REPORT XVI

DISINVESTMENT COMMISSION

DECEMBER 2002

'Trikoot - I', IInd Floor
Bhikaiji Cama Place, R K Puram
New Delhi - 110066

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Note: The Tables contained in this Report are based on information received from the management of the PSEs and other sources.

PART - A

1. INTRODUCTION

The Disinvestment Commission was reconstituted vide Government of India, Ministry of Disinvestment Resolution No.11012/1/2000-Admn. dated 24th July, 2001.

Earlier, during 1996-1999, the Commission made recommendations in respect of 58 PSEs which had been referred to it by the Government. Out of these 58 PSEs, following four were referred back to the Commission for a fresh review:

(i) Manganese Ore (India) Ltd. (MOIL)
(ii) Neyveli Lignite Corporation Ltd. (NLC)
(iii) Projects & Equipment Corporation Ltd. (PEC)
(iv) Rail India Technical & Economic Services Ltd. (RITES)

The Commission submitted its recommendations in respect of these four PSEs in Report XIII. Out of these, Government has already taken the decision to disinvest 51% shares in MOIL.

In Reports XIV and XV submitted in September and November, 2002, respectively, the Commission submitted its recommendations in respect of the following Public Sector Enterprises:

(i) Central Inland Water Transport Corporation Ltd. (CIWTC)
(ii) Cochin Shipyard Ltd. (CSL)
(iii) Dredging Corporation of India Ltd. (DCI)
(iv) Hindusthan Shipyard Ltd. (HSL)
(v) IRCON International Ltd. (IRCON)
(vi) National Projects Construction Corporation Ltd. (NPCC)
(vii) Semiconductor Complex Ltd (SCL)
(viii) Telecommunications Consultants India Ltd. (TCIL)

This Report (XVI) contains recommendations in respect of the following companies:

(i) Cotton Corporation of India Ltd. (CCI)
(ii) Indian Medicines Pharmaceuticals Ltd (IMPCL)
(iii) Jute Corporation of India Ltd. (JCI)
(iv) National Buildings Construction Corporation Ltd. (NBCC)

All these reports are available in Disinvestment Commission's website: **www.disinvest.gov.in.**

Currently, the following Public Sector Enterprises are under study:

(i) Bharat Sanchar Nigam Ltd.,
(ii) Central Mine Planning & Design Institute Ltd.,
(iii) Hoogly Dock & Port Engineering Ltd.,
(iv) Mahanagar Telephone Nigam Ltd.,
(v) National Small Industries Corporation Ltd.,
(vi) Power Finance Corporation Ltd.,
(vii) Rajasthan Drugs & Pharmaceuticals Ltd., and
(viii) Rural Electrification Corporation Ltd.

In addition, the Commission has recently decided to take up the following PSEs for study:

(i) Brahmaputra Valley Fertilizer Corporation Ltd.
(ii) Central Cottage Industries Corporation Ltd.
(iii) Educational Consultants India Ltd.
(iv) Handicrafts & Handloom Export Corporation Ltd.
(v) Hospital Services Consultancy Corporation Ltd.
(vi) Karnataka Antibiotics & Pharmaceuticals Ltd.
(vii) National Film Development Corporation Ltd.,
(viii) National Handloom Development Corporation Ltd.
(ix) National Seeds Corporation Ltd.
(x) North Eastern Electric Power Corporation Ltd.
(xi) State Farms Corporation of India Ltd., and
(xii) Water & Power Consultancy Service India Ltd.

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PART - B

2. SPECIFIC RECOMMENDATIONS

2.1 COTTON CORPORATION OF INDIA LTD. (CCI)

INTRODUCTION

Cotton Corporation of India Limited (CCI) was set up in 1970 primarily to act as a canalising agency for the supply of cotton to the domestic textile mills, given the huge supply side deficit prevailing in the cotton industry in those days.

With the changing cotton scenario, the role and functions of the company were revised from time to time. As per the policy directives received from the Ministry of Textiles in 1985 (reiterated in the Textile Policy, 2000), the CCI became the sole agency of the Government for undertaking the price support operations, to ensure remunerative prices to the cotton farmers. Besides, price support operations, whenever it was considered commercially prudent, the Corporation was also free to undertake commercial operations for supplying cotton to the National Textile Corporation (NTC) mills, unit mills of State Textile Corporations, Co-operative Spinning Mills and private mills, in addition to purchasing cotton for fulfilling export quotas released in its favour. Broadly, the functional roles assigned to the Corporation, are:

- To undertake price support operations, whenever the market prices of *kapas* rule below the support prices announced by the Government of India, without any quantitative limit;

- To undertake commercial operations only at CCI's own risk, and

- To purchase cotton to fulfil the export commitments.

With cotton exports having been placed under Open General Licence (OGL) from July 1, 2001, the last role of CCI is no longer relevant. The company, however, remains free to export cotton as per its own initiatives to different countries.

Since opportunities for undertaking price support operations have been infrequent, CCI has been undertaking commercial operations at its own risk and cost, with the objective of covering its establishment costs during the non-MSP (minimum support price) years without falling back on the Government. The aim of such operations has been to at least meet the annual cost of the bare minimum infrastructure maintained by the company for undertaking the price support operations (estimated to be of the order of Rs. 25-28 crore). CCI has, therefore, been operating in competition with private cotton traders and other institutional buyers while undertaking such operations, with its market share varying between 4% and 6%. Given its main objective, even while undertaking commercial operations, CCI has tried to give preference to those varieties of cotton and in those States where the prices are under pressure.

The company is wholly owned by the Government of India, with an authorised capital of Rs. 75 crore and paid-up capital of Rs. 25 crore as of March 31, 2002 and is under the administrative control of the Ministry of Textiles.

The total employee strength of CCI, on March 31,2002, was 1076, comprising 136 officers, 376 field staff and 564 office staff.

CCI deals in one product, i.e., cotton. It procures seed cotton (*kapas*) directly from the farmers. This seed cotton is required to be ginned (separation of seed from lint) and then pressed into full pressed bales before it is marketed to the domestic spinning mills or exported. The by-product obtained after the processing is cottonseed, which is separately sold without any further processing. CCI does not have manufacturing facilities of its own and therefore, outsources its ginning and pressing requirements.

The table below shows the level of purchases (in terms of equivalent cotton bales) undertaken by CCI over the past 12 years:

Table 1
Figures in lakh bales (1 bale = 170 kgs)

Year	Purchases
1990-91	10.19
1991-92	10.00
1992-93	11.87
1993-94	7.76
1994-95	8.43
1995-96	10.17
1996-97	11.20
1997-98	8.12
1998-99	4.29

Year	Purchases
1999-00	5.09
2000-01	6.03
2001-02	8.60

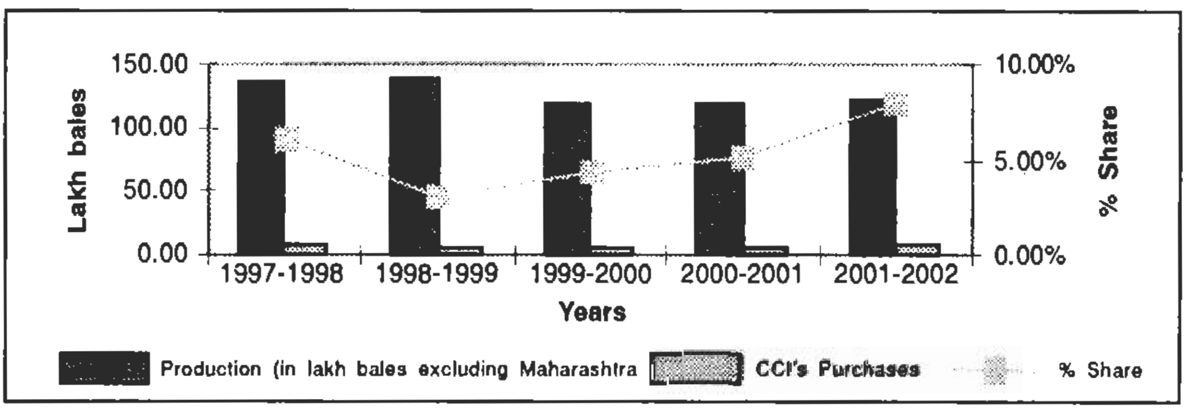
Source: Company Annual Reports/ICRA Advisory Services (ICRA)

Most of the above purchases had been commercial in nature, with the opportunity of MSP operations having been very limited.

CCI operations are spread across all the cotton-growing states except Maharashtra (where cotton falls under the Monopoly Procurement Scheme of the State Government). Under Monopoly Cotton Procurement Scheme in Maharashtra, the Maharashtra State Co-operative Cotton Grower's Marketing Federation (MSCCGMF) is the sole agency responsible for procuring the entire cotton available in the State of Maharashtra. CCI has, however, been allowed to operate in Maharashtra with effect from FY2002-03 (effective August 2002). In other States, CCI buys raw cotton directly from the cotton growers under the aegis of Agricultural Produce Market Committees (APMCs) at auctions conducted in the APMC yards. Such purchases by the company are in open competition with other traders and State agencies.

Maharashtra accounts for around 15-20% of the total cotton production in India. Excluding Maharashtra (where the Federation has hitherto controlled all procurement activities), the market share of CCI in the procurement market has been in the range of 4% to 8% as the Table below shows. The rest of the market is controlled by merchant ginners/traders (around 90-95%) and State Co-operative Bodies (1.5-2%).

Table-2 – Trend in Market Share of CCI



Source: ICRA

CCI's corporate headquarters are located at Belapur, Navi Mumbai. The company has 15 Branch offices located across the country.

The branch offices at Ahmedabad, Bhatinda, Coimbatore, Guntur, Indore and Kolkata are carrying out sales functions as well since a large number of textile mills are located in these areas.

The purchase and processing operations are carried out in interior parts of the States, where cotton is grown and marketed through "Purchase Centres". The Corporation has around 200 Purchase/Procurement Centres spread throughout the country. These centres physically handle procurement, processing, storage and deliveries and report to the respective Branch Offices.

Since the company does not have its own processing units, it engages ginning and pressing factories on job basis, at the various procurement centres. Sufficient ginning and pressing capacities exist in various upcountry procurement centres where CCI is operating.

For storage, CCI hires godowns on per bale basis from the Central/State Warehousing Corporations (CWC/SWC), godowns of APMC and co-operative societies. In case of shortage of capacity, private godowns are also hired (mostly during the MSP operations).

The exports mainly take place from Mumbai or Kolkata. The company has constructed a warehousing complex at Navi Mumbai for storage of cotton bales (principally for exports). At Kolkata, the Corporation hires godowns on per bale basis, either from CWC/ SWC or from private parties as per its requirement. CCI currently does not import cotton.

Price Support Operations (MSP Operations)

As mentioned earlier, CCI undertakes Price Support Operations, without any quantitative limit, under situations when the market prices of *kapas* fall to the level of support prices, as announced by the Government during every cotton season. As and when required, the company also engages the services of Co-operative Societies for augmenting its Price Support Operations for the benefit of cotton growers.

An overview of the Price Support Operations undertaken by the company during the past 20 years is provided in the table below:

Table 3 – CCI's MSP operations

Year	Quantity purchased in bales	Value in Rs. Crore
1982-83	191,000	47.79
1983-84	11,000	4.19
1984-85	78,000	19.24
1985-86	12,51,000	304.93
1986-87	4,55,000	106.87
1989-90	2,000	00.55
1992-93	2,000	00.74
1996-97	10,000	5.90
1999-00	6,000	4.65
2001-02	8,50,580	778.92

Source: Company Annual Reports/ICRA

MSP operations were undertaken by CCI on a few occasions. Sizeable operations were carried out only in 1985-86 and 1986-87. It undertook major MSP operations after a gap of 16 years again in 2001-02. MSP operations were undertaken in all the cotton growing states throughout the country except the State of Punjab, where the market price remained above the support price.

For carrying out the MSP operations, CCI claims subsidy towards any losses incurred on account of MSP operations as also for the administrative and other overhead costs incurred in connection with these operations. However, CCI is not entitled to receive any service charges for carrying out the MSP operations. It may be mentioned that since FY1983, CCI has claimed substantial subsidy from the Government (for MSP operations) only during FY1986 and FY2002. In the remaining years, CCI did not incur any loss on its MSP operations due to the favourable movement in the cotton prices consequent to CCI's MSP related intervention. During FY2002, CCI procured around 8.5 lakh bales under MSP operations and has already claimed reimbursement worth Rs. 79 crore towards losses incurred on these operations. The company has also undertaken MSP operations during the current fiscal for the quarter ended June 30, 2002. The loss on this count has been estimated at Rs. 29 crore and would be claimed from the Government during FY2003.

To ensure that the benefits of MSP operations accrue to all, CCI took special steps in FY02 to publicise the MSP operations through the APMCs so that the farmers could bring their produce to the market yards and offer it to CCI under MSP operations. The details of such beneficiary farmers are given in the table below:

Table 4 – Number of Farmers Benefiting from CCI's MSP Operations in 2001-02

State	No. of Procurement Centres	Approximate Number of Beneficiary Farmers
Gujarat	32	56,287
Rajasthan	23	16,460
Madhya Pradesh	24	32,484
Orissa	3	2,074
Andhra Pradesh	56	1,44,932
Total	**138**	**2,52,237**

Source: CCI / ICRA

Domestic Sales

CCI has been undertaking commercial operations apart from acting as a price support agency of the Government. In the domestic market, CCI has been supplying cotton to both the private mills as well as to the institutional buyers in the public sector. The company's sales to the various sectors, viz., private and institutional, over the past few years is given in the table below:

Table 5 – CCI's Domestic Sales

(Figures in lakh bales)

Year	Pvt.	NTC	STC/Co-op	Total
1997-98	4.54	1.16	1.28	6.98
	65%	17%	18%	100%
1998-99	4.56	0.86	0.90	4.12
	72%	14%	14%	100%
1999-00	3.38	0.74	0.79	4.91
	69%	15%	16%	100%
2000-01	4.20	0.84	0.76	5.80
	73%	14%	13%	100%
2001-02	4.02	0.53	0.59	6.31
	78%	10%	12%	100%

Source: CCI / ICRA

The sales to mills in the institutional sector (NTC/STC/Co-operatives) have come down considerably during the past few years, mainly because of closure of a large number of mills, and the precarious financial position of the existing units. CCI has compensated for reduced business from these sectors by increasing its presence in the private sector, which accounts for more than 70% of the country's total spindle capacity. Through sustained efforts, CCI increased its share of supplies to private mills from a level of 16% during 1991-92 to over 78% in 2001-02.

Export sales

CCI has been the largest exporter of cotton from India. The major export destinations of the Corporation are Bangladesh, Indonesia, Malaysia, Hong Kong, Taiwan, Japan, Thailand, the Philippines, South Korea, Spain, Germany, Romania, and Italy.

Prior to July 2001, there used to be a quota system, wherein the Government of India used to allocate export quota to the various parties. CCI used to be one of the major beneficiaries of this system as it used to get a major chunk of the export quota, where the margins used to be much higher. Post July 2001, exports of cotton have been placed under the Open General Licence (OGL) and the quota system has been abolished. Though CCI does not have any overseas office, the company holds membership of many international cotton associations and export bodies, which helps it in being in constant touch with the export market. Over the years, CCI has established itself in the overseas markets as a supplier of quality cotton, for timely shipment and contract performance. Though the CCI's ability to effectively compete in the export market (post abolition of the quota system) is yet to be tested, given its past record and experience, the company should be able to compete in the international cotton market even in future, under open market conditions, subject to the overall export feasibility.

Development Activities

In addition to the efforts in the area of marketing, CCI has also launched a number of schemes with the objective of benefiting cotton growers through channels like increasing sowing area, yield and production in the country and upgradation of processing facilities and other infrastructure. The company is also the authority for Mini Missions III & IV (part of the Technology Mission on Cotton launched by GoI in February, 2000) for improving cotton marketing infrastructure and technological upgradation of ginning and pressing facilities. During 9th plan, 51 market yards and 150 cotton G&P factories were modernised under MM-III & IV respectively. In the 10^{th} plan period, it is proposed to modernise/develop 200 market yards under MM-III, which together with those already covered during the 9^{th} plan, will cover more than 80% of the seed cotton arrivals. Under MM-IV, it is proposed to modernise 350 G&P factories, which together with those already covered, will cover about 50% of processing facilities.

However, the various developmental activities undertaken by CCI are not unique in nature and can easily be undertaken by other agencies and developmental bodies.

INDUSTRY OVERVIEW

Industry Relevance

The textile industry in India accounts for 20% of the total industrial production and around 30% of the total export earnings of the country, besides providing employment to around 20 million people. Cotton is the most important segment of the textile industry. With over 9 million hectares of area under cotton cultivation (largest area cultivated for the purpose in the world), India is amongst the world's largest potential reservoirs of this fibre. Internationally, India ranks third in the production of raw cotton in the world after China and the US, with a production level of around 14 million bales and accounts for approximately 21% of the world's total cotton area and 16 % of the global cotton production.

Rise in Imports

Government had placed imports of cotton under OGL during 1994-95, due to tight supply position in the country and to help the textile mills procure their raw material at competitive prices. However, imports remained restricted to some select varieties of cotton and were primarily resorted to meet the shortfall in domestic supply of cotton in the country. As imports were expensive due to high international cotton prices, domestic cotton prices adjusted themselves solely with the domestic demand-supply position.

With international prices coming down compared with the domestic prices during 1997-98, textile mills resorted to importing cotton on a large scale. These imports further increased in 1998-99 and 1999-2000 and have now become a regular feature. The details of imports of cotton in the country since 1989-90 are given in the table below, clearly indicating a steep rise in imports from 1997-98 onwards:

Table 6 – Imports of Cotton

Qty in lakh bales

Year	Imports
1989-90	—
1990-91	—
1991-92	3.00
1992-93	1.15
1993-94	3.00
1994-95	5.89
1995-96	0.50
1996-97	0.30
1997-98	4.13
1998-99	7.87
1999-2000	22.01
2000-2001	22.13
2001-2002	22.00

Source: CCI / ICRA

In addition to the pricing and availability issues, the quality-related issues are increasingly dictating imports of cotton.

Fall in Exports

The country, which had been a net exporter of cotton since the mid-1980s, became a net importer from 1997-98 onwards, when the international prices of cotton became lower than or equal to the domestic prices. During the year 1998-1999 and 1999-2000, the international prices of cotton for almost all varieties became cheaper and thus exports became negligible. The details of exports of cotton from the country from 1989-1990 onward are given in the table below, clearly indicating a steep fall in exports from 1997-1998 onwards:

Table 7 – Exports of Cotton

Qty in lakh bales

Year	Exports
1989-90	13.71
1990-91	11.90
1991-92	0.77
1992-93	13.77
1993-94	3.90
1994-95	1.08
1995-96	8.00
1996-97	16.82
1997-98	3.50
1998-99	1.01
1999-2000	0.65
2000-2001	1.00
2001-2002	1.00

Source: CCI/ICRA

Price Trends

The domestic prices of cotton followed international trends. In view of the larger crop size compared with that of 2000-2001, huge carry over stock, bad financial condition of the textile mills and depressed demand of cotton yarn in the domestic and international markets, there was a continuous decline in the prices of most of the varieties of *kapas* right from the beginning of 2001-02. The situation was further compounded by the efforts of the Maharashtra Federation to liquidate huge amounts of stock during the later part of the year, which had a destabilising effect on cotton prices across the board. *Kapas* prices subsequently touched MSP levels for most of the varieties in Andhra Pradesh, Gujarat, Madhya Pradesh, Haryana, Rajasthan, Karnataka, Orissa and Meghalaya and CCI commenced MSP operations on a large scale.

Stagnation in Cotton Demand from Textile Mills

Slowdown in demand for yarn and fabrics has resulted in low capacity utilisation of textile mills, leading to lower off-take of cotton. While facing this crisis for survival, the mills have now reorganised their priorities and are buying cotton for immediate consumption only, without creating large inventories as used to be the practice in earlier years.

MSP Mechanism

The objective of the Government's price policy for agricultural produce aims at ensuring remunerative prices to the growers for their produce, with a view to encouraging higher investment and production. MSP for cotton is fixed after taking into consideration the recommendations of the Commission of Agricultural Costs and Prices, the views of State Governments and Central Ministries and other key stakeholders.

