

REPORT

XVII

DISINVESTMENT COMMISSION

JANUARY
2003

'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.

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

- (i) Hooghly Dock and Port Engineers Ltd. (HDPE)
- (ii) National Small Industries Corporation Ltd. (NSIC)
- (iii) Rajasthan Drugs and Pharmaceuticals Ltd. (RDPL)

With this report, the reconstituted Commission has submitted fresh recommendations in respect of 15 companies and review recommendations for 4 companies.

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

Currently, the following Public Sector Enterprises are under study:

1. Bharat Sanchar Nigam Ltd.
2. Brahmaputra Valley Fertilizer Corporation Ltd.
3. Central Cottage Industries Corporation Ltd.
4. Central Mine Planning & Design Institute Ltd.
5. Container Corporation of India Ltd. (Review)
6. Educational Consultants India Ltd.
7. Handicrafts & Handloom Export Corporation Ltd.
8. Hospital Services Consultancy Corporation Ltd.
9. Karnataka Antibiotics & Pharmaceuticals Ltd.
10. Mahanagar Telephone Nigam Ltd.
11. National Film Development Corporation Ltd.
12. National Handloom Development Corporation Ltd.

13. National Mineral Development Corporation Ltd. (Review)
14. National Seeds Corporation Ltd.
15. North Eastern Electric Power Corporation Ltd.
16. Power Finance Corporation Ltd.
17. Rural Electrification Corporation Ltd.
18. State Farms Corporation of India Ltd. and
19. Water & Power Consultancy Services (India) Ltd.

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PART - B

2. SPECIFIC RECOMMENDATIONS

2.1 HOOGHLY DOCK AND PORT ENGINEERS LTD. (HDPE)

INTRODUCTION

Hooghly Docking & Engineering Company Ltd. was established in 1819. Subsequently, it merged with Port Engineering Works, which had been with Andrew Yule Ltd and was renamed as Hooghly Dock and Port Engineers Limited. The Company was nationalised in 1984 through an Act of Parliament entitled “Hooghly Docking & Engineering Company Limited (Acquisition & Transfer of Undertaking) Act 1984”, as a result of the heavy losses sustained by the company. Initially under the Ministry of Industries, HDPE is currently under the Ministry of Shipping. Its main objectives are shipbuilding and ship repairing.

HDPE has two units located at Salkia and Nazirgunge in Howrah district, West Bengal, on the bank of the Hooghly River. The unit in Salkia is capable of ship repair and shipbuilding, whereas the Nazirgunge unit has facilities for shipbuilding and General Engineering/Foundry works. Clients of HDPE have mainly been Central and State government organisations and PSUs. The main types of vessels that are built/repared by HDPE include tugs, dredgers, port crafts, as well as passenger and cargo vessels.

The authorised share capital and paid-up share capital of the company, as on 31.3.2001 were Rs.300 million (mn.) and Rs.250 mn. respectively. The paid-up shares are fully held by Government of India. As on 31.10.2002, the number of employees on roll was 803.

HDPE's business profile

The following table shows the company's business profile during the last five years:

Table 1*(In Rs. mn.)*

Year ending March 31	2001	%	2000	%	1999	%	1998	%	1997	%
Shipbuilding	13.6	47%			11.7	21%			95.8	90%
Shiprepair	15.0	52%	20.6	90%	40.0	73%	29.7	89%	8.1	8%
Other op. Income	0.3	1%	2.2	10%	3.3	6%	3.6	11%	2.6	2%
Total Sales	28.9	100%	22.8	100%	55.0	100%	33.3	100%	106.5	100%
Production	203.4		429.0		92.2		74.2		32.8	

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

HDPE records the sale of vessels only on actual delivery. Thus the vessels that are in the production process and not yet delivered would be recorded as work-in-progress. The production on account of shipbuilding has shown an erratic trend over the years. This is due to the inability of the company to secure orders on a regular basis. However, the company is currently trying to improve the ship building revenues by targeting orders from Inland Waterways Authority of India, Lakshadweep and Andaman & Nicobar administration.

Efforts made by the Government of India for revival of HDPE

Various committees and consultants have been appointed to study the status of the company and suggest remedial measures, before and after its nationalisation in 1984.

Even after nationalisation, the company continued to incur losses and was on the verge of closure in 1994. However, the Ministry of Surface Transport and the management decided to formulate a revival plan in two phases, Short-term plan and Long-term plan. While HDPE submitted the Short term plan, M/s ICICI were entrusted with the task of preparing the long term plan.

The Short term revival plan comprised mainly two projects: 400 Passenger-cum-100T cargo Vessel (400 PAX) for Andaman & Nicobar administration and Light House Tender Vessel (LHTV) for Director General of Lighthouses and Lightships. The contract for the 400 PAX was signed in 1987, but was cancelled due to HDPE's delay in construction and completion. The contract was later revived as

a part of the short term revival plan. While work on 400 PAX is still in progress, LHTV was officially delivered in September, 2002. The long-term plan, submitted by ICICI in 1997 to the Ministry of Shipping, has not yet been updated or implemented.

INDUSTRY REVIEW

Domestic Market

The domestic shipbuilding industry is small in size compared to the global industry. It consists of four large and twenty-four small shipbuilding yards. The four major yards are Hindustan Shipyard Ltd. (HSL) and Cochin Shipyards Ltd.(CSL) under the Ministry of Shipping and Mazagon Dock and Garden Reach Shipbuilders and Engineers under the Ministry of Defence. Disinvestment Commission has already recommended for privatisation of HSL and CSL.

Shiprepair activity is largely centred in eighteen small-sized commercial dry docks equally divided between the public and private sectors. Some of the major domestic shipbuilding yards and their capacities are listed in the table below:

Table-2 - Domestic Shipbuilding Industry – Capacities and Turnover

Company	Location	Owner ship	Type of Vessels	Turnover 2000-01	Profits	Ship Building Capacity				
						Rs. Mn	Rs. Mn	No. of vessels	Dry Dock details (Metres)	
									Length	Width
CSL	Cochin	MoST	Ships incl. Bulk carriers & oil tankers	3281.3	384.9	2	246	38		
HSL	Vishakhapatnam	MoST	Ocean Going vessels	1665.9	(189.8)	3.5	240-244	38 - 53		
MDL	Mumbai	MoD	Port crafts & Misc	15369.5	(183.6)	—	190-216	19 - 29		
GRSE	Kolkatta	MoD	Correte, Frigate, Fleet tanker, Survey vessel	2291.7	314.2	9	172	23		

...Contd.

Company	Location	Owner ship	Type of Vessels	Turnover 2000-01	Profits	Ship Building Capacity				
						Rs. Mn	Rs. Mn	No. of vessels	Dry Dock details (Metres)	
									Length	Width
HDPE	Kolkata	MoST	Tugs, Dredgers, Port crafts, Passenger & cargo vessels	28.9	(309.8)	3.5	94	13.4		
Goa Shipyard Ltd.	Goa	MoD	Tugs, launches, dredgers, passengers, ferries, fishing vessels, etc.	1336.7	49.3	5.8	105	12		
Shalimar Works	Kolkata	Govt. of WB	Passenger cargo and tugs	30.5*	(71.4)*	5	55	12		
Central Inland Water Transport Corpn.	Kolkata	MoST	Tugs, Fishing trawlers, survey launch, HSD tankers, self propelled barges etc	52.8	(782.6)	4	90	16		
ABG Shipyard	Surat	Private Sector	Bulk Carrier, Dumb barges, Pusher tugs, Newsprint carrier, Container ships	971.0	17.8	14	Max 102	18		
Bharti Shipyard	Mumbai	Private Sector		855.2*	19.7*	NA	NA	NA		
TEBMA Shipyard	Chennai	Private Sector		468.8	9.7	NA	NA	NA		

Source: Report of the Working Group on Shipbuilding and Ship repair Industry/CRISIL Advisory Services

Note : The figures in brackets indicate losses.

* pertains to year 1999-00.

The domestic industry caters largely to the requirements of the Central and State Government organisations like SCI, DCI, various port trusts and the Indian Navy. Most PSU yards operate on very low margins, primarily on account of their higher labour force.

Shipbuilding market

The fleet size of Indian flag carrying ships, as of June 2001, was around 10.4 million Dwt, with the majority of vessels being dry bulk carriers, or crude and product tankers.

Nearly 30% of the Indian fleet is about 20 yrs old and another 30% is between 16-19 yrs old. Hence, there is expected to be replacement demand for the existing fleet which would be met either by new vessels or purchase of second hand vessels. The draft tenth plan report on shipping envisages acquisition of 156 vessels of various types. The demand for Inland waterway vessels is expected to grow due to the subsidy scheme announced by GoI to encourage National Inland Waterways.

The order book for Indian flag carrying vessels as of December 2001 was 52 vessels (0.73 million Gross Tonnage). Out of this, 41 vessels (0.14 million GT) are scheduled for delivery in 2002, 9 vessels (0.43 million GT) in 2003 and the balance 2 vessels (0.17 million GT) for 2004. Bulk of the Indian fleet has been built abroad with Indian yards accounting for only a small fraction of the domestic fleet. Hence, high-cost yards such as HDPE may not benefit from this replacement demand during the tenth plan period.

Problems faced by the Indian Shipyards

*** New Norms for procurement**

As per the current practices, Indian shipping companies in the public sector are required to float global tenders for acquisition of new vessels. In this global market, Indian shipyards find it increasingly difficult to compete with the low prices of shipyards in South Korea, China and Japan.

*** Timely availability of inputs**

Timely availability of quality material inputs at competitive prices is crucial for success in shipbuilding. Due to inadequate growth of marine infrastructure in the country, Indian shipyards depend on overseas sources for supply of raw materials, equipments and spares required for shipbuilding, which constitute 65 % of the total cost of the ship. Indian shipyards block huge amounts in inventory resulting in a high carrying cost. This dependence also restricts their flexibility in product mix and production rates.

* Labour productivity

The productivity of Indian labour in shipbuilding is low. Improvement of productivity requires investment in new technologies, which the Indian shipyards are unable to carry out due to resource constraints.

* Exchange rate fluctuations

Since shipbuilding has to depend heavily on overseas sources for materials, adverse fluctuations in prices/foreign exchange rates have a direct impact on viability of these operations.

Key Success Factors in the industry

Cost competitiveness – Given the overcapacity in the industry, new building realisations are expected to continue at their low levels. Thus, cost competitiveness would continue to remain a critical success factor for the industry. It is, therefore, essential for shipyards to be able to match up to the labour productivity rates in Korea and Japan. In addition, access to cheap labour and key raw materials would also increase the cost-competitiveness of shipyards.

While labour rates in India are low, labour productivity levels in Indian yards compare poorly to established international norms, which severely hamper the competitiveness of these yards.

Marketing Network – A stable order-book would help in shipyards scheduling and bulk ordering of raw materials and result in a concurrent improvement in labour productivity levels. Optimum capacity utilisation would also help in better overhead management. All the above factors would have a significant impact on the margins of a shipyard. Thus, having a marketing network that is able to build up an order pipeline is critical to the success of any shipyard.

Policy & Regulatory issues for the industry

Taxation related issues

Section 33 AC of the Income Tax Act allows the appropriation of profits for creation of reserves to be utilised for acquisition of new ships. This reduces the

tax liability of shipping companies that are planning to earmark profits in a reserve for future capacity expansion, which in turn should improve the order-book position for the domestic shipbuilding industry. The depreciation rates for ships have also been enhanced from 20 to 25 % w.e.f. April 2001.

Implementation of the proposed tonnage tax system would have a positive impact on the profitability of the domestic shipping industry

Subsidy related issues

Under the **shipbuilding subsidy** scheme, an Indian public sector shipyard is allowed to match the lowest quote for an ocean going vessel in an open tender. The subsidy scheme was originally notified in August 1997 and was valid over the period 1997-2002. In October 2002, the Government decided to extend the Shipbuilding subsidy scheme that was applicable to only Central Public Sector Shipyards to State PSU's yards also. The salient features of the scheme for domestic and export orders are:

- Eligible Shipyards under this scheme, would be eligible for shipbuilding subsidy upto a maximum of 30 % of the price of the vessel for both domestic and export orders.
- For domestic orders, subsidy would be applicable to ocean going merchant vessels of maximum 80 metres in length. However, for export orders there is no restriction on type and size of vessel.
- The scheme would be valid upto August 2007.

GoI also had an **interest differential subsidy** scheme, according to which an Indian owner placing an order on public sector shipyards for ship acquisition and raising funds for the purpose from Indian financial institutions would be eligible to receive an interest differential subsidy wherever the interest rate was greater than 9%. The interest differential subsidy was capped at a maximum of 5% and was available for upto 80% of the ship acquisition cost. However the interest subsidy scheme has been discontinued with effect from August 2002.

From the above, it appears that tax and subsidy regimes are unlikely to be of much help to HDPE.

HDPE OPERATIONS

Facilities

HDPE is one of the smaller shipyards in the country having an installed shipbuilding capacity of only 2500 Dwt. It has the capacity to manufacture various types of inland & ocean going vessels of small & medium size like dumb barges and tugs like fishing trawlers, dredgers, offshore patrol vessels, passenger vessels, etc.

HDPE has two units, one in Salkia and another in Nazirgunge located on the bank of River Hooghly. The height of the old Howrah bridge restricts the capability of the Salkia unit to build bigger vessels. The company has also set up ship repair units in Kidderpore and in Haldia for wet repairs. The details of HDPE's facilities are given in the table below:

Table 3

Location	Business capability	Dry-dock facility	Other facility
Salkia	Ship building & repairs	94 * 13.4 * 8.6 M ³	Two no's of building berths of 80 * 29 & 70 * 22 M ² 9 no's of cranes ranging from 10-40 ton
Nazirgunge	Ship building	—	One berth of 90 * 60 M ² 8 cranes ranging from 3-20 ton
Kidderpore & Haldia	Wet repairs	—	NA

Source: CRISIL Advisory Services

The dry-dock at Salkia has a capacity for handling vessels of upto 1000 Dwt.

Capacity Utilisation

The capacity utilisation in HDPE has been low, primarily on account of slack order book position. The normal time taken for a small sized tug or vessel is around 18-20 months. The company has delayed the delivery of certain orders like the 400 PAX, LHTV and 30 Tonne tug. Fund crunch is one of the main causes for the delay.

The order book position of the company during in the past five years is given below:

Table 4 - Order book position

	New Orders secured (in Rs mn.)	Production (In Rs. mn.)
1997-98	885.5	74.2
1998-99	300.5	92.2
1999-00	Nil	429.0
2000-01	18.5	203.4
2001-02	Nil	109.3

Source: CRISIL Advisory Services

The company has not secured any major order in the past three years. The orders in 1997-98 were due to the Short-term revival plan. In 1998-99, HDPE got several orders viz 30 T Bollard Pull tug, hydraulic surface dredger, Survey vessel and 2 pontoons. The current orders are expected to be completed by 2004-05. Out of the new orders received since 1997 of Rs. 1204.5 mn., the unexecuted portion in 2002-03 was only Rs. 377.1 mn. on account of 400 PAX, LHTV and Multipurpose Tug for Dredging Corporation of India Ltd.

The revenue on account of ship repair has been showing a declining trend since 1998-99. The average realisation per ship repair has also gone down. The average ship repair time at HDPE is around 2-3 months per ship. One of the major orders secured by HDPE recently is the repair order of a large vessel from SCI and two dredgers from Inland Water Authority of India.

Market Share

Ship building

HDPE's current clients in the ship building business are Kolkata Port Trust (KoPT), A&N administration, and Inland Waterways Authority of India (IWAI). Its capabilities are restricted to building small vessels and its competitors in shipbuilding and ship repairing are Central Inland Water Transport Corpn., (already recommended by the Commission for privatisation), Shalimar Works Ltd and East Coast Boat Builders & Engineers in the small vessel segment, all located in the Eastern region.

HDPE is targeting further orders from IWAI, A&N administration and Lakshadweep. The Company has also appointed agents in Delhi to enhance their marketing efforts. The bigger shipyards, unable to secure orders for ocean going vessels, are also competing with the smaller yards for the small vessel orders, thus increasing competition in this segment.

Ship repairs

HDPE's clients in the ship repair business include KoPT, A&N administration and IWAI. Since 1998-99, ship repair revenue has been on a decline mainly due to a reduction in orders from Kolkata Port Trust, HDPE's major client. Currently, HDPE's target customers include IWAI, SCI and the Geological Survey of India. They have also opened small units in Kidderpore and Haldia to cater to ships arriving in the Kolkata Port Trust.

FINANCIAL PERFORMANCE OF HDPE

Profit & Loss Account and Balance Sheet of the company are given below:

Table 5 - Profit & Loss Account

	2000-01 Rs. Mn	% of OI	1999-00 Rs. Mn	% of OI	1998-99 Rs. Mn	% of OI	1997-98 Rs. Mn	% of OI
Income from Operations:								
Sales (net of Excise Duty)	28.9	14%	22.8	5%	55.0	54%	33.3	41%
Accretion/ (Decretion) to Stocks	174.5	85%	406.2	94%	37.2	37%	46.6	58%
Other related income	2.3	1%	1.8	0%	9.6	9%	0.9	1%
Operating Income	205.6	100%	430.8	100%	101.8	100%	80.8	100%
Expenditure:								
Material Costs	144.8	70%	284.1	66%	23.3	23%	6.4	8%
Power & Fuel Costs	5.9	3%	6.6	2%	5.3	5%	5.4	7%
Employee Costs	106.4	52%	110.8	26%	110.2	108%	99.9	124%
Other Manufacturing Expenses	26.6	13%	29.6	7%	17.5	17%	10.1	13%
Selling Expenses	13.3	6%	4.2	1%	9.3	9%	3.6	4%

...Contd.

	2000-01 Rs. Mn	% of OI	1999-00 Rs. Mn	% of OI	1998-99 Rs. Mn	% of OI	1997-98 Rs. Mn	% of OI
Other Expenses	17.9	9%	23.7	5%	16.0	16%	9.3	12%
Miscellaneous Expenditure written off	0.3	0%	0.3	0%	0.3	0%	0.3	0%
Less: Expenditure Capitalized	—	—	—	—	—	—	—	—
Cost of Sales	315.4	153%	459.5	107%	181.9	179%	135.0	167%
OPBDIT	(109.8)	(53%)	(28.7)	(7%)	(80.1)	(79%)	(54.2)	(67%)
Interest and Finance Charges	198.6	97%	184.0	43%	159.1	156%	136.8	169%
Depreciation	11.7	6%	5.2	1%	5.0	5%	5.1	6%
OPBT	(320.1)	(156%)	(217.9)	(51%)	(244.2)	(240%)	(196.1)	(243%)
Non-operating Income	11.7	6%	19.4	5%	19.0	19%	7.8	10%
Extraordinary Income/ (Expenses)	0.3	0%	0.2	0%	0.1	0%	0.4	0%
Prior Period Adjustments	(1.7)	(1%)	(1.7)	0%	(6.4)	(6%)	(65.9)	(82%)
Non-cash Adjustments							0.3	
APBT	(309.8)	(151%)	(200.0)	(46%)	(231.5)	(227%)	(253.5)	(314%)
Tax	—		—		—		—	
PAT	(309.8)		(200.0)		(231.5)		(253.5)	
Reported PAT	(309.8)		(200.0)		(231.5)		(253.5)	
Equity Dividend	—	—	—	—	—	—	—	
Accretion to Reserves	(309.8)		(200.0)		(231.5)		(253.5)	
Net Cash Accruals	(298.0)		(194.8)		(226.4)		(248.4)	

Source: CRISIL Advisory Services

Note : Figures shown in the brackets indicate negative figures.

