons such as managerial, technical, financial or marketing problems resulting in lower or irregular cash flows and/ or inability to pay off the dues to the lender(s) in a timely manner.

The benefits of rehabilitation are that, while on one hand the asset is retained in the books of the Bank, on the other hand the account turns into a performing asset and the yield on the account is better as compared to an account where a compromise settlement is to take place. Thus, rehabilitation of the sick account is the most desired recovery tool for NPAs.

However, rehabilitation has its own challenges. While an active participation of the borrower is utmost essential, the participation of other term lenders/ creditors/ working capital banker(s) is also important and in case any party is not co-operative, success of the rehabilitation package becomes suspect.
**Handholding stage**

Timely and adequate assistance to MSMEs and rehabilitation effort shall begin on a proactive basis when early signs of sickness are detected. This stage would be termed as ‘handholding stage’ as defined below. This shall ensure intervention by banks immediately after detecting early symptoms of sickness so that sickness can be arrested at an early stage. An account may be treated to have reached the ‘handholding stage’; if any of the following events are triggered:

- 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 branches shall take timely remedial action which includes an enquiry into the operations of the unit and proper scrutiny of accounts, providing guidance/counselling services, timely financial assistance as per established need and also helping the unit in sorting out difficulties which are non-financial in nature or requiring assistance from other agencies. In order to ensure timeliness for taking remedial action/measures in ‘handholding stage’, the handholding support to such units should be undertaken within a maximum period of two months of identification of such units.

This would enable the bank to take timely action in identification of sick units for their revival. The MSME units which could not be revived after intervention by banks at the ‘handholding stage’ need to be classified as sick subject to complying with any one of the two conditions as laid down below and based on a viability study the viable/potentially viable units be provided rehabilitation package. The rehabilitation package shall be implemented speedily in a time bound manner. The rehabilitation package should be fully implemented within six months from the date the unit is declared as 'potentially viable' / 'viable'. While identifying and implementing the rehabilitation package, the bank shall do ‘holding operation’ for a period of six months. This will allow small-scale units to draw funds from the cash credit account at least to the extent of their deposit of sale proceeds during the period of such ‘holding operation’.

Units becoming sick on account of wilful mismanagement, wilful default, unauthorized diversion of funds, disputes among partners / promoters, etc. shall not be classified as sick units and accordingly shall not be eligible for any relief and concessions. In such cases, steps shall be taken for recovery of bank’s dues. The declaration of a borrower as a wilful defaulter shall be done strictly in accordance with the extant RBI guidelines.
Rehabilitation package for sick units

Eligibility

All potentially viable sick units/service sector projects assisted by the Bank/FI are eligible to seek rehabilitation packages for revival. The unit shall be capable of being restored to normal health within a reasonable time. However, sick units categorized as a case of suspected fraud are not eligible for such package and steps shall be taken for recovery of bank’s dues.

Discussions shall be held with the promoters of sick but potentially viable units to work out a suitable rehabilitation programme to turnaround the unit. There is scope to improve use of this tool of NPA management further to reduce the number of sick units in the Bank’s portfolio as well as to improve recovery from sick but viable units.

Definition of sick MSME unit

As per extant RBI guidelines, an MSME unit may be classified as sick if:


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<th>Any of the borrowal accounts of the enterprise remains NPA for 3 months or more</th>
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<td>There is erosion in the net worth of the borrower due to accumulated losses to the extent of 50 percent of its net worth during the previous accounting year;</td>
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<td>The stipulation that the unit should have been in commercial production for at least two years has been removed</td>
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Viability

The decision on viability of the unit shall be taken at the earliest but not later than 3 months of becoming sick under any circumstances.

The following procedure should be adopted by the banks before declaring any unit as unviable:

a. 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. 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. 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.

c. The next higher authority should take such decision only after giving an opportunity to the promoters of the unit to present their case.

d. 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.

e. 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.