In the case of cotton, the MSP is fixed for the common varieties of *kapas* (seed cotton) like Bengal *Desi*, V797, J-34, LRA 5166, S-6, etc., and varies across States. The average support prices for the different grades of *kapas* for the past 11 years are indicated in the table below:

Table 8 - Support Prices Announced by the Government of India

(Prices in Rs. per quintal)

Variety	91-92	92-93	93-94	94-95	95-96	96-97	97-98	98-99	99-00	00-01	01-02
Bengal *desi*	600	690	780	870	1,000	1,025	1,025	1,075	1,175	1,215	1,250
V797	660	760	855	950	1,095	1,125	1,265	1,370	1,475	1515	1,560
J-34	680	785	885	985	1,135	1,165	1,310	1,440	1,575	1,625	1,675
LRA-5166		900	1,010	1,120	1,260	1,290	1,430	1,545	1,650	1,700	1,750
H-4	840	950	1,050	1,200	1,350	1,380	1,530	1,650	1,775	1,825	1,875
JKHY-1	840	950	1,050	1,200	1,350	1,380	1,530	1,650	1,700	1,750	1,800
S-6	860	975	1,080	1,230	1,385	1,415	1,565	1,670	1,795	1,840	1,840
DCH-32	920	1,040	1,150	1,300	1,465	1,500	1,660	1,790	1,930	2,000	2,075
Suvin	1,280	1,450	1,600	1,830	2,060	2,105	2,330	2,520	2,750	2,900	3,000

Source: ICRA Analysis

As indicated earlier, the prices of cotton have generally ruled above MSP levels over the major part of the last decade.

National Textile Policy 2000

The new textile policy announced (in November 2000) by the GoI seeks to enhance the competitiveness of the Indian textile and clothing industry, besides targeting US$50 billion in exports of textile and textile products by the year 2010. As a part of the new policy, a Technology Mission on Cotton has been set up. The aim of the mission is to bring about rapid improvements in production, productivity and quality of cotton in an integrated manner by covering all aspects of the crop, i.e., research & development, marketing infrastructure and processing facilities.

Taxes and duties

Import of cotton attracts 10% import duty with imposition of 4% Special Additional Duty. There is no excise duty on *kapas*. Post 2005, with implementation of WTO norms, it may be expected that the import duty would come down further. Besides, around 1% market levy is imposed by the Regulated Market Committees (APMCs) on the total value of cotton bought by any trader (including CCI). In this regard, it is alleged that some private traders avoid paying these statutory levies by procuring *kapas* directly through farmers (through their local contacts), thus avoiding APMC organised auctions.

Likely Future Scenario:

Dependence on Quality Cotton Imports to Continue

The need for good quality natural fibre by export-oriented spinning mills in particular has led to regular import of large quantities of cotton. Though steps have been initiated to improve the quality of indigenous fibre under the aegis of the Technology Mission on cotton, it would take a while before these initiatives start bearing fruits. Therefore, import of raw cotton is expected to continue in the short to medium term. About 22 to 25 lakh bales of cotton are expected to be imported in the coming season. CCI is currently not importing cotton due to its perceived domestic/national image but perhaps needs to cash in on this opportunity in order to improve its trading volumes in future.

Exports - Uncertain but Possible

As per the estimates of International Cotton Advisory Committee (ICAC), the world cotton production is expected to fall to 19.16 mtpa in 2002-03 from 21.42

mtpa in 2001-02. On the other hand, the consumption is likely to go up to 20.55 mtpa from 20.07 mtpa last year. This, coupled with the fact that there has been a crop setback in China, India and the US in this season, is expected to result in lower end-season stocks and some possibility of exports. However, there is no possibility of any large-scale exports in the near future as international prices, though expected to be firm, are not likely to witness an increasing trend. Further, domestic consumption is expected to increase and this, coupled with estimated cotton production in India, is expected to result in higher domestic realisations and opportunities. There are also quality issues associated with Indian cotton, which also preclude any possibility of large-scale exports in the short to medium term.

Over the long term, however, with the improvement in quality of cotton as well as quality of processing, larger export opportunities exist.

Overall Domestic Cotton Consumption Likely to Increase

Though during the 9th Five-Year Plan period, cotton consumption achieved a growth rate of around 3%, the future is expected to be brighter. Industry experts feels that in the 10th Five-Year Plan period, the consumption is likely to achieve a 4% growth rate. This increase is expected on the back of the likely general improvements in the country's economic scenario coupled with an increase in preference for cotton fabrics and good demand from the mills.

Prices Expected to Rule Firm

Cotton prices, both domestic and international, have witnessed one of lowest levels in the past few years and, have been exhibiting an increasing trend of late. With consumption expected to increase and production likely to suffer a slow down, industry sources feel that prices in the coming season would witness an increasing trend. However, in the short to medium term, domestic prices are expected to witness a marginally higher level vis-à-vis the international prices.

Likelihood for MSP in Future

Cotton, being a commodity product, exhibits demand-supply and price volatility and it is difficult to predict the timing and extent of likely MSP operations in the coming years. CCI may or may not be required to undertake MSP operations in future, depending upon the movement in the cotton prices both in the domestic and international markets.

OPERATING PERFORMANCE OF CCI

Decline in Turnover

CCI's turnover has been witnessing a declining trend since FY1997 both in quantity and value terms.

CCI's topline has witnessed a decrease both due to decline in the quantity of bales sold as also due to a decline in prices. The fall in volume terms can be attributed to drop in exports. Exports, which accounted for around 34% of the total turnover in FY1997 now contributes only 2% to the total turnover of the company.

Continuous Decline in Trading Margins

The decline in the total turnover has adversely affected the trading operations of CCI, resulting in a steady decline in the gross (as well as net) trading margins from a high of 10.7% (7.4% net) in FY1997 to a low of 3.96% (-0.59% net) in FY2001. The operating performance of FY2002 is strictly not comparable with rest of the years since in this year CCI mainly undertook MSP operations. The decline in margins can mainly be attributed to:

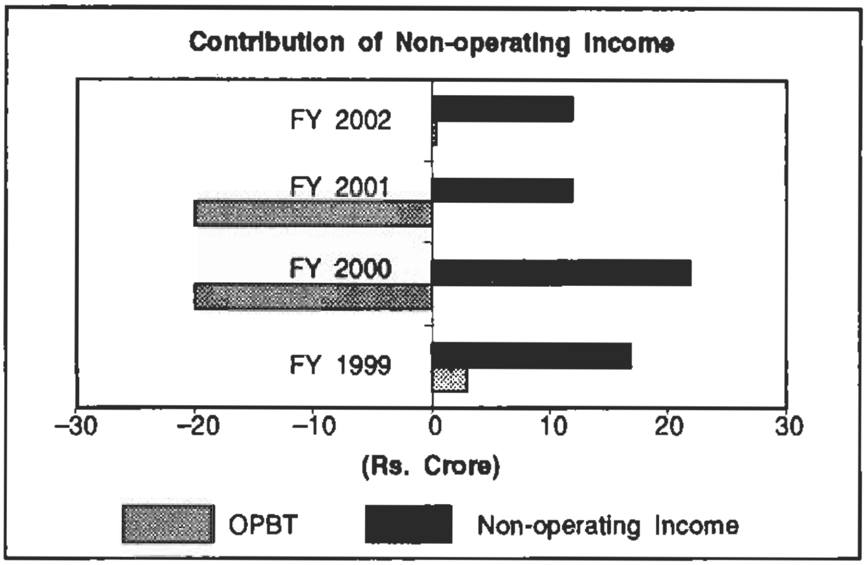
- Non-feasibility of exports, where the margins were higher vis-à-vis the domestic sales; and
- Low off-take from the end user segment--the textile mills--on account of their huge inventories and poor financial position.

Increase in Overheads

Trading being a low margin business, it is extremely crucial to keep the overheads low. Over the years, CCI's trading overheads ranged from 3.3% to 6.25% of the operating income.

The bulk of the trading overheads comprise employee costs, which increased from Rs. 14 crore in FY1996 to Rs. 24 crore in FY2001 (CAGR of 11.25%) owing to wage revisions. CCI's manpower levels are high, especially in light of the fact that CCI's competitors in the trading business operate with much lower manpower levels (broadly estimated around 50-60% lower even after accounting for differences in operating practices). Though CCI has offered a VRS to its employees in May 2001, it has not resulted in any substantial reduction in the employee costs. During the past four years, CCI has become highly dependent on non-operating income to show net profits. This is illustrated in the following table:

Table No. 9



Source: ICRA Analysis

This non-operating income comprises interest and rental income as also a non-cash income in the form of write back of provisions.

FINANCIAL PERFORMANCE

Past Financial Performance (FY1970 to FY1991)

Till FY1989, CCI was a loss-making PSE with accumulated losses aggregating Rs. 125 crore. A changing business environment coupled with an internal reorganisation resulted in a turnaround of the company in FY1990. India became a cotton exporting country and CCI benefited from the export quotas allotted to it by the Government. Domestic sales also improved owing to better performance of the textile mills in the country.

CCI dovetailed its purchase and sales activities, upgraded quality standards and reduced its inventories. This strategy yielded good results and CCI made handsome profits from FY1990 onwards and its accumulated losses were wiped off in FY1991.

Recent Financial Performance

Since the turnaround, CCI has been earning profits. The past Profit and Loss account and Balance Sheet of CCI are given Tables below:

Table 10 - Profit and Loss Account

Rs Crore

Period ending	31/03/2002	31/03/2001	31/03/2000	31/03/99	31/03/98	31/03/97	31/03/96
Gross Sales	628.55	681.54	523.84	728.93	1014.29	1268.95	856.35
Subsidy on MSP Operations	79.46	0.00	0.00	0.00	0.00	0.00	0.00
Grant in aid for VRS	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net Sales	708.01	681.54	523.84	728.93	1,014.29	1,268.95	856.35
Other Related Income	17.84	15.38	11.91	34.67	28.04	38.23	51.40
OPERATING INCOME	725.85	696.92	535.75	763.60	1,042.33	1,307.18	907.75
Material Costs/Purchases	843.96	740.54	488.44	447.32	925.40	1,025.80	846.30
Expenses on Trading	5.55	6.78	4.10	5.85	11.63	16.27	8.92
(Accr.)/Decr. to Stocks	-227.72	-107.57	2.55	234.60	-20.15	80.54	-44.25
Consumable Stores / Processing charges	47.03	29.58	22.97	22.14	39.31	44.61	28.42
TRADING EXPENSES	668.82	669.33	518.06	709.91	956.19	1,167.22	839.39
Gross Trading Profit	**57.03**	**27.59**	**17.69**	**53.69**	**86.14**	**139.96**	**68.36**
Administrative Expenses	4.86	4.76	5.62	5.61	5.07	4.24	3.94
Employee Costs	32.80	24.17	23.27	26.84	23.42	16.74	13.97
Other Expenses	0.11	0.44	2.48	2.46	1.70	1.36	0.41
Selling Expenses	2.43	1.89	1.64	2.06	10.53	20.04	4.69
Misc. Exp. W/O	0.42	0.43	0.50	0.73	0.43	0.51	0.25
Trading overheads	40.62	31.69	33.51	37.70	41.15	42.89	23.26
Net Trading Profit	16.41	-4.10	-15.82	15.99	44.99	97.07	45.10
OPBDIT	16.41	-4.10	-15.82	15.99	44.99	97.07	45.10
Interest and Finance Chgs	13.93	13.64	2.31	11.64	7.43	18.89	21.34
OPBDT	2.48	-17.74	-18.13	4.35	37.56	78.18	23.76
Depreciation	2.05	2.07	1.39	1.31	0.73	0.53	0.39
OPBT	0.43	-19.81	-19.52	3.04	36.83	77.65	23.37
Non-operating Income: Grant in aid for VRS	12.16	11.59	21.63	17.14	6.22	2.95	25.16
Prior period adjustments	-0.30	-0.36	-0.65	-1.27	-1.37	-0.96	-1.32
ADJ. PROFIT BEFORE TAX (APBT)	12.29	-8.58	2.10	18.91	41.68	79.64	47.21
Tax	1.00	0.00	0.35	6.00	12.50	30.50	22.00
ADJ. PROFIT AFTER TAX (APAT)	**11.29**	**-8.58**	**1.75**	**12.91**	**29.18**	**49.14**	**25.21**

Source: ICRA

Table 11 - Balance Sheet

ASSETS (Rs. Crore)	31/03/2002	31/03/2001	31/03/2000	31/03/99	31/03/98	31/03/97	31/03/96
Gross Block	73.08	72.78	70.17	41.68	21.98	15.60	14.17
Less : Revaluation Reserve							
Gross Block	73.08	72.78	70.17	41.68	21.98	15.60	14.17
Less : Accumulated Depreciation	-9.21	-7.46	-5.27	-3.97	-2.72	-2.08	-1.58
Net Block	63.87	65.32	64.90	37.71	19.26	13.52	12.59
Capital Work in Progress	0.00	0.00	0.00	19.37	24.73	14.38	3.21
NET FIXED ASSETS	63.87	65.32	64.90	57.08	43.99	27.90	15.80
Investments in securities	0.05	0.05	0.05	0.05	0.05	0.05	0.05
TOTAL INVESTMENTS	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Stock in trade + Goods in transit							
Raw Materials	45.63	2.51	10.67	27.56	41.61	59.79	51.10
Work in progress							
Finished Goods	452.38	269.65	154.97	139.59	359.93	321.74	411.21
Others	2.35	0.47	0.42	0.45	0.67	0.53	0.29
TOTAL INVENTORIES	500.36	272.63	166.06	167.60	402.21	382.06	462.60
Receivables (More than 6 months)	60.06	58.31	58.06	61.80	64.61	67.71	78.84
Receivables (Less than 6 months)	51.16	100.17	67.08	57.20	95.93	135.25	105.77
Less: Provision for doubtful debts	-3.20	-3.09	-3.14	-3.16	-3.23	-3.26	-3.22
TOTAL RECEIVABLES	108.02	155.39	122.00	115.84	157.31	199.70	181.39
Advances recoverable	102.65	19.36	35.62	19.83	23.05	21.29	17.39
Deposite with government and Other authorities	0.61	0.63	0.65	0.35	0.58	0.91	0.31
Cash and Bank Balances	0.37	0.43	1.21	0.30	3.29	0.45	0.35
Advance Tax/ refund of income tax due	59.37	59.01	69.38	0.00	0.00	0.00	0.00
Less: Provision for doubtful loans & advances	-0.07	-0.07	-0.07	-0.08	-0.86	-0.84	-0.84
TOTAL OTHER ASSETS	162.93	79.36	106.79	20.40	26.06	21.81	17.21
TOTAL CURRENT ASSETS	771.31	507.38	394.85	303.84	585.58	603.57	661.20
TOTAL ASSETS	835.23	572.75	459.80	360.97	629.62	631.52	677.05

...contd.

LIABILITIES (Rs. Crore)	31/03/2002	31/03/2001	31/03/2000	31/03/99	31/03/98	31/03/97	31/03/96
Equity Share Capital	25.00	25.00	25.00	23.00	23.00	23.00	23.00
Share Application Money	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Profit & Loss Account	215.97	204.67	213.26	211.50	198.59	170.42	121.29
GROSS RESERVES	215.97	204.67	213.26	211.50	198.59	170.42	121.29
Less : Misc Expenditure not W/O	-0.29	-0.20	-0.32	-0.79	-0.56	-0.53	-0.26
NET RESERVES	215.68	204.47	212.94	210.71	198.03	169.89	121.03
TANGIBLE NET WORTH	240.68	229.47	237.94	233.71	221.03	192.89	144.03
TOTAL LONG TERM DEBT	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bank Borrowings	220.19	254.04	104.92	24.66	299.23	295.71	380.88
Other Short Term Loans & Advances	200.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL SHORT TERM DEBT	420.19	254.04	104.92	24.66	299.23	295.71	380.88
Sundry Creditors	77.87	10.55	18.34	38.21	37.23	41.88	60.37
Advance from Customers	24.51	5.34	10.33	19.98	18.71	28.33	20.50
Interest Accrued but Not Due	1.27	0.17	0.08	0.01	0.26	0.12	1.00
Interest Accrued and Due (on loans from GoI)	0.00	5.97	11.97	17.97	23.97	29.97	35.97
Other Current Liabilities	15.81	13.32	9.64	25.26	29.17	26.94	24.70
TOTAL OTHER LIABILITIES	119.46	35.35	50.36	101.43	109.34	127.24	142.54
Provision for Taxes	54.90	53.89	66.60	1.17	0.02	15.68	9.60
TOTAL PROVISIONS	54.90	53.89	66.60	1.17	0.02	15.68	9.60
TOTAL CURRENT LIABILITIES	174.36	89.24	116.96	102.60	109.36	142.92	152.14
TOTAL OUTSIDE LIABILITIES	594.55	343.28	221.88	127.26	408.59	438.63	533.02
TOTAL LIABILITIES	835.23	572.75	459.80	360.97	629.62	631.52	677.05

Source: ICRA

The key features of CCI's financial performance are as follows:

- CCI made handsome profits from FY1991 to FY1997, mainly on the back of good exports, where the realisations were higher coupled with a good demand in the domestic market from the textile mills;

- However, the scenario changed since FY1998. Whereas, on the one hand, exports became unfeasible with international prices coming down, on the other hand, imports became a regular feature;
- Due to the South-East Asian crisis, yarn demand in these countries nose-dived and the domestic textile industry, which was heavily dependent on export of yarn to these countries, also suffered;
- This situation was further compounded by general depression in the domestic economy. The changed scenario had an adverse impact on the functioning of the CCI and negatively affected its turnover and profits; and
- CCI undertook major MSP operations during FY2002 and the share of commercial operations during FY2002 was almost neglgible. The operating income for FY2002 includes a claim of Rs. 79.46 crore, being the subsidy claimed by CCI from GoI on account of the losses suffered on MSP operations. Out of this subsidy claim, CCI has already received an amount aggregating Rs. 25 crore during the current fiscal (FY2003) from GoI.

SWOT ANALYSIS

A SWOT anyalysis of CCI is presentged in the following paragraphs, which covers issues spanning its internal and external inviromment. This is followed by an analysis of CCI's competitive positioning in the cotton trading business.

Strengths

- ❒ Good network of branches and procurement centres with presence in all the major cotton producing States;
- ❒ An experienced workforce that has, over the years, developed a good understanding of the trade and industry;
- ❒ Good reputation as a trusted market intermediary with supplier of quality cotton with least contamination;
- ❒ As the price support agency of GoI, CCI has been able to successfully manage the price support operations as and when required;
- ❒ As CCI accounts for 5-8% of the total purchases, it is able to supply bulk quantity of cotton whenever required by mills, thus giving it an advantage.

- CCI has substantial physical assets. It owns the Corporate office at Belapur (6 floors), warehousing complex at Navi Mumbai, Branch offices at Ahmedabad, Guntur, Indore, Rajkot and Sriganganagar.

Weaknesses

- Inadequate marketing focus and the absence of the practice of actively soliciting business from the clients;
- Unable to capitalise on low international prices, as and when that happens, due to lack of imports which, in turn, affects both its sales and margins;
- Prone to political interference. This sometimes leads to setting up procurement centres at sub-optimal locations as also procuring low quality cotton sometimes;
- Lack of adequate training opportunities to employees down the ranks in the areas of trade, marketing, and understanding of the industry dynamics has resulted in skill shortage on multiple aspects at the junior levels;
- As per GoI policy guidelines, CCI does not offer credit facilities/terms to customers. This is in contrast to private traders who offer attractive credit facilities, thus adversely affecting CCI's business;
- Based on an informal market survey conducted by ICRA, it is estimated that CCI's net margins are 1-2% lower than those of the private traders

Opportunities

- Abolition of the monopoly procurement scheme in Maharashtra would open more avenues for CCI to increase its procurement and the market share; and
- Developing countries like Bangladesh offer scope for export of Indian cotton, which can be exploited by CCI in the years to come.

Threats

- Competition from the private traders, who are more cost competitive vis-à-vis CCI; and
- Likely increase in the consumption of manmade fibres, due to various reasons, may lead to a decline in cotton consumption, which may adversely affect CCI's operations.

CCI's Capabilities

Although CCI has, over the years, been able to build a good reputation for itself in the market and has a large network with presence in all the major cotton producing States, the company has numerous weaknesses when compared to private trading companies. These include lack of global information database, hierarchical and bureaucratic organisational structure, which is not too conducive for the lean operations of a trading company (from the commercial point of view) and lack of marketing skills.

Disinvestment Options

Two scenarios have been analysed to evaluate the restructuring and disinvestment potential/ options for CCI, which are linked to the future of the MSP policy of the Government for cotton. These are:

- Scenario A – The Government continues with the present MSP policy for cotton
- Scenario B – The Government discontinues the MSP policy for cotton

The impact of these two scenarios on CCI and the options under both these scenarios are discussed in the following sections.

Scenario A – The Government continues with the present MSP policy for cotton

CCI has been implementing the Government's MSP policy for cotton. The essence of MSP operations is to insulate farmers from market risks to a certain extent. MSP interventions for cotton have been quite infrequent in the past and are unlikely to recur on a consistent basis in the foreseeable future. The demand for cotton is also projected to exhibit a healthy growth in future. However, the cotton textile industry (both in terms of production and spindlage) is spread throughout the length and breadth of the country and occasional instances of the need for MSP arising in some State or some part of the nation cannot be ruled out even under generally favourable market conditions.