Table 6 - Balance Sheet

(Rs. Mn.)

BALANCE SHEET (as of March 31)	2001	2000	1999	1998
Liabilities				
Share Capital	250.0	250.0	245.0	208.6
Reserves & Surplus	(1976.6)	(1666.9)	(1466.8)	(1235.4)

...Contd.

BALANCE SHEET (as of March 31)	2001	2000	1999	1998
Net worth	(1726.6)	(1416.9)	(1221.8)	(1026.8)
Long Term Debt (Incl interest accrued)	1745.3	1566.2	1411.6	1090.8
Short Term Debt	—	—	—	—
Total Debt	1745.3	1566.2	1411.6	1090.8
Current Liabilities	1375.2	1176.4	875.2	513.2
Provisions	41.9	41.2	39.2	97.7
Current Liabilities & Provisions	1417.1	1217.6	914.4	610.9
Total Liabilities	1435.8	1366.9	1104.2	674.9
Assets				
Gross Block	179.5	133.0	118.1	112.1
Net Fixed Assets	105.7	110.3	66.6	62.3
Investments	1.9	1.9	1.9	1.9
Current Assets	1328.1	1254.3	1035.1	609.7
Miscellaneous Expenditure	0.1	0.4	0.6	1.0
Total Assets	1435.8	1366.9	1104.2	674.9

Source: CRISIL Advisory Services

Note: Figures, shown in brackets, indicate negative figures.

Production increased in the year 1999-2000, mainly on account of the short-term revival plan comprising the two projects: 400 PAX at a cost of Rs. 734.3 mn., and Light House Tender Vessel at Rs. 471.2 mn.

In order to achieve the breakeven point at the present condition, the company has to reach a turnover of around Rs. 480 mn., that is, more than twice the level of 2000-01. This turnover is assuming an average vessel order of Rs. 120 mn. and delivery schedule of around 20-24 months. It is estimated that HDPE needs to have an order book of 8 vessels at any point of time under various stages of construction, which appears unlikely.

The shipbuilding production of its competitors is given below:

Table 7

Company	Production (In Rs. Mn.)	Type of Vessels built	Clients
Shalimar Works Ltd (Govt. of WB)	297.4	Tugs, Cargo Vessel, water barge, catamaran launch, survey launch	Vizag Port Trust, A & N admn, Kolkata Port Trust.
Bharati Shipyard Ltd (Pvt.)	854.2	Tugs, Grab dredger, despatch vessel	Not Available
TEBMA Shipyards (Pvt.)	465.43	Tugs, pilot launches	Ennore Port Trust. Reliance Petroleum
Alcock Ashdown (Govt. of Gujarat)	318.43	B.P.Tug, 50 passenger ferry, patrol launch	Not Available

Source: CRISIL Advisory Services

Note: The production of Shalimar Works and Bharati Shipyard pertains to year 1999-00, while that for TEBMA and Alcock Ashdown pertains to 2000-01

Employee Costs

Table 8 - Employee Costs

	No. of Employees	Employee Costs (Rs. Mn.)	Average Cost per Employee (In Rs Mn.)	Y-O-Y growth of per- employee cost
95-96	1320	74.07	0.05	
96-97	1267	76.23	0.06	5.03%
97-98	1216	99.86	0.08	36.47%
98-99	1202	110.2	0.09	13.29%
99-2000	1133	110.84	0.09	4.18%
2000-01	1032	106.41	0.10	3.54%

Source: CRISIL Advisory Services

HDPE had 1032 employees on its rolls as of 31st March 2001, with employee costs accounting for 52% of the operating income, as compared to 5-12 % for other private shipyards like ABG, TEBMA and Bharati Shipyard. This is mainly because HDPE has a high proportion of the employee expenses as fixed cost unlike the private sector shipyards, which employ most of the workforce on

contract basis tied to specific projects. The grade wise division of manpower in HDPE is given below:

Table 9

Category	As on date of nationalisation (068.6.1984)	As on 31.3.2002	As on 31.10.2002
Executives	141	71	68
Supervisors	92	97	86
Staff	232	74	70
Sub staff	324	136	114
Workmen	1566	523	465
TOTAL	2355	901	803

Source: HDPE

The majority of the employees are in the workmen and sub-staff category. During 2001-02, the number of employees declined significantly through the Voluntary Retirement Scheme (VRS), funded by the Government as grant. Out of the reduced strength, only 9 % are likely to retire in the next 4-5 years. Majority of the employees are below 47 years of age.

The wage agreements were signed in 1992 and 1997. Arrears of around Rs 35 mn. are due to the employees on account of the 1992 wage revision. The latest wage revision (w.e.f. 1997 for officers and w.e.f 2000 for workers) is pending Government approval and implementation. This is expected to add around Rs 100 mn.

As a part of the Long Term Revival plan, the Human resources division of Garden Reach Shipbuilders and Engineers conducted a manpower planning study. The optimum employee strength suggested by GRSE was in the range of 670-700.

Operating Margin

The table below gives the average contribution for all activities and the operating margins as a percentage of production:

Table 10

	2000-01	99-2000	1998-99	1997-98	1996-97	1995-96
Contribution (Production less material and direct expenses)	17%	28%	60%	85%	49%	38%
Operating Margins as a % of Production	-54%	-0.1%	-0.9%	-73%	-2.7%	-128%

Source: CRISIL Advisory Services

The industry average contribution is estimated to be in the range of 20-30%. Though HDPE generates the contribution as per industry standards, it still incurs losses on account of high fixed overheads, mainly in the form of employee cost.

Net Profit

The operating losses coupled with interest payments have resulted in continuous losses for the company for the past five years. As per provisional financial results of 2001-02, PAT is minus 282.5 mn. rupees.

Net Worth

Against the paid up share capital of Rs.250 mn, the accumulated losses have resulted in a negative net worth of about Rs.1730 mn. As per provisional financial results of 2001-02, the tangible net worth, as on 31.3.2002, is minus 1931.3 mn. rupees.

Total Debt

The company had a cash credit limit of Rs. 41.0 mn. with State Bank of India which became inoperative since 1993. However, Interest due on that sum amounting to Rs. 139.2 mn is being shown under sundry creditors and negotiations are still on with SBI to settle the liability. Penal interest on the same is being provided in the books.

The Company had the following long term loans as on 31st March 2001:

- Cash Credit from State Bank of India for Rs. 2.3 million (Balance as per book)

- Interest free loan from SCICI for Rs. 9.3 million
- Plan and Non-Plan loan from the GoI
 - ❖ Principal outstanding : Rs 813.7 million
 - ❖ Interest accrued and due (including penal interest on the same): Rs. 920 million

The Govt. of India provides assistance to the company in the form of plan and non-plan loan assistance. The plan loans are provided only for capital expenditure whereas non-plan loan are provided for revenue expenditure. The interest on these loans are due and unpaid, and is being treated as a part of the long-term loan.

The funds infused by the GoI each year is given in the table below:

Table 11

(in Rs. Mn.)	1996-97	1997-98	1998-99	1999-00	2000-01
Plan funds – Equity	29.1	36.5	36.4	5.0	-
Plan funds – Loan	29.1	36.5	36.4	5.0	-
Non-Plan loan	64.5	40.0	96.1	40.0	40.0
Total	122.7	113.0	168.9	50.0	40.0

Source: CRISIL Advisory Services

Fixed Assets

The company's gross block as of March 31, 2001 was Rs. 179.5 Mn. whereas net fixed assets was Rs. 105.8 mn. Fixed assets are stated at cost in the company's annual reports and the company has not undertaken any revaluation of assets in its books. The company had not incurred any significant capex till 1999. In 2000 and 2001, the Company incurred Rs 61.4 mn. as capital expenditure, especially on Plant & Machinery. M/s Devcon Engineers & Valuers carried out a valuation of immovable & movable properties of HDPE in February 2002. The revised value is shown under:

Table 12

Asset	Value in books (Rs. Mn.)	Value based on valuation (Rs. Mn.)
Landed Property	7.7	261.8
Building/Plant/Machinery/ Fixture & Fittings (Net Value)	97.5	149.0
Total	105.2	410.8

Source: CRISIL Advisory Services

Land property consists of 10.67 acres of freehold land at Salkia and 19.58 acres of leasehold land at Nazirgunge. The Auditors have stated that the title deeds, agreements and mutation in respect of freehold land, and lease deed of leasehold land were not available for verification.

Business Plan of HDPE

Future Plan/ Outlook of the Company

As per the management of HDPE, the company needs to achieve production levels of around Rs. 480 mn. in order to break even. This would translate into an order book of around 8 vessels with an average value of Rs. 120 mn. and delivery schedule of 24 months.

The orders upto the break-even level are expected by HDPE through support from the Ministry of Shipping, subject to satisfactory performance on the 400-passenger vessel contract under execution. However, going by the past performance, the capability of the company to reach the break-even level or efficiently execute new orders is doubtful.

Order book position in ship building

As of 1st April 2002, the company had unexecuted orders to the tune of Rs. 395.1 mn., of which Rs. 306.9 mn. relates to the 400 passenger vessel. The production schedule of the company from 2002-2007 is given below:

Table 13 - Projected Production Schedule

(Rs.Mn)

Year	2002-03	2003-04	2004-05	2005-06	2006-07
Shipbuiding Orders					
400 PAX (A & N Admn)	102.0	152.5	52.4		
LHTV (DGLL)	4.7				
Multi purpose tug (DCI)	65.5				
5 nos. Pontoons	18.0				
Specified expected orders					
3 Nos Accommodation Boat (IWAI)	14.6	10.4			
2 nos Floating Dock (IWAI)	31.5	92.0	16.5		
Deep Stambha (DGLL)	11.5	45.5	13.0		
Cargo Vessel (IWAI)		100.0	100.0		
2 10 T Pusher tugs		50.0	90.0		
Other Expected orders					
1 st Phase			150.0	150.0	
2 nd Phase			42.0	210.0	168.0
3 rd Phase				138.0	230.0
4 th Phase					112.5
Ship Repair					
Ship repair	35.0	40.0	45.0	40.0	50.0
Total	282.8	490.4	508.9	538.0	560.5

Source: CRISIL Advisory Services

Capital expenditure plans

As per the working group report on Ship building, the company has plans to invest Rs 200 mn. as capital expenditure in the tenth plan period, out of which Rs. 180 mn. would be towards modernisation of ship building facility at Salkia and Nazirgunge and the remaining Rs. 20 mn. would be for renewals and replacements.

SWOT Analysis of HDPE

Strengths

- The location of the yard along the inland Hooghly waterway, proximity to A&N islands and to the Kolkata port could be of advantage. It has a substantial chunk of valuable land.
- Capability to manufacture small sized vessels like tugs, dredges, fishing trawlers etc. It is also building bigger vessels like 400 passenger vessel and LHTV. It has also repaired passenger vessels and bulk carriers in the past.

Weaknesses

- The height of the old Howrah bridge restricts the capacity of Salkia unit to build bigger vessels.
- It has a large and ageing workforce with low productivity. The current employee strength is around 800 as against the optimum assessed employee strength not exceeding 700.
- The yard was on the verge of closure and has been revived under a short term plan formulated wherein some orders were awarded to the yard on nomination basis through the Ministry of Shipping.
- The marketing ability of the yard, in comparison with other private yards is poor and it is unlikely that the yard will be able to secure orders from the private sector.
- The high fixed costs of the company impact its competitiveness and its ability to secure orders through competitive bidding.
- Negative net worth and lack of credit from banks have impacted the working capital management resulting in delays in execution of orders.

Opportunities

- The subsidy scheme for construction of vessels for Inland Waterways Transportation (IWT) is expected to generate more business for Indian shipyards.

Threats

- The absence of a stable order book, high employee strength and the related costs are resulting in operating losses to the company and impacting seriously its viability.
- The inability of the larger PSU yards to secure orders for larger vessels has resulted in these yards focussing on the smaller vessels from IWAI, A & N administration, port trusts and Lakshadweep. This is expected to result in the PSU yards vying with the Ministry of Shipping for securing these orders and the jobs being awarded to the better-run PSU yards.
- Even if the company secures some of the targeted orders, its capacity to execute them efficiently is doubtful, going by its past performance.

Financial assessment of HDPE

HDPE was nationalised since it had been incurring losses continuously. However, even after nationalisation in 1984, the company has continued to make losses. HDPE's operating losses have resulted in large negative net worth. The company has not been able to service its debt obligations and depends on GoI for funds support to bridge its operating losses. The GoI has been infusing Rs. 50-100 mn. every year by way of equity debt infusion. The company has not come under the purview of BIFR only because companies engaged in Shipping and related activities are exempt from BIFR provisions.

There have been a number of Committees which have studied the viability of HDPE and the company is operating mainly due to the short term revival plan under implementation. Even this has not enabled the company to turn around.

HDPE has outstanding principal debt of Rs. 853.7 mn. and accrued interest of Rs.1096.0 mn. payable to GoI as of 2001-02. In addition, there is a pending dispute on accrued interest payable to SBI on the cash credit facilities extended to HDPE in the past. The SBI liability is of the order of Rs. 162.2 mn. as of 31.3.02. HDPE is most unlikely to be able to service this liability in the future.

Arrears to the tune of Rs. 35 million are still due to the employees on account of wage revision in 1992 and another wage revision (w.e.f 1997 for Officers and w.e.f 2000 for workers) is pending. Any revision in the salaries would result in an additional burden on the GoI.

The adverse condition of HDPE together with the fact that it is not operating in a strategic sector, clearly point to the need for GoI to exit from HDPE by sell-off of its entire equity in the company to a strategic investor, failing which closure seems to be the only option. However, it has to be ensured that the strategic investor fulfils the existing commitment of HDPE in completing the works in hand, especially the 400 PAX for A&N administration. Transaction documents have to make appropriate provisions accordingly.

The key barriers to disinvestment are expected to be:

- High debt liability on the books of the company, which HDPE is unable to service
- Absence of sustainable order book
- High employee strength
- Prolonged history of operating losses
- Poor quality of Accounting records as evident from the auditor's report.

It may be noted that the company was nationalised in 1984 under an Act of Parliament. Therefore, before proceeding with the sale of GoI equity in favour of a strategic buyer, necessary legal clearance from the appropriate authority is to be obtained.

RECOMMENDATIONS

In view of the issues and facts analysed above, the Commission recommends that the GoI should disinvest its entire stake in HDPE at the earliest to a strategic buyer, together with financial restructuring, details of which have to be finalised in consultation with prospective buyers. If disinvestment does not succeed, owing to lack of interest of suitable bidders or for any other reason, closure/winding up of HDPE is recommended.

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2.2 NATIONAL SMALL INDUSTRIES CORPORATION LTD. (NSIC)

INTRODUCTION

Established in 1955, National Small Industries Corporation Limited (NSIC) is a pioneer public sector undertaking engaged in providing support for the growth and development of small-scale industries in the country. The Corporation was initially set up under the Ministry of Industry, Government of India, with the objective of aiding, counselling, assisting, financing, protecting and promoting the interests of the small-scale sector. NSIC is currently under the Ministry of Small Scale Industries.

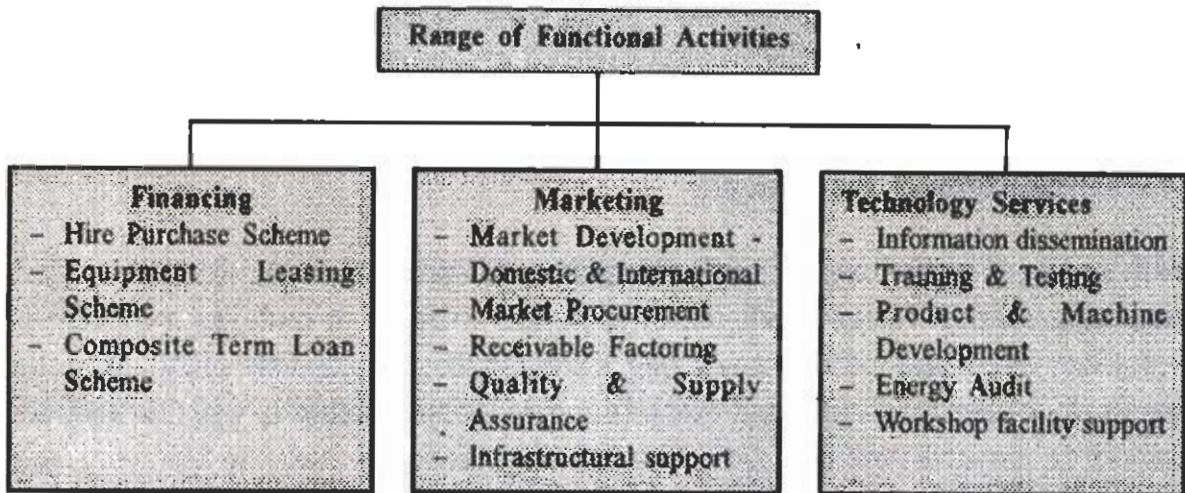
Having linkages with various industries and industry associations both at the national and international levels, and a large network of offices, NSIC has a good track record of setting up projects in different countries, organising buyer-seller meets, workshops/seminars and large industry expositions of international standards.

The authorised and paid up capital of the company, as on 31.3.2001, were Rs.1750 million and Rs.1679.9 million respectively, the entire subscribed capital being held by Government of India. The total number of employees, as on 31.3.2001, was 1346.

The activities mandated by the Government of India for NSIC can be broadly classified as commercial and promotional. NSIC's commercial activities were envisaged to earn a reasonable margin of profit to cover the Corporation's overhead expenses, keeping in view the main objective of development of small-scale industries. The commercial activities were to be financed either out of share capital or with loan assistance that may be sanctioned by the Government from time to time.

The promotional schemes were to be financed in the form of reimbursement of the actual expenditure incurred by the Corporation. Such reimbursements were to be made taking into account the profits, if any, made by the Corporation in its commercial activities.