The Fraud Monitoring Cell at HO, however, take decision in cases of malfeasance or fraud without following the above procedure.

**Formulation of a rehabilitation package**

After identifying a sick unit, the causes of its sickness shall be diagnosed and remedial measures decided after examination of its viability in consultation with other lenders, as far as practicable.

The rehabilitation package shall be based on analysis of past operations and address the deficiencies. The promoters shall be involved in the preparation of the package. A joint package preparation in consultation with working capital banker would ensure that the package addresses all relevant issues affecting its turnaround.

Study of the feasibility of operating the unit at the existing level of installed capacity and within the prevailing business environment shall be carried out in addition to reappraisal of management set up and market prospects.

In respect of units covered under the ECGC/CGTMSE guarantee, rehabilitation measures could be considered subject to approval of the package by ECGC/CGTMSE as the case may be.

Rehabilitation Package should be fully implemented **within 6 months** from the date the unit is declared as ‘Potentially viable/viable’
Reliefs and Concessions for Rehabilitation of Potentially Viable Units

It is emphasized that only those units which are considered to be potentially viable shall be taken up for rehabilitation. No unit will be taken up for rehabilitation by the bank unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of rehabilitation package. The viability shall be determined by the bank based on the acceptable viability benchmarks determined by them, which may be applied on a case-by-case basis, depending on merits of each case. Illustratively, the parameters may include the Return on Capital Employed, Debt Service Coverage Ratio, Gap between the Internal Rate of Return and Cost of Funds and the amount of provision required in lieu of the diminution in the fair value of the restructured advance. In fact, the viability study itself shall contain a sensitivity analysis in respect of the risks involved that in turn will enable firming up of the corrective action matrix.

Rehabilitation shall be done after looking into cash flows of the borrower and assessing the viability of the projects/activity financed by bank. The units not considered viable shall not be rehabilitated/restructured and banks shall accelerate the recovery measures in respect of such accounts.

The reliefs and concessions specified are not to be given in a routine manner and shall be decided by the Bank based on the commercial judgment and merits of each case. Bank shall also have the freedom to extend reliefs and concession beyond the parameters in deserving cases. Only in exceptional cases, concessions/reliefs beyond the parameters shall be considered.

Norms for grant of reliefs and concessions by the bank to potentially viable sick MSE units for rehabilitation are furnished below:

Waivers/funding:

i. Interest due on cash credit and term loan

If penal rates of interest or damages have been charged (PI/LD), such charges shall be waived from the accounting year of the unit in which it started incurring cash losses continuously. After this is done, the unpaid interest on term loans and cash credit during this period shall be segregated from the total liability and funded. No interest may be charged on funded interest and repayment of such funded interest shall be made within a period not exceeding three years from the date of commencement of implementation of the rehabilitation programme.

ii. Unadjusted Interest Dues

Unadjusted interest dues such as interest charged between the date up to which rehabilitation package was prepared and the date from which actually implemented, may also be funded on the same terms as at (i) above.
iii. **Term loans**

The rate of interest on term loans may be reduced (from the date it started incurring cash losses) where considered necessary, by upto 3% in case of micro/decentralized sector units and upto 2% for other small enterprise, subject to the floor of banks base rate.

a. The cutoff date for reduction in interest rate would be the date from which interest has been in default.

b. In the case of multiple loan accounts, the earliest date of interest default shall be taken as the cutoff date.

c. Reduction in the rate of interest as stated above could be considered in isolation for restructuring an account as well as a part of a restructuring package.

iv. **Working Capital Term Loan (WCTL)**

After the unadjusted interest portion of the cash credit account is segregated as indicated at (i) and (ii) above, the balance representing principal dues may be treated as irregular to the extent it exceeds drawing power. This amount may be funded as Working Capital Term Loan (WCTL) with a repayment schedule not exceeding 5 years. The rate of interest may be reduced by upto 3% in case of micro/decentralized sector units and upto 2% for other small enterprises, subject to the floor of Bank’s base rate.