Besides undertaking MSP operations, CCI also undertakes commercial operations. The cotton market is quite volatile and is subject to substantial price variations. Given the commodity nature of the cotton business and the volatile cotton markets, any adverse movements in the cotton prices could result in CCI incurring huge losses, which, in turn, may have to be borne by Government.

Whether MSP interventions are to be continued, based on socio-economic reality, is for the Government to decide. Nevertheless, given that MSP interventions for cotton are not continuous and in fact, quite infrequent and the risks associated with the cotton trading business, it may not be prudent to continue bearing these risks through CCI forever. However, till such time that MSP is in vogue, there exists a necessity for agencies that can effectively carry out the operations related to the MSP. The issue that needs to be considered in this scenario is whether instrumentalities other than CCI can also implement MSP operations.

Given the fact that CCI's net margins are lower than those of the private traders, it is felt that a competitive bidding process for conducting MSP operations could help in reducing CCI's operational costs as also its losses. Therefore, it is felt that implementing MSP through a competitive bidding process is desirable. In the case of certain commodities (like Rice), arrangements already exist in some states for agencies to implement price support and procurement operations. Based on such experience, a competitive bidding system should be attempted immediately for cotton, so that the costs of procurement, storage and sale of cotton can be minimised. However, such a system needs to be field-tested and the market sentiments, once the system is introduced, require to be carefully assessed.

The path forward

Therefore, a suitable competitive bidding process for MSP operations with a view to cutting costs and reducing losses needs to be introduced at the earliest. Under this system, the GoI would restrict itself to announcement of MSP and contract out MSP operations in the major cotton growing states/regions on a least cost basis to different bidders. Government has to designate an agency to coordinate this job. It is important to build into the competitive bidding system adequate checks and balances in order to ensure that the benefits of MSP operations pass on fully to the intended beneficiaries. Such a system could include:

a. Requiring the bidder(s) to maintain a separate ledger for MSP operations and conducting monthly audits of the same, with the actual on-ground inspection of the bidder's godowns;

b. Spot checks on the beneficiaries of MSP operations;

c. Monthly audit of the bidder's books of accounts for MSP operations;

d. Spot checks with mills buying cotton from the bidder to ensure that the sales prices quoted by the bidder to the GoI are correct; etc.

It should be recognised that CCI has adequate experience in implementing MSP in the past and is an organisation having wide spread acceptability and recognition amongst cotton growers throughout India. CCI has also taken up a number of promotional/developmental schemes. However, it should now concentrate on reducing the transaction costs of procurement, storage and sale, by participating in a competitive bidding process. Given these facts, it is suggested that the GoI divests only 51% of its shareholding in CCI in favour of a strategic partner while retaining the balance 49% for a minimum period of 3 years. This, in turn, would help GoI to have some control over the implementation of MSP operations, in case such a need arises. The balance equity can be divested at a stage when the new system has taken roots and gained acceptability amongst the different stakeholders in the cotton trading business. The strategic partner should be in a position to improve the management of CCI leading it to higher efficiency and enhanced level of growth.

In the event no suitable partner is found for CCI, it is recommended that the GoI continues with its shareholding in CCI till such time (about 3 years) that the new system of implementing MSP stabilises and finds acceptance amongst different stakeholders in the cotton trading and growing business. During this period, CCI should participate in the MSP bidding process along with other bidders and also carry out commercial operations as at present. Disinvestment of CCI can be taken up thereafter.

Scenario B – The Government discontinues the MSP policy for cotton.

In case the MSP mechanism for cotton is done away with, there is no rationale for the GoI to be in trading business. The GoI should, under such a scenario, concentrate on selling its entire shareholding in CCI to a strategic buyer.

RECOMMENDATIONS

If MSP continues, the Commission recommends that the GoI should introduce a competitive bidding process for MSP operations with a view to cutting costs and reducing losses in respect of such operations. Under this system, the GoI would restrict itself to announcement of MSP and MSP operations could be contracted out in particular states/regions on a least cost basis to different

bidders. A system of adequate checks and balances has to be formulated and tried in order to ensure that the benefits of MSP operations pass on to the intended beneficiaries.

However, given the fact that the competitive bidding system for MSP operation for cotton is yet to be field-tested and that the market sentiments for such a system also need be assessed, it is recommended that the GoI disinvests initially 51% of its shareholding in CCI in favour of a strategic partner, retaining the balance 49% for a minimum period of 3 years. The remaining equity can be disinvested later at a time when the new system has fully taken roots and gained acceptability amongst the different stakeholders in the cotton trading business.

In the event that the GoI does not find a suitable strategic partner for CCI at this stage, it is recommended that the GoI continues to retain its share in CCI till such time (about 3 years) that the new system of implementing MSP through competitive bidding route stabilises. Disinvestment of CCI can be taken up thereafter. Meanwhile, CCI should take part in the bidding process for MSP, with other bidders, and continue to improve its operational efficiency.

If MSP is discontinued, 100% disinvestment of CCI in favour of a strategic buyer is recommended.

* * *

2.2 INDIAN MEDICINES PHARMACEUTICAL CORPORATION LTD. (IMPCL)

INTRODUCTION

IMPCL is a Government of India undertaking under the administrative control of the Department of Indian Systems of Medicine & Homeopathy (ISM&H), Ministry of Health & Family Welfare. Incorporated in 1978, it was set up for production of Ayurvedic and Unani medicines based on classical formulation and registered as a small-scale industry with the District Industries Centre, Almora. Commercial production started in June 1983. With its manufacturing facilities located in Mohan, Almora District, Uttaranchal, it acquired licence to manufacture ayurvedic and unani medicines in various forms such as churnas (powder), tablets, pills, rasas, asvas and ointments. The sales turnover of the company in FY2002 was Rs.39.6 mn. As the unit was established in view of the difficulties faced by Central Government Health Scheme in procuring standard ayurvedic and unani medicines, the products of the company are mainly supplied to CGHS and other Government establishments.

As on March 31, 2002, the authorized equity share capital of IMPCL was Rs.20 mn. The paid up share capital has been raised recently to Rs.20 mn. Government of India holds 51% share and the balance is held by Kumaon Mandal Vikas Nigam Limited (KMVNL), a profit-making undertaking of the Government of Uttaranchal. IMPCL is a private limited company, designated as a "Mini-Ratna" company.

As on 31.3.2002, IMPCL had an employee strength of 130 – 3 in Group A and 7, 10 and 110 employees in Groups B, C and D respectively. The average age of employees is about 40 and most of the employees are either unskilled or semiskilled. IMPCL also employs 40 – 50 casual labour for short periods.

INDUSTRY ANALYSIS

Types of Medicine Systems & ISM&H

Pharmaceuticals include medicinally effective chemicals that are consumed in appropriate dosage. The four primary streams of medical science under the supervision of which pharmaceuticals are consumed include:

Allopathy or occidental medicine which has gained global popularity.

Ayurveda is an ancient Indian science, which uses herbal/mineral remedies. Around 1000 B.C, the knowledge of Ayurveda was comprehensively documented in Charak Samhita and Sushruta Samhita.

Unani, having Greek origin, is prevalent in certain areas of South East Asia. The Unani system emphasises the use of naturally occurring, mostly herbal medicines though it uses ingredients of animal and marine origin also.

Homeopathy, founded by a German physician, was fairly popular in the early 19th century. Of late, there has been a resurgence of interest in this form of treatment in many parts of the world.

Except for the allopathy system, all other systems of medicine are covered under ISM&H. Over the years, they have become part of the culture and tradition of our country.

These systems use various raw materials such as medicinal plants, materials of marine and animal origin, minerals, metals etc. However, medicinal plants form 80% of the raw materials used. The effectiveness of these systems mainly depends upon the proper use and sustained availability of genuine raw materials.

Distribution of Medicinal Plants in India

Around 70% of India's medicinal plants is found in tropical areas, mostly in the various forests spread across the Western and Eastern ghats, the Vindhyas, Chotta Nagpur plateau, Aravalis & Himalayas. Although less than 30% of the medicinal plants is found in the temperate areas and higher altitudes, they include species of high medicinal value.

All Indian Systems of Medicine function through two streams:

Folk Stream: This comprises the oral traditions practiced in rural areas. The carriers of these traditions are millions of housewives, thousands of traditional birth attendants, bone setters, village practitioners skilled in accupressure, eye treatments, treatment of snake bites and the traditional village physicians/herbal healers, the vaidyas or the tribal physicians.

Classical stream: At the second level of traditional health care system is the scientific or classical system of medicine. This comprises the codified and organised medicinal wisdom with sophisticated theoretical foundations and philosophical explanations expressed in classical texts like 'Charak Samhita', 'Sushruta Samhita' and hundreds of other treatises, including some in the regional languages, covering various branches of medicine and surgery.

Industry structure

Most of the ayurvedic and unani drug manufacturers in India follow the classical stream for manufacturing medicines. Except few big companies such as Dabur, Zandu Pharmaceuticals, Baidyanath, Himalaya Drugs, Charak, etc, majority of the ayurvedic and unani drug manufacturers belongs to the small-scale sector. While small-scale units mainly produce classical medicines, operations of most of the leading ayurvedic drug manufacturers are organised into following divisions:

- Medicinal Range;
- Personal Care;
- Pure Herbs; and
- Animal Care Division.

In these companies, personal care division is the largest contributor to the revenue and mainly caters to various personal needs of consumers such as health care, skin care, oral care, hair care, etc. The leading products of this division are chyavanprash, hair oil and balm. These companies also produce classical products, which are mainly ayurvedic medicines. The ayurvedic divisions of companies like Dabur and Zandu Pharmaceuticals account for about 10% of their total turnover.

As estimated by Dabur, the market size of the classical medicines is around Rs.5000 mn. In FY2001, turnover of Dabur's ayurvedic medicine division was around Rs.1000 mn accounting for 20% of the market share. According to another leading ayurvedic drug manufacturer, Zandu, classical ayurvedic products are mainly manufactured in the unorganised sector and, therefore, it is very difficult to get statistical data on this industry. Thus the classical ayurvedic medicine industry is divided into the large sized players and small-scale players operating in unorganised sector. The table below gives the difference between the small and large players on various parameters:

Table 1 - Comparison of Large and Small Players

Parameter	Large players	Small players
Manufacturing facilities	Employ state-of-the-art modern manufacturing facilities	Less inclined towards modernisation of manufacturing facilities
R&D	Product development through primary research and clinical trials	Limited product development through research. Rely mainly on observational test and pharmacopoeial knowledge
Product range	Cover health care, classical and animal care products	Cover only classical ayurvedic products
Standardisation	Focus on standardisation to ensure consistency	Inadequate standardisation of procedures for raw material testing and production
Polyherbal formulations	Strong R&D enables development of polyherbal formulations	Manufacture mostly simple single herb products
Sales force and distribution network	Vast sales network and highly experienced sales force	Sales are mainly restricted to OTC products

Source: Credit Analysis & Research Ltd. (CARE)

OPERATIONS OF IMPCL

Production facilities and manufacturing process

Manufacturing facilities of IMPCL are located at a single location at Mohan, Almora District, Uttaranchal. They are situated on a 38 acre plot of land taken on lease for 99 years from Uttar Pradesh State Industrial Development Corporation Ltd (UPSIDC). This plot of land was designated as an industrial area by GoUP in 1978 and 16 sheds were constructed through UPSIDC for accommodating 16 small-scale entrepreneurs. Since the response was unsatisfactory, it was decided to allot these sheds to IMPCL to start its operations. Apart from 16 sheds, the facilities include two administrative buildings also. Since the location of 16 sheds was not scientifically planned, there is excess transportation of material, leading to higher process time and also possible contamination of material.

Location

The plot of land is adjacent to the well-known 'Corbett National Park' (CNP). Due to this, there are restrictions on erecting boundary walls and attempts at cultivation of medicinal plants are often foiled by wild animals. The factory is located in a hilly region. During monsoon season, heavy currents of mountain streams flowing throughout the region make access to the factory by road difficult.

Products

IMPCL manufactures a wide range of products in both ayurvedic and unani categories. The number of products manufactured by IMPCL in last five years is given in the table below:

Table 2 - Production - ayurvedic and unani products

(Nos.)

Sr. No.	Type of Product	2002	2001	2000	1999	1998
1	Ayurvedic	216	160	167	162	151
2	Unani	42	58	68	66	40

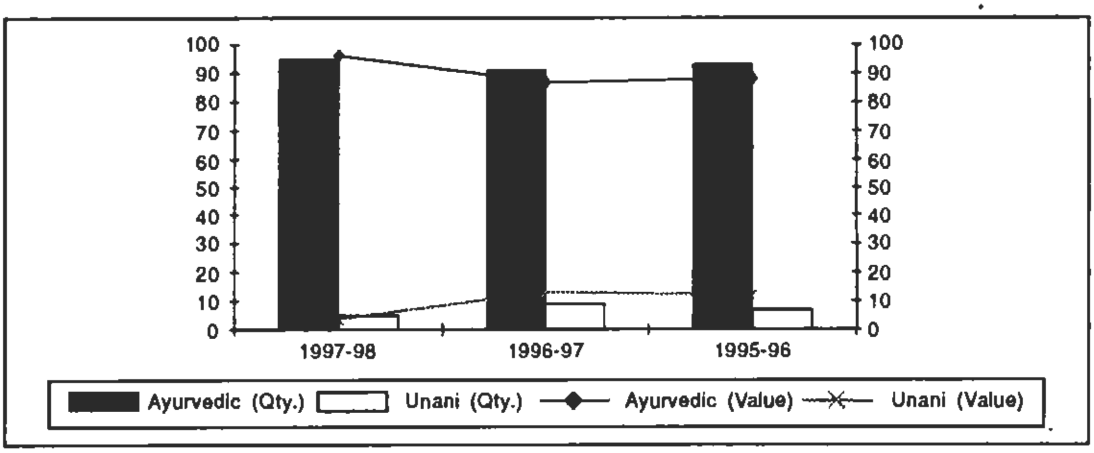
Source: CARE

Usability of same machines to manufacture most of the products gives IMPCL flexibility in changing its product-mix based on demand from customers. IMPCL follows the directives contained in the Ayurvedic Formulary of India and other standard texts, for manufacturing ayurvedic and unani medicines. For manufacturing patented medicines, its own prescribed formulae are used.

Production-mix

The production-mix of ayurvedic and unani medicines in terms of quantity produced and value of production for period FY1996 to FY1998 is given in the table below:

Table 3 – Production mix



Source: CARE

Ayurvedic medicines contribute about 90% of production both in-terms of value and volume. Balance is contributed by unani medicines.

Unhygienic production environment

The maintenance of the surroundings and interiors of the manufacturing facility leaves a lot to be desired. It is essential that hygienic conditions be maintained in the environment in which medicines are prepared. Further, the environment allows roaming rodents as well as pets. Restrictions on erecting boundary walls may limit the ability of the management to keep the wild animals out. Good Manufacturing Practices (GMP), recommended by drug authorities, are not properly followed.

Sales Profile

IMPCL sells its products mainly to Government establishments such as:

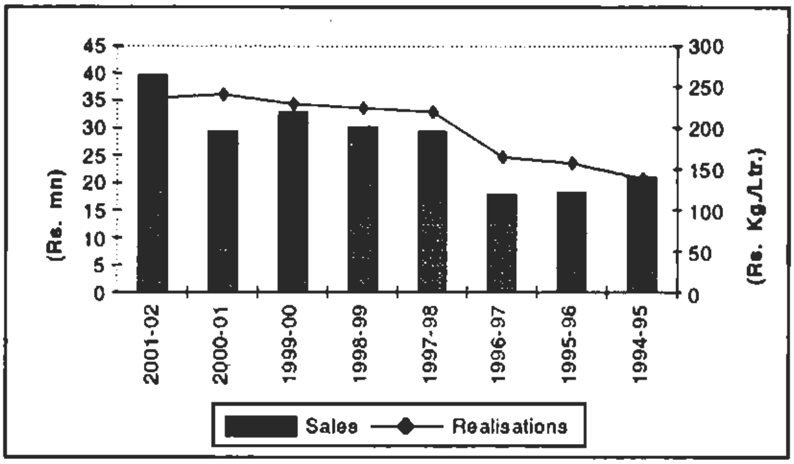
- Hospitals and dispensaries covered under CGHS;
- Central Government research units all over India; and
- All related departments of certain State Governments such as Haryana, Rajasthan, Uttar Pradesh, Himachal Pradesh etc.

For supplying the medicines, IMPCL enters into long term Purchase Agreements (PA) with CGHS. The existing PA with CGHS is valid upto FY2003. The prices for sales to CGHS are vetted by the Cost Account Branch of Ministry of Finance (Expenditure Department), GoI. Apart from sales to Government organisations, the company also sells its products in the open market. However, the open market sales are limited to nearby towns such as Ramnagar and Almora. Though IMPCL has appointed stockists (total 5) for its open market sales, the sales are restricted to products such as Chyavanprash. The main reasons for poor response to open market sales are lack of product promotion and strong competition from large number of established brands in the classical ayurvedic product category.

IMPCL sells few patented products such as M. Liv, M. Vasaco Syrup etc. Sales of these products contribute to very small part (1.8%) of its total sales.

The sales of the company and realisations during period FY1994 to FY2002 are given in the table below:

Table 4



Source: CARE

IMPCL's sales realisations increased from Rs. 137.2/kg/ltr in FY1995 to Rs. 235.7 kg/ltr in FY2002.

Marketing/branding

As mentioned earlier, majority of IMPCL's sales is to Government organisations. IMPCL is given purchase preference by these organisations. Annually, CGHS requires around 400 different types of products. Out of this, about 170 products are bought from IMPCL. These products are purchased from other suppliers only if a particular product is not available with IMPCL or IMPCL is not in a position to supply the same in a particular time frame. However, the purchases by CGHS from other suppliers are not on bulk basis. Thus, with assured market from Government establishments, marketing has been a neglected activity at IMPCL. The company employs only one medical representative and most of the time he is busy with Government quotations and tenders.

Although IMPCL is an established brand with Government organisations, there is limited awareness of the brand in the open market. IMPCL's negligible presence in various product categories in the open market has affected its brand image.

The prices of IMPCL's products appear to be competitive with the established ayurvedic manufactures like Baidynath and Zandu. However, SSI players have a price advantage over IMPCL.

R&D facilities /New Technology/Upgradation of plant

India, as a member of WTO, would start recognising product patents from January 2005. With this, introduction of new products would be difficult unless the company invests sufficient amount of funds in R&D activities to develop new medicines. IMPCL employs standard manufacturing processes given in ayurvedic formulary. Even the manufacturing processes of patented products are not very complicated. As a result, in the past, company has not established any R&D facilities. However, the company has plans now to start R&D activities within its premises and has earmarked a place for its establishment.

Raw materials

Raw materials required by the company are mostly agro-based and are in the form of herbs, plants, fruits, minerals and spices. Total raw material items required by the company are around 500 and majority of them is available locally. The local purchases of raw material are done from KMVNL, which is a 49% equity shareholder in the company. Rest of the items is purchased through tender and spot market transactions. Other sources of raw material are markets in Delhi, Haridwar, Shahjahanpur etc.

FINANCIAL POSITION

Operating profits

A summary of operating profitability of IMPCL is given in the table below:

Table 5 - Operating profitability - Past - Audited (FY1995-FY1998)

(Rs.mn)

Year Ended March 31	1998	1997	1996	1995	CARG (1995-1998) %
Total Income	28.4	20.1	17.2	23.3	6.8
Total Expenses	24.2	20.3	16.0	20.2	6.2
PBDIT	4.1	-0.2	1.2	3.1	10.4
(% of Total Income)	14.5	- ve	7.1	13.1	
PAT	1.8	-1.6	0.3	0.0	
(% of Total Income)	6.5	- ve	2.0	-	
Net Cash Accruals	2.2	-0.3	0.6	0.2	

(CARG – Growth p.a.)

Source: CARE

Table 6 - Operating profitability- Past - Unaudited (FY1999-FY2002)

(Rs.mn)

Year Ended March 31	2002	2001	2000	1999	CARG (1998-2002) %
Total Income	38.6	29.3	33.0	29.0	10.0
Total Expenses	33.1	25.1	28.4	25.3	9.3
PBDIT	5.5	4.2	4.6	3.6	14.7
(% of Total Income)	14.2	14.2	14.0	12.6	
PAT	3.0	2.2	2.6	2.0	
(% of Total Income)	7.8	7.5	7.9	6.9	
Net Cash Accruals	3.5	2.6	3.0	2.3	

Source: CARE

The operations of IMPCL have exhibited growth over the period (from FY1995 to FY1998) on almost all parameters. During the period under review, both income and expenditure grew at a CARG of 7%. Fluctuation in total income was mainly on account of varying quantum of orders received from CGHS and State Governments. It also affected the profitability of the company. Given below are the Profit & Loss Account and Balance Sheet of the company:

Table 7 - Profit & Loss Account

(Rs. mn.)