NSIC is involved in wide-ranging functions, as shown below:



Source: ICRA Advisory Services (ICRA)

Details of some functional activities/schemes are given below:

Hire Purchase scheme

This has been the flagship activity of the corporation and has been operational for over four and a half decades. It is a pioneering scheme to supply both indigenous and imported machines on easy Hire Purchase terms to first generation entrepreneurs and existing units. It was started with a view to promoting small and ancillary units and to modernise the existing ones on easy Hire Purchase terms.

Equipment leasing scheme

With an objective of modernisation, diversification and expansion of existing units, the corporation launched Equipment Leasing Scheme in the year 1987. It provides 100% finance, single window service for indigenous as well as imported machines.

Composite Term Loan Scheme

Under this, the corporation is providing assistance to first generation entrepreneurs having innovative ideas and viable projects. Maximum assistance of Rs 2.5 million is provided to tiny units for procurement of land and building, machinery and equipment and for working capital. This scheme is linked with Credit Guarantee Fund under which loans are covered against payment of one time upfront fee of 2.5% of the loan sanctions and annual fee of 1% on the outstanding amount. The

Large and Medium Scale Units generally buy products, sub-assemblies etc. from the SSI sector on a deferred payment basis, which results in shortage of funds for the SSI units. Accordingly, NSIC has evolved a scheme of financing sale bills of the SSIs.

Marketing Support Programme

With an aim of motivating the small enterprises, this programme provides diversified marketing support to the small sector to access markets at multiple locations. It comprises direct and indirect marketing. Direct marketing consists of the consortia approach, tender marketing and marketing development centres, whereas indirect marketing services include raw material assistance as well as Carrying and Forwarding agency. Under the consortia approach small units producing the same products are associated in the form of the consortium. NSIC secures orders for bulk quantities, which are then farmed out, to small scale units as per their production capacity. Under tender marketing, the Corporation identifies large number of items for which it actively participates in tenders of Centre & State Government, Public Sector Enterprises on behalf of small-scale units. On receipt of the orders, the Corporation farms out these orders to the units on whose behalf it has quoted and get the items made under its own supervision.

Integrated Marketing Support Programme

The supply bills of small scale units to the eligible purchaser including electricity boards and other Government departments are discounted under this scheme and arrangements are made that the purchaser shall make the payment to the corporation on due date. The seller SSI unit gets the payment of supply bills on discounting by the corporation and the amount advanced on discounting is adjusted on realization of payments of bills from the purchaser. This scheme seeks to mitigate the problem of units for delay in payment by the purchaser and helps in providing working capital.

Government Purchase Programme

Involves enlisting small-scale units as competent to undertake supply of various items to the Government. This is done to avoid multiplicity of registration with various Government agencies and to ensure that the units registered with NSIC are considered at par with those registered directly with purchasing agency. The units registered with NSIC are extended following facilities:

- ★ Issue of tender sets free of cost
- ★ Advance intimation of tenders issued by DGS & D
- ★ Exemption from payment of earnest money
- ★ Waiver of security deposit upto the monetary limit for which the unit is registered.
- ★ Issue of competency certificate in case the value of an order exceeds the monetary limit, after due verification.

The total number of units enlisted under the scheme upto 31.3.2002 (since inception) was 32,496.

Exports & Exhibitions

The role of the organisation in the area of exports is as follows:

- ★ Assist export of quality products of the small-scale units,
- ★ Facilitate easier access to SSIs in established global markets,
- ★ Inducing small enterprises in India to export markets, and
- ★ Effectively display product and technologies of small-scale industries at international forums.

NSIC, being a recognized export house, has facilitated the export of goods produced by the SSI units. The table below provides an idea of the value of exports of the organisation over the past few years:

Table 1

Year	Amount (in Rs mn)
1996-97	167.5
1997-98	137.5
1998-99	120.6
1999-00	121.1
2000-01	149.9

Source: ICRA

The corporation has a scheme of assisting the small-scale units in participating in trade fairs and exhibitions both at the national and the international level. One of the most important domestic fairs organized by NSIC is ' TECHMART 'held at New Delhi every year.

Participation in Global Tenders

The corporation, on behalf of the SSI units, regularly participates in various global tenders funded by World Bank, ADB and other multilateral agencies. Some of the sectors that are covered under the global tenders are light engineering goods, electrical transmission products, laboratory equipment, machine tools & workshop equipment, surgical & medical products etc.

Software Technology Parks

Recognizing the relevance of infrastructural support for sustained growth of the SMEs in the area of software, NSIC has undertaken several initiatives to promote the software exporting units by setting up Software Technology Parks exclusively for them. The first STP was set up in 1995 at Okhla and the second has been commissioned at Chennai.

Enterprise Building Programme

The programme lays emphasis on enterprise promotion and self-employment through ventures capable of generating additional employment, and helps first generation entrepreneurs in setting up of their units. Under this, special initiatives are developed for the educated youth, considering their potential and availability of various inputs for the industry. Training is provided to these entrepreneurs and later they are encouraged to avail finance under the Composite Loan scheme to set up their own ventures.

Technical Service Centres and Extension Centres

The Corporation has Technical Service Centres in Okhla (New Delhi), Rajkot (Gujarat), Howrah (West Bengal), Chennai (Tamil Nadu) & Hyderabad (Andhra Pradesh). In addition to these, there are other centres at Aligarh (Uttar Pradesh) and Rajpura (Punjab). The scope of operations of these Technical Service & Extension Centres cover activities like training, testing, providing workshop facility support, product & machine development, energy audit, tool kit development etc.

INDUTRY OVERVIEW

Composition of the Industrial Sector

The industry sector in India is broadly segmented into three categories namely:

- (1) Large scale factory sector
- (2) Small scale factory sector
- (3) Village and small industries sector

The units in the large-scale factory sector and small-scale factory sector are classified on the basis of the upper limit on investment in plant and machinery. The village and small industries sector is further classified into two broad categories namely, the Modern small-scale industries and Traditional industries. The Modern small-scale industries cover Small Scale Industry (SSI) units (both factory/ non-factory sectors) and Powerloom units. The Traditional Industries sub sector comprises Tiny and Cottage industry segments like Handloom, Khadi and Village Industries, Handicrafts, Sericulture, Silk and Coir. The SSI sector consists of different segments, such as, ancillary undertakings, tiny units, export oriented units, women enterprises and small scale service & Business (industry related) Enterprises. This segmentation within the SSI sector has been taken up in tandem with the socio-economic policies of the country from time to time.

Relevance of SSI sector

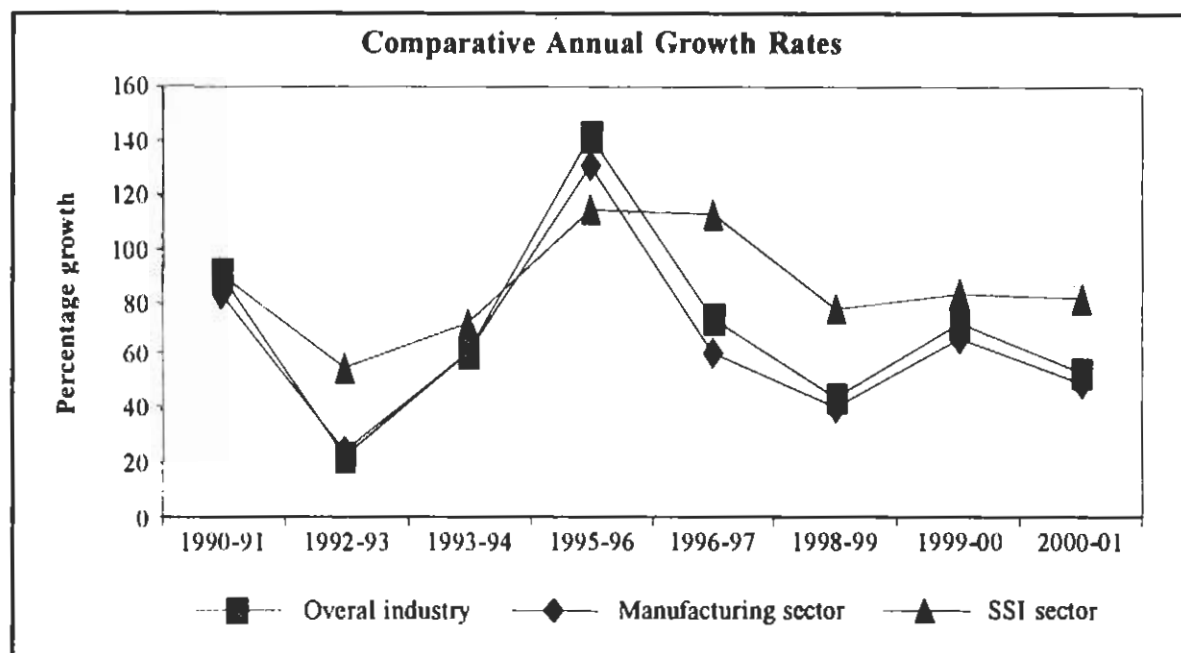
The development of the small-scale sector was undertaken post-Independence with an objective of overcoming the two major problems facing the Indian economy- poverty and unemployment. The phenomenal growth of the SSI sector has been an important feature of the economic development of the country. It has contributed substantially towards the overall growth of the Gross Domestic Product (GDP) as well as employment and exports. Currently, the sector contributes to around 95% of the total industrial units.

Growth of the Sector

The Indian small-scale sector has been witnessing steady growth over the past, and now occupies a significant position in the economy, in terms of its contribution

towards both the national income and employment. As the table below shows, during most of the years this sector has been exhibiting better growth rates compared with the overall industrial and manufacturing sectors. The sub-sectors accounting for the bulk of the value addition in the small-scale sector are chemicals, food products, basic metal industries, electrical machinery, etc.

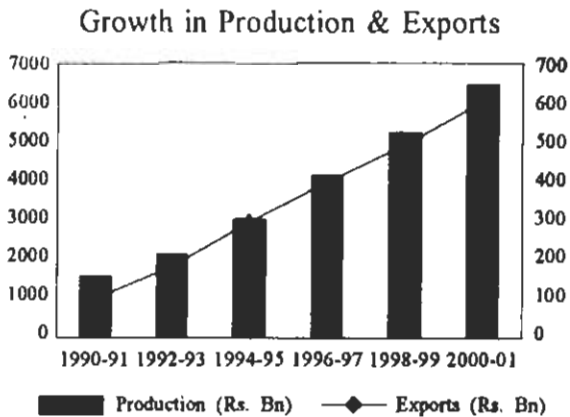
Table 2 - Comparative Annual Growth Rates



Source: SIDBI Report, 2001 / ICRA Analysis

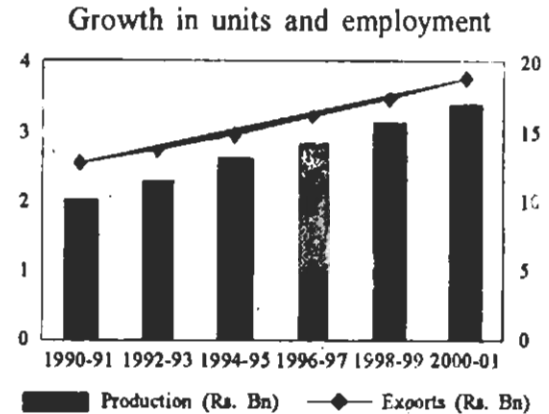
The most significant achievement of the small-scale sector is in the area of exports, with their share in the overall exports growing from 16% in 1973-74 to around 34% in 2000-01. This increase was possible largely because of the inherent strengths of the SSIs in some niche sectors, coupled with the developmental support extended by the Government. The indirect exports from the SSI sector comprise: (i) products of SSIs purchased by other exporters/trading houses/export houses and thereafter exported under their own consignments; and (ii) parts and components manufactured by the SSIs but used by other large industries in the manufacture/assembly of the final products that they export. Table 3 below provides growth in production & exports and table 4 exhibits the growth of SSI sector units and employment

Table 3 - Growth in production & exports



Source: SIDBI Report 2001 / ICRA Analysis

Table 4 - Growth in units and employment



Source: SIDBI Report 2001 / ICRA Analysis

In the area of exports, sectors like chemicals, jute, leather, beverages, garments, processed food etc., are prominent.

The Ministry of SSI is the apex body responsible for the growth and promotion of the SSI sector, which includes overseeing the formulation and implementation of the policies and programmes for the development of the small-scale units through support agencies and specialised services.

The implementation of policies and various programmes/schemes for providing infrastructure and support services to small enterprises is undertaken through State Industrial Development Organisation (SIDO), NSIC and three training institutes — National Institute for Small Industry Extension Training (NISJET), National Institute for Entrepreneurship and Small Business Development (NIESBUD) and Indian Institute of Entrepreneurship (IIE).

Functional Classification of Institutions/Organisations

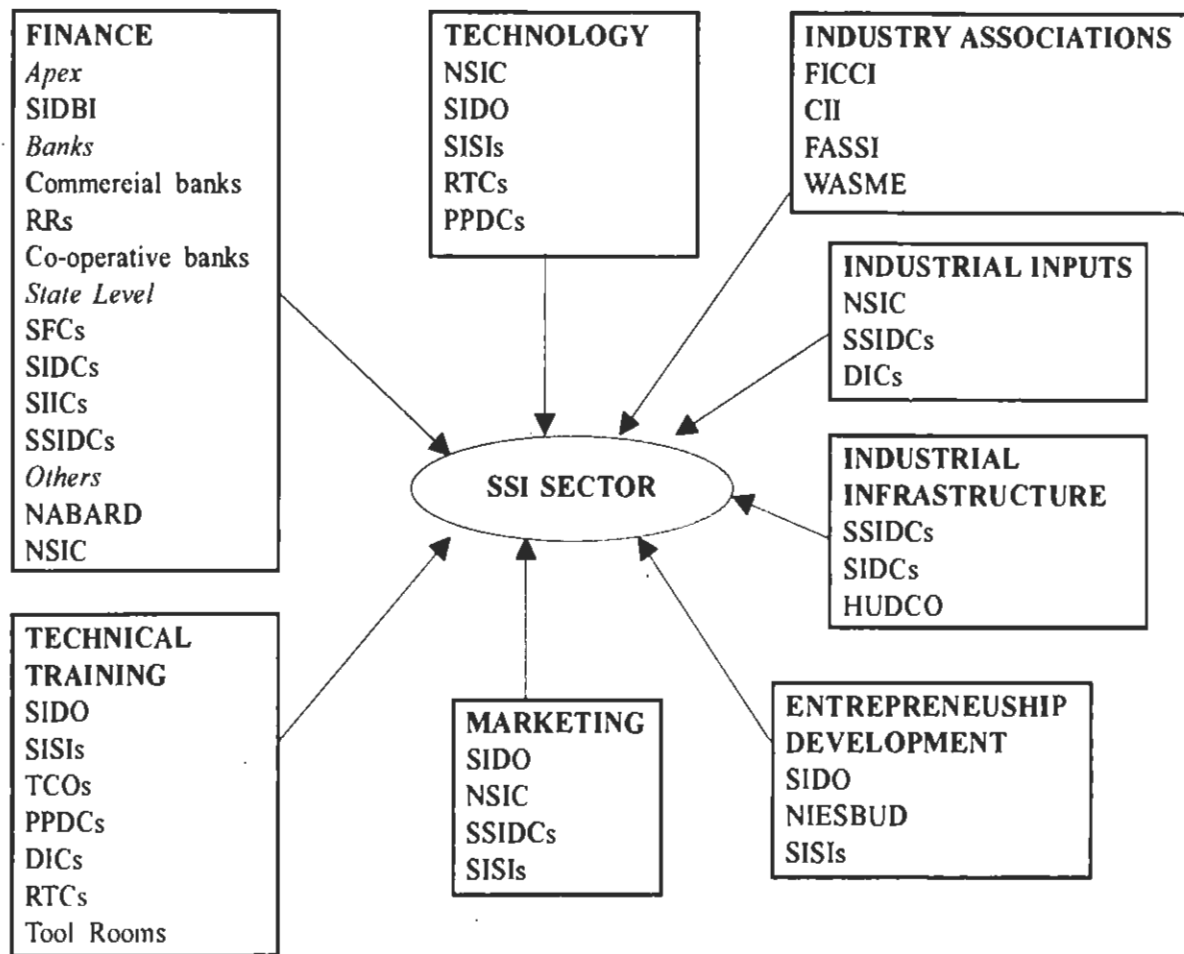
The resource requirements of the small-scale sector can broadly be classified into the following areas:

- ★ Financing;
- ★ Marketing;
- ★ Technology;
- ★ Industrial Inputs;

- ★ Infrastructure; and
- ★ Training & Entrepreneurship Development.

The table below shows the various institutions that provide support to the SSI sector:

Table 5 - Functional Classification of Support Institutions



Source: ICRA

Note: SIDBI: Small Industries Development Bank of India; RRB: Regional Rural Bank; SFC: State Financial Corporation; SIDC: State Industrial Development Corporation; SIIC: State Industrial Investment Corporation; SSIDC: State Small Industries Development Corporation; NABARD: National Bank for Agriculture & Rural Development; NSIC: National Small Industries Corporation; SIDO: Small Industries Development Organization; SISI: Small Industries Services Institute; TCO: Technical Consultancy Organisations; PPDC: Product cum Process Development Centre; DIC: District Industries Centre; RTC: Regional Testing Centre; FICCI: Federation of Indian Chamber of Commerce and Industry; CII: Confederation of Indian Industries; FASSI: Federation of Associations of Small Industries of India; WASME: World Association for Small and Medium Enterprises; HUDCO: Housing & Urban Development Corporation; NIESBUD: National Institute For Entrepreneurship & Small Business Development.

Regulatory & Policy Framework

The Industries (Development and Regulation) Act of 1951 is a Central Act, which governs the small-scale industries. In addition, the sector is governed by a multitude of acts/rules and regulations formulated by authorities at various levels — Central, state and local authorities.

These regulations can be classified into:

- ★ Labour-related issues;
- ★ Tax-related issues;
- ★ Finance-related issues;
- ★ Location-related issues;
- ★ Product-related issues;
- ★ Environment-related issues; and
- ★ Safety, security, hygiene, health and welfare-related issues.

The above Acts/Rules are applicable for the industrial sector as a whole, and have not been formulated keeping in mind the specific needs and limitations of the small-scale sector. Compliance with these regulations involves substantial costs and, given the small size and scale of operations of the SSI sector, these costs impose a heavy burden on the operational viability of individual units. The industry has been strongly representing against the multiplicity of Acts and high compliance costs associated with them. There is a need for simplifying the regulatory framework for the small-scale sector and customising it to suit its specific requirements.

Evolution of SSI Policy Framework

The SSI policy framework is a result of six Industrial Policy Resolutions, which were adopted by successive Governments at the centre, and were aimed at promoting industrial growth and determining a pattern of state intervention and assistance for the SSI sector.