v. **Working Capital**

Interest on working capital may be reduced by upto 3% in case of micro/decentralized sector units and upto 2% for other small enterprises, subject to the floor of Bank’s base rate.

vi. **Contingency Loan Assistance**

For meeting escalations in capital expenditure to be incurred under the rehabilitation programme, banks/financial institutions may provide, where considered necessary, appropriate additional financial assistance upto 15 per cent of the estimated cost of rehabilitation by way of contingency loan assistance. Interest on this contingency assistance may be charged at the concessional rate allowed for working capital assistance.

**Additional finance assistance**

Need-based additional working capital limit/term loan required for restarting / operating the unit on viable lines could also be considered as part of the rehabilitation package for the following purposes:

a. **Purpose**

i. For purchase of balancing equipment or overcoming the identified bottlenecks in the existing plant and machinery, civil construction etc
ii. For payment of statutory liabilities and pressing creditors excluding borrowings from promoters, their friends and associates to the extent considered necessary. Such dues shall be normally allowed to be liquidated over a period of time in installments.

iii. To raise margin money for additional working capital needed for rehabilitation.

iv. To meet cash losses after excluding interest on both term loans and working capital borrowings that may be incurred during the period of implementation of the rehabilitation package.

v. To meet retrenchment compensation, if required

vi. For any other purpose considered necessary for revival of the unit/concern.

b. Interest rate

Interest on additional working capital limit/term loan may be charged upto base rate plus 1.50%.

c. Repayment period

i. To be fixed on a case to case basis with adequate moratorium depending on the projected cash flow and DSCR. While the desirable DSCR is 1.5:1 the same could be relaxed upto 1.25:1 by the sanctioning authority.

ii. The repayment period shall normally not exceed 7 years from the date of disbursement of additional assistance.

Reschedulement

The principal installments could be rescheduled with a repayment period not exceeding 7 years from the date of implementation of the package.

Cash losses

Cash losses are likely to be incurred in the initial stages of rehabilitation programme till the unit reaches the break-even level. Such cash losses excluding interest as may be incurred during the nursing programme may also be included in the rehabilitation cost and funded by the bank.

Future cash losses in this context will refer to losses from the time of implementation of the package up to the point of cash break-even as projected. Future cash losses as above, shall be worked out before interest (i.e., after excluding interest) on working capital etc., due to the bank(s) and shall be funded.

Promoters’ Contribution

Promoter’s contribution towards the rehabilitation package is fixed at a minimum of 15 per cent of the additional long-term requirements under the rehabilitation package. It would be desirable that upto 50% of the promoter’s contribution is brought in upfront and the balance within 6 months from the date of communication of approval of the package.
For arriving at promoter’s contribution, the monetary value of the sacrifices from banks, financial institutions and Government may be taken into account, in addition to the long-term requirement of funds under the rehabilitation package. While evolving packages, it shall be made a precondition that the promoters should bring in their contribution within the stipulated time frame. Further, in regard to concessions and relief made available to sick units, bank shall incorporate a ‘Right of Recompense’ clause in the sanction letter and other documents to the effect that when such units turn the corner and rehabilitation is successfully completed, the sacrifices undertaken by the bank shall be recouped from the units out of their future profits/cash accruals.

Other sources of funds for rehabilitation shall be identified which could include disposal of stocks/assets not required, rapid collection of outstanding bills, etc.

**Leasing of plant**

If the sick unit is not viable on its own, the possibility of leasing of the plant and machinery of the sick unit to a healthy company, which may be in a position to make better use of the installed facilities and facilitate recovery of dues to the Banks, could be explored.

The sick unit undertaking manufacturing activity on behalf of a healthy company on the basis of processing fees could also be considered.