	Year ended March 31	2002	2001	2000	1999	1998	1997	1996	1995
	Net sales	39.6	29.3	33.0	30.1	29.3	17.7	18.1	21.0
	Change in stock	-1.0	0.0	0.0	-1.2	-1.1	2.2	-1.0	2.1
	Other income					0.2	0.1	0.1	0.3
A.	**Total income Expenses**	**38.6**	**29.3**	**33.0**	**29.0**	**28.4**	**20.1**	**17.2**	**23.3**
	Raw material	17.0	13.3	14.5	11.8	12.4	8.7	7.3	9.8
	Freight					0.2	0.1	0.2	0.2
	Power & fuel					1.7	1.2	0.9	1.2
	Employee cost	10.6	10.5	10.4	9.7	8.1	8.9	6.4	7.4
	Admin. Operativs '& other expenses					1.8	1.3	1.2	1.6
B.	**Total expenses**	**33.1**	**25.1**	**28.4**	**25.3**	**24.2**	**20.3**	**16.0**	**20.2**
C.	**PBDIT (A-B)**	**5.5**	**4.2**	**4.6**	**3.6**	**4.1**	**-0.2**	**1.2**	**3.1**

...contd.

	Year ended March 31	2002	2001	2000	1999	1998	1997	1996	1995
D.	Depreciation	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.3
E.	**PBIT (C-D)**	**5.0**	**3.7**	**4.2**	**3.3**	**3.8**	**-0.5**	**0.9**	**2.7**
F.	Interest	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3
G.	**Profit from operation (E-F)**	**4.8**	**3.5**	**4.0**	**3.0**	**3.5**	**-0.7**	**0.7**	**2.4**
H.	Add :Non operation income					0.0	0.0	0.0	0.0
I.	Less: Amortisation					0.0	0.0	0.0	0.0
J.	**PBT (G+H-I)**	**4.8**	**3.5**	**4.0**	**3.0**	**3.5**	**-0.7**	**0.7**	**2.4**
K.	Tax	1.8	1.3	1.4	1.1	1.7	0.9	0.4	2.4
L.	**PAT (J-K)**	**3.0**	**2.2**	**2.6**	**2.0**	**1.8**	**-1.6**	**0.3**	**0.0**
M.	Prior period adjustment					0.0	1.0	0.0	-0.1
N.	Adjusted PAT (L+M)	3.0	2.2	2.6	2.0	1.8	-0.6	0.3	-0.1
O.	Gross cash accruals (D+N)	3.5	2.6	3.0	2.3	2.2	-0.3	0.6	0.2
P.	Dividend					0.0	0.0	0.0	0.0
Q.	Retained profit (N-P)	3.0	2.2	2.6	2.0	1.8	-0.6	0.3	-0.1
R.	Net cash accruals (O-P)	3.5	2.6	3.0	2.3	2.2	-0.3	0.6	0.2

Source: CARE

Table 8 - Balance Sheet

(Rs. mn.)

	As on March 31	2002	2001	2000	1999	1998	1997	1996	1995
	Fixed Assets								
	Gross block					8.8	8.4	8.2	8.2
	Less: Depreciation					6.3	6.0	5.7	5.4
	Net block	2.8	2.8	2.7	2.5	2.5	2.4	2.5	2.8
A.	**Total fixed assets**	**2.80**	**2.80**	**2.70**	**2.50**	**2.5**	**2.4**	**2.5**	**2.8**
	Current assets								
	Inventory					11.6	11.9	9.3	9.7
i.	RM stores & consumable					6.6	5.3	5.1	5.0
	WIP					1.6	0.8	0.8	0.9
	Finished goods					3.4	5.8	3.4	3.7
	Sundry debtors					18.4	14.3	9.3	9.4
	6m					3.0	3.3	1.3	0.8
	6m					15.4	10.9	8.0	8.5
	Loan & advances					10.8	9.3	8.4	6.6
	Cash & bank balance					0.9	0.7	3.8	3.3
B.	**Total current assets**					**41.7**	**36.2**	**30.7**	**28.9**

...contd.

	As on March 31	2002	2001	2000	1999	1998	1997	1996	1995
	Current liabilities								
	Sundry creditors					8.1	6.4	2.5	2.0
	Provisions					13.1	11.2	9.4	8.9
	Other current liabilities					0.2	0.2	0.2	0.2
C.	**Total current liabilities**					21.4	17.9	12.1	11.1
D.	**Net working capital (C-D)**	36.2	26.0	23.6	21.6	20.3	18.3	18.6	17.8
E.	**Operating capital employed (A+D)**	39.0	28.8	26.3	24.1	22.8	20.8	21.2	20.0
F.	**Investment**					0.0	0.0	0.0	0.0
G.	**Total operating capital Employed (E+F)**	39.0	28.0	26.3	24.1	22.8	20.8	21.2	20.6
	Terms labilities								
	Unsecured Loans								
	From USIDC					2.0	2.0	2.0	2.0
	From GOI					2.7	2.5	2.2	2.0
H.	**Total Term liabilities**	5.9	5.6	5.3	5.0	4.7	4.5	4.5	4.0
I.	**Shareholders fund (G-H)**	33.1	23.2	21.0	19.1	18.1	16.3	16.9	16.6
	Equity Capital	17.1	10.0	10.0	10.0	10.0	10.0	10.0	10.0
	Reserves & surplus	16.0	13.2	11.2	9.1	8.1	6.3	6.9	6.6
	General reserves					0.4	0.4	0.4	0.4
	P&L					7.7	5.9	6.5	6.1
	Miscellaneous expenses					0.0	0.0	0.0	0.0
	Networth	33.1	23.2	21.2	19.1	18.1	16.3	16.9	16.4

Source: CARE

Past Financial Ratios

Past financial ratios for IMPCL are given in the table below:

Table 9

Financial ratios	2002	1998	1997	1996
Debt Equity ratio (times)	0.18	0.26	0.28	0.25
PBILDT / Total Income (%)	14	14	-ve	7
Return On Investment (ROI) (%)	13	17	-ve	4
Return on Networth (RONW) (%)	9	10	-ve	2
Capital Turnover Ratio (times)	0.99	1.24	0.97	0.81
Book Value (Rs.) *	1936	1809	1626	1690

Face value of share - Rs.1000/-

Source: CARE

IMPCL is virtually a debt free company. The returns (ROI &RONW) earned by the company were low and varied over the period under consideration. This was due to poor capacity utilisation on account of varying quantum of orders from CGHS and State Governments and other organisations. During the period under review, the book value of IMPCL's share (face value Rs.1000) increased from Rs. 1690 per share in FY1996 to Rs. 1936 per share in FY2002. This was mainly due to profitable operations and zero dividend payout.

Expansion proposals of IMPCL

IMPCL is having two proposals to improve its operations:

Proposal I - Renovation & Modernisation of the existing set up

This proposal involves carrying out few modifications without disturbing the existing manufacturing set-up. The objectives of this proposal are:

- Laying out a regular process flow pattern with adequate linkage between process areas.
- Adopting a methodical system of material transport to and from the sheds to facilitate efficient movement of raw materials and finished products.

Apart from carrying out process changes, this proposal would also involve improvements in flooring, ceilings, painting walls and few general repairs and maintenance on a case-to-case basis.

These modifications are envisaged to improve the quality of drug production and raise the manufacturing facilities to an optimum level. The modernisation plan is estimated to cost around Rs 10 mn, which involves procurement of new machinery worth Rs 6.0 mn and repair and renovation work of Rs.4.0 mn. This modernisation programme is being taken up with the recently enhanced share caplital. However, with the existing workforce and Government demand oriented production, IMPCL may not be able to take advantage of increased production capacity and its gains are likely to remain limited to marginally better profitability and improved product quality.

Proposal II - Complete revamping of the existing set up

A complete revamping of the process flow pattern would require dismantling of the existing set-up. Such a process would involve temporary interruption of all manufacturing activities. The investment requirement of this proposal would be higher as compared to the earlier option. A proposal on this line was presented to GoI and its response is awaited. The implementation of the proposed plan would completely revamp the process flow pattern and the production and quality management would become easier. Also, by increasing capacities of certain equipment and making them fully automatic, it may be possible to increase production level. This would enable IMPCL to take care of open market sales. The table below indicates the investment envisaged by IMPCL for implementing Proposal II.

Table 10 - Investment envisaged for Proposal II

Sr. No.	Expenditure head	Rs mn
1.	Marketing expansion, sales promotion, advertisement	10
2.	Quality control/R&D	10
3.	Machinery and Instruments	5
4.	Single chain production unit	15
5.	Water	1
6.	Amenities (staff quarters, guesthouse, etc.)	9
	Total	50

Source: CARE

With the implementation of this proposal, IMPCL expects to achieve a turnover of Rs.150 mn by FY2009. However, without better management and workforce, IMPCL may not be able to take advantage of improved operations.

SWOT ANALYSIS

Strengths

1. Only manufacturing unit of ayurvedic and unani medicines under the Government.

2. Captive customer base. CGHS falls under same ministry as IMPCL i.e. Ministry of Health and Family Welfare.

3. Assured profits. IMPCL has a track record of making profits since inception. The price list of IMPCL approved by Cost Accounts Branch, Department of Expenditure, Ministry of Finance includes 30% mark up on cost of sales.

4. Proximity to raw material sources. IMPCL is situated in the region where raw material for manufacturing of ayurvedic and unani medicines is available in abundance. The other major raw materials centres such as Shahjahanpur, Delhi and Haridwar are also located in the northern region. The company is a small-scale unit and enjoys all the benefits available to small scale industry. Classical products constitute majority of company's sales and these products are exempted from excise duty.

5. Single location plant. Single location facility allows greater co-ordination among various departments of the company leading to better control of activities.

Weaknesses

1. Concentrated sales. CGHS is the largest customer of IMPCL accounting for around 75% of the total sales. The orders from other customers such as State Government hospitals and research units under ISM&H are not regular. This leads to a huge concentration risk. Purchases by CGHS are effected through a fixed term contract/MoU with IMPCL. In case of any refusal or decline by CGHS to honour its commitment, IMPCL may face difficulty in selling its products.

2. Negligible open market sales. In the past, IMPCL's management has been focussing on sales to Government institutions and has not devoted its attention to developing open market sales. As a result, open market sales are negligible and are restricted to nearby areas. Though IMPCL has recently started open market sales by appointing agents, it has met with limited success on this front.

3. Weak brand. Since most of IMPCL's sales are to Government institutions, there is limited awareness about the company in the open market. It may be difficult to establish the 'IMPCL' brand in the market due to strong competition from branded products from leading ayurvedic & herbal product manufacturers. The company may not be in a position to make the investment required for pushing the products through advertisement.

4. Few patented products: Most of IMPCL's sales are in the classical product category and it sells very few patented products. In the absence of proper R&D facility and suitable manpower, it lacks the ability to undertake new product development.

5. Economies of scale & distorted product costing. IMPCL manufactures large number of both ayurvedic and unani medicines. Due to this, economies of scale are not available resulting in high product cost.

6. Lack of marketing and distribution network. The marketing and distribution network is almost absent. The marketing department has three persons comprising one Medical Representative and two executives.

7. Inefficient operations and poor maintenance: The activities of the company were fitted into a layout designed for 16 different industrial units. This layout offers certain disadvantages such as non-streamlined operations, open air handling of raw materials and work-in-progress leading to possibilities of contamination.

8. Weak profile of employees. Most of the employees are unskilled and lack formal education. Many of them have been in employment of IMPCL for a very long time. Some of the senior officials have also been with IMPCL for a long time. While this has ensured continuity in management, it has not exposed the senior officials to the emerging trends in manufacturing activities and management methods. Updating of manufacturing methods and management skills is a *sin qua non* for the company to develop competitive strength.

9. Absence of R&D facilities. Company has not invested in sophisticated R&D practices. Most of IMPCL's products are manufactured on the basis of standard procedures and process given in the ayurvedic pharmacopoeia and formulary. Due to the absence of modern R&D facilities, IMPCL has not been able to develop any new products and its new product portfolio has remained stagnant.

10. Quality Control: IMPCL relies on traditional practices for quality control. Non-standardisation of processes, reliance on manual testing methods and physical (colour, size, taste, etc) examination for raw materials as well as finished products put a serious question mark on the quality and consistency of products manufactured by IMPCL.

Opportunities

1. Due to its minimal side-effects, Ayurveda is gaining increasing acceptance as an alternative medicine both in India and some western countries. This provides

an excellent opportunity for IMPCL to tap markets domestically as well as internationally.

2. Presently, entire sales of IMPCL are targeted to Governments and related organisation. Considering the demand for ayurvedic product, IMPCL may market its products in the nearby areas initially and in other regions subsequently. To achieve this, it can employ proper marketing strategy with strengthened marketing and distribution network. It can even sell its products to local municipalities and Government organisations. It may even think of advertising its products in local media and television channels.

3. Conversion of unutilised land into Ayurveda Health Centre. The location of the company adjacent to the CNP offers it an opportunity to establish an Ayurveda Health Centre. The CNP attracts a large number of domestic as well international tourists. An Ayurveda Health centre run by an Ayurveda medicine manufacturing company in salubrious surroundings can be an attraction to the tourists. Needless to mention that IMPCL needs to maintain high quality standards for attracting tourists.

4. IMPCL can start a showroom and put its products on display as well as on sale to the tourist. This will aid IMPCL in marketing its products to other regions as well as to the international markets.

Threats

1. Uncertain quality. The company does not have a Quality Control Department or proper R&D facilities to test the manufactured products and the company relies on traditional methods of testing. Thus it may be difficult for IMPCL to ensure consistency in its products and quality is uncertain. This leaves the company vulnerable to litigation in case of any adverse reaction due to consumption of any of its medicines.

2. Concentrated sales. Majority of IMPCL's sales is to CGHS and Government departments. IMPCL gets price as well as product preference from these departments. Any decline in order or refusal to buy from these departments could put IMPCL in difficulty as its open market sales are negligible.

3. IMPCL is a very small company as compared to other players in the industry.

DISINVESTMENT CONSIDERATIONS

IMPCL was set up with the objective of supplying quality ayurvedic and unani medicines to CGHS. At the time of establishment of IMPCL, the ayurvedic medicine industry was dominated by small-scale producers scattered through out the country. CGHS would have had to rely on a large number of manufacturers for procuring the quantity of medicines it required. With large number of texts recommended for manufacturing medicines in ayurveda, standardisation was a major issue faced by the industry. Further, the small size of operation was a hindrance in installing state-of-the art quality control facilities. Under such a situation, IMPCL was set up with the objective of supplying quality medicines to CGHS. Over the years, the ayurvedic industry has seen the emergence of large sized manufacturers like Dabur, Baidynath, Zandu, Himalaya Drugs etc who are not only producing large variety of medicines but also have improved quality standards. In this changed scenario, there is no rationale for continued involvement of GoI in IMPCL.

Presence of large sized manufacturers of ayurvedic medicines provides CGHS with alternative sources of supply for their requirements. Annual purchases of Rs. 30-40 mn by CGHS are a small portion of the turnover of classic ayurvedic medicines of the industry. In view of this, it is felt that CGHS may not face any problems in purchasing its requirements from other manufacturers in the industry. Although IMPCL is a profit making company, its profits are largely due to preferential purchases of medicines on cost-plus-basis by CGHS. The open market sales comprise a very small portion of the total sales. It is evident that IMPCL may not be able to establish brand 'IMPCL' due to strong competition and lack of resources.

Medicines prepared under unhygienic conditions and without proper quality control, can turn out to be a health hazard. With the emergence of large sized manufacturers in the ayurvedic industry and inability of IMPCL to survive without preferential purchase schemes, it is felt that, IMPCL, in its present form, has outlived its utility. Further, the very small size of operations (annual sales of Rs. 39.6 mn in 2001-02) also does not justify the continued involvement of GoI in the company. Continued involvement of GoI in companies like IMPCL is also inconsistent with the policy of restricting Government ownership to sectors of strategic importance only.

In view of these factors, the following two options have been considered for disinvestment of GoI's stake in IMPCL:

Option I - Sale of entire stake of GoI to KMVNL;

Option II - Sale of GoI's stake to a strategic investor;

Option I - Sale of GoI stake to KMVNL

IMPCL is a Joint Venture (JV) between GoI and KMVNL. KMVNL is closely associated with IMPCL in two ways:

- as a JV partner by virtue of its 49% equity stake in the company; and
- as a major raw material supplier.

On acquiring total ownership, KMVNL may continue with the present operations or shift present operations to another location and find alternative use for the land.

The land on which the manufacturing facility has been located is taken on lease from a State Government body. KMVNL is also a State Government body set up with the objective of developing the hilly regions in the State. One of the focus areas of KMVNL is development of tourism. It operates a large network of tourist guesthouses across the region. As mentioned earlier, the land on which IMPCL's manufacturing facility is located is not particularly suitable for a manufacturing facility, while it has the potential to be used as a tourist attraction. The factory is located near the well-known 'CNP', which attracts a large number of tourists every year. As such, the site offers many attractions. Considering the above, and the fact that IMPCL is a private limited company with attendant restrictions on sale of shares, GoI should consider to offer its entire equity stake in IMPCL to KMVNL. An appropriate price for GoI's stake may be negotiated after completion of audit of the accounts of the company for the latest completed FY.

Option II - Sale of GoI's stake to a strategic investor

One of the factors affecting operations of IMPCL is the lack of exposure of its senior officials to modern manufacturing practices and management systems. Some of the senior officials have been with the organisation since inception and are keen on maintaining *status quo*. It is, therefore, felt that a strategic investor may be able to induct management skills required to modernise the operations of the company. He may be also required to infuse additional capital required for modernising the operations of the company.

The main hindrance in successful implementation of this Option is the absence of any items of value in the company. From the point of view of the investor, apart from assured sales to CGHS, there is hardly any valuable attraction viz, physical assets, IPRs, human resources or marketing infrastructure. However, as mentioned earlier, the location has other attractions. For using the land for any other purpose (the plant site area is designated as an industrial area), approval of appropriate State authorities would be required. Besides, any strategic partner would find it difficult to run business without co-operation from KMVNL. As such, consultation with KMVNL is necessary while selecting a strategic partner. Further, it is felt that there may be need to give some commitment regarding assured off-take of medicines by Government institutions, for a period of 2 years or so, to ensure smooth transition of business as also to attract a suitable strategic partner.

RECOMMENDATIONS

Based on the analyses of facts and issues above, the Commission recommends that the Government should first offer to sell its equity to KMVNL at a negotiated price. In case KMVNL is not interested, GoI should sell its entire equity in IMPCL in favour of a strategic partner through a competitive bidding route. Should KMVNL be also interested to simultaneously exit from IMPCL, 100% equity of IMPCL may be disinvested in favour of a strategic buyer.

Before starting disinvestment, all pending audit of accounts for FY1999-2002 should be completed.

* * *

2.3 JUTE CORPORATION OF INDIA LTD. (JCI)

INTRODUCTION

The Jute Corporation of India (JCI), a Public Sector Enterprise under the Ministry of Textiles, was incorporated in 1971 for conducting price support operations in jute to ensure minimum prices to jute growers and impart stability to raw jute prices. Apart from support operations, the corporation is also involved in commercial trading of jute.

The authorised as well as the paid up capital of the corporation as on March 31, 2001 was Rs. 5 crore, entirely held by Government of India.

The corporation has been making losses since its inception, and the Government took a decision in 1980-81 that losses incurred by JCI on price support operations would be reimbursed by the Government.

JCI has completely eroded its net worth and had accumulated losses of Rs. 105.75 crore as on March 31, 2001. In 2000-01, the company had an operating income of Rs. 135.76 crore and had suffered an operating loss of Rs.16 crore and had an interest expense of Rs. 37.47 crore. The operating loss and interest expense were sought to be compensated by a subsidy claim on the Government to the extent of Rs. 52.41 crore.

The company has its corporate office at Kolkata and 16 regional offices in the jute growing states of West Bengal, Assam, Bihar, Orissa, Meghalaya, Tripura and Andhra Pradesh. There are 143 Direct Procurement Centres (DPC) and 28 sub-centres, attached to these regional offices which are involved in the procurement, sorting and warehousing of raw jute. The State-wise break up is given below:

Table 1

State	Nos. of DPC/ sub- centres
West Bengal	100
Bihar	20
Assam	25
Meghalaya	1
Tripura	5
Orissa	7
Andhra Pradesh	13

Source: JCI / ICRA Advisory Services (ICRA)

JCI does not possess much fixed assets (apart from its corporate office premises) as its entire network of procurement centres and the processing/warehousing facilities have been taken on rent.

The company had 1,640 permanent employees as on March 31, 2001 and an additional 606 employees who are termed as "casual" but who enjoy benefits similar to those of permanent employees (except VRS benefits). JCI also hires around 2,500-3,000 contract labour during the season across all its procurement centres to execute the manual operations of weighing, sorting and baling of jute.