The Industrial Policy Resolution, 1948, assigned a primary role to small-scale industries since they were particularly suited to utilise local resources and, in the process, achieve 'self sufficiency' in respect of certain industrial goods.

The second Industrial Policy Resolution of 1956 underlined the role that the SSI sector could play in providing employment opportunities, mobilising local skills and capital resources and, in the process, integrate with the large industrial sector. The Industrial Policy Statement of 1977 provided a further impetus to the sector, and stressed upon wider dispersal of cottage and small industries in the rural areas and small towns.

The Industrial Policy Statement of 1980 paved the way of ancillarisation and creation of nuclear units for the growth of the SSI sector. The Statement of 1990 laid increased emphasis on the enhancement of the SSI sector's contribution in overall exports, employment generation and dispersal of industries in the rural areas. The industrial policy measures announced in 1991 laid special thrust on promotion and strengthening of small, tiny and village industries.

The guiding philosophy behind the evolution of policy framework, over the four decades has been to protect and promote the SSI sector. The recent changes in international trade patterns have warranted a shift from the protectionist stance to the adoption of a promotional stance. Realising this, the Government of India has adopted policy measures to promote and sustain the SSI sector in the changed global trade scenario, and announced the Comprehensive Policy Package for the SSI sector in 2000.

The policy comprises several measures in the areas of:

- ★ Fiscal support (Direct and Indirect Taxes);
- ★ Credit/financial support;
- ★ Technology support (technology adoption, dissemination and upgradation);
and
- ★ Marketing support (market and product development).

The SSI Sector--Current Issues and Concerns

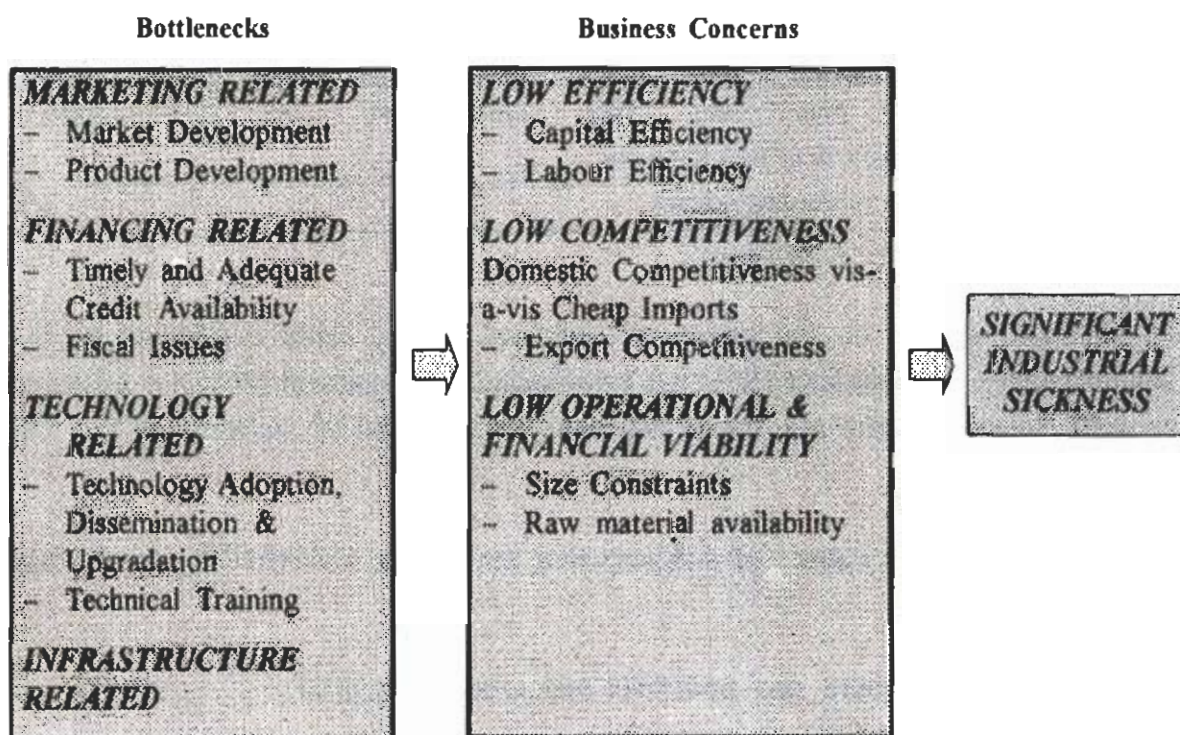
The focus accorded to the development and promotion of the SSI sector in the early years, post-Independence, was with a view to:

- ★ Generating employment opportunities on a large scale, given the labour intensity of the sector;
- ★ Mobilising local skills and capital resources;

- ★ Providing a boost to the overall exports; and
- ★ Balancing regional development for removing regional disparities.

The table below depicts the issues and highlights the major bottlenecks that constrain the SSI sector today:

Table - 6 Bottlenecks and Concerns in the SSI sector



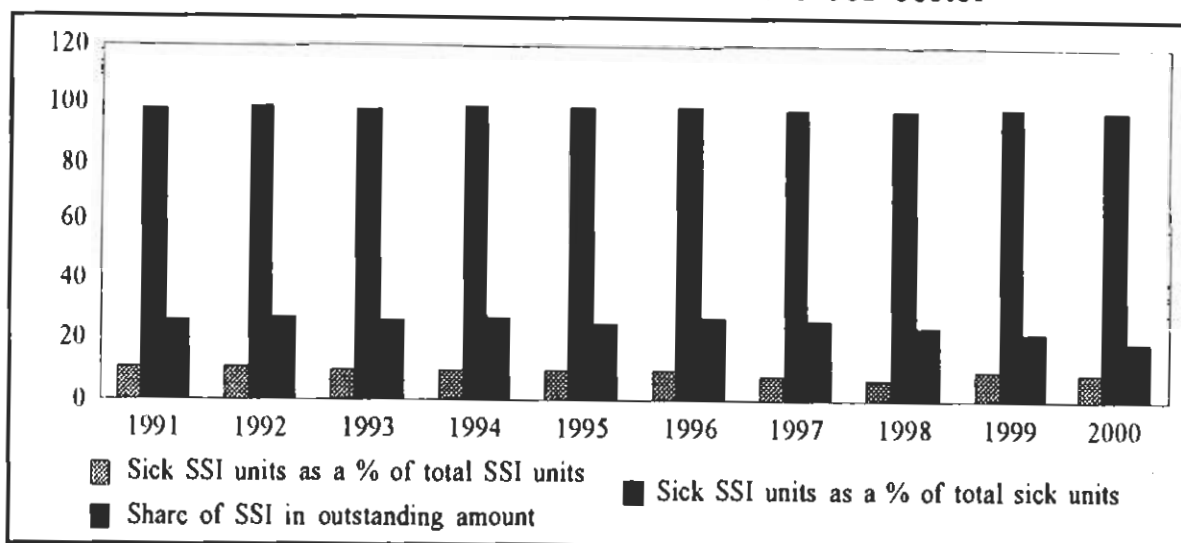
Source: ICRA

Sickness in the SSI Sector

The SSI sector has been suffering from endemic sickness for a very long time.

The table below provides a snapshot view of the sickness in the SSI sector during the period FY1991 to FY2000. As is evident, the SSI sector has historically accounted for almost 99% of total incidence of industrial sickness in the national economy. The incidence of sickness within the SSI sector has remained close to a level of 10% during the same period. Despite such high levels of sickness in the sector, its share in the total outstanding amount due on account of total industrial sickness has been close to 20%. This is a reflection of the small size of average lending prevalent in the SSI sector.

Table 7 - Incidence of Sickness in the SSI Sector



Source: SIDBI Report 2001 / ICRA Analysis

An All-India survey on the causes of sickness of SSI units conducted by the Development Commissioner (SSI) has established that financial problems followed by marketing problems are the prime causes of industrial sickness in the SSI sector.

Some of the specific causes of sickness that have been identified by the Survey are:

- ★ Paucity of adequate raw materials and working capital;
- ★ Delayed receivable realisation;
- ★ Marketing-related problems;
- ★ Management deficiencies; and
- ★ Technological obsolescence.

The policy initiatives on the part of the Government need to address precisely these bottleneck areas, so as to revive and sustain the health of the SSI sector. Increasing the competitiveness of this sector has become even more critical in the light of the changed global trading scenario as a result of imminent changes that are likely to be brought about under the WTO regime.

The issues confronting the SSI sector and the policy initiatives required to address the same are analysed in the following sections.

Marketing Related Issues

Policy of Reservation

Reservation of products for exclusive manufacture by the small-scale sector has been one of the most critical policy instruments for the sector. The idea was to protect the interests of the SSI sector, keeping in mind its vulnerability to competition from large and medium scale industries.

This policy has been criticised on the following grounds:

- ★ Reservation has not helped the growth of the small-scale sector in the country. In fact, the units in the unreserved category have actually witnessed higher levels of growth compared with those in the reserved list.
- ★ Reservation, in many cases, becomes irrelevant since the SSI units are not producing a large number of reserved products. It also appears inconsistent with the new international trade policy, which allows the items reserved for the SSI sector to be freely imported.
- ★ Reservation has also hampered India's ability to expand exports in many crucial areas including textiles and leather.

The Government has gradually been dereserving products from the reservation list over the years, to face the challenges likely to be posed under the WTO regime.

Preferential Purchase & Price Policy

The Preferential Purchase & Price Policy provides marketing support to SSI units by ensuring assured markets for products of SSI units. This has been undertaken with a view to protecting the SSI sector from market competition, mainly the large-scale sector. The nature of benefits extended under this Policy are price and products based. NSIC is the designated nodal agency to promote the marketing of SSI products to the Government under the Preferential Purchase & Price Policy.

During the early years of its implementation the Policy, this policy did make a positive contribution in securing markets for the SSI sector but of late, its impact

has been below desired levels. The main reason for the decreased effectiveness of the scheme in recent years has been the waning of buyer interest for products supplied under the scheme. This has happened due to availability of cheaper and better quality alternatives in the market.

Export Promotion

With a view to assisting the small units in the area of exports, numerous initiatives, like participation in international exhibitions, training programme for packaging for exports etc have been taken over the years.

Finance Related Issues

Fiscal Concessions

In order to foster the growth of SSI units, the Government has extended various fiscal concessions to small units mainly under the General Excise Exemption Scheme. Fiscal incentives provided to small-scale enterprises are in the nature of tax/duty concessions granted in the form of exemptions, rebates, refund or postponement of direct or indirect taxes leviable on production or profit, besides special tax concessions.

Credit Flow to SSI Sector

Realising the importance of credit in enhancing the growth of the SSI sector, the Government has formulated several policies and programmes, from time to time, to increase the flow of credit to the sector. The Reserve Bank of India (RBI) has been playing a lead role in formulating and implementing credit policies relating to the SSI sector in India. The small-scale sector has been included as part of the priority sector lending by banks. As per the guidelines issued by RBI, the public sector banks are required to lend 40% of their net bank credit to the priority sector that includes agriculture, SSI and others, viz., exports, housing, etc.

It has been observed that the share of the net bank credit in favour of the SSI sector has been in the range of 12%- 17% over the past five years. SIDBI is the apex financing bank for the small-scale sector and provides assistance in the areas of technology upgradation, venture capital financing, information technology, export promotion, etc. Other institutions like State Financial Corporations, scheduled

banks, State Industrial Development Corporations (SIDCs) are the other important agencies in the area of financing. Credit in direct/indirect forms is also disbursed by organisations like NABARD, NSIC, etc.

Small Size and Ownership Pattern

The various fiscal and monetary schemes designed to create, support and foster the small-scale sector have discouraged the expansion of units in this sector. This is largely because the economic benefits from migrating to a larger size do not necessarily outweigh the loss in terms of benefits that accrue by remaining within the definition of SSI. These schemes have also been largely responsible for the current ownership pattern prevalent in this sector that is heavily skewed in favour of proprietary concerns.

Technology Related Issues

Individual small-scale enterprises lack the technical expertise and financial muscle for the development of technology. Lack of information is an obstacle in the selection, acquisition and application of appropriate technology options. The Government has undertaken various initiatives to enable:

- ★ Identification of appropriate technology available domestically or overseas;
- ★ Technology transfer and consequent adoption by the beneficiary units;
- ★ Constant technology upgradation; and
- ★ Reducing the total cost of technology ownership for small-scale units.

Despite several initiatives on the part of the Government in the area of technology upgradation of SSIs, there has been a lack of skill and technology content in the SSI output. In addition to this, the lack of focus on Research & Development has compounded the problem, and has consequently resulted in lower export competitiveness.

Infrastructure Related Issues

Both the Central and the State Governments have devised various schemes for the development of infrastructure facilities for the growth of the SSI sector. The idea behind this was to provide common shared resources to a conglomeration

of SSI units to achieve economies of scale. The main schemes of the Government under this specific initiatives cover the Industrial Estates, Growth Centres, Special Economic Zones, Export Oriented Zones, etc. The basic objective of these initiatives has been to attract entrepreneurs to set up small industries or to shift existing units to industrial areas provided with infrastructure facilities like water, electricity, roads, banks, canteen, watch & ward, communication facilities, etc.

Government's Role in the SSI Sector

Global experience suggests that the role of the Government should be that of a facilitator rather than that of implementing and offering all services directly. Government should restrict itself to ensuring a conducive legal and fiscal framework, by formulating an appropriate set of policies. The major service that public agencies and Ministries should extend is to provide information and marketing services required by the SSIs for their growth and enhanced competitiveness.

Policy makers in developing countries should aim to generate conditions that move SSIs away from relying on their own limited capacity towards co-operation within industrial clusters to gain greater competitive strength.

The new trade regime offers both opportunities and threats to the growth of the SSI sector. Opportunities exist in the form of ample scope for market expansion, and threats in the form of limited domestic market potential due to the disadvantageous position of the Indian small-scale units with respect to technology and quality aspects:

Freeing of global trade is likely to adversely impact the small-scale sector, primarily by way of displacement of demand for Indian goods.

To face the challenges emanating from the WTO Agreement, SSI units irrespective of their size require technology upgradation and modernisation. Technology is the key element to productivity, quality, competitiveness and market acceptability of products. Government should provide infrastructural and credit support to the SSI sector to enable it to squarely face competition from world imports.

The impact of the WTO regime on various industry verticals in the SSI sector has been analysed below:

Table 8 - Impact Analysis of WTO Agreements on SSIs in India

Sectoral Agreement/ Regulations	Industry Scope & Coverage	Nature of Impact on SSI Sector
General Agreement on Tariff and Trade	Manufactured goods	All sectors subject only to tariff protection; New export markets to open up
General Agreement on Trade and Services	Services	Some services to open up to foreign competition
Agreement on Agriculture	Agriculture Products	No significant impact on SSIs
Agreement on Textiles & Clothing	Textiles & Clothing	Competition on price & quality without any concessions
Trade Related Investment Measures	Foreign Investment	Increased flow of foreign investment, new markets for SSIs
Trade Related Intellectual Property Rights	Intellectual Property	Cost to increase due to patents on traditional technologies
Sanitary and Phytosanitary Measures	Activities involved in health & hygiene	Constraints on exports despite price Competitiveness
Technical Barriers to Trade	All activities	Constraints on exports despite price competitiveness
Anti-dumping	All activities	Can be used against cheap imports
Safeguard measures	All activities	Can be used against cheap imports
Subsidies & Countervailing Duties	All activities	Benefits & support mechanisms need to be restructured

Source: SIDBI Report, 2001/ ICRA

The small-scale units would also have to take a serious note of the growing Technical Barriers to Trade (TBT), in view of the high technical standards set by the developed countries. Therefore, there is an urgent need to reorient the policies governing the small-scale sector in order to improve its competitive strength and long-term growth prospects.

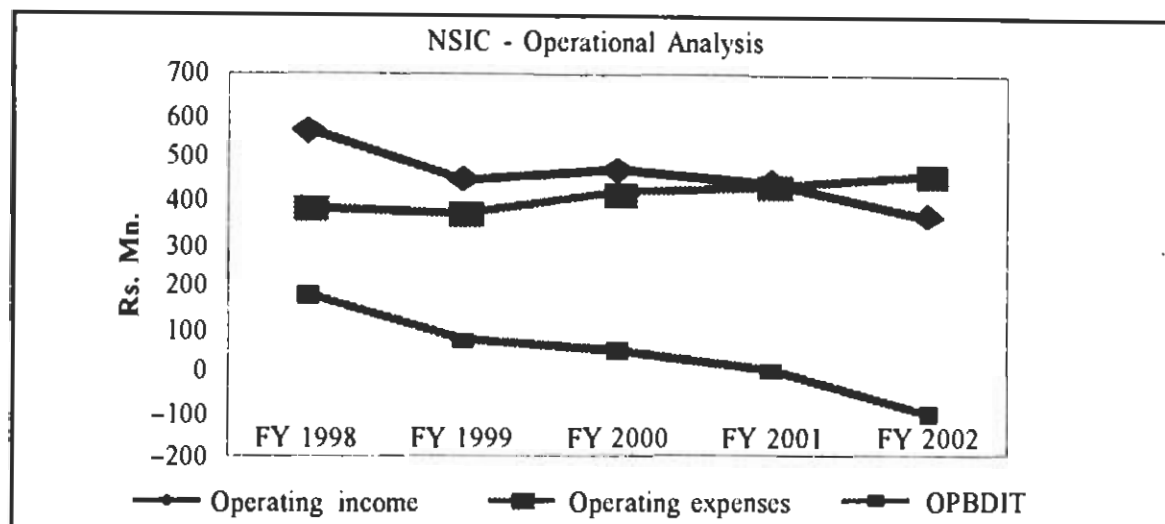
More specifically, the focus areas for the Government in this regard would perhaps include examining the need to SSI to have enhanced investment limits, clustering of SSIs, re-examining the reservation issue, and adequate and timely credit availability.

OPERATING PERFORMANCE OF NSIC

Rising Operating Losses

The operating margin of NSIC has witnessed a declining trend owing to a steady increase in operating cost coupled with declining operating income. Table below exhibits the decline in the operating margin over the period FY1998-02:

Table 9 - Operating Performance of NSIC



Source: Company Information / ICRA Analysis

Declining Operating income

Income from operations can be classified broadly into: Marketing, Financing, Technical Services and Other Related Income. The table below shows the deteriorating trend, business segmentwise:

Table 10 - Operating Income of NSIC

(in Rs. mn)

Business Segments	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Marketing					
Sales	1055.5	944.1	1064.3	1871.2	1828.5
Purchases	1045.9	929.5	1055.8	1862.0	1826.1
Service Charges	104.9	70.7	60.7	50.5	39.3
Marketing Income	114.5	85.3	69.2	59.7	41.7

...Contd.