**General**

i. The relief/concessions to the extent indicated above are not intended to be given as a matter of course in all cases of rehabilitation of sick SME units/service sector projects.

ii. The nature and extent of relief/concessions required/warranted within these parameters would be decided depending upon the merits of each case.

iii. The rehabilitation package would preferably be drawn after crystalizing the dues/liability as on a future date viz., next interest/installment due date.

iv. However, reduction in interest rate, waiver etc., could be granted retrospectively also, wherever necessary.

v. All interest rate concessions would be subject to annual review depending on the performance of the units.

**Guarantors and third party mortgagors – Confirming parties**

The guarantors and third party mortgagors shall be made confirming parties to the arrangements for grant of relief/concessions/waivers, etc., as far as practicable.
Failure to comply with terms and conditions

In case the unit, to which relief/concessions/waivers have been granted in terms of above guidelines/schemes, does not co-operate or fails to comply with the terms and conditions thereof, the same shall stand withdrawn and the entire amount due prior to grant of such relief, concessions and waivers together with all interest, penal interest etc. shall become payable to the bank at its sole discretion. This shall invariably be stated in all communications of the bank to borrower advising grant of rehabilitation/restructuring approval.

Right to get recompensed

Bank shall have the right to get recompensed for the relief/concessions granted under the restructuring scheme in respect of those units in which there is improvement in the financial health.

Bank shall incorporate a ‘Right of Recompense’ clause in the sanction letter and other documents to the effect that when such units turn the corner and rehabilitation is successfully completed, the sacrifices undertaken by banks shall be recouped from the units out of their future profits/cash accruals.

However, invocation of the clause would be considered only after taking into account the case specific circumstances, borrower’s intentions to pay the dues, track record in meeting commitments, prospects of market growth, need for fresh infusion of funds in the project, diversification/expansion proposed to be undertaken, etc.

Proposals from wilful defaulters

Units becoming sick on account of willful mismanagement, willful default, unauthorized diversion of funds, disputes among partners/promoters, etc. will not be considered eligible for rehabilitation and steps shall be taken for recovery of bank’s dues. The definition of willful default will broadly cover the following:

   i. Deliberate non-payment of the dues despite adequate cash flow and good net-worth.

   ii. Siphoning off of funds to the detriment of the defaulting unit

   iii. Assets financed have either not been purchased or have been sold and proceeds have been mis-utilized

   iv. Misrepresentation/ falsification of records

   v. Disposal/removal of securities without bank’s knowledge; and.

   vi. Fraudulent transactions by the borrower
Illustrative list of warning signals of incipient sickness

1. Continuous irregularities in cash credit/overdraft accounts such as inability to maintain stipulated margin on continuous basis or drawings frequently exceeding sanctioned limits, periodical interest debited remaining unrealized;

2. Outstanding balance in cash credit account remaining continuously at the maximum;

3. Failure to make timely payment of installments of principal and interest on term loans.

4. Complaints from suppliers of raw materials, water, power, etc. about non-payment of bills

5. Non-submission or undue delay in submission or submission of incorrect stock statements and other control statements.

6. Attempts to divert sale proceeds through accounts with other banks

7. Downward trend in credit summations.

8. Frequent return of cheques or bills.

9. Steep decline in production figures.

10. Downward trends in sales and fall in profits.

11. Rising level of inventories, which may include large proportion of slow or non-moving items

12. Larger and longer outstandings in bill accounts.

13. Longer period of credit allowed on sale documents negotiated through the bank and frequent return by the customers of the same as also allowing large discount on sales.

14. Failure to pay statutory liabilities.

15. Utilisation of funds for purposes other than running the units.

16. Not furnishing the required information/data on operations in time.

17. Unreasonable/wide variations in sales/receivables levels vis-à-vis level of co-operation for stock inspections etc.

18. Delay in meeting commitments towards payments of installments due, crystalized liabilities under LC/BGs etc.

19. Diverting/routing of receivables through non-lending banks.