In 1968, the Agricultural Prices Commission, now known as the Commission for Agricultural Costs and Prices (CACP) recommended that the Government might consider the suitability of entrusting a separate agency with the exclusive responsibility for price support operations in raw jute. This would enable the jute farmers to get the right price for their produce and also prevent jute prices from falling to levels lower than the Minimum Support Price (MSP). The Government also felt that it should be obligatory for such an agency to buy whatever quantities are offered for sale at the minimum support prices in specified assembling points.

In 1969, the Government finally accepted these recommendations and, accordingly, JCI was incorporated in April 1971, with the primary objective of conducting price support operations. However, JCI was also allowed the flexibility of carrying on commercial trading operations in jute.

JCI's current activities and ensuing revenue streams can be segregated into three distinct components:

Support Operations: This pertains to JCI buying jute at MSP, fixed by the Government from time to time, and then selling jute to domestic jute mills under open-market or Government-controlled schemes. The bulk of JCI's support operations are geared towards selling jute to the jute mills for B-Twill bags, against prices set by the Jute Commissioner, based on inputs given by JCI and the industry. B-Twill bags are bought by FCI for storing foodgrain. Jute mills that wish to participate in the supply of the bags are required to buy a certain proportion of their requirement of raw jute for manufacturing these bags from JCI. The company also sells the jute procured through support operations in the open market and the quantum of jute sold through free sale as a proportion of total jute procured through support operations has been about 18% from 1996-97 to 2000-01.

Commercial Operations: This pertains to JCI buying jute at open market prices against firm-buy commitments from jute mills, the primary customer for these being the National Jute Manufacturers Corporation (NJMC).

Promotion of Diversified Jute Products: This activity entails JCI running a showroom, called *"Sonali"* in an up-market location in Kolkata, in collaboration with Jute Manufactures Development Council (JMDC), which sells jute handicrafts sourced from craftsmen/cottage industry entrepreneurs. The margins from this business have consistently been negative, since this activity focuses on the promotion of diversified jute products rather than commercial return.

Support operations comprise the bulk of JCI's revenue. Its commercial operations were confined mainly to selling jute to NJMC. Due to JCI having stopped selling to NJMC since 1992-93 as a fall-out of NJMC's weakening financial condition, the commercial operations of JCI have been negligible in the past 10 years. All the commercial transactions with NJMC have been against a guarantee of payment provided by the Ministry of Textiles. The commercial operations of JCI got a fillip in 1999-00, as the company was allowed to access the Government guaranteed line of credit for commercial operations (in addition to support operations). JCI does not have any export operations.

JCI has not been able to get new customers in commercial operations or for the free sale part of support operations. The company's inability to grant credit terms to the customers has been one of the reasons for inhibiting commercial operations. JCI is constrained from giving credit to its customers by the terms of the Government guaranteed commercial borrowing. Apart from these trade terms, JCI's lack of focus and the low level of resources deployed on marketing, have also inhibited its commercial operations.

The table below gives the year-wise extent of support and commercial operations of JCI since inception of operations.

Table 2 - YEARWISE OPERATIONS OF JCI

All figures in thousand bales

Year	Total production in India	Procured by JCI		Total Operations of JCI
		Support Operations	Commercial operations	
1972-73	6090	0	89	89
1973-74	7676	122	603	725
1974-75	5034	17	544	561
1975-76	5914	569	11	580
1976-77	7099	813	0	813
1977-78	7154	0	68	68
1978-79	8333	48	783	831
1979-80	7692	526	336	862
1980-81	8160	1041	21	1062
1981-82	7400	1759	0	1759
1982-83	6300	656	201	857
1983-84	6600	1	839	840
1984-85	7343	0	1014	1014
1985-86	12500	2683	141	2824
1986-87	7500	2224	0	2224
1987-88	6300	543	0	543
1988-89	6900	1	680	681
1989-90	7250	0	508	508
1990-91	9000	0	852	852
1991-92	9000	504	114	618
1992-93	7700	917	0	917
1993-94	7000	7	0	7
1994-95	8200	1	0	1

...contd.

Year	Total production in India	Procured by JCI		Total Operations of JCI
		Support Operations	Commercial operations	
1995-96	8100	0	0	0
1996-97	10200	0	22	22
1997-98	10900	985	0	985
1998-99	8300	9	45	54
1999-2000	7800	18	89	107
2000-2001	9400	462	0	462

Source: ICRA

JCI's share capital has remained unchanged at Rs. 5 crore during the past 30 years. With the company having sustained losses over the past years, this has led to the complete erosion in the net worth of the company. As on March 31, 2001 the accumulated losses stood at Rs.105.75 crore.

Future Plans of JCI

As the cropping pattern of jute is dependent on favourable climatic conditions as well as the perception of the farmer community regarding relative prices of the substitutable crops, it is difficult to predict the years in which support operations might need to be initiated. JCI is thus not able to gauge the quantum of support operations that it might be expected to execute in the coming years, though it feels that it may conform to the pattern that has been existing since the inception of MSP for jute.

An analysis of the frequency of support operations of jute shows that it reaches a peak every five years, with the terminal years on the two ends of the cycle showing nil operations. There is a low volume of support operations in the second and the fourth year of this cycle. However, deviations have happened in the periodicity of this cycle, due to climate related or external conditions.

Regulation may not be Supportive of any Protection of the End-Use of Jute

Changes in the Jute Packaging Materials (Compulsory Use in Packing Commodities) Act, 1987 have brought down the compulsory packaging of 100% foodgrain and sugar. This is expected to decrease the demand for jute, which might lead to a situation of excess supply of raw jute, thereby necessitating greater price support operations in the coming years.

Commercial Operations unlikely to take off for JCI

JCI wants to concentrate on commercial operations in a bid to reduce the component of subsidy claim from the Government. However, JCI is not able to indicate the level of commercial operations that it would be able to do in the ensuing years, as it feels that the quantum would be dictated by market conditions. Given the level of commercial operations undertaken by JCI in the past as well as the commercial acumen demonstrated by it, it is perceived that the company may not be able to garner substantial sales on this front.

Principal Reasons for Low Coverage of the Jute Market by JCI

JCI's coverage has been 5%-8% of the raw jute market and the main causes that have contributed to such low coverage can be summarised as follows:

- The company has discontinued the practice of going to local jute markets to buy jute and has switched to the practice of farmers coming to its procurement centres to sell their produce. This has made it difficult for many farmers to approach JCI;

- Due to issues of security, JCI started paying farmers through bearer cheques, in contrast to their earlier practice of paying in cash, a practice that was more convenient to small farmers;

- JCI's reliance on a single-warehousing model, wherein all its procurement centres usually have only one attached warehouse of about 6,000 quintal capacity, constrains the procurement capacity of the company; and

- Lack of focus on marketing has led JCI to be primarily dependent on Government regulations for the purpose of selling its jute.

Reasons for the Sickness of JCI

JCI has been incurring losses since its inception and the main reasons contributing to this are:

- **Operation in a Regulated Market**

While JCI's procurement in its support operations is governed by MSP, its selling is also governed (on the major part) by the Derivative Minimum Price which is set by the Jute Commissioner depending on inputs from the industry and JCI. This price does not absorb even thenormal annual increase in expenses for the maintenance of JCI.

- **Funding Policy**

While it was decided that the losses incurred by JCI on its support operations will be subsidised by the Government, the company has, against a subsidy claim of Rs. 461.01 crore, received only Rs. 222.4 crore.

This deficit has been compensated by the Government by giving the company interest-bearing loans, against which the interest is quite high. With the Government having stopped payment of subsidy since 1996-97 onwards (though the practice is understood to have been resumed since May 2002), the interest burden has risen considerably leading to higher losses for JCI.

- **Lack of Commercial Operations**

While JCI should have been able to cover the losses on its support operations by having more commercial operations, it has not been able to do that because the organisation lacks a marketing focus and is risk-averse in commercial trading.

Lack of flexibility of JCI in its payment terms and insistence on 100% advance in all cases, have led customers to prefer private traders whose payment terms are geared towards credit.

- **Decreasing Resource Base**

With a freeze on recruitment since 1991, the number of permanent employees has been steadily decreasing from 1,815 in 1995-96 to the current level of 1,640 as on March 31, 2001. While the current manpower level is also high for the extant operations of JCI, with the superannuation, increasing age of the experienced staff and lack of suitable training at the junior level, JCI faces a skill shortage.

- **Increasing Fixed Costs**

With 95% of the staff on CDA scale, there has been an increase in the wage bill due to acceptance of the 4th and 5th Pay Commission recommendations.

Since the premises of all the regional offices, the procurement centres and the attached warehouses have been taken on rent, JCI has to face an escalation of around 15% in the rental outlay of almost all the properties every three years. This has led to an increase in the overheads.

JCI has tried to counter the problem of decreasing reach on account of closure of its procurement centres by tying up with the co-operative societies of different States. However, due to lack of experience of the employees of these co-operative societies in sourcing and sorting of raw jute, the quantum of customers' quality claims is higher for material delivered from these nodes, leading often to an increase in marketing costs.

INDUSTRY OVERVIEW

India is the largest producer of jute in the world contributing 62% to the world production in 2001-02, followed by Bangladesh at 30%.

The past 20 years have been witnessing increased jute production in the country and currently India's production stands at about 1.8 to 2 million tonnes per annum (mtpa) of raw jute. The total area under jute cultivation is estimated to be around 822 thousand hectares, with an estimated 4 million farmers, most of them small and marginal, being involved in the cultivation of this crop.

West Bengal accounts for almost 69% of raw jute cultivation followed by Assam, Bihar and Andhra Pradesh.

The production as well as imports of raw jute in India, as well as trend of consumption of raw jute in India over the past few years, are shown in the following tables:

Table 3

Unit: lakh bales; each bale equivalent to 180 kg

	FY97	FY98	FY99	FY00	FY01	FY02
Opening Stock	5	18.5	27	22	10.5	11
Production of Raw jute	102	109	83	78	94	105
Import of Raw Jute	2.4	2.5	9	8	4	4
Supply of Raw Jute	109.4	130	119	108	108.5	120

Source: Website of the Office of Jute Commissioner / ICRA

Table 4

Unit: lakh bales; each bale equivalent to 180 kg

	FY97	FY98	FY99	FY00	FY01	FY02
Mill Consumption	84.6	96	90	90.5	90.5	92
Exports	0	0	0	0	0	0
Rural Consumption	6.5	7	7	7	7	8
Total Consumption	91.1	103	97	97.5	97.5	100
Closing Stock	18.5	27	22	10.5	11	20

Source: Website of the Office of Jute Commissioner / ICRA

At the current level of production of finished jute products as well as rural consumption of jute sticks for fuel, etc., the quantum of domestic jute production is adequate to meet these requirements. The imported raw jute caters for the requirements of those mills that produce export items or high-end items for the domestic market. Currently, there is no export of raw jute from India. Informal estimates peg the annual value of raw jute production worth around Rs. 1,500 crore and the value of finished jute products produced every year to be around Rs. 3,500 crore.

Finished products of jute comprise *hessian*, sacking cloth, carpet backing cloth (CBC) and other miscellaneous items. Sacking cloth, used for making of gunny bags, comprises almost 60% of the total finished jute production.

With the Indian jute industry having lost the CBC market of the US in the mid-1980s, the industry has not been able to regain that market or enter new markets, leading to an overall decline in the jute industry.

Structure of the Jute Trading Industry

There are 76 jute mills in the country and their spatial distribution across the different States is shown in the table below. Apart from six mills owned by the Government and managed by the Government agency NJMC, the rest of the mills are in the private sector.

Table 5

State	Nos of jute mills
West Bengal	59
Andhra Pradesh	7
UP	3
Orissa	1
Bihar	3
Assam	1
Tripura	1
M.P.	1
Total	**76**

Source: Website of the office of Jute Commissioner/ICRA

However, of these 76 mills, two mills have been closed for the past 12 years and 34 have been referred to the Board for Industrial and Financial Reconstruction (BIFR). There are around 2 to 2.5 lakh workers employed across all the operational jute mills.

The jute trading industry is dominated by trading arms of the private sector jute mills and their employees are posted at all important jute growing and trading centres. Apart from these extensions of the jute mills, there is also a network of jute traders, and the Jute Balers Association estimates this figure to be around 15,000. These traders sell either to the trading arms of the jute mills or to the jute mills directly. Given the spread of jute cultivation and number of farmers involved in the cultivation of this crop, there is a necessity of a tiered structure of traders.

The chain of material flow starts with collection of material at the village level by brokers, which is then sold to a bigger trader at the *taluka* level. This material is then brought to the nearest commercial jute hub and sold either to representatives of the trading arms of the jute mills or to JCI. However, there are also instances where the grower directly brings his produce to either JCI or to the local jute market.

Currently, forward trading in sacking, *hessian* and raw jute is carried out. The East India Jute and Hessian Exchange (EIJHE) is one of the oldest commodity trading exchanges in the country. However, with the Government having banned all forms of hedging, except forward trading from 1984-1992, the Exchange had been active only in forward trading of jute. The Exchange has requested the Forwards Market Commission to permit it to begin futures trading in raw jute and tea. EIJHE has also initiated talks with Calcutta Stock Exchange for setting up a common platform for commodities trading.

Prevailing Policy/Regulation

There are various statutes that govern different facets of the jute industry and the Office of the Jute Commissioner is the nodal agency for implementation of all such policies. The Ministry of Textiles has also recently unveiled the National Textiles Policy, 2000, which also contains certain promotional measures for the ailing jute industry.

Some of the policies that have an impact on the functioning of the jute trading industry and more specifically on the support operations of jute are enumerated below:

Jute Packaging Materials (Compulsory Use in Packing Commodities) Act, 1987:

The various orders enacted under this Act, at periodic intervals, have enabled the Government of India to set the minimum percentage of jute that needs to be used in jute packaging material for four commodities - cement, urea, foodgrain and sugar.

While cement was taken out of the purview of this order earlier, the 15% reservation of urea was removed in July 2001 and only compulsory packaging of 100% of sugar and foodgrain in jute packaging was retained till June 30, 2002. However, 10-kg and lower packs of sugar and foodgrain that are meant for exports and retail sale were also made exempt from compulsory jute packaging.

In July 2002, the Government of India diluted the existing compulsory packaging limit by including the following:

- For sugar, the limit was brought down from 100% to 75% till June 2003, which would be reduced to 50% by June 2004; and

- For foodgrain, the limit was brought down from 100% to 80% till June 2003, which would be further reduced to 60% by June 2004.

- The Indian Jute Manufacturers Association (IJMA), fearing a decline in the requirement of jute and thereby a further adverse impact on the ailing jute industry, had challenged the order in court and, in August 2002, the Calcutta High Court passed a judgement in favour of the Government, upholding its decision.

- A high-powered Ministerial Committee has also been formed with representatives from the Ministries of Agriculture, Textiles and Consumer Affairs, which are looking at the sustainability of the Act beyond 2004.

Jute and Jute Textile Control Order, 2000, which repealed the Jute Textiles (Control) Order, 1956 and the Jute (Licensing and Control) Order, 1961. This is linked to the approval for continuing the purchase of jute bags through DGS&D for FCI and other State foodgrain procuring agencies at prices fixed on the basis of Tariff Commission. This provides a selling route for the jute procured by JCI at support prices that are higher than the ruling market prices.

National Textile Policy 2000:

The Government of India announced the new National Textile Policy (NTP) 2000, with the objective of facilitating the Textile and Jute industry to attain and sustain a pre-eminent global standing in the manufacture and export of textile/jute materials.

POSITION OF JCI IN THE JUTE TRADING INDUSTRY

JCI is the largest trader in the jute market with its network of 171 procurement centres and over 2,250 employees (including casual employees). The basic objective of JCI is support operations which is different from that of the private jute trading community which mainly engages in commercial trading. This has resulted in JCI having a very low coverage in the jute market. While formal figures on the other jute traders are not available, informal discussions with the industry representatives reveal that JCI compares unfavourably on size/revenue basis with other private players. Its total costs are understood to be around 30% higher than those of private players. The condition of its rented warehouses and baling presses is often quite poor. Therefore, in its current condition, JCI does neither have the necessary infrastructural facilities nor the commercial expertise of competent employees which are deemed as the key success factors for a company to operate successfully in the commercial trading operations of jute.

To increase its coverage in the raw jute market, JCI has tied up with BENFED, the apex co-operative marketing agency in West Bengal with 65 procurement centres in the rural areas. In Bihar, it has teamed up with BISCMF, which has nine centres.

In Meghalaya, the State co-operative agency, with two procurement centres, will offer price support on its behalf. Negotiations for similar arrangements with agencies in Assam, Orissa and Andhra Pradesh are under way. These agencies are paid a handling charge of Rs. 85 per quintal. Apart from this, JCI has also tied up with 20 village-level bodies -*Samabay Krishak Unnayan Samitis* in West Bengal and five *Gram Panchayat* Service Societies in Assam, which collect material from the farmers in their respective villages and get it to the nearest DPC or outlet of the co-operative societies. A handling charge of Rs. 2.50 per quintal is paid to these village-level bodies.

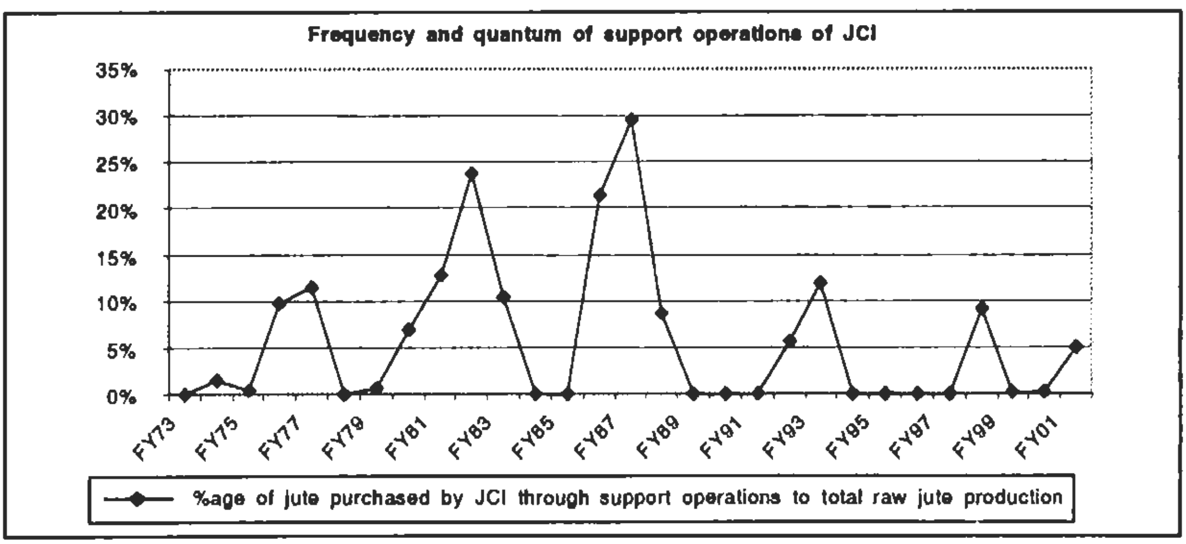
Process of Fixation of MSP

Government's price support policy for agricultural produce aims at ensuring remunerative prices to the growers for their produce with a view to encouraging higher investment and production. MSP for important items, including jute, is fixed after taking into consideration the recommendations of the CACP, views of State Governments and Central Ministries.

Frequency and Impact of Support Operations of JCI

The Government organises support price purchase operations through public agencies like the FCI for paddy, wheat and coarse cereals, Cotton Corporation of India for cotton, NAFED for oilseeds and pulses, Tobacco Board for tobacco and JCI for jute. The trend of JCI's support operations over the past 30 years illustrates the frequent but unpredictable need of support operations.

Table 6



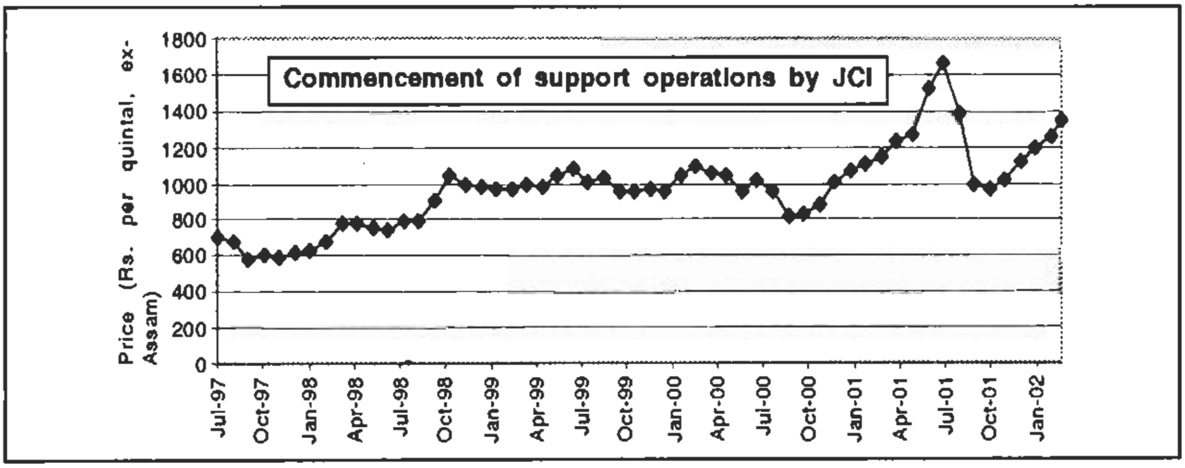
Source: JCI / ICRA

The table shows that there was nil or negligible support operations for jute by JCI in 16 years of its operations. For the balance period, the coverage has usually been around 8%--10% of the total jute cultivation, especially in the period since 1990-91. However, if an analysis is done for the quantum of raw jute purchased by JCI in the four-five months when MSP is in operation, it will be seen that JCI procures around 18% - 22% of the total raw jute available in those months.