Business Segments	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Technical Services	57.8	48.3	51.8	51.9	48.5
Financing					
Hire Purchase	26.7	23.8	31.5	46.0	50.7
Equipment Leasing	76.7	64.3	56.1	43.8	28.7
Interest Income	259.3	185.4	194.7	168.8	126.2
Financing Income	362.7	273.5	282.3	258.6	205.6
Other Related Income	33.6	48.8	76.1	77.3	72.5
Total Income	568.6	455.9	479.3	447.6	368.3

Source: Company Annual Reports / ICRA

The table illustrates the increasing contribution of Other Income and decreasing contribution of marketing, technical and financing segments in the total income of the Corporation.

Marketing Income

NSIC earns marketing income primarily in the form of service charges, earned under the raw material assistance scheme and margins earned on marketing goods of the SSI sector.

Decrease in income derived from marketing activities during the period FY1998-02 can be attributed to lower GDP growth on account of deceleration in overall industrial manufacturing, and lower growth in agriculture and allied sectors. In addition, the slowdown in the global economy further aggravated the situation. The above factors had a direct adverse impact on the industry in general and SSI sector in particular.

In addition, due to the liberalised international trade scenario and the resulting easy availability of factor inputs, reliance of the SSI sector on NSIC for its raw material needs has reduced.

Financing Income

Income from financing activity comprises hire charges, lease rentals against equipment & machinery made available to SSI units and interest income earned on term loans & advances extended by the Corporation to beneficiary units.

The income from Hire Purchase & Leasing activity has shown a downward trend perhaps as a result of lower reliance of the SSI sector on NSIC, given the easy and cost-effective options available elsewhere. The lowering of import barriers and simplification of processes provide much cheaper avenues for the SSI sector to source their equipment and machinery requirements.

Interest income earned by NSIC has decreased over the period FY1998-02 owing to decrease in outstanding loans to the SSI sector. NSIC is a marginal player in the term-lending business to the SSI sector when compared with prime lending institutions such as SIDBI and commercial banks.

Moreover, NSIC's inability to source low-cost funds has rendered its lending operations uncompetitive over the years.

Technical Services

The income from Technical Services of NSIC comprises income from sale of goods produced by NSIC's Technical Service Centres and realisation from provision of training services. The table below provides the details on income earned by NSIC Technical Service Centres. It is observed that the income arising from NTSC's sales has declined over the years. This has happened owing to a shift in focus from production activities to value-added services like training & testing, due to the low profitability of production activities. The increased impetus accorded to training is reflected in the rising income levels from this activity.

Table 11 - Growth Trend in Technical Services Income

(in Rs. mn)

Business segments	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Technical Services – Sales	42.2	36.2	38.0	30.0	22.3
Growth (%)	-6%	-14%	5%	-21%	-26%
Income from Training	15.5	12.1	13.7	21.9	26.2
Growth (%)	125%	-22%	13%	60%	20%

Source: Company Information ICRA Analysis

Other Related Income

The other related income of NSIC comprises discounts earned on bulk purchases, and licence & housekeeping fee charged for providing shared support services

under the Software Technology Park of India (STPI) Scheme. Details of other related income of NSIC are provided in the table below. Income from licence & housekeeping fees has grown steadily over the period FY1998-02 owing to the high growth in the demand for software products & services. Due to lower levels of business activity in the small-scale sector, the discounts earned by the Corporation on account of bulk purchases on their behalf have undergone a decline.

Table 12 - Growth in Other Related Income

(in Rs. mn)

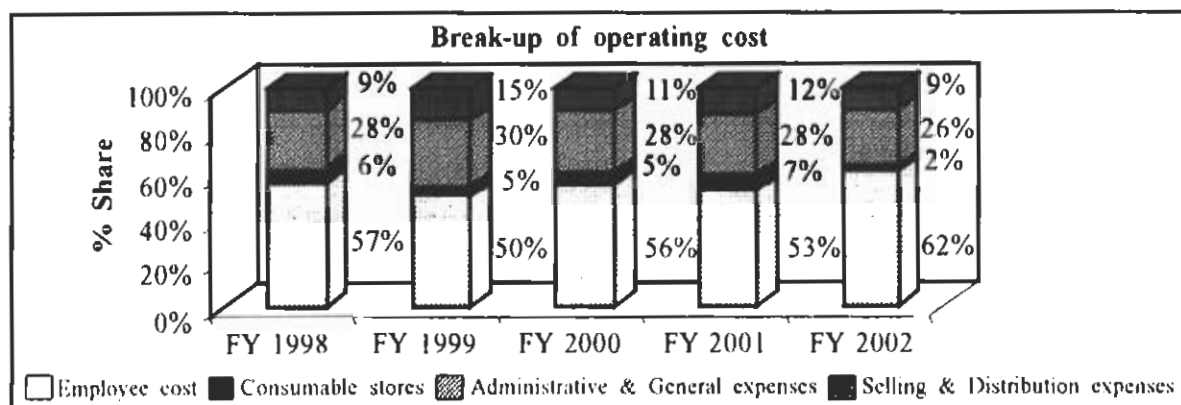
Business segments	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
License & Housekeeping Fees (STP)	15.5	20.2	21.4	30.4	32.1
Growth (%)	77%	30%	6%	42%	6%
Discounts Earned	23.9	28.5	54.6	46.9	40.4
Growth (%)	-35%	19%	92%	-14%	-14%

Source: Company Information / ICRA Analysis

Rising Operating Costs:

The major operating costs of NSIC are employee costs and administrative & general expenses. These two accounting heads cumulatively have historically accounted for more than 80% of the total operating cost of the Corporation. Given the low focus on marketing and distribution activities, the associated costs have averaged at around 10% of the total operating costs. The table below depicts the share of various operating cost heads.

Table 13 - Break-up of Operating Cost of NSIC



Source: Company Information / ICRA Analysis

The total operating cost of the Corporation has witnessed a steady increase over time, primarily on account of the increase in the Employee and administration & general expenses, in absolute terms. The table below provides the trends in operating cost for NSIC for the period FY1998-02. The rise in employee costs for the year FY02 is attributable to VRS expenditure incurred during the year:

Table 14 - Trends in Operating Cost

(in Rs. mn)

Operating costs	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Employee Cost	219.9	190.2	239.7	234.8	290.0
Growth (%)	12%	-14%	26%	-2%	23%
Consumable, Stores	23.5	18.2	22.7	30.9	11.2
Growth (%)	12%	-23%	25%	36%	-64%
Administrative & General Expenses	106.2	114.0	117.0	126.3	120.9
Growth (%)		7%	3%	8%	-4%
Selling & Distribution Expenses	36.1	55.2	45.1	51.2	44.1
Growth (%)		53%	-18%	14%	-14%

Source: Company Information, ICRA Analysis

The table below shows that the operating cost per unit of operating income has increased from 0.68 to 1.27 over the period FY1998-02:

Table 15 - Operating Costs as Percentage of OI

Operating Costs as a % of OI	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Employee Cost	39	42	50	52	79
Consumable Stores	4	4	5	7	3
Administrative & General Expenses	19	25	24	28	33
Selling & Distribution Expenses	6	12	9	11	12
Total	68	83	89	99	127

Source: Company Information / ICRA Analysis

FINANCIAL PERFORMANCE

The balance sheet and profit and loss statement of NSIC depicting its financial performance over the past five years are given below:

Table 16 - Balance sheet

(in Rs. Mn)

ASSETS	31.03.98	31.03.99	31.03.00	31.03.01	31.03.02
Gross Block	755.8	734.4	711.5	665.2	685.5
Less : Depreciation	325.4	335.8	337.8	331.8	338.9
Gross Assets Post Depreciation	430.4	398.7	373.6	333.4	346.6
Less : Lease Adjustment Account	63.7	69.1	69.9	62.2	58.1
Net Block	366.7	329.6	303.7	271.1	288.5
Capital Work in Progress	6.2	13.5	26.1	54.0	0.7
NET FIXED ASSETS	372.9	343.0	329.8	325.1	289.2
Investments (NSC/GOI)	22.5	22.5	13.0	13.0	13.0
TOTAL INVENTORIES	51.4	49.4	47.6	27.9	21.7
Receivables (More than 6 months)	1243.9	1238.1	1145.7	1184.7	1183.8
Receivables (Less than 6 months)	375.7	371.4	392.8	282.5	191.5
Less : Provision for Doubtful debts & Advances	457.6	462.8	420.4	416.6	725.1
TOTAL RECEIVABLES	1161.9	1146.7	1118.1	1050.6	650.2
Cash and Bank Balances	427.2	789.9	741.5	290.6	181.4
Security Deposit with project authorities	3.3	6.0	7.9	11.5	10.5
Advances recoverable in cash/kind/value to be received	1093.1	1190.1	22.5	18.5	14.5
Advances to Staff	16.4	18.3	23.8	32.3	37.7
Interest receivable/accrued	42.7	44.7	38.9	12.8	14.5
Claims Receivable/Balance with customs port trust and excise authorities	0.5	0.3	0.3	0.3	0.3
Other current assets including prepaid expenses	484.5	823.2	808.1	791.6	649.6
Advance IT/TDS/Interest Tax	46.5	93.1	97.3	27.6	28.1

...Contd.

ASSETS	31.03.98	31.03.99	31.03.00	31.03.01	31.03.02
TOTAL OTHER CURRENT ASSETS	2114.2	2965.5	1740.4	1185.5	936.5
Total non current assets	783.6	1026.4	2330.3	1703.7	1006.9
TOTAL CURRENT ASSETS	3327.5	4161.6	2906.1	2264.0	1608.4
TOTAL ASSETS	4506.6	5553.6	5579.3	4305.8	2917.5
LIABILITIES					
Equity Share Capital	1319.9	1509.9	1679.9	1679.9	1679.9
Capital Reserve	83.9	83.1	86.7	90.6	87.2
General Reserve	1.1	1.1	1.1		
Profit & Loss Account	21.2	54.1	51.4	-472.2	-1313.4
GROSS RESERVES	106.2	138.3	139.2	-381.6	-1226.2
Less : Misc Expenditure not w/o		0.1	0.1	0.1	0.1
NET RESERVES	106.2	138.3	139.1	-381.6	-1226.3
TANGIBLE NET WORTH	1426.1	1648.2	1819.0	1298.2	453.6
Redeemable NCDs	350.0	350.0	500.0	500.0	500.0
Term loans (SIDBI)	137.9	69.4	25.0	0.00	0.00
Term Loan (Rupee Term loans)	673.1	1090.3	840.4	828.1	454.8
Term Loans(GOI/KFW)	438.1	472.0	432.3	421.2	435.7
TOTAL LONG TERM DEBT	1599.1	1981.7	1797.7	1749.2	1390.4
Cash Credit	158.1	484.0	973.6	320.8	214.1
Short term loan - Banks/Corporate Bodies/Others	—	6.3	1.9	2.2	—
Other short term loans & advances	392.4	348.1	119.6	118.8	146.7
TOTAL SHORT TERM DEBT	550.5	838.4	1095.2	441.8	360.7
Total Debt	2149.6	2820.1	2892.9	2191.0	1751.1
Sundry creditors	281.3	421.3	414.6	387.4	246.5
Security Deposits	10.3	45.0	14.9	16.1	10.5
Family Pension & Provident fund Payable	3.0	1.3	0.9	1.0	0.9
Earnest Money Deposit	27.7	35.0	30.7	22.3	25.1
Other liabilities	233.2	273.4	130.3	123.1	123.6
Interest accrued and due on loans	59.9	62.6	42.9	1.3	0.3

...Contd.

LIABILITIES	31.03.98	31.03.99	31.03.00	31.03.01	31.03.02
Interest accrued but not due on loans	59.6	56.3	48.1	51.2	76.8
TOTAL OTHER LIABILITIES	675.1	894.9	682.4	602.4	483.7
Provision for income tax	47.9	60.8	82.8	20.2	15.9
Provision for Dividend incl. Dividend Tax			7.6		
Other provisions	85.9	54.9	62.0	104.0	115.1
Provisions for Exchange Variation	121.9	74.7	32.5	89.8	98.1
TOTAL PROVISIONS	255.8	190.4	185.0	214.1	229.1
TOTAL CURRENT LIABILITIES	930.9	1085.3	867.4	816.5	712.8
TOTAL OUTSIDE LIABILITIES	3080.5	3905.4	3760.3	3007.5	2464.0
TOTAL LIABILITIES	4506.6	5553.6	5579.3	4305.8	2917.5

Source: ICRA

Table 17 - Profit & Loss Statement

(In Rs.Mn.)

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Sales	1055.5	944.1	1064.3	1871.2	1828.5
Purchases	1045.9	929.5	1055.8	1862.0	1826.1
Service charges	104.9	70.7	60.7	50.5	39.3
NTSC	42.2	36.2	38.0	30.0	22.3
MARKETING INCOME	156.7	121.5	107.2	89.7	64.0
Hire Purchase activity	26.7	23.8	31.5	46.0	50.7
Equipment leasing	76.7	64.3	56.1	43.8	28.7
Interest income	259.3	185.4	194.7	168.8	126.2
FINANCING INCOME	362.7	273.5	282.3	258.6	205.6
OTHER INCOME	49.2	60.9	89.8	99.3	98.7
Total income	568.6	455.9	479.3	447.6	368.3
Employee cost	219.9	190.2	239.7	234.8	290.0
Consumable stores	23.5	18.2	22.7	30.9	11.2
Administrative & General expenses	106.2	114.0	117.0	126.3	120.9
Selling & Distribution expenses	36.1	55.2	45.1	51.2	44.1
Total expenditure	385.8	377.5	424.5	443.3	466.1

...Contd.

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Operating profit / loss	182.9	78.4	54.8	4.3	-97.8
Depreciation	52.2	48.7	44.0	44.4	36.5
Provision for bad & doubtful debts	74.4	43.7	49.8	447.5	723.1
Interest & finance charges	250.8	219.1	282.5	242.2	203.2
Non operating income	258.3	370.1	379.4	265.0	254.2
Less: Extraordinary expenses	24.2	103.5	4.1	4.6	32.7
Tax	21.2	6.6	24.6	17.4	0.9
PAT	18.4	26.9	29.2	-486.8	-840

Source: ICRA

Profitability and Returns

The financial performance of NSIC over the period FY1998-02 is marked by growing levels of operating losses coupled with significant increase in provisions for bad & doubtful debts, resulting in increase in net losses. The table below provides the trends in profitability over the past five years:

Table 18 - Trends in Profitability

(in Rs.Mn)

Trends in Profitability	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Operating Profit/Loss	182.9	78.4	54.8	4.3	-97.8
Depreciation	52.2	48.7	44.0	44.4	36.5
Provision for Bad & Doubtful Debts	74.4	43.7	49.8	447.5	723.1
Interest & Finance Charges	250.8	219.1	282.5	242.2	203.2
Extraordinary Expenses	-24.2	-103.5	-4.1	-4.6	-32.7
Profit before Non-operating Income & Tax	-218.7	-336.6	-325.6	-734.4	-1093.3
Non-operating Income	258.3	370.1	379.4	265.0	254.2
PBT	39.6	33.5	53.8	-469.4	-839.1
Tax	21.2	6.6	24.6	17.4	0.9
PAT	18.4	26.9	29.2	-486.8	-840.0

Source: Company Information / ICRA Analysis

Depreciation Charges

The depreciation charges of the Corporation have been more or less stable over the period FY1998-02 on account of insignificant investments in fixed assets.

Provisioning for Bad & Doubtful Debts

The significant increase in the magnitude of provisions for bad & doubtful debts during FY01 and FY 02 has been on account of the tightening of provisioning norms by NSIC. It made provisions for Rs. 450 million and Rs. 720 million during FY01 and FY02, respectively. In FY03, NSIC aims to provide for another Rs. 200 million. Since FY01, the Corporation has adopted NBFC norms while making provisions for bad & doubtful debts.

Interest & Finance Charges

The interest & finance charges of NSIC have been reducing since FY00 on account of retirement of outstanding debts by the Corporation. Additionally, the Corporation has not resorted to fresh borrowings, thereby resulting in a net decline in the interest charges.

The extraordinary expenses increased substantially in FY02 on account of adjustments made against VRS expenses incurred during the previous years.

Non-operating Income

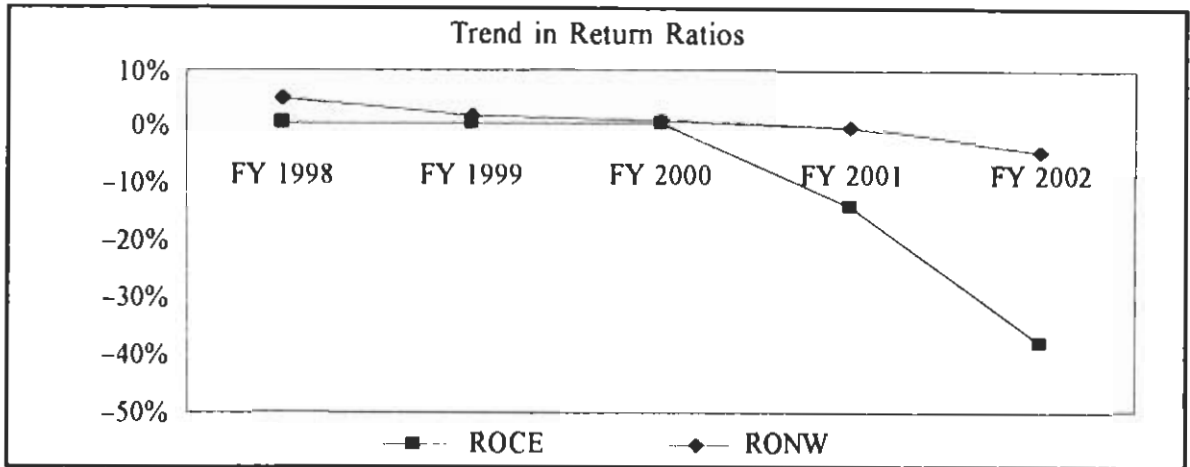
This comprises grants and subsidies extended by the Government of India for undertaking socially desirable but economically unviable promotional activities. The Government compensates the Corporation for net losses incurred by it in its promotional activities after making relevant adjustments against profits earned by its commercial activities.

Trends in Return Ratios

The returns earned by NSIC both on the capital employed (ROCE) and net worth (RONW) have shown a downward trend during the period FY1998-02. The Corporation's operating and net margins have suffered during this period, thus adversely impacting the return. The revenue generating capacity of the Corporation's assets too has decreased over the period FY1998-02. This coupled with negative operating and net margins have contributed to decreasing returns.

The table below depicts the trends in the Return Ratios of NSIC:

Table 19 - Trend in Return Ratios



Source: Company Information / ICRA Analysis

Capital Structure and Coverage

NSIC has a highly leveraged capital structure. Heavy losses incurred by the Corporation during FY01 and FY02 have eroded the net worth significantly. The extent of erosion in the net worth has been much more than the corresponding decline in liabilities.