Prices Stabilised with JCI's Market Interventions

JCI's entry in the market bolsters the open market prices of jute. The table below shows the increase in price of jute in the open market that has followed the initiation of support operations by JCI:

Table 7



Source: ICRA

Coverage of intended beneficiaries uncertain

Apart from the positive impact on open market prices, JCI's mandate is also to procure only from farmers, so that the benefits of this exercise percolate to the cultivator for whom this is intended. However, owing to difficulty of identification, the company often sources material from any supplier who directly brings jute to the company's procurement centres. Informal estimates peg the proportion of intermediaries in the supplier list of JCI to be 40% or even higher.

To find a solution to this problem, JCI has taken up the matter with the State Government to utilise the network of Block Development Offices/*gram panchayats*, etc., to issue Jute Cards to bona-fide jute growers. However, while JCI has been insisting on this for a long time, due to the procedural bottlenecks involved and the huge number of the jute grower community, proper implementation of this is yet to happen.

Employee Profile

JCI has three categories of employees:

Permanent employees: These are employees engaged in all functions apart from supervising/ doing the activities of weighing, sorting and baling of raw jute.

Casual employees: These are employees engaged in the supervision of contract labour that are engaged in the weighing, sorting and baling of jute and also in security related jobs. There are around three-four casual employees attached to each procurement centre, with a total of 606 such employees across all procurement centres as on March 31, 2001.

Contract labour: These are employees engaged in the execution of the manual tasks of weighing, sorting and baling of jute. These employees are paid on a weekly basis. During support operations, each procurement centre employs around 15 - 20 contract labourers per day on a daily wage basis and their wages are shown as part of operational expenses.

The deployment of staff at the Head Office and Regional Offices is very high, given the nature of administrative functions performed by these two nodes. If the 606 casual employees deployed across the 171 procurement centres are included in the employee base, the deployment figure at procurement centres goes higher. JCI employs approximately 2,500 - 3,000 contract labourers across all procurement centres, which further skews the deployment pattern at the procurement centres. The scope for manpower rationalisation thus exists at Head Office, Regional Offices and procurement centres.

The 606 casual employees employed across all procurement centres have been associated with JCI for the past 25 years or more. They enjoy benefits similar to that of permanent employees like a fixed retirement age, statutory payments of PF and gratuity as well as certain leave benefits. Even during the periods when JCI is not involved in either support or commercial operations, these casual employees continue to be on the rolls of JCI. However, these employees cannot avail of VRS benefits, as they do not belong to the category of permanent employees.

OPERATING PERFORMANCE

Government Regulated Purchasing and Selling Prices

While JCI's procurement in its support operations is governed by MSP, its selling of jute for B- Twill bags (comprising the major proportion of sales) is also governed by the Derivative Minimum Price which is set by the Jute Commissioner depending on the inputs from the industry and JCI. JCI expects that it will be compulsory for jute mills in the country to procure their entire requirement of raw jute for goods supplied under the B-Twill Link Scheme from JCI.

The computation of this selling price, which is termed as the Derivative Minimum Price, is only able to partially cover JCI's overheads and operating expenses. In fact, from a review of this selling price for the past 2 to 3 years it appears that that the Derivative Minimum Price does not absorb even the normal increase in expenditure for maintaining JCI operations (such as increase in salaries and wages, power costs, etc). As a result, the trading margins on support operations are negative.

Thus, JCI incurs losses on every quintal of raw jute sold by it under the B-Twill link scheme. With the free sale of jute at open market prices constituting only 18% of its total sales under support operations wherein it is partially able to recover other costs, JCI makes losses on its entire support operations.

Increasing Subsidy Claims

The main components of JCI's costs comprise interest expense on Government loans and employee costs which have to be incurred even in those years when there are no support operations.

Compounding Financing Charges Increases Subsidy Claims

With a high interest of 18.5% on Government loans (and 2.5% penal interest) and the Government having resorted to financing JCI in the past five years through interest-bearing loans, rather than subsidy, the interest expense has shown a rise. The company has not been in a position to repay either its debts or the interest portion thereon and this situation has led to further spiralling in the total interest expense. The average interest rate for the company currently stands at around 22% (including penal interest).

As this interest outgo is also accounted for by the company while claiming subsidy, claims for subsidy have been increasing over the years.

Increasing Employee Costs

While the number of permanent employees decreased from a level of 1,745 in 1996-97 to 1,640 in 2000-01, the employee cost has risen from Rs. 16.36 crore in 1996-97 to Rs. 26.63 crore in 2000-01. With variability in the level of support operations and very minimal level of commercial operations, the employee cost as a proportion to total income, is high. Since support operations usually peak every five years, in the years of low or nil support operations, the manpower remains grossly underutilised. Apart from the employee cost, JCI also hires about 2,500-3,000 contract employees during the support operations season to do the manual jobs of weighing, sorting a baling of raw jute. Manpower rationalisation in JCI is an urgent necessity.

FINANCIAL PERFORMANCE

The financial statements of JCI, in the form of Income Statement, Balance Sheet and Financial Ratios are shown below:

Table 8 – Income Statement

Amounts in Millions of Rupees Income Statement	**1997 12 Mths**	**1998 12 Mths**	**1999 12 Mths**	**2000 12 Mths**	**2001 12 Mths**
Sales (*less Claims*)	32.3	708.0	740.8	231.0	786.3
Acc/(Dec) to WIP	3.1	711.0	-693.8	-16.4	46.9
Trading Income	0.0	0.0	0.0	0.0	0.4
Subsidy from Government	0.0	136.8	589.3	554.1	524.1
Operating Income	**35.4**	**1555.7**	**636.3**	**768.7**	**1357.6**
Purchases	31.8	979.4	83.4	175.9	634.9
Trading Expenses	1.4	93.3	52.6	7.7	84.6
Insurance & Warehousing	8.5	16.2	18.2	10.5	11.2
Employee Cost	163.6	237.8	244.3	276.7	266.3
Other expenses	6.6	10.4	10.3	44.9	18.7
Provision for doubtful debts/advances/loss	0.0	0.1	7.4	-0.1	0.2
OPITDA	**-176.5**	**218.5**	**220.2**	**253.1**	**341.6**
Depreciation	0.2	0.2	0.4	0.4	0.5
OPIT	**-176.7**	**218.3**	**219.8**	**252.7**	**341.1**

...contd.

Amounts in Millions of Rupees **Income Statement**	**1997 12 Mths**	**1998 12 Mths**	**1999 12 Mths**	**2000 12 Mths**	**2001 12 Mths**
Interest Income	1.1	1.3	3.8	12.2	3.4
Other Income	0.3	1.3	3.2	7.7	14.4
Recovery of Bad Debts	0.0	0.0	0.0	0.0	9.9
Prior Period Adjustments	-15.2	-1.8	-0.6	-4.1	0.6
EBIT	**-190.5**	**219.1**	**226.2**	**268.5**	**369.3**
Interest on Bank Loan		23.4	11.4	1.1	14.9
Interest on Govt. Loan	134.5	190.5	239.2	288.7	353.9
Bank Charges and Guarantee Fees	0.3	6.8	4.2	4.4	6.0
Interest – Others	0.3	0.3	0.1	0.0	0.0
INTEREST EXPENSE	**135.1**	**220.9**	**254.9**	**294.3**	**374.7**
NET PROFIT	**-325.6**	**-1.8**	**-28.7**	**-25.8**	**-5.4**
Adjustment to Retained Earnings	0.0	0.2	0.6	0.5	-0.2
TOTAL CHANGES IN RETAINED EARNINGS	-325.6	-1.6	-28.1	-25.3	-5.7

Source: ICRA

Table 9 – Balance Sheet

Amounts in Millions of Rupees ASSETS	**Mar 31 1997 12 Mths**	**Mar 31 1998 12 Mths**	**Mar 31 1999 12 Mths**	**Mar 31 2000 12 Mths**	**Mar 31 2001 12 Mths**
Cash in Hand	1.1	3.3	8.4	14.1	5.3
Cheques in Hand	0.0	0.0	0.0	0.0	5.7
Stamps in Hand	0.0	0.0	0.0	0.0	0.0
Current Account	11.8	22.5	15.0	7.5	17.2
Savings Account	28.2	15.6	51.3	3.8	7.5
Short Term Deposit	0.0	29.1	47.8	110.6	175.1
Cash and Bank Balances	**41.0**	**70.6**	**122.5**	**136.0**	**210.9**
Debtors outstandings for < 6 months	3.2	38.1	58.7	0.7	59.3
Debtors outstandings for > 6 months	642.2	642.2	642.2	642.2	642.2
Less: Allow for Doubtful Accts	0.9	0.9	0.9	0.9	0.9
Total Accounts Receivable - Net	**644.6**	**679.4**	**700.0**	**642.0**	**700.6**

...contd.

Amounts in Millions of Rupees ASSETS	Mar 31 1997 12 Mths	Mar 31 1998 12 Mths	Mar 31 1999 12 Mths	Mar 31 2000 12 Mths	Mar 31 2001 12 Mths
Advances	50.2	56.7	77.1	79.7	92.3
Less: Provisions – Doubtful	5.1	5.1	12.3	12.3	12.2
Advances(less Provisions)	45.1	51.6	64.8	67.5	80.1
Advance Tax	23.7	28.9	40.2	41.9	40.5
Loans and Advances	**68.8**	**80.5**	**105.0**	**109.4**	**120.6**
Raw Jute - Price Support	0.0	714.1	10.2	2.7	50.6
Raw Jute – Commercial	3.1	0.0	10.0	1.0	0.0
Add: Abnormal Shortage of Stock	4.5	4.5	4.5	4.5	4.5
Less: Provision for Abnormal Shortage	4.5	4.5	4.5	4.5	4.5
Total Inventory	**3.1**	**714.1**	**20.1**	**3.7**	**50.6**
Subsidy Receivable	**580.7**	**717.7**	**1307.6**	**1862.3**	**2386.1**
TOTAL CURRENT ASSETS	**1338.3**	**2262.3**	**2255.2**	**2753.4**	**3468.8**
Leasehold Premises	0.0	0.0	0.0	0.0	23.6
Furniture	3.8	3.8	3.9	3.9	3.8
Computer	0.3	1.0	1.3	1.5	1.5
Other Fixed Assets	1.8	1.9	1.9	1.9	2.4
Gross Fixed Assets	5.9	6.7	7.0	7.3	31.4
Less: Accumulated Depreciation	3.6	3.8	4.1	4.5	4.2
Total Fixed Assets – Net	**2.3**	**2.9**	**2.9**	**2.9**	**27.2**
TOTAL NON-CURRENT ASSETS	**2.3**	**2.9**	**2.9**	**2.9**	**27.2**
TOTAL ASSETS	**1340.5**	**2265.1**	**2258.1**	**2756.2**	**3496.0**
LIABILITIES					
Sundry Creditors	10.6	10.4	10.4	10.4	10.9
Claims Payable	62.3	74.7	77.0	77.3	93.8
Jute Special Development Fund	23.1	23.1	24.9	25.9	27.0
Raw Jute Buffer Stock Scheme	37.4	37.4	37.4	37.4	37.4
Grants	7.1	22.0	23.2	20.8	11.6
Interest Accrued and Due	1362.2	1536.4	1791.1	1957.2	2265.3
Interest Accrued but not due	12.5	28.8	13.2	135.9	180.2
Provisions for Bonus	2.5	1.5	1.6	0.0	0.3

...contd.

Amounts in Millions of Rupees LIABILITIES	Mar 31 1997 12 Mths	Mar 31 1998 12 Mths	Mar 31 1999 12 Mths	Mar 31 2000 12 Mths	Mar 31 2001 12 Mths
Provision for Tax	8.0	16.4	24.8	25.5	36.8
Other Current Liabilities	124.9	227.0	187.6	211.1	233.6
TOTAL CURRENT LIABILITIES	**1650.5**	**1977.5**	**2191.4**	**2501.4**	**2896.7**
Cash Credit	0.0	339.2	0.0	0.0	0.0
Unsecured Loan – GoI	636.8	896.8	1043.4	1256.8	1606.8
TOTAL LT LIABILITIES	**636.8**	**1236.0**	**1043.4**	**1256.8**	**1606.8**
TOTAL LIABILITIES	**2287.3**	**3213.5**	**3234.8**	**3758.2**	**4503.5**
Equity Share Capital	50.0	50.0	50.0	50.0	50.0
Loss as per Last Account	-671.1	-996.8	-998.4	-1026.7	-1051.9
Profit/ (Loss) for the year	-325.6	-1.6	-28.3	-25.2	-5.7
Revenue Reserves [incl P&L]	-996.8	-998.4	-1026.7	-1051.9	-1057.6
NET WORTH	**-946.8**	**-948.4**	**-976.7**	**-1001.9**	**-1007.6**
TOTAL LIABILITIES & NET WORTH	**1340.5**	**2265.1**	**2258.1**	**2756.2**	**3496.0**

Source: ICRA

Table 10 – Financial Ratios

Financial Ratios	Mar 31 1998 12 Mths	Mar 31 1999 12 Mths	Mar 31 2000 12 Mths	Mar 31 2001 12 Mths
PROFITABILITY RATIOS:				
OPBIDT/OI, %	14%	35%	33%	25%
PAT/OI, %	0%	-5%	-3%	0%
Return on Average Equity %	0%	3%	3%	1%
COVERAGE RATIOS:				
Interest Coverage (EBIT/Tot.Interest)	1.0	0.9	0.9	1.0
ACTIVITY RATIOS:				
Receivables in Days	159.4	401.6	304.8	188.4
Inventory in Days	194.9	17.6	2.6	18.2
Payables in Days	2.8	9.2	7.4	3.9
Inventory/OI, %	167.5	11.5	1.8	13.6
OI/Gross Block	233.4	90.4	104.8	43.2

...contd.

Financial Ratios	Mar 31 1998 12 Mths	Mar 31 1999 12 Mths	Mar 31 2000 12 Mths	Mar 31 2001 12 Mths
NCA/(NCA+FA)	1.0	1.0	1.0	1.0
LIQUIDITY RATIOS				
Quick Ratio	0.8	1.0	1.1	1.2
Current Ratio	1.1	1.0	1.1	1.2
Sales / Net Working Capital	5.5	10.0	3.1	2.4
Net working capital / Sales, %	18%	10%	33%	42%
LEVERAGE RATIOS:				
Total Liabilities / Total Net Worth	-3.4	-3.3	-3.8	-4.5

Source: ICRA

As can be observed, JCI has a very weak financial position given the sustained losses suffered during the past 30 years. The sustained loss has led to erosion in the net worth of the company. It had accumulated losses of Rs.105.75 crore as on March 31, 2001.

The total debt burden currently stands at Rs. 387 crore. As stated earlier, JCI has taken interest- bearing loans from the Government to finance its operating losses. The company has neither repaid the loans nor the interest accrued thereon, thereby leading to a virtual debt trap.

JCI has an outstanding receivable of Rs. 64.13 crore as on March 31, 2001 against supplies made to NJMC till 1991-92 on credit terms. These represent almost 75% of income accruing to JCI from its support and commercial operations in 2000-01. As NJMC falls under the same administrative Ministry, no legal action has been taken. An interest of Rs. 192.88 crore is due on this amount, which has been computed by JCI. This interest component is not reflected in the company's Balance Sheet.

While the outstanding amount of Rs. 64.13 crore is shown as a category of debt that is considered good by the management, given the worsening condition of NJMC and recent orders of work suspension in its main unit, the possibility of NJMC repaying this debt does not appear to be bright.

SWOT ANALYSIS

The key success factor of a trading organisation like JCI lies in being able to source effectively and also market it to a wide and appropriate customer base. The ability of JCI to execute these functions depends on the quality and quantum of its resources as well as the efficiency of its supporting systems.

Strengths

- **JCI as a support operations agent:**
    - Good network of procurement centres, with presence in all the major jute producing States;
    - Competence in buying jute;
    - Enjoys a reputation in the market of supplying good quality material;
    - Ability to collect information on jute related matters from the grassroots level and communicate to the Government; and
    - Access to adequate working capital through the Government guaranteed Rs. 99 crore line of credit.
- **JCI as a commercially viable entity**
    - Has an access to the resource base of the support operations, i.e., the network of procurement centres and manpower;
    - Knowledge of buyers and sellers in the market through its MSP procurement operations and B-Twill link sale scheme; and
    - Access to adequate working capital, since the Government has allowed JCI to use the Government guaranteed Rs. 99 crore line of credit for commercial operations also.

Weaknesses

- **JCI as a support operations agent:**
    - JCI's discontinuation of the practice of going to local jute markets to buy jute and switching to the practice of farmers coming to JCI's procurement centres to sell their produce has made it difficult for many farmers to approach JCI;

    - Due to issues of security, JCI started paying farmers through bearer cheques, in contrast to the earlier practice of paying in cash, which was more convenient to small farmers;

    - JCI's reliance on a single-warehousing model, wherein all its procurement centres usually have only one attached warehouse of about 6,000 quintal capacity, constrains the procurement capacity of JCI; and

    - Lack of focus on marketing has led JCI to be dependent on Government regulations for the purpose of selling its jute.

- **JCI as a commercially viable entity:**

    - Lack of marketing focus in the organisation, an aversion towards taking risk of commercial trading, lack of flexibility of JCI in its payment terms and insistence on 100% advance in all cases, have led customers to prefer private traders whose payment terms are geared towards credit.

    - While the current manpower level is high for the extant operations of JCI the organisation also faces a skill shortage on multiple aspects.

    - High labour related expenses and spiralling financial charges, coupled with increasing quantum of quality claims and increase in rental expenses have led to an unviable cost structure of the company.

    - It is understood on the basis of data obtained from the company as well as through informal surveys that the total cost for JCI is about 30% more than that of a private trader after taking into account the overheads, service charges and payments to State Cooperatives. As such, substantial scope of cost reduction exists.

Opportunities

- **JCI as a support operations agent:**

    - With the amendment in the Jute Packaging Materials (Compulsory Use) Act 1987, it is expected that the demand for raw jute may decrease, which might lead to an excess supply situation of raw jute, thereby requiring a higher degree of support operations; and

    - With the closure of jute mills in Bangladesh, possibility of imports of quality raw jute from Bangladesh is high, leading to an excess supply situation of raw jute, thereby necessitating higher degree of support operations.

- The Government has recently decided to mandate all jute mills supplying jute bags through the B-Twill Link scheme to procure jute from JCI.

- **JCI as a commercially viable entity:**

    - The need of the jute mills to have a credible source of supply of good quality jute exists.

Threats

- **JCI as a support operations agent and as a commercially viable entity:**

- **Funding policy of the Government:**

  While Government had decided that the losses incurred by JCI on its support operations will be subsidised by the Government, JCI has, against a subsidy claim of Rs. 461.01 crore, received only Rs. 222.4 crore. This deficit has partially been compensated by the Government by giving JCI interest-bearing loans.

- **Changes in the senior management team**

  JCI is expected to experience a vacuum in the senior management level with the CMD and other senior executives due to retire shortly and its operations can get hampered due to the simultaneous exit of its key personnel.

- **Changes in the external environment:**

  With the Indian jute industry having lost the carpet-backing-cloth market of the US in the mid-1980s, the industry has not been able to regain that market or enter new markets, leading to a decline in the jute industry and, therefore, the demand for raw jute;

  Lack of investments by the jute industry has led to a decline in productivity coupled with the closure of jute mills on account of labour and/or financial problems. This has translated into lower production of finished jute goods;

  With farmers getting attractive prices for other crops like sunflower and other cash crops, the total acreage under jute cultivation has come down;

Dissemination of information and spread of literacy among the farmer community has led to a higher awareness and bargaining power of farmers, leading to lesser requirement of support operations; and

Dilution of the Jute Packaging Materials (Compulsory Use) Act, 1987 which earlier stipulated the compulsory packaging of cement, urea, foodgrain and sugar in gunny bags has led to the lowering of usage of gunny bags by end-user industries, adversely impacting the requirement of raw jute.

DISINVESTMENT OPTIONS

Since the cropping pattern of jute is dependent on climatic conditions as well as perception of the farmer community regarding relative prices of substitutable crops, it is difficult to predict the years in which support operations require to be initiated. Thus, JCI is not able to gauge the quantum of support operations that it might be expected to execute in the coming years, though it feels that it may conform to the pattern that has been developed since the inception of MSP operations for jute.