The interest coverage of the Corporation has assumed critical proportions since FY01 as the table below shows. The significant operating losses incurred by NSIC during the FY01 and FY02 were the main cause for this deterioration in the Corporation's ability to service its debt obligations.

Table 20 - Trends in DER & Coverage Ratios

	FY1998	FY1999	FY2000	FY2001	FY2002
Debt—Equity	1.51	1.71	1.59	1.69	3.86
Interest Coverage	1.37	1.37	1.34	-0.75	-2.94

Source: Company Information / ICRA Analysis

Working Capital and Liquidity Position

Though the current ratio of NSIC, which is indicative of the short-term liquidity position of an entity, has been declining since FY98, it still is at a comfortable level.

The net working capital intensity of NSIC witnessed a steady decline over the period FY98-FY02, due to a shift in NSIC's operations away from highly working capital intensive activities such as raw material assistance.

SWOT ANALYSIS

The strengths, weaknesses, opportunities and threats of NSIC as it exists today is presented below:

Strengths

- ★ A National level organisation carrying the Government of India brand equity;
- ★ Provides a complete integrated package of services, ranging from financial inputs to marketing of the final products manufactured by the small-scale units;
- ★ Linkages with industry associations both within the country and overseas;
- ★ Network of offices at strategic SSI locations for effective nationwide reach; and
- ★ Considerable physical asset base.

Weaknesses

- ★ Lack of financial appraisal skills leading to significant levels of Non Performing Assets (NPAs)
- ★ Recovery of dues, which is again related to high proportion of NPAs, is an issue
- ★ Sub-optimal use of human resources – Large proportion of employees require training and new skills
- ★ Poor levels of physical asset utilisation;
- ★ Limited reach to the beneficiaries--most active beneficiaries (1000~1500 per year) located within a 50 km radius of an NSIC office; and
- ★ High cost of overheads, mainly in the area of employee cost (salaries & wages)

Opportunities

- ★ The small-scale sector in India is expected to witness high rates of growth in the future. Correspondingly, the requirements of the sector will also grow manifold, which can be translated into a potential growth opportunity for an organisation such as NSIC.
- ★ With globalisation, the SSI sector faces serious threats primarily in the area of quality and cost competitiveness. This scenario calls for provision of services such as technological support, credit and marketing support.

Threats

- ★ Competition from commercial banks and other financial institutions in the area of financing, and few State-level organisations in the area of marketing;
- ★ Persisting level of sickness in the SSI sector poses a serious threat to the existence of NSIC, since that renders its range of commercial operations non-viable.

DISINVESTMENT CONSIDERATIONS

Since NSIC is in a business that is 'non-strategic' in nature, policy guidelines do not restrict its disinvestment. However, to analyse the rationale for NSIC's disinvestment, its distinct activities require to be evaluated. The business activities of NSIC have been broadly identified, as shown below:

Financing Activity

- ★ Long-term Financing, and
- ★ Short-term Financing.

Marketing

- ★ Promotional, and
- ★ Commercial.

Technical Services

- ★ Training & Testing

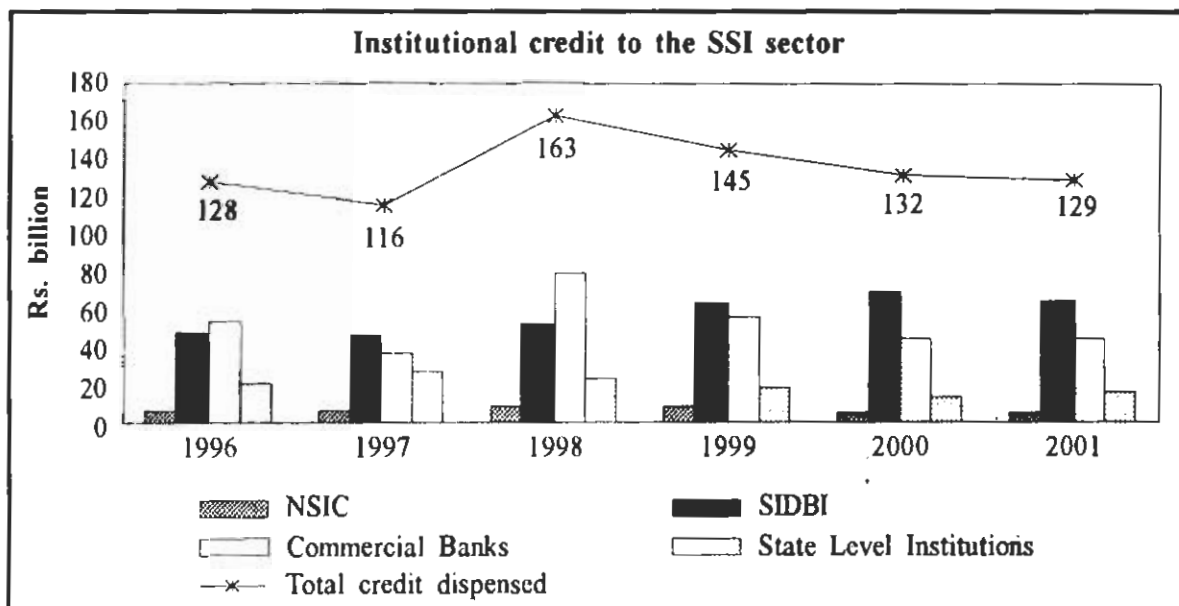
It is felt that the risks associated with the revenue streams of the above business activities are distinct from one another. Consequently, the key success factors of each area of activity too are distinct. Sustaining each of the above business activity calls for separate skill sets, both human and operational.

Financing Activity

Highly Competitive

A multitude of national and State-level financing institutions are currently undertaking the role of credit dispensation to the SSI sector. Moreover, there exist prime lending agencies such as SIDBI and commercial banks that carry specific RBI mandates to meet a minimum priority sector lending target. Hence, there is a plethora of institutions that provide adequate quantum of credit to the SSI sector in the national economy. The presence of prime lending institutions for the SSI sector ensures availability of specialised skills in credit appraisal systems. In the current context, NSIC's role in this area is thus not critical especially during the last two decades. NSIC has been a marginal player in terms of the total credit dispensed to the SSI sector. The share of NSIC has remained almost insignificant over the past five years as is evident from the table below. In fact, post-FY99, NSIC's contribution has witnessed a significant decline both in percentage share and absolute terms. SIDBI and commercial banks account for bulk of the credit extended to the SSI sector.

Table 21 - Credit Flow to the SSI Sector



Source: SIDBI Report 2001 / ICRA Analysis

Analysis of financing business of NSIC

The financial services business of NSIC consists of hire purchase, leasing and loans and advances. The amount of assets hired and leased and the amounts outstanding under the various businesses are shown below:

Table 22 – Amounts outstanding under Hire Purchase & Leasing schemes
(in Rs. Mn)

	March 2001	March 2002
Gross stock on hire	481.1	494.5
Net stock on hire (Principal outstanding)	357.3	376.8
Leased assets (Net block)	85.8	46.8
Equipment leasing scheme		13.5
Less: Unaccrued interest (Principal outstanding)		3.6
Equipment leasing scheme (Net)		9.9

Source: Company Annual Reports - ICRA

It can be observed that an amount of Rs. 376.8 million is the principal outstanding on hire purchase accounts and Rs. 46.8 million is the net block of leased assets.

The extent of receivables and provisioning thereon is shown in the table below. The amount of receivables on account of the financing business is very high. It can be observed that the provisioning against receivables is to the extent of 45%. These receivables include the overdue instalments and the unaccrued principal amount of defaulted accounts.

Table 23 – Amount outstanding and provisions

(in Rs. Mn)

	2000-01		2001-02	
	Amount outstanding	Provisions	Amount outstanding	Provisions
Sundry Debtors – Hire Purchase	864.7	64.2	869.6	352.5
Sundry Debtors – Leasing	149.0	16.1	149.9	25.4
Loans and advances	1843.9	480.5	1534.3	756.4
Bills discounted	483.6	56.2	439.5	183.7
Advances recoverable	22.9	3.8	18.2	3.7
Provision for interest receivable		27.4		27.4
Total	3364.1	648.4	3011.5	1349.3

Source: Company Annual Reports - ICRA analysis

The total provision including provision for marketing and other activities, amounted to Rs. 1376.3 million.

In addition to the above, an amount of Rs. 604.0 million relate to receivables under hire purchase and leasing schemes, outstanding for over 6 months that are considered good by NSIC. Further defaults in this category could result in increased losses. It could be observed that substantial portions of the loans and advances are doubtful of recovery and have been provided for.

It could be observed that the provisioning norms followed by NSIC are rather liberal as compared to the regulatory norms for similar businesses.

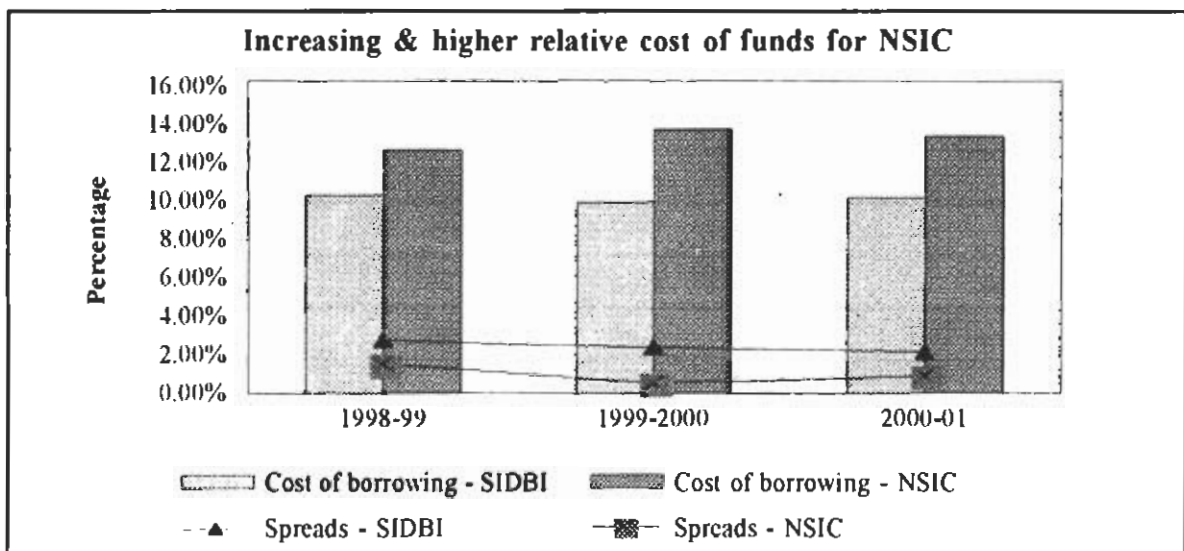
Evaluation on Key Success Factors

The Key Success Factors for sustaining competitive advantage in the area of financing are discussed below:

Access to Low-cost Funds

Since interest spreads eventually determine the profitability of any financing business, access to low-cost funds become critical. The table below gives an idea of the historical cost of borrowings and consequent interest spreads enjoyed by NSIC and SIDBI. Since SIDBI accounts for around 50% of the total credit dispensed to the SSI sector, it serves as a fair representative of other prime lending agencies, and its performance can, therefore, be taken as a benchmark for operational efficiency in the financing sector.

Table 24 - Increasing & Higher Relative Cost of Funds for NSIC



Source: Company Information, SIDBI Report 2001 / ICRA Analysis

Unlike institutions such as SIDBI, NSIC does not have recourse to low-cost funding sources such as public deposits, etc. The first time that NSIC invited public deposits was in the FY92-93 and these lines of funding continued until FY98. The average cost of funds for NSIC has been at around 12%, and the major sources of borrowings for the Corporation have been foreign lines of credit, SIDBI and commercial banks.

Although the Corporation currently avails of certain International Lines of Credit at competitive rates, continuation of these Lines in future is uncertain, since according to Company sources, the Government of India has expressed its inability to stand guarantee for them any more in the future.

In addition to high cost of funds, the Corporation's inability to absorb depreciation charges on account of Leasing & Hire Purchase activities make these businesses unattractive.

Credit Appraisal Skills & Knowledge of Industry

Over the years, the Corporation has suffered from the absence of an industry vertical focus approach. As a result, it has been unable to develop expertise in analysing industry specific risks associated with project lending. Inadequate risk appraisal abilities have contributed to the accumulation of a huge quantum of NPAs for the Corporation, thus adversely impacting the return on capital deployed. The table below provides a comparison of NPA levels of major lending institutions in the priority sector:

Table 25 – Comparison of NPA levels

(Net NPAs as % of advances)

Institution	FY1997-98	FY1998-99	FY1999-00	FY2000-01
SBI	6.07	7.18	6.41	6.03
Canara Bank	7.52	7.09	5.28	4.84
Bank of Baroda	6.60	7.70	6.95	6.77
Punjab National Bank	9.60	8.96	8.52	6.69
SIDBI	—	—	1.33	1.23

Source: Report on Trend and Progress of Banking in India 2000-01, SIDBI Annual Reports ICRA

In comparison to other lending institutions, the NPA levels of NSIC have been significantly higher. Since FY01 the corporation has been making provisions for

NPAs as per the NBFC norms, as a result of which the magnitude of NPAs have risen substantially to 60 –70% of total advances made by the corporation.

The fact that NSIC has continued to attract SSI beneficiaries, in spite of its uncompetitive lending rates, is perhaps more a reflection on its clients a number of whom appear to be using NSIC funds for unviable projects. It is understood that the majority of the beneficiaries approach NSIC after being turned down by other institutions, on grounds of either the project being non-viable or entailing high risk.

Given the above situation, it is evident that NSIC does not have the necessary skills to be a prudent player in the financial services business.

The auditors in their report (FY 2001 and FY 2002) too have opined that there are “deficiencies in appraisal, sanction, non-registration of charges with authorities and follow-up for marketing and hire-purchase activities”.

The Expenditure Reforms Committee Report has also questioned the relevance of NSIC continuing with its schemes of raw material supply and hire purchase/leasing of equipment, in the context of freer trade with dismantling of controls and the emergence of leasing companies in the private sector.

Marketing Activity

Market development and promotional activities assume critical importance for the SSI sector, given their small size and the resulting insignificant marketing clout. The small average size of an SSI unit does not justify large investments in market development; hence, individual units in the sector find it difficult to either develop or tap markets.

In addition to the above, the changes in the international trade climate have further reinforced the need for a National level agency to undertake marketing activities on behalf of the SSI units, in order to enhance their overall competitiveness.

The Expenditure Reforms Commission Report (Fourth Report) 2001, has also highlighted the need and importance of marketing activity in the SSI sector. According to the Report, the marketing activity should receive top priority in the reorientation of the functions of the small establishments in the new competitive environment. In this context, it will be necessary to:

- ★ Promote the formation of consortia of small industries to market their products under a brand name;
- ★ Establish linkages between small and large industries on a mutually beneficial basis to utilise the superior marketing capabilities of large industries to market the products of small industries; and
- ★ Promote ancillary industries, in a big way, as vendors to large industries.

The area of marketing includes the entire gamut of activities as enumerated below:

- ★ Research & Development;
- ★ Product Design & Innovation;
- ★ Product & Process Improvements and Development of Improved Packaging Techniques;
- ★ Common Facility Services;
- ★ Manpower Development/Training; and
- ★ Provision of Technical Know-how and Access to Information.

Technical Services

Role/activity Overlaps

There are several organisations involved in providing assistance to the SSI sector in the area of technical services. SIDO is the primary agency undertaking technical assistance and overseeing functioning of many similar institutions like Small Industries Service Institutes (SISIs), Testing Centres, Tool Rooms, Product- Process Development Centres (PPDCs) etc. Therefore, there exists a clear-cut overlap of roles between SIDO, state-level organisations and NSIC in this area. An analysis of the physical locations of the technical institutes run by agencies such as NSIC, SIDO, SIDBI and other State level bodies clearly brings out the overlap of their geographical presence. It is also clear that SIDO apart from being present in all locations where NSIC has a presence, has locational reach, which is more extensive.

NTSC's Operations not Self-sustaining

An evaluation of the financial performance of NSIC Technical Service Centres reveals that these Centres have not been self-sustaining and have been a drag on

the NSIC's cash flows. These Centres have never been able to generate enough income to cover their expenses. In fact, in spite of Government support in the form of grants, these Centres have remained in the red.

DISINVESTMENT CONCERNS

The analysis above suggests that NSIC should continue in the business of marketing with enhanced focus and should discontinue providing assistance in the area of financing and technical services.

Financing and Technical Services:

Since NSIC is a marginal player in the financing business and does not possess the requisite traits for achieving success, continuation of this activity would be a drain on the Government's resources, especially in view of the fact that its portfolio is highly contaminated by NPAs. These services can be provided much better by other existing organisations, as discussed earlier.

The financial unviability of the Technical Service Centres operated by NSIC has also been discussed earlier. Moreover, there exist a high level of duplication of activities among different organisations, many of which are better equipped and are already providing such services. These services have also not appreciably impacted on the growth of the SSI sector in India. The fact that the current operations of Technical Service Centres are both operationally and financially non-viable, rules out immediate strategic interest from potential buyers. In addition, in terms of quality, the assets owned by these Centres are technologically outdated and substandard. Hence, any restructuring efforts aimed at attaining financial viability would require huge investments. This fact, combined with the absence of any well-defined revenue streams from this business, points to a likely lack of buyer interest.

Marketing Services:

Economic rationale for continuation of the marketing activities exists in the light of the new trade regime, and the growing magnitude of sickness in the SSI sector. The nature of marketing services required by the SSI sector should essentially be promotional in nature. Moreover, the revenue streams associated with these activities do not appear to be remunerative, thus making marketing activities unattractive

to the private sector. Private sector participation is more likely to be limited to certain industry verticals such as:

- ★ Leather
- ★ Garments and
- ★ Auto ancillaries

Since these industry verticals in the SSI sector have established their domestic and international competitiveness, they are likely to invite private sector interest. Hence there is a need for a Government agency like NSIC to promote other sectors as it would not be remunerative for the private sector to undertake promotional services for the entire SSI sector.

Therefore, there is a need for the Government to continue providing marketing support to the SSI sector through efficiently run organisations/bodies. There are several Government bodies in addition to NSIC that provide some sort of marketing support to the small sector. Most of these organisations/bodies are at the state level and their focus and reach are limited to their respective states.