Two scenarios to evaluate the restructuring and disinvestment potential/ options for JCI, linked to the future of the MSP policy for jute, are analysed below:

Scenario A: The Government continues with the present MSP policy for jute

Scenario B: The Government discontinues the MSP policy for jute

Scenario A - Continuation of the MSP policy by the Government

As mentioned earlier, the rationale for MSP is to protect farmers from market risks to the extent possible and to ensure that jute growers are not compelled to resort to distress sale. As such, the continuation of the Government policy of MSP for jute would require the existence of one or more implementing agency/agencies. JCI has been the agency that has been implementing the Government's MSP policy for jute. In the process, the company has, however, incurred huge losses. The company's operating costs are also understood to be around 30% more than that of competing private traders.

However, given the economic rationale that competition breeds efficiency, the fact that JCI's operations are not as efficient as that of its private sector competitors from the financial view point and that the coverage of intended beneficiaries of JCI's operations is, in any case, also uncertain (it is estimated that only 60% of

JCI's purchases are directly from farmers and the balance from intermediaries), a competitive bidding process for conducting MSP operations has the potential to reduce JCI's operational costs as well as its losses. As such, implementation of MSP operations through an appropriate competitive bidding process is desirable. Under this system, the Government could restrict itself to announcement of MSP and contract out MSP operations in jute growing states/regions on a least cost basis to different bidders. Government has to designate an agency to coordinate this job.

However, in the context of jute, the following factors are important:

- The market conditions of jute are not encouraging and the likelihood of MSP happening with high frequency in the future is strong;

- The jute market, both in terms of production and consumption, is localised in the Eastern Zone, with a large concentration in West Bengal. The structure of the jute market in these areas is such that mill owners and jute traders often belong to the same family group or company. According to some industry experts, this fact has also been partly responsible for the jute market turning into a buyers' market in recent years.

Thus in the case of jute, the Government would have to be careful in formulating the bidding criteria for MSP operations in order to prevent manipulation of the system and to ensure that the benefits of MSP operations pass on fully to the intended beneficiaries. Such a system could include:

- Requiring the bidder(s) to maintain a separate ledger for MSP operations and conducting monthly audits of the same, with actual on-ground inspection of the bidder's godown;

- Regular checks on the beneficiaries of MSP operations;

    - ❑ Monthly audit of the bidder's books of accounts for MSP operations;

    - ❑ Spot checks with mills buying jute from the bidder to ensure that the sales prices quoted by the bidder to the Government are correct; etc

Once the adequate system for bidder selection for MSP operations is finalised and a proper system of checks and balance is formulated, and after JCI becomes a leaner and more efficient organisation competing with other organisations, disinvestment of JCI can be considered.

Having stated this, the next question that arises is – What value does JCI bring to a potential buyer?

The networth of JCI is completely eroded and accumulated losses currently stand at over Rs 100 crore. Even if its balance sheet be 'cleaned' through adequate restructuring measures, the company is unlikely to attract buyer interest due to the following reasons:

1. The company has no business value and also has negligible fixed assets. While the book value of its plant and machinery as well as its leasehold premises stands at Rs 2.71 crore, the value realisable on sale of JCI could perhaps be even lower.

2. The company possesses knowledge of buyers and sellers in the market through its MSP procurement operations and B-Twill link sale scheme; however, this strength is more a function of its employees who can be recruited directly by a competitor.

3. The company has a good network of procurement centres. However, a majority of these are rented and can be hired by a potential bidder depending on his procurement priorities and strategy.

4. The company lacks commercial focus and possesses an unviable cost structure.

5. JCI does not have a captive client base, i.e., clients who procure jute only from JCI. Jute being a commodity business, jute mills essentially look for quality and price. This is normally achieved through procurement of jute from various sources.

It is, therefore, likely that JCI may not attract adequate buyer interest if it is decided to divest Government stake in JCI. Considering the points discussed above, disinvestment of JCI is not advisable at this stage. The stress now should be to make JCI a much leaner and more efficient organisation, by cutting costs through every possible means – so that it can compete with others in conducting price support operations.

Once the competitive bidding process is formulated, standardised and finds acceptance, say after a period of 5 years, restructuring and disinvestment of JCI should be taken up. During this intervening period, JCI should participate in the MSP bidding process along with other bidders.

Restructuring of JCI

In order to generate buyer interest, an overall improvement is required in the operations of JCI, which would lead to its increasing its coverage in the raw jute market in its support operations and development of commercial skills.

The cost to the Government would considerably reduce if a financial and organisational restructuring exercise is carried out in JCI. Some issues for consideration are listed below:

Financial restructuring:

- Since the Government has been funding JCI with interest-bearing loans rather than with only subsidy, the interest component and outstanding loan amount of JCI is showing a constant rise. JCI, while computing its subsidy claims, includes the interest that it has to pay to the Government, thereby increasing the amount of subsidy claims. This leads to an anomaly that needs to be corrected.

- Government could consider to write-off, at the appropriate stage, the entire outstanding loan amount given by it to JCI and interest payable on these loans, amounting to Rs. 387.21 crore as on March 31, 2001.

- This could be considered to be offset against the subsidy receivable of Rs 238.61 crore, NJMC dues of Rs 64.13 crore and accumulated losses of Rs 105.76 crore. This would lead to the creation of a healthy balance sheet for JCI.

Organisational restructuring:

- Given the current role of the Head Office and Regional Offices in the operations of JCI as well as reliance of JCI on casual and contract employees to execute all manual jobs related to the weighing, sorting and grading of jute, it is evident that there is scope for substantial manpower rationalisation at the Head Office, the 16 Regional Offices and the 171 procurement centres.

- The financial and organisational restructuring should be considered to make JCI competitive and ready for eventual disinvestment. Rationalisation of workforce should be started immediately.

Scenario B - Discontinuation of the MSP policy by the Government

In the event of discontinuation of the MSP policy, there would not be any rationale for the Government to continue in the jute trading business. Given the fact that JCI in its current stake is unlikely to attract buyer interest, the company should be disinvested after suitable financial and organisational restructuring, failing which closure/winding up of JCI is the only alternative.

RECOMMENDATIONS

In case Government continues the price support operations for jute, the Commission recommends that JCI should not be disinvested now. Instead, a competitive bidding process for MSP operations needs to be introduced immediately with a view to cutting JCI's costs and reducing its losses. Under this system, the Government should restrict itself to announcement of MSP and contract out MSP operations in particular states/regions or so, on a least cost basis to the most appropriate bidder(s). The Government would of course need to build in a system of adequate checks and balances in order to ensure that the benefits of MSP operations pass on fully to the intended beneficiaries. The purpose of MSP operations is to benefit jute growers and not to subsidise the inefficiency of any organisation. Exposing JCI to competition would lead to higher efficiency and lower costs of transaction. Concurrently, to make JCI a much leaner and more efficient organisation, every attempt should be made to cut costs and restructure the organisation. After a period of 5 years or so, once the bidding process for MSP operation is standardised and finds wide acceptance, and JCI improves its performance significantly, disinvestment of at least 51% of GoI equity in favour of a strategic partner is recommended, together with organisational and financial restructuring, the details of which have to be formulated in consultation with prospective bidders.

In the event of MSP policy for jute being discontinued, the Commission recommends that the entire equity of JCI be disinvested in favour of a strategic buyer, together with organisational and financial restructuring. In case disinvesment of JCI is not possible, owing to lack of interest of buyers or any other reason, closure/winding up of JCI should be pursued.

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2.4 NATIONAL BUILDINGS CONSTRUCTION CORPORATION LTD. (NBCC)

INTRODUCTION

NBCC was incorporated as a Public sector undertaking in 1960. Currently, it is under the administrative control of the Department of Urban Development.

The activities of NBCC can be broadly classified as construction, real estate and project management/consultancy services. The construction activities of NBCC cover the following segments: Institutional, Housing and Industrial sector, Energy Sector (RCC Chimney, Cooling Towers and Transmission lines), Environmental sector (water, sewerage & effluent treatment plants), Telecommunications, Transportation (Roads, Flyovers, Bridges, Airports etc.), and others (including annual maintenance contracts).

Consultancy services related to construction include various types of architectural and engineering services like planning, design, construction and management services for building structures, installations, civil engineering works etc.

The company has an authorised share capital of Rs.1200 million (mn) (Rs. 900 mn equity shares and Rs.300 mn preference shares). As on 31.3.2001, its paid up capital was Rs.1116.5 million, held entirely by Government of India. Its performance has been rated "Excellent' by Department of Public Enterprises for years 1995-96 to 1998-99. In 1999-2000 and 2000-01, it has been rated "Very Good" and "Good' respectively.

The company has been reporting losses in the past and the losses have been mainly on account of:

- Difficulties in realisation of dues from clients of projects in Libya and Iraq,
- Heavy borrowings during 1986-87 for overseas projects which led to abnormal debt equity ratio of 13.44: 1 and resulting in sharp rise in interest burden from Rs. 190 mn (1992-93) to Rs. 370 mn. (1994-95), and
- Losses incurred in the construction of Fourth Oil Berth at Butcher Island, Mumbai for Mumbai Port Trust.

Financial Restructuring

In November 1998, the Ministry of Urban Development approved the financial restructuring of NBCC w.e.f 1.4.97. The salient features of the restructuring are as follows:

- Conversion of GoI loan of Rs. 917.0 mn. into equity of Rs. 617.0 mn. and Non-cumulative preference shares of Rs. 300 mn;
- Interest liability on GoI. loan amounting to Rs. 671.4 mn. as of 31.03.97 was frozen and made payable in five equal instalments beginning 2000-01;
- Interest on overdue interest of Rs. 343.0 mn. as on 31.03.97 has been waived from the contingent liabilities;
- Authorised capital has been enhanced from Rs. 200 mn. to Rs. 1200 mn;
- RBI Bonds and interest thereon amounting to Rs. 260.9 mn. as on 31.03.97 to be treated as current liability.

The aim of the financial restructuring was to make the Balance Sheet bankable and to make the Corporation self-sustaining. However, these objectives have not been realised so far.

There were 3151 employees on the roll of the Corporation as on 31.3.2001.

The company has formed a joint venture with M/S Jamal Trading, Botswana, titled "Jamal-NBCC International (Proprietory) Ltd.", with a share holding of 49%.

INDUSTRY REVIEW

Industry Size

The construction industry accounts for around 4.5-5% of India's GDP and had a size of around Rs. 1200 billion in 2001-02 (current prices). The industry's performance has a high degree of direct correlation with India's GDP and hence, is affected by the general level of economic activity in the country.

Industry Structure

The construction industry can be classified into number of sub-groups on the basis of size of the players, the sectors being catered to by the industry and the type of contracts.

The competition, technical complexity and operating margins are different for different segments. Currently, the demand for road projects has increased due to the NHDP project. However, the competition in this segment is very high and margins are low. Also these do not always require very complex technical expertise. In the construction of oil and gas infrastructure, for example, the operating margins are high because such works also require a high level of technical expertise.

The low technology segments, particularly housing construction, are dominated by the unorganised sector, which accounts for an estimated 90 per cent of the industry's total turnover. The organized sector has a major presence in infrastructure projects and industrial construction projects, which require strong technical and project management capabilities.

The construction intensity (proportion of construction cost to the total capital cost) in various sectors is given below:

Table 1

Sector	Construction Intensity (%)
Building	76
Roads	63
Bridges	65
Dams	75
Power	38
Railway	78
Medium Industry	20
Transmission	22
Urban Infrastructure	66
Maintenance	81

Source: Credit Rating Information Services of India Ltd. (CRISIL) Advisory Services

Thus, it can be observed that construction comprises nearly 60-80 % of project cost of infrastructure projects like road, housing, railways etc. In projects like power plants, industrial plants etc, the share is much lower.

Major Players & competition in the industry

There are more than 2800 construction companies in the country, of which 10 companies are in the public sector. The industry is characterised by a large number of small companies using labour intensive, outdated technology and equipment.

The major players like Hindustan Construction Company (HCC), Simplex Concrete Piles Ltd, L&T, Gammon India, Jayprakash Industries, Petron Engineering, Shapoorji Pallonji Group and Unitech have a strong presence in the industrial and infrastructure construction segments.

The recent consolidations in the sector and the increasing presence of multinationals have had an impact on the level of competition in the construction sector. In March 2000, Shapoorji Pallonji acquired a stake in Afcons, and in July 2000, Skanska acquired Kvaerner International.

Recently, the sector has been opened to foreign players. As a result, international construction companies have begun to enter the sector in India, mainly through joint ventures or consortia with the Indian players. Almost all these companies are engaged in the core sector construction related to highways, power, chemical, petrochemical, fertilizer or other EPC contracts. The entry of foreign players is expected to improve efficiency, capital investments and technological levels, but it could also be a threat to domestic players. Increased foreign private participation in private infrastructure projects (especially in the power sector) might result in the increased usage of construction services of multinationals (due to their higher financial strength and tie-ups with private infrastructure companies).

In the housing construction segment, competition is expected to continue to be significant, due to the presence of a large number of unorganised players in the private sector. Housing construction accounts for a significant proportion of the industry's total turnover. Hence, the level of competition in the industry is expected to continue to remain significant.

Some of the major players in the construction industry and their segment of operation (2000-2001) are given below:

Table 2

Companies	Major Discipline	Sectors/Area of operation	Turnover (Rs. Mn.)	Net Profit
L & T (ECC)	Civil, Mechanical, Electrical	All	Rs. 49060 mn. (Only Engg and Constrn) and Rs. 84072 mn. for the company as a whole	Rs. 3468 mn. (Overall)
Hindustan Construction Company (HCC)	Civil	Roads, Irrigation, structures, dams, tunnels & structures (marines & civil)	4376.8	346
Gammon	Civil	Bridges, dams & Industrial Structures	5275	148.7
Afcons	Civil	Roads, Bridges, Piling, Industrial Buildings & Marine structures	2500	259.8
Jayprakash Industries	Civil	Dams, Hydro Power & Industrial Structures	3500	NA
Kvaerner	Civil	Structures, Piling	4000	74
Simplex Concrete Piles Ltd	Civil	Piling & Structures	3925.9	51
IRCON	Civil	Railways	7439	656.1
IVRCL	Civil and Commercial	Pipelines, Environment and Corporate parks	2676.1	128.0
Jog Engineering	Civil	Roads	1007.2	47.3

Source: CRISIL Advisory Services

The key demand driver for the Indian construction industry is the level of infrastructure activity in the country. The major clients for most construction companies tend to be the Central or State Governments, public sector undertakings and local authorities.

Government Policy

The industry is influenced by policies, such as the National Housing and Habitat policy, the Urban Land Ceiling Regulation Act (ULCRA), and other land laws. According to an estimate, repealment of the ULCRA is expected to increase the availability of land for housing projects by around 0.2 million hectares, across over

64 cities. The ULCRA has been repealed by the Centre, the Union territories, and by states, such as Punjab, Gujarat, Delhi, Haryana, and Karnataka. In the medium term, many other states are also expected to repeal the ULCRA.

The construction industry is directly affected by the government's budgetary outlay on roads and infrastructure. In the Union Budget 2001-02, the total outlay for the road sector was increased by 93 per cent, to Rs. 87.3 billion.

With liberalisation of the economy in the 1990s, various steps have been taken by the government to make construction, architectural and engineering services globally competitive. Some of the reforms which have a direct impact on these services include simplified procedures for foreign investments, automatic approval of foreign equity participation up to 74 per cent in key infrastructure industries, such as construction of roads, bridges, rail beds, ports and harbours, duty concessions on imports of raw materials and equipment and availability of ECB (external commercial borrowing) for the infrastructure projects. Other developments that have helped the growth of these services are development of insurance products to mitigate construction risks, grading of construction agencies, establishment of Construction Equipment Banks, etc.

INDUSTRY OUTLOOK

Infrastructure projects

During the next five years, the growth in demand from road projects is expected to continue. The road projects under the Golden Quadrilateral and North-South-East-West corridors are expected to be completed by 2003 and 2006 respectively. According to National Institute of Construction Management and Research (NICMAR) estimates, during the next five years, the investment in roads (for construction of national highways, super national highways and state highways) is expected to increase by over Rs. 620 billion. The other projects in the infrastructure sector would be in the areas of ports, airports and power. The total investment in power sector is expected to increase by around Rs.1200 billion.

Housing and Urban Infrastructure

The demand in the housing sector is expected to increase on account of:

- Favourable housing policies by the Govt.

- Thrust by banks and housing finance companies

- Decline in housing rates.

The focus on the housing sector is expected to continue in the Tenth Plan also.

Commercial and Infrastructural projects

Currently, the demand in this segment is low due to lack of investments from large projects. However, there has been increase in the investment in commercial complexes and multiplexes during the past five years due to tax incentives offered by the Government. and growth in the retail segment. During the next five years, investments are expected to grow mainly due to higher growth in commercial and multiplex projects.

In the medium term, demand for construction services is expected to be strong due to road and highway projects, and continued demand from the housing segment, as a result of favourable government policies.

Market Position of NBCC

Majority of the clients of NBCC are Govt. departments and PSUs. The company derives two advantages while bidding for the PSU projects:

- Orders allotted directly on a nomination basis from the Ministry of Urban Development

- Purchase preference in case of PSUs under the Central Govt.

The percentage of nominated and competitively bid projects out of the works completed during the years 1999-2002 is given below:

Table 3

	1999-2000	2000-01	2001-02
Works Completed			
Nominated	50%	59%	37%
Competitively Bid	50%	41%	63%
Number of Private sector Clients	1 Out of 41 Projects	Nil out of 23 projects	2 Overseas Clients out of 26 projects

Source: CRISIL Advisory Services

Even though the above table suggests that the company has been awarded contracts on competitive bidding, the client profile indicates that the majority of the clients are in the public sector only, where NBCC enjoys a purchase preference. The segment wise turnover of NBCC for FY 2000-01 is given below:

Table 4

Segment	**% of turnover**
Institutional, Housing and Industrial	32
Energy Sector	22
Environment Sector (Water, sewerage & ETP's)	5
Telecom	6
Transportation (Roads, Flyover, Bridges and Airports)	5
Project Management	14
Real Estate	3
Others (Including Annual Maintenance contract)	8
Overseas Projects	5

Source: CRISIL Advisory Services

The Institutional, Housing / Industrial and the Infrastructure segments contribute to a substantial portion of its turnover.

Although NBCC has executed a number of projects such as Institutional Complexes, Industrial Structures, Airports & Runways, Bridges, Flyovers, Environmental Projects, Cooling Towers, Transmission Lines, RCC Chimneys, Railway Complexes, Roads & Highways, Hotels and Hospitals, Real Estate Complexes etc. in India and abroad, including landmark projects like the tallest RCC TV Tower in India (235 mtrs. high) in New Delhi, Eight-lane bridge in India over the River Yamuna in New Delhi, Office Complex for SCOPE, New Delhi (1.12 lakhs sq. mtrs.) etc. majority of these projects had been executed a number of years ago and the execution experience in the last five years has been mostly limited to institutional buildings. Recently, it has executed Seelampur Station of Delhi Metro. In the segments that the company has been operating, some segments like real estate have been consistently making high margins, mainly because the land is allotted to NBCC at reserve price by the Ministry. Some segments like transportation have been incurring losses while the margins in rest of the segments vary according to the size of the project.

The major projects completed in the past four years are mostly institutional buildings and Energy sector related projects like cooling towers and chimneys. Further it is seen that the contract price for major projects are in the range of Rs. 60-250 mn. Assuming an average turnover of Rs. 100 mn. per project, the number of assignments required to achieve a turnover of Rs. 4000 mn. would be about 40 projects. However, the margins would vary for each project depending on the contract price and the cost incurred on the project. Hence, controlling cost and preventing overruns become a major factor to increase the margins.

Joint Ventures and Alliances

The company has entered into joint ventures in a few countries for executing projects in those countries and strategic alliances for technology transfer. However, the company has not made any investment in these companies. The companies in which NBCC has joint ventures and alliances are listed below:

Joint Ventures

- M/s Jamal Trading Company of Botswana for development of infrastructure projects in Botswana
- M/s Balcke –Durr Cooling Towers Ltd (a German company) for design support for construction of Cooling Towers
- M/s Wabag (a German Company) for design support for construction of sewage treatment plants using UASB Technology
- M/s Collin Construction Co of Turkey for construction of Road Projects

Alliances

- M/s NTPC for design support of Chimneys & Cooling Towers
- M/s Hamon Thermal Engineers of Belgium for total Thermal Design Engineering
- M/s Associated Builders Corporation Ltd. for civil engineering projects in Bangladesh

The Company is in the process of forming a consortium with M/s Parsons Consultant (USA) for development of Building projects in Afghanistan.