The range of marketing activities undertaken by various agencies is highlighted in the table below:

Table 26 - Institutional Presence in Marketing services

<i>Organisations</i>	<i>Marketing Promotion</i>		<i>Marketing Commercial</i>	
	<i>Exhb/Buyer-Seller Meets</i>	<i>Export Development</i>	<i>Internal Marketing</i>	<i>Exports</i>
SIDO	✓	✓		
SIDBI				✓
State-level Institutions			✓	
NSIC	✓	✓	✓	✓

Source: ICRA analysis

As is evident, NSIC is the sole agency providing support in the whole gamut of marketing activities. Though there exists some amount of role duplication among different institutions, barring NSIC there is no single nodal agency that undertakes the entire range of marketing functions for the SSI sector. NSIC is the pioneer agency in the area of providing marketing support to the SSI sector and, in view of its long experience, is suited for such a role.

By virtue of having been the sole agency for co-ordinating UN supported buying programs, the corporation has gained experience in international marketing, and knowledge of procedural matters relating to international trade and policy.

In the present scenario, NSIC appears to be an agency that is much more suitable than others to perform the role of market development for the SSI sector. In such a scenario, there is a case for NSIC to continue to provide these services, especially in the changing context of global competitiveness.

It is, therefore, desirable to pursue closure of the financing activity and all NSIC Technical Service Centres, while strengthening its marketing activities with enhanced focus on industry verticals. Efforts will have to be made to identify and develop SSI clusters based on locational resource advantages. Since NSIC does not appear to have requisite knowledge, information/database and skills to be of substantial service to the SSIs in this area, special efforts have to be made to develop such capabilities and expertise. NSIC, while concentrating exclusively on marketing services, should have the needed flexibility to avail the services of the best professionals in this specialised field.

With a view to enhancing the competitiveness through a judicious blend of promotional and commercial activities, it is suggested that the thrust could be, inter alia, on the following lines:

- ★ Identification and adoption of SSI industry verticals for fostering growth and sustenance; and
- ★ Clusterisation of SSI units to reap benefits of shared resources and resultant collective efficiencies.

The specific initiatives under the above-mentioned approaches could be :

- ★ Upgrade the identified sectors in terms of Product Design, Quality Control, Packaging Product Development and Linking to the global markets through sustainable international partnerships.
- ★ Consortium Building and Brand Building for institutional and product group market development; and for small and tiny SSIs in clusters or otherwise.
- ★ Facilitate integration of SSIs with the Information Society to take advantage of e-commerce opportunities.
- ★ Support in patent protection

- ★ Networking with national and international industry associations and multilateral agencies linked with the development of small-scale enterprises.
- ★ Technology oriented intervention by way of Technology Information dissemination, search and transfer to the SSI Sector, and supplementing private sector initiatives in R&D/product design/prototyping.

Marketing and finance activities of NSIC are carried out of the common premises and no clear allocation of human resources for the two activities exist. Hence, a closure of financing activities envisages sale or transfer of the existing loan portfolio to other institutions such as SIDBI, appropriately discounted by the potential buyer to incorporate NPAs.

The book value of such loans and advances stands at Rs 1041.2 million as of 31st March 2002. According to a preliminary estimate, of this amount, further Rs 200 million is to be provided as doubtful in the accounts of FY 03.

The closure of NSIC Technical Service Centres would entail sale of the existing fixed assets of these Centres, which include plant & machinery, land & buildings, etc as well as rationalising the manpower associated with these centres, by offering them suitable compensation package.

The estimated value of such sale, after adjusting for VRS expenditure, according to ICRA, will be as follows:

Book value of assets	...	Rs 64.5 million (Net realizable value has to be determined through asset valuation exercise, since the market value would to be much higher)
Less, VRS	...	Rs 228.8 million
Total outflow	...	Rs 164.3 million

Since market value of NTSC's assets would be substantially higher than the book value, an asset valuation and subsequent sale of NTSC's assets would perhaps result in net cash inflow to the Government.

RECOMMENDATIONS

Under the circumstances explained, the Commission is of the view that NSIC should not be disinvested now. The Commission recommends the following course of action:

- Step 1 - NSIC should immediately discontinue its Financing activities, through sale or transfer of its loan portfolio to other institutions, such as SIDBI.**
- Step 2 - Hive off, in a phased manner, the Technical Service Centres of NSIC to appropriate private agencies or state institutions, failing which sale of fixed assets etc. is to be effected while offering an appropriate compensation package to the employees (like VRS). This process should be completed within a time-schedule, not exceeding 3 years.**
- Step 3 - NSIC, with suitable organisational and financial restructuring, should continue the marketing activities with enhanced focus. Since NSIC does not appear to have requisite expertise information /database and skills in the area of marketing, it would have to develop requisite expertise and capabilities, either by inducting competent professionals or by availing the services of the best professionals in the field, so as to be able to extend more effective service to the SSI sector in India in the rapidly changing global context.**

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2.3 RAJASTHAN DRUGS & PHARMACEUTICALS LTD. (RDPL)

INTRODUCTION

RDPL was established in the year 1978 as a Joint Venture with Rajasthan Industrial Development and Investment Corporation Ltd. (RIICO). It is a subsidiary of Indian Drugs & Pharmaceuticals Ltd. (IDPL) under the administrative control of Department of Chemicals & Petrochemicals, Ministry of Chemicals and Fertilisers. Though designated as a 'mini ratna' company, RDPL has not been in a position to fully capitalise on its status as a 'mini ratna' owing to various reasons. The basic objective of setting up RDPL was to ensure availability of life saving and other essential drugs to Government hospitals in the state of Rajasthan. Sales of the company are mainly targeted at Government Institutions in Rajasthan and other states. The manufacturing unit of the company is located at Jaipur, Rajasthan. RDPL started its commercial operations in 1981, and with improved production and manufacturing capabilities in nineties, it became a profitable company. For the FY ended March 31 2002, RDPL recorded sales of Rs.166 mn and Profit after Tax of Rs.9 mn. It had an employee strength of 154 on 31.3.2001, excluding casual employees.

The Authorised and Paid-up share capital of RDPL as on March 31st 2002, were Rs.20 mn and Rs.10.66 mn respectively. IDPL holds 51% of paid up capital, the balance being held by RIICO.

INDUSTRY ANALYSIS

The contribution of pharmaceutical industry towards growth, development and building a strong human capital of the country is evident from the improvement in life expectancy, a leading health and economic indicator, from 41.32 years in the sixties to 62.9 years in 1998-99. Moreover, with the increased availability of medicines and healthcare facilities, the infant mortality rate has decreased from 146 per thousand births in 1960-61 to 69 per thousand births in 1998-99.

Bulk drugs

Bulk drugs are medicinally effective chemicals. They are derived from four types of drug intermediates (raw materials):

- ★ Plant derivatives (herbal products);
- ★ Animal derivatives (e.g. insulin extracted from bovine pancreas);
- ★ Synthetic chemicals; and
- ★ Biogenetic (human) derivatives (e.g. human insulin).

The profit margins in the bulk business are typically lower than in the formulation business. Bulk drug discovery requires intensive and expensive research. The inventors, to ensure commercial gains on their R&D investment, patent new drugs. Bulk drugs can be broadly categorized as:

- ★ Under patent;
- ★ Off patent or generic.

Formulations

Formulations are the finished dosage forms of one or a combination of bulk drugs. To prevent misuse/incorrect administration, most formulations are disbursed by pharmacies only under medical prescription and these are called ethical products. However, some formulations such as pain balms, health tonics etc do not require prescription by doctors. These are called Over-The-Counter (OTC) products.

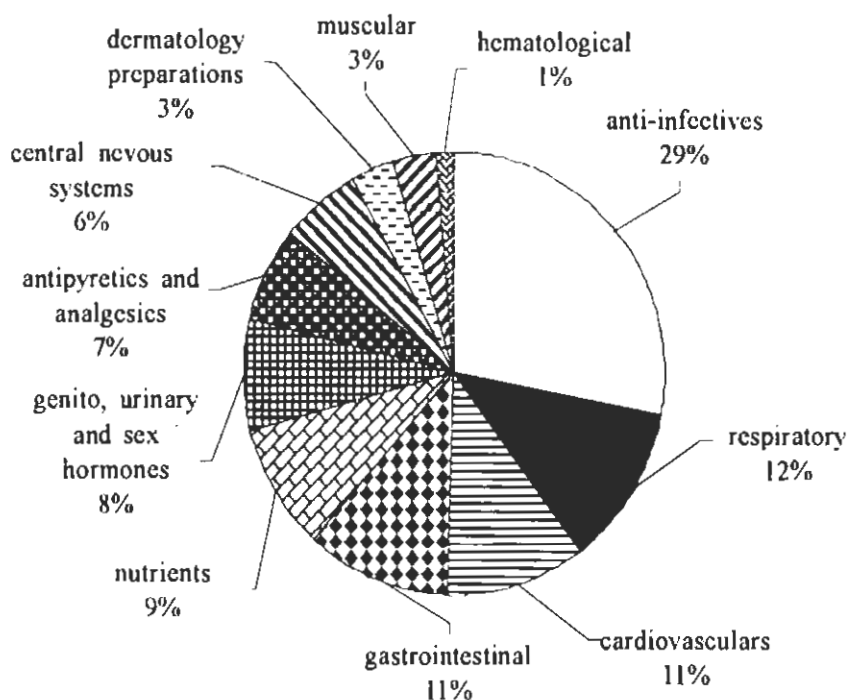
Segments

Bulk drugs and formulations are classified into different segments as per their therapeutic effectiveness against a particular disease or ailment. They can be broadly classified into four segments:

- ★ Anti-infectives segment (antibiotics, anti-protozoals, anti-helminthics and anti-malarial); Antipyretics and analgesics segment;
- ★ Antipyretics and analgesics segment;
- ★ Life-style related drug segment (gastrointestinal, cardiovascular, diabetic, respiratory, central nervous system and such other related problems) ; and
- ★ Vitamins segment.

Market share of various therapeutic segments (in terms of value) in India is illustrated below:

Segment wise market share in India



Source: Credit Analysis & Research Ltd. (CARE)

In developed nations, lifestyle related drugs command a higher market share as opposed to anti-infective drugs in developing nations. In India, the anti-infective is the largest segment and accounts for almost 29% of the total therapeutic market. However, growth rates for new drugs in the anti-infective segment and other segments such as cardiovascular and central nervous system are high, while growth rates for older antibiotic drugs such as penicillin have declined. This is a reflection of India's changing demographics and several lifestyle alterations that have been taking place during the last decade. This has caused pharmaceutical companies to restructure their product portfolio.

Industry Structure and Financials

The Indian Pharmaceutical Industry is highly fragmented with more than 23,000 licensed pharmaceutical manufacturers in the country and most of these are private players. However, almost 90% of the market share is with top 100 players. Recent trend shows some consolidation amongst the organised sector players. But, there is little consolidation at the lower end of the market. The large number of players has made the industry highly competitive. The players in the Indian Pharmaceutical Industry belong to one of the four major categories:

- ★ Large and medium scale domestic pharma companies;
- ★ Multinational pharmaceutical companies(MNCs);
- ★ Small Scale Industrial units; and
- ★ Manufacturers of alternative medicines like Ayurvedic, Homeopathic, Siddha and Unani systems.

The Indian pharmaceutical industry caters to about 70% of the domestic bulk drug requirements and manufactures almost the entire range of formulations. The net sales of Indian pharmaceutical industry (including MNCs) were approximately Rs.210 bn in FY2001. Formulations accounted for around 81 percent of the total sale and bulk drugs for the balance. Over the past five years, domestic sale has grown at about 12% per annum compared to 5-6 % growth rate in developed countries. The growth of Indian pharmaceutical industry has been predominantly volume driven rather than price driven, which is a reflection not only of the severe competition but also perhaps of the impact of Drug Price Control Order (DPCO) on prices in the domestic market. The table below gives details of top five players of Indian industry for the year ended March 31, 2001:

Table 1 - Details of Industry Leaders

Company	Op. Income (Rs. Mn.)	Market share (%)	Technology	EBIDTA margin (%)
Ranbaxy Laboratories Ltd.	14863.66	7.96	Applied research – High Basic Research – High	13.08
GlaxoSmithkline Pharma	13430.08	7.19	Applied research – High Basic Research – High	10.33
Cipla Ltd	9871.29	5.29	Applied research – High Basic research - Low	22.01
Aurobindo Pharma Ltd @	9472.52	5.07	Applied research – High Basic research – Low	11.15
Dr. Reddy's Laboratories Ltd	9263.80	4.96	Applied research – High Basic Research – High	27.19

@ Primarily a Bulk Drugs company. It derived about 78% of its revenues from bulk drugs and intermediates
Source: CARE

Indian pharmaceutical industry is a net foreign exchange earner for the country. Exports now form a significant part of the sales of leading Indian companies. India's pharma exports were Rs.87 bn in FY 2001. India exports formulations as

well as bulk drugs. Exports are mainly to developing countries in case of patented drugs and to the developed nations in case of generics. The imports in FY2001 were to the tune of Rs.17 bn. Many of Affiliates/Subsidiaries of MNC's in India import bulk drugs from the parent company. Also, local players who export formulations avail of duty free imports.

Indian companies have benefited from the process patent regime, which allowed them to reverse-engineer drugs at a fraction of the original cost. The market share of Indian Companies has gone up steadily from 20% in FY1971 to nearly 64 percent in FY2001.

The investment in research and development for Indian companies as a percentage of sales is approximately 1.5-2% compared to 15-20% for MNCs. The Indian companies have a significant cost advantage in production as well as product development costs as compared to their counterparts in developed countries. However, Indian companies lack the financial strength necessary for basic research. Of late, the trend has been to discover new molecules and license them out to global drug majors for further development.

Indian companies have started moving up the value chain and have been successful in making inroads into the US generic markets. More than 25 Indian companies have obtained USFDA approval and the industry is increasingly getting accreditation abroad. The key for success in generic markets in developed countries is the ability to tackle the regulatory environment, getting approvals for the generic versions of the patented drugs, marketing tie-ups, approvals for domestic manufacturing facilities from regulatory bodies like USFDA and a thorough understanding of the legal environment.

Regulatory Framework:

The pharmaceutical industry is one of the highly regulated industries in India. Regulatory measures have played an important role in determining the competitive scenario of the Indian pharma industry. These regulations and controls work at three different levels: patents, pricing and quality.

Indian Patent Act, 1970

Indian Patents Act, 1970 was introduced to encourage indigenous research in the industry. This Act regulates patents for products processed or manufactured in

India by providing 'product patents' for non-chemical items and 'process patents' for items like pharmaceuticals, agro-chemicals and food products.

'Product patents' recognise the product and thereby provide the inventor (and/or his successor) the exclusive right of utilising the benefits of the invention for a specified period. 'Process patents' on the other hand, recognise the process to manufacture a product and the patent holder (and/or his successor) has the exclusive right of utilising the benefits of the process during a specified period.

GATT/WTO

India is a signatory to General Agreement on Tariffs and Trade (GATT) and is now a member of World Trade Organisation (WTO). As per WTO terms, India is required to change its current intellectual property laws to recognise product patents. Further, the terms of the patents would require to be extended from present five years from the date of granting (or sealing of patent) or seven years from the date of application, whichever is shorter, to 20 years. India has time till the year 2004 to comply with these terms. Post 2004, WTO requirements would come into full force.

In the mean time, India has, with an amendment in 1999 to the Indian Patent Act, allowed acceptance of applications for product patents for drugs and medicines, except for chemical substances which are intermediaries in the preparation or manufacture of medicines or drugs. However, such applications will be processed only after the year 2004.

As a member of WTO, India has raised concerns regarding the impact of WTO terms on public health. The Doha Declaration on Trade Related Intellectual Property Rights (TRIPS) and Public Health has reaffirmed that public health considerations will supercede commercial interests; however, the mechanisms for remedying the problem of availability and accessibility of patented drugs have not yet been fully addressed.

The conduit to achieve this is supposedly through the Compulsory Licensing System. It means a developing country may ask a patent holder to supply the drug at a cheaper rate to its market and if the company does not heed to the request, the country can authorize a local player to manufacture the drug for the market.

Drugs Price Control Order (DPCO)

DPCO was first introduced in 1970 with the objective of keeping the prices of life-saving and essential drugs under control. The National Pharmaceutical Pricing Authority (NPPA) is the regulatory body responsible for issuing DPCO and its implementation. Initially, the list included 347 bulk drugs, which were governed by this order. The list was progressively pruned to 145 in 1987. Presently, under DPCO, 1995 there are 74 bulk drugs and their formulations under price control covering approximately 40% of the total market. The profitability of a company operating in Indian markets is significantly affected by the composition of its product portfolio. A significant percentage of products falling under DPCO can adversely affect the profitability of any drug company.

Drug and Cosmetics Act, 1940

The drug regulatory norms in India are derived from the Drug and Cosmetics Act, 1940, and the same are enforced through the office of the Drug Controller of India. This office is the highest authority for overseeing the conduct of clinical trials and for the maintenance of quality control norms in the drug production process.

National Pharmaceutical Policy, 2002

GoI had announced the new Pharmaceutical Policy in February 2002. The main issues emphasised in the NPP are reduction in number of drugs under DPCO, support to indigenous Research and Development (R&D) and establishment of a Central Drug Standard Control Organisation (CDSCO) to ensure high standards of quality, safety and efficacy of drugs and pharmaceuticals.

Outlook for Indian Pharmaceutical Industry

Indian pharmaceutical industry has made enormous progress during the last decade, has achieved self-sufficiency and is targeting to get a bigger share of international market. Domestic Pharmaceutical companies have managed to show a better performance based on process patent regime and low cost advantage. Post 2004, Indian pharmaceutical companies may not be able to reverse engineer patented products and this may significantly impact their performance. However, factors like relaxation on DPCO front, low-cost advantage, process re-engineering skills, manufacturing facilities compliant with international regulatory standards, availability

of a large pool of skilled professionals are strong positives for the industry. In the next few years, many drugs are likely to go off-patent. It is estimated by CARE that between 2002-05, \$42,000 mn of branded products will lose their patent protection. Also, contract manufacturing and contract research are emerging fields and Indian pharmaceutical industry is well placed to capitalise on this. Integration with international markets is expected to impose major changes in the functioning of domestic players. Domestic players will have to increase their expenditure on the R & D front, establish marketing/technical tie ups with global majors and develop detailed understanding of regulatory environment of the developed countries to ensure success in international markets. However, in the absence of strong research base, manufacturing facilities compliant with International standards and strong financials, small players may increasingly find it difficult to survive in the future.

OPERATIONS OF RDPL

Manufacturing Facilities

RDPL's manufacturing facilities are located at a single location at Vishwakarma Industrial area in Jaipur, on a 9-acre plot of land taken on 99-year lease from RIICO. RDPL's operations are organised in various sections producing tablets, capsules, liquid, powder and vials/ampoules. The table below gives the capacity build up in various sections during the last five years:

Table 2 -Manufacturing Capacity

Sr. No.	Item	Unit	2001-02	2000-01	1999-00	1998-99	1997-98
1.	Tablets	Million Nos.	300	300	300	300	300
2.	Capsules	Million Nos.	45	45	30	30	24
3.	Liquid Orals	K.L.*	300	120	120	120	90
4.	Powder	M.T.®	50	50	50	50	50
5.	Vials/ Ampoules	Lakh/Nos.	15	15	15	15	15

Installed capacities are subject to variation depending upon product-mix.