FINANCIAL PERFORMANCE OF NBCC

The Profit & Loss Account and Balance Sheet of NBCC are given below:

Table 5 – Profit & Loss Account

	2000-01 Rs.Mn.	1999-00 Rs. Mn.	1998-99 Rs. Mn.	1997-98 Rs. Mn.
Income from Operations:				
Value of Work Done	2896.5	2847.4	2942.3	2500.9
Work-in-progress	210.4	75.7	63.8	83.7
Operating Income	**3106.9**	**2923.1**	**3006.1**	**2584.6**
Expenditure:				
(Accretion)/ Decretion to stocks	80.9	96.3	95.6	105.3
Material Costs	552.9	501.0	519.2	447.4
Employee Costs	494.7	449.7	405.0	388.9
Other Manufacturing Expenses	1801.4	1762.8	1865.9	1478.2
Power & Fuel Costs	12.4	11.6	10.4	11.3
Selling Expenses	4.5	8.1	6.4	7.6
Other Expenses	171.1	156.9	165.3	150.7
Provisions and Write offs	101.3	70.8	75.6	42.0
Cost of Sales	**3219.3**	**3057.2**	**3143.5**	**2631.4**
OPBDITA	**-112.4**	**-134.1**	**-137.4**	**-46.8**
Interest and Finance Charges	129.4	142.6	161.8	296.5
Depreciation	5.5	5.9	6.1	6.0
Amortisation	44.2	37.2	33.6	36.2
OPBT	**-291.5**	**-319.8**	**-338.9**	**-385.5**
Non-operating Income	26.3	100.8	42.3	236.3
Extraordinary Income/(Expenses)	2.2	3.4	1.9	0.9
Cash Adjustments	85.3	215.2	163.2	82.9
Non Cash Adjustments	203.3	123.3	201.9	57.1
APBT	25.5	122.9	70.4	-8.3
Tax	0.6			
PAT	**24.9**	**122.9**	**70.4**	**-8.3**
Reported PAT	24.9	122.9	70.4	-8.3
Preferred Dividend				
Accretion to Reserves	24.9	122.9	70.4	-8.3
Net Cash Accruals	30.4	128.8	76.5	-2.3

Source: CRISIL Advisory Services

Table 6 - Balance Sheet

(Rs. Mn.)

BALANCE SHEET (as of March 31)	2001	2000	1999	1998	1997
Liabilities					
Equity Share Capital	816.50	816.50	816.50	199.50	199.50
Reserves & Surplus	-1,156.80	-1,181.67	-1,304.57	-1,374.95	-1,366.62
Net worth	-340.30	-365.17	-488.07	-1,175.45	-1,167.12
Preference Share Capital	300.00	300.00	300.00	300.00	300.00
Long Term Debt	1,268.79	1,161.07	1,104.83	2,200.52	2,088.84
Short Term Debt	260.74	266.49	228.81	218.90	221.81
Total Debt (excl Pref share capital)	1,529.53	1,427.56	1,333.64	2,419.42	2,310.65
Current Liabilities & Provisions	4,099.65	4,262.62	4,218.73	3,987.78	4,016.64
Current Liabilities	3,895.11	4,118.44	4,082.74	3,807.61	3,858.12
Provisions	204.54	144.18	135.99	180.17	158.52
Total Liabilities	**5,588.88**	**5,625.02**	**5,364.30**	**5,231.75**	**5,160.18**
Assets					
Gross Block	267.16	272.43	272.67	243.47	240.18
Net Fixed Assets	84.50	81.74	78.24	79.20	92.83
Investments	123.85	137.25	137.25	202.40	228.65
Current Assets	5,378.86	5,402.70	5,143.82	4,943.69	4,831.54
Miscellaneous Expenditure	1.66	3.33	4.99	6.43	7.16
Total Assets	**5,588.88**	**5,625.02**	**5,364.30**	**5,231.75**	**5,160.18**

Source: CRISIL Advisory Services

Employee Costs

Table 7 - Employee Costs

	Average No. of Employee	Employees Costs (Rs. Mn)	Average Cost per Employee (Rs Mn)	Y-O-Y growth In per emp cost
1996-97	3436	299.2	0.087	
1997-98	3404	388.9	0.114	31.2%
1998-99	3345	405.0	0.121	6%
1999-2000	3261	449.7	0.138	13.9%
2000-01	3178	494.7	0.155	12.9%

Source: CRISIL Advisory Services

NBCC had 3151 employees on its rolls as of 31st March 2001, with employee costs accounting for 17.1 % of operating income in 2000-01, as compared to around 5.78 % for Gammon India and 7% for HCC. Though the company had announced a VRS scheme, there has been no significant decrease in the number of employees.

The majority of the employees are in the age group of 40- 45. The number of employees in the age –group of 50-58 is only 18 %. This would mean that the number of persons retiring in the next ten years would be marginal.

Out of the employees on the rolls of the company currently, around 460 employees are employed at the Head office. The HO expenses are targeted to be decreased from 7% to 3% of the turnover, indicating that around 200 employees are estimated to be surplus at the HO. The Company has conducted an internal exercise to determine the surplus manpower in locations other than head office. Around 448 employees have been estimated to be the surplus manpower in zonal and project offices, the division of which is given below:

Table 8

Category	Total	Surplus
Group A	626	36
Group B	362	21
Group C	355	38
Group D	1683	353
Total	**3016**	**448**

Source: CRISIL Advisory Services

Thus of the total manpower of 3016 as of 1.7.02, around 650-700 employees are surplus.

Around 1100 employees are unskilled workmen drawing an average salary of around Rs. 0.1 mn. per annum which is not commensurate with the contribution/ skill set of the employees. The employee cost as a percentage of turnover for other private sector companies are given below:

Table 9

Company	Employee cost as % of turnover
Gammon India	7.9
Hindustan Construction Company	8.4
Afcons Infrastructure	15.4
NBCC	15.9

Source: CRISIL Advisory Services

In the case of NBCC, unskilled workmen are paid higher as compared to the industry norms. Further, the resistance to work at far away project locations results in in-efficient manpower utilisation.

As per the industry norms, around 70% of the work force in a construction industry is productive work force or the work force contributing directly to the revenues of the company. As compared to the industry norms, only 50% of the work force of NBCC directly contribute to the revenues. Hence, there is a need to rationalise the ratio of technical to administrative manpower in NBCC.

Subcontracting Expenses

Subcontracting expenses constitute the major chunk of other manufacturing expenses. The major portion of this expenditure is on Piece Rate Work contract (with materials). Subcontracting expenses have been decreasing over the past three years, from Rs. 1840 million in 1998-99 to Rs. 1791 million in 2000-01. However, subcontracting expenses as a percentage of total revenues has remained around 62% of the operating income.

Table 10 - Subcontract cost as a % of Operating Income

2000-01	1999-2000	1998-99	1997-98	1996-97	1995-96
61.90%	61.70%	62.50%	58.00%	61.30%	69.60%

Source: CRISIL Advisory Services

The percentages of subcontract cost and employee cost to sales for other companies are listed below:

Table 11

Company	% of Subcontract + employee cost to turnover
NBCC	79.0%
Gammon India	35.8%
HCC	37.1%
Afcons	31.2%

Source: CRISIL Advisory Services

The percentage of employee cost and job work cost of NBCC is much higher than the industry average in terms of direct expenses and employee costs. Some of the reasons for the same are:

- The company has surplus labour
- The company subcontracts a substantial portion of work due to lack of equipments and hence bears the hiring charges for the equipment as well as the sub-contracting charges

Operating Margin

A very high wage cost as compared to the private players has resulted in negative operating margins for the company. Presented in the table are operating margins of competing companies.

Table 12

	Operating margin (% of O.I)
Afcons Infrastructure	6.4
Gammon India	7.9
HCC Ltd	17.2
NBCC	-3.6
Simplex Concrete Piles	6.8

Source: CRISIL Advisory Services

Net Worth

The share capital of the company has been fully eroded by accumulated losses, thus resulting in a negative net worth. However, since NBCC is a construction company, it has not been referred to BIFR.

Total Debt

The Company has a long-term debt of Rs. 1269 mn. and short-term debt of Rs. 260 mn as on 31st March, 2001. The details of loan on the books of the company as on 31st March 2001 and 2002 are given below:

Table 13

Secured Loan	As on 31/3/2001 Rs. Mn.	As on 31/3/2002 Rs. Mn.	Rate Of Interest	Terms of repayment
Demand Loan from Banks	97.5	38.7	10.5% p.a	Payable on Demand
Cash Credit	26.07	3.7	15.5% p.a	Payable on Demand
Unsecured Loans				
Rupee Term Loan converted from Euro-Dollar loan	373.8	401.5	13 % p.a	In 7 equal yearly instalments after a moratorium of 3 years from April 2001
From Govt. bodies (Interest Accrued and Due)	671.4	671.4		Payable in 5 equal annual instalments beginning 2000-01
Outstanding interest on un-secured loan from OIDB	126.0	126.0		Payable Rs. 10 Mn per annum w.e.f 1999-00

Source: CRISIL Advisory Services

During the year 2001-02, the company has repaid part of the demand loan and cash credit. Also the Euro-dollar loan along with the interest due has been converted into Rupee term loan.

The long-term debts are in the form of demand loan from banks to the tune of Rs.38.7 mn. secured against investments and deposits. The remaining long-term debt is unsecured loan from Banks guaranteed by the President of India and loans from the Government bodies. As a result of restructuring in 1998, the principal portion of the Government loan was converted into equity and preference shares, and the interest liability was frozen upto 31st March 1997.

The outstanding interest of Rs.126 mn. is on account of borrowing from Oil Industry Development Board (OIDB) for the construction of Fourth Oil Berth at Butcher Island. The Ministry has sanctioned Rs.130 mn. towards repayment of the same, which is a part of the current assets. However, the same has not yet been disbursed.

Out of the above loans, the instalments of two loans are due from 2000. However, the Company has defaulted on the repayment of the same.

Off Balance Sheet Items

The company has recognised the following contingent liabilities as of March 31, 2001 in its annual report:

Table 14

As of March 2001	**Rs.Mn**
Claims against the Company against which NBCC have lodged claims of Rs. 2463 Mn. And a further Rs. 564 Mn. of claims have been lodged for which no counter claims have been made	3477.3
Tax claims raised by Libyan Govt. for which NBCC has filed appeals	573.7
Claims raised by Canara Bank which is under arbitration with PMA	112.7
Govt. guarantee charges, the waiver of which has been proposed to the Ministry	150.4
Total	**4314.1**
Total Assets	5588.8
Contingent Liabilities as % of Total Assets	**77 %**

Source: CRISIL Advisory Services

In addition to the above-mentioned liabilities, there are other contingent liabilities, like:

- Recovery at penal rate on account of excess consumption of material over theoretical norms for the materials supplied by the clients at issue price and free of cost pending final settlement with the clients

- Customs duty on Plant and Machinery imported from abroad on re-export basis for foreign projects in the event these are lost, scrapped or not disposed off as per local laws.

The contingent liabilities are as high as 77 % of the total assets. The majority of these are arbitration cases and other claims against the corporation, against which the company has also lodged counter claims. The details of the same are given below:

Table 15

Nature of Liabilities	Number of cases	Amount Rs. Mn.	Counter claims filed
Arbitration cases with clients – (mostly PSU's and Govt Depts)	31	1575.1	2374.0
Other amounts due to PSU's, and Govt Depts		410.7	
Amounts due to subcontractors	223	1114.0	652.0
Performance Guarantee		253.4	
Demand in respect of taxes not accepted by the corporation	17	72.8	NA
Others		51.3	
Total		**3477.3**	

Source: CRISIL Advisory Services

Business Plan of NBCC

Future Plan/ Outlook of the Company

The Company is trying to come out of its serious financial difficulties by taking, inter alia, the following course of action:

- Reduction in overheads and salaries
- Improving industrial relations
- Entering into Joint Ventures and Strategic Alliance for business growth, and
- Efficient project execution plan and prioritisation of projects.

The thrust areas for the company in the future include:

- Real Estate Property Development by tapping FDI
- Construction of Chimneys, Cooling Towers and other industrial structures
- Environment Engineering Plants (Water & sewage treatment)
- Power and Transmission lines in domestic/ overseas market
- Roads, Bridges and flyovers
- Low cost mass housing projects
- Post completion maintenance services to utilise the surplus manpower.

Turnover Growth

The company has targeted around 4 % increase in the income:

Table 16 - Planned Turnover Growth at NBCC

(In Rs. Mn.)

	2002	2003	2004	2005	CAGR from 2002-05
Turnover (in Rs. Mn.)	3992.8	4000.0	4250.0	4500.0	3.03 %
Domestic %	92.8	98.75	97.65	96.67	
Foreign %	7.2	1.25	2.35	3.33	

Source: CRISIL Advisory Services

Thus, the company has projected an increase in its turnover from the eurrent levels of Rs. 3992 mn. to around Rs. 4500 mn. by 2005, which corresponds to an average annual growth rate of around 3 %.

Order Book Position of the Company

The order book of the company as on 1.4.2002 is Rs. 6600 mn and NBCC expects it to be realised in next two years. Details are given below:

Table 17

Position	**Rs. Mn.**
Order Book as on 1.4.2002	**6600**
Income during 2002-03	
Against works in hand as on 1.4.2002	3250
New orders	750
Total	**4000**
Income during 2003-04	
Against works in hand as on 1.4.2002	3000
New orders	1250
Total	**4250**

Source: CRISIL Advisory Services

SWOT Analysis

Strengths

- Operating units/ zones all over India – The company has six zonal offices providing a good geographical coverage for taking up projects in every corner of India, including sensitive areas.

- Presence in varied segments of construction like buildings, infrastructure, real estate and consultancy with reasonable past experience profile.

- International presence with past / ongoing projects in countries like Iraq, Libya, Maldives, Mauritius, Turkey and Botswana.

- It is a ISO 9000 company. Can take up large value projects at short notice.

Weaknesses

- Huge employee strength of over 3000 people resulting in heavy overheads and weak competitive position. As per the company, around 650-700 employees are surplus. Around 1143 employees are in the unskilled category. The ratio of administrative to technical employees is also high. There is inability to retain talent and new professionals cannot be recruited due to employment freeze.

- Unwillingness of the employees to locate to far-away project locations

- Old Liabilities: Around 70 % of the net debtors are more than 3 years old. Around Rs. 1514 mn. of dues pertaining to projects executed in Libya and Iraq are more than 10 years old and the recovery of the same is very doubtful. Also, debts pertaining to domestic debtors amounting to Rs. 400 mn. are more than 3 years old. The provision for these doubtful debts would lead to further increase in accumulated losses.

- The company's cash flow indicates that it is unlikely to repay the restructured GoI debt / redeem the preference capital. It has already defaulted in the payment of instalment in the year 2000-01 and 2001-02. The balance sheet of the company is weak and it is not in a position to raise funds from the market on the basis of its own strength. In 1998, a financial restructuring was carried out to make the company self sufficient and bankable. However, this has not been achieved.

- Some of the zonal setups are unable to generate revenues from its working, thus resulting in strain on central reserves.

- The company lacks a Unique Selling Proposition and is unable to bid for BOOT type of projects due to poor balance sheet strength.

Opportunities:

- Huge investments are planned in the infrastructure sector, especially in roads and energy. Energy is one of the thrust areas identified by the company and it has carried out a number of small value projects in this segment. However, the company has not carried out significant work in the road segment in the recent past.

- The housing sector is also expected to grow rapidly in the next decade due to favourable policies and low interest rates.

- The maintenance service, which NBCC has recently ventured into, offers high margins and can also absorb surplus unskilled labour.

Threats:

- The Company being a public sector enterprise gets a purchase preference for PSU projects. However, the advantage would be lost in case of competition when the preference may not be available.

- The Company gets land on reserve price from the Government, for development of real estate projects. However, when this benefit is discontinued, there will be further financial setback.

- Private sector companies have very low fixed expenditure and offer stiff competition in securing new projects. Ability of NBCC to match the terms of the private players is doubtful.

- Foreign companies operating on BOOT concepts normally prefer to associate with private companies. This may reduce the business opportunity for NBCC.

Financial assessment of NBCC

The GoI had approved financial restructuring of NBCC in 1998. The company has started reporting profits post the financial restructuring. However, the profits are mainly on account of prior period adjustments and write back of earlier years provisions. The accumulated losses as of FY 2001-02 are Rs. 1051.8 mn. (provisional) and the networth continues to be negative.

As indicated earlier, the company's debtors' position is critical and the auditors have also qualified it. Around 70% of NBCC's debtors are more than 3 years old. Of these, around Rs. 1514 mn. pertain to debtors on account of projects in Iraq and Libya, which are more than 10 years old. Also, domestic debtors to the tune of Rs.400 mn. are more than 3 years old and not provided for in the books. Provisioning of these doubtful debts would adversely impact the balance sheet of the company. It is likely that in the case of strategic sale, potential private bidders may consider these debtors as unrealisable. The company also has around Rs.112 mn. as deposits with Rasheed Bank in Iraq. However, the auditors have qualified that the confirmation of these balances is not available and the cash cannot be repatriated.

The company had received a sum of Rs.191.5 mn. as RBI bond, which was in excess of the settlement amount for past Iraqi dues. The bond along with interest amounting to a total of Rs.266 mn is shown under current liabilities payable to GoI. The company is not in a position to repay the same.

As a part of the financial restructuring, GoI has converted Rs. 300 mn. of debt to 7% non-cumulative preference shares redeemable at Rs. 50 mn. every year beginning FY 2002-03. In view of the liquidity position of the company, it is doubtful whether NBCC would be able to redeem the preference shares.

As a part of the financial restructuring, the GoI has frozen accrued interest to the tune of Rs.671.4 mn. and made it repayable over five year period beginning FY 2000-01. The company has not been able to repay this debt over the last two financial years and is unlikely to do so in the future.

Similarly, the company has borrowed from the Banks (on GoI guarantees) for executing projects in Iraq and Libya. The total principal due on the same is around Rs.400 mn on which the Company is charged around Rs. 40 mn. as interest. This debt is repayable from FY 2004-05.

The company also has an outstanding interest due of Rs.126 mn. to OIDB. As against this, the Ministry had sanctioned Rs.130 mn. for repayment of this interest but has not paid the same. Hence, the company has current asset and current liability to the extent of Rs. 130 mn and Rs.126 mn. respectively.

The company also has a huge contingent liability in its books to the extent of around 77% of its total assets. A major portion of the contingent liability relates to claims filed against the company against which the company has also filed counter claims. Of this, Rs.1985 mn. relate to the dues from other PSUs and Govt Departments. Of the balance, substantial portion is on account of disputes with the sub-contractors.

Overall, the company's financial position is very weak and it is doubtful if the company would be able to repay its debt obligations. Provisioning for doubtful debts would result in further accumulated losses. Hence a financial restructuring package would be required to make the company more bankable and to facilitate disinvestment. However, the financial restructuring needs to be carried out only to facilitate disinvestment, as financial restructuring without disinvestment might not yield the desired results as evident from the experience of the earlier financial restructuring.

Financial Restructuring

NBCC has accumulated losses of around Rs.1051.8 mn. on its balance sheet as of March 31, 2002. The company hopes to generate profits of about Rs.80-100 mn. a year in the next three years. As discussed earlier, it may be necessary to consider, inter alia, the following:

Convert the GoI debt obligation of Rs.671.4 mn. into equity and to convert the Rs.300 mn. Preference share capital into equity capital.

The debtors are to the tune of Rs.1914 mn. Out of this, around Rs. 1514 mn. on Iraq / Libya projects can perhaps be considered unrealisable. Hence, it may be necessary to assign a part of these debtors to the GoI and provide for balance as bad debts. Also, cash balance in Iraq to the tune of Rs.112 mn. may be considered to be assigned to the GoI.

Write back of liabilities payable to GoI to the tune of Rs.266 mn. towards excess payment received against settlement of past Iraqi dues.

RECOMMENDATION

It is desirable that the Government should exit from the company for the following reasons:

- NBCC's capabilities are in the construction sector where there is enough competition from the private sector. Hence, there are no strategic reasons for its continuance in the public sector.

- Since there is enough competition in the construction sector, the services would also be quite competitive. Therefore, there is no need for a public sector enterprise to be present in the sector even as a countervailing force. In other words, there is no fear of cartelisation in this sector.

- The employment opportunities in the construction sector are quite high. Hence, there are no social benefits for continuance of the company as a public sector enterprise.

However, the company has started improving its performance and is attempting to be competitive. Besides, it has taken up a number of important projects, including in the North East. Since the company seems poised for a recovery, Government should continue to retain some share for a minimum of 3 years, which can be disinvested later with the prospect of better value realisations.

The Commission, therefore, recommends that upto 74% equity in NBCC, held by Government of India, be sold to a strategic partner through the competitive bidding route. The Commission further recommends that a financial and organisational restructuring package for NBCC be formulated in consultation with the prospective bidders and implemented at the time of disinvestment. At least 26% shares should be retained with the Government for a minimum period of 3 years.

* * *