The installed capacities are on two-shift basis.

**K.L.- Kilo Litres, ®M.T.- Metric Tonnes*

Source: CARE

RDPL's production facilities comprise semi-automatic as well as automatic machines. Human interference in the manufacturing processes is limited to the extent of loading, collection and packing of medicines. The filling of liquid orals is also automated.

It may be seen from above that capacity in capsule section increased from 24 million in 1997-98 to 30 million in 1998-99 and further to 45 million in 2000-01. This was mainly achieved through addition of new semi-automatic capsule filling machine. Capacity in liquid section was also increased from 90 K.L. in 1997-98 to 120 K.L. in 1998-99 and further to 300 K.L. in 2001-02.

Production is normally planned on the basis of feedback from Government institutions. Orders from Government institutions are mainly received during the last two quarters of the year. In order to reduce the pressure on manufacturing facilities during the latter part of the year, the company manufactures selected products in advance based on its past experience. Presently, the company is operating two shifts per day and therefore, there exists spare production capacity. In FY2002, RDPL manufactured around 60 to 65 formulations. It manufactures drugs for companies such as Hindustan Latex Ltd. (HLL) and Elcon Drugs and Pharmaceuticals Ltd., a small-scale unit which operates in Jaipur. RDPL makes oral rehydration salt 'Jal Jeevan' for HLL. Production of 'Jal Jeevan' made by RDPL is around 1% of RDPL's manufacturing capacity.

RDPL manufactures products mainly in the anti-infective segment of allopathic medicines. Various categories covered by RDPL under the anti-infective segment are anti-TB, antibiotics and antibacterial. It also manufactures drugs in anti-pyretic segment. In the future, RDPL plans to enter into lifestyle segment which is growing at a faster rate as compared to other segments.

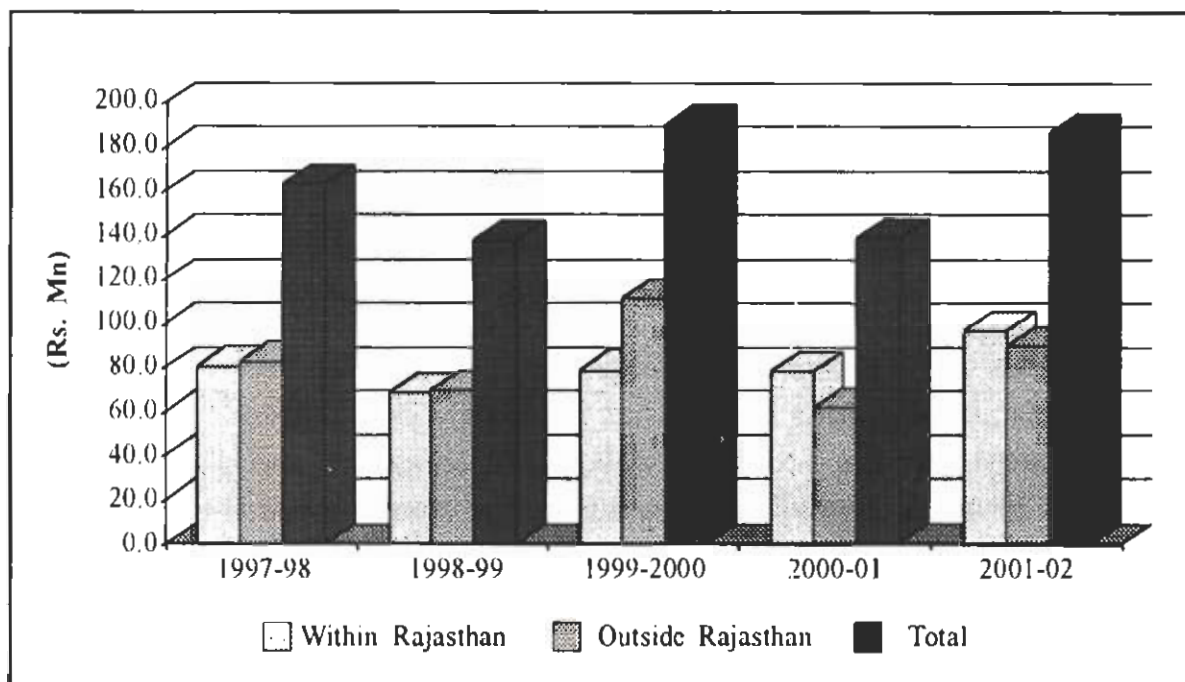
Raw Materials

The principal RMs used by RDPL include bulk drugs such as Ampicillin, Refampicin, Sulphamethoxazole, Trimethoprim, Ciprofloxacin, Metronidazole, Metaclopramide, Ibuprofen, Paracetamol, Isoniazid, Ethambutol, Tinidazole etc. Availability of RMs is not an issue as almost all RMs are available indigenously. RMs are purchased directly from the market or through dealers.

Sales

RDPL focuses mainly on institutional sales. It sells its products to Government institutions within Rajasthan as well as outside Rajasthan. The table below gives composition of RDPL's sales during last five years:

Table 3 - Composition of RDPL's sale



Source: CARE

Sales to Government institutions in Rajasthan contribute about 50% of RDPL's total sales and the balance is contributed by sales to states such as Andhra Pradesh, Karnataka, Pondicherry, Tamil Nadu, Madhya Pradesh, Uttar Pradesh, Bihar, Jharkhand, Punjab, Haryana and Delhi. Occasionally RDPL also supplies drugs and medicines to GoI.

While orders from GoI are not regular, orders from the state governments have been fairly steady. On March 10, 1988, GoRJ introduced a purchase policy in favour of PSUs with a special preference to RDPL. As per this policy, certain drugs and medicines are to be purchased only from PSUs and if RDPL offers lower rate or rates comparable to other PSUs, preference is given to RDPL.

The company has yet to achieve any significant sales in the open market or export market and thus it is totally dependent on Government institutional sales.

Marketing & Distribution Network

While supplies to GoRJ are made directly by the company, supplies to Government institutions outside Rajasthan are made through distributors. RDPL is having its own sales depot at Delhi and carrying and forwarding agents at Bhopal, Hyderabad and Chennai. RDPL also employs a small marketing team of seven officers to cover Government institutions in Rajasthan and other states.

Quality Control

RDPL has a well-equipped QC department run by qualified staff. The quality control begins at raw material stage. This includes testing of incoming bulk drugs, excipients and packing material. The produced drugs are tested at three stages namely, during process, final product stage and at packing stage. Every product has to pass a stability test before it is cleared for commercial sales.

RDPL follows GMP requirements recommended by the Drug Control Authorities. However, its manufacturing facilities are not WHO-GMP certified. The company is taking steps towards becoming WHO-GMP compliant and plans to invest around Rs.20 mn in upgrading its facilities. The company has already initiated steps in this regard. This would also make the company eligible to bid for supplying medicine under programmes funded by multilateral agencies such as World Bank and Asian Development Bank.

FINANCIAL POSITION OF RDPL

Operating profits

A summary of operating profitability of RDPL during period FY1997 to FY2002 is given in the table below:

Table 4 – Operating profitability-Past

(Rs.Mn.)

Year ended March 31	2002	2001	2000	1999	1998	1997	CARG (%)
Total Income (<i>incl. ICDS kit sale</i>)	170.0	126.9	180.2	139.2	164.2	125.6	6.2
Total income (<i>excl. ICDS kit sale</i>)	n/a	126.9	132.6	139.2	134.9	107.3	—
Total Expenses	153.6	118.8	166.6	130.6	151.5	119.7	5.1
PBDIT	16.4	8.1	13.6	8.6	12.7	5.8	23.0

...Contd.

Year ended March 31	2002	2001	2000	1999	1998	1997	CARG (%)
(% of Total Income)	9.6	6.4	7.6	6.2	7.7	4.6	
PAT	8.9	3.4	6.7	4.0	6.7	1.7	39.5
(% of Total Income)	5.2	2.7	3.7	2.9	4.1	1.3	
Dividend (incl. tax)	1.6	1.2	2.0	1.2	1.8	1.2	6.4
Net Cash Accruals	8.4	2.9	5.4	3.8	5.5	1.1	51.1
Retained profit	7.2	2.2	4.5	3.1	4.9	0.5	72.2

CARG -Growth p.a. between FY1997 to FY2002.

Source: CARE

The operations of RDPL have exhibited growth over the period on almost all parameters. During the period under review, both income and expenditure grew at around 6%. The fluctuation in total income was mainly on account of irregular orders (ICDS kit) received from GoI. This resulted in fluctuation in profitability of the company. The drastic reduction in total expenses in FY 2001 was due to absence of purchased finished goods and packing material for ICDS kit. RDPL is a dividend paying company with growth in dividend payout at around 6%.

The Profit & Loss Accounts as well as the Balance Sheets are summarised below:

Table 5 – Profit & Loss Accounts

(Rs.Mn.)

For the Year ended	31/03/02	31/03/01	31/03/00	31/03/99	31/03/98	31/03/97
Net Sales & transfers	166.38	126.30	179.87	138.06	162.81	127.68
Increase/(decrease) in stock	2.66	-0.04	-0.10	0.74	0.97	-2.60
Other Operational income	0.97	0.61	0.44	0.41	0.45	0.47
Total Income	170.01	126.87	180.21	139.20	164.24	125.56
a. RM. stores & other cons (net)	109.09	83.18	131.75	101.43	126.69	98.22
b. Salaries & Wages	28.90	23.31	21.40	19.82	15.11	13.60
c. Power & Fuel	3.29	2.86	2.69	1.70	1.92	1.66
d. Factory OH	2.48	2.27	1.74	1.53	1.70	1.54
e. Admn. Selling & Dist. OH	9.85	7.14	9.02	6.07	6.12	4.71
Total Cost of Production	153.62	118.75	166.60	130.56	151.54	119.73
Gross Profit PBILDT	16.39	8.12	13.61	8.64	12.70	5.82
less : Depreciation	1.11	0.82	0.91	0.71	0.60	0.59

...Contd.

For the Year ended	31/03/02	31/03/01	31/03/00	31/03/99	31/03/98	31/03/97
PBILT	15.28	7.30	12.70	7.93	12.10	5.23
less : Interest	0.69	1.66	1.24	1.11	1.20	0.95
Profit Before Tax	14.58	5.64	11.46	6.83	10.90	4.28
Tax	5.70	2.26	4.79	2.82	4.21	2.60
Profit After Tax	8.88	3.38	6.67	4.01	6.69	1.68
Prior year adjustment	0.00	-0.08	-0.20	0.25	-0.01	-0.03
Adjusted PAT	8.88	3.30	6.47	4.25	6.69	1.65
Gross Cash Accruals	10.00	4.12	7.38	4.96	7.28	2.24
Dividend (Amount) (incl. div. tax)	1.60	1.17	1.95	1.17	1.76	1.17
Retained Profit	7.21	2.19	4.49	3.12	4.93	0.48
Net Cash Accruals	8.40	2.95	5.43	3.79	5.52	1.07

Source: CARE

Table 6 – Balance Sheet

(Rs. Mn)

Assets	31/03/02	31/03/01	31/03/00	31/03/99	31/03/98	31/03/97
Gross Block	22.55	18.77	18.47	16.31	13.52	13.56
less : Depreciation	11.16	10.05	9.36	8.46	7.90	7.44
Net Block	11.39	8.72	9.11	7.85	5.63	6.12
add : Capital WIP	0.00	0.00	0.00	1.73	1.14	0.00
Total Fixed Assets	11.39	8.72	9.11	9.58	6.77	6.12
Inventories	23.76	12.32	13.09	12.46	9.87	10.08
Sundry Debtors	78.07	53.98	86.37	52.47	49.89	48.63
Loans & advances	7.57	3.97	3.76	3.59	7.58	3.46
Cash & Bank balances	2.35	1.55	1.34	0.78	0.79	1.28
Total Current Assets	111.75	71.83	104.56	69.31	68.13	63.45
Sundry Creditors	32.49	23.75	42.63	26.57	21.12	23.02
Other current liab./provisions	24.91	16.27	16.45	11.31	15.62	9.56
Total Current Liabilities	57.40	40.02	59.08	37.88	36.75	32.58
Net Working Capital	54.36	31.81	45.48	31.43	31.38	30.87
Total Assets	65.75	40.53	54.59	41.01	38.15	36.99

...Contd.

Liabilities	31/03/02	31/03/01	31/03/00	31/03/99	31/03/98	31/03/97
Equity Share Capital	10.66	10.66	10.66	10.66	10.66	10.66
Reserves & Surplus	33.32	26.11	23.92	19.44	16.31	11.39
Cash Credit	20.76	1.80	18.06	8.96	9.23	12.99
Unsecured loans	1.00	1.95	1.95	1.95	1.95	1.95
Total Term Liabilities	21.76	3.75	20.01	10.91	11.18	14.94
Total Liabilities	65.75	40.53	54.59	41.01	38.15	36.99

Source: CARE

Cash Flow

Given below is the cash flow position of RDPL during period FY1998 to FY2002:

Table 7 – Past Cash flow

(Rs mn)

For the year ended March 31	2002	2001	2000	1999	1998
Cash from op. activities (a)	-11.13	19.73	-4.91	6.05	7.48
Purchase of fixed assets (b)	-3.79	-0.29	-0.43	-3.38	-1.10
Financing activities					
Fresh equity issue	0.00	0.00	0.00	0.00	0.00
Increase in loans	18.01	-16.26	9.10	-0.26	-3.76
Interest charges	-0.69	-1.66	-1.24	-1.11	-1.20
Dividend paid	-1.60	-1.17	-1.95	-1.17	-1.76
Net cash from fin. activities (c) (=)	15.72	-19.22	5.89	-2.69	-6.86
Surplus/Deficit for the year (a+b+c)	0.80	0.22	0.55	-0.02	-0.48
Closing cash balance	2.34	1.54	1.32	0.77	0.79

Source: CARE

RDPL had negative cash flow from operations during a few years due to delay in payment by Government institutions. This was funded mainly through short term borrowing from banks. The major capital expenditure by RDPL in FY1999 and FY2002 was due to capacity expansion of its capsule and liquid oral sections.

Financial Ratios - Past

Financial ratios for RDPL are given in the table below:

Table 8 - Financial Ratios - Past

For the year ended/As at 31 st March	2002	2001	2000	1999	1998
Debt Equity Ratio (times)	0.02	0.05	0.06	0.06	0.07
Current Ratio (times)	1.4	1.7	1.4	1.5	1.5
PBILDT / Total Income (%)	9.6	6.4	7.6	6.2	7.7
PAT / Total Income (%)	5.2	2.7	3.7	2.9	4.1
Return On Investment (ROI) (%)	28.7	15.3	27.1	20.8	32.7
Return on Networth (RONW) (%)	22.0	9.5	20.6	14.0	27.3
Capital Turnover Ratio (times)	3.2	2.7	3.8	3.6	4.4
Average Collec. Period (days)	144.8	202.8	140.9	135.3	110.4
Average Inventory (days)	42.9	39.1	28.0	31.2	24.0
Average Creditors (days)	94.1	145.7	95.9	85.8	63.6
Book Value (Rs.)	41.3	34.5	32.4	28.2	25.3
Earnings per share (Rs)	8.3	3.2	6.3	3.8	6.3

Source: CARE

RDPL is a debt free company. It has not availed of any long-term loans and over the years has financed its working capital requirements through cash credit facility and short term loans from banks. With the current ratio of 1.4 as on March 31, 2002, its liquidity position can be considered comfortable. RDPL has very low net and gross profit margins. This is mainly due to coverage of most of its products under DPCO and sales to Government institutions. RDPL operates at low inventory levels. Its poor collection efficiency resulted in a very high average collection period of around 150 days. The high level of debtors is mainly due to delay in payments by Government institutions. During the period under consideration, the average credit period was around 90 days. Since most of the assets of the company are depreciated, its capital turnover ratio is very high. Returns earned by company fluctuated mainly due to irregular orders from GoI. During the period under review, the book value of RDPL's share increased from Rs.25 per share as at the end of FY1998 to Rs.41.3 per share as at the end of FY2002. RDPL is a dividend paying company.

Contingent Liabilities

Contingent liabilities as on March 31st 2002, which have not been provided for by the company, include the following:

- ★ Sales tax demand of Rs.0.73 mn. The case has been heard by Additional Commissioner (Appeals). RDPL feels that the matter is likely to be decided in its favour.
- ★ Income tax demand for assessment year 1994-95 of Rs.4.18 mn. This has arisen because of dispute related to capital gains on sale of land. Presently, the matter is under appeal with CIT (Appeals).
- ★ Land development charges wrongly deducted by RIICO out of sale proceeds under dispute. RDPL has made a request for refund of the same. It has already recovered Rs.0.52 mn and Rs.0.63 mn are still pending with RIICO.

Manpower

RDPL employs full strength of sanctioned manpower i.e.150 excluding daily wage workers. The details of department-wise manpower employed by RDPL as on March 31, 2002 are shown below:

Table 9 - Department-wise manpower allocation

Department	Number of Employees			Total
	Executives	Supervisors	Workers	
Production	09	05	64	78
Q.C.	02	06	03	11
Maintenance	03	03	09	15
Store	03	—	05	08
Administration/Security	05	01	07	13
Finance	04	05	02	11
Sales	08	02	04	14
Total	34	22	94	150

Source: CARE

The average age of RDPL's employees is around 45 years.

Customer satisfaction

RDPL supplies drug formulations to Government institutions in Rajasthan as well as other states. Occasionally, company has also supplied drugs and medicines

to Government of India under ICDS scheme and Child Survival Safe Motherhood (CSSM) programme. The company, being a Public Sector unit, enjoys purchase preference from all the states. The Government of Rajasthan is outrightly purchasing its maximum requirements of drugs and medicines from RDPL.

As the entire production caters to Government institutions, the quality and acceptability of the products in the open market cannot be ascertained.

SWOT Analysis

Strengths

- ★ Preferred supplier to GoRJ - GoRJ is the largest customer of RDPL accounting for about 50% of its sales. Whatever items are manufactured by RDPL and required by the Government hospitals are procured by GoRJ under the purchase preference policy.
- ★ Good experience in institutional sales.
- ★ Good Financial health - RDPL is almost a debt free company, which is in good financial health.
- ★ Flexible manufacturing facilities - RDPL is basically a formulation unit. It employs general-purpose machines, which can be used interchangeably for manufacturing different products. This allows the company to change its product-mix according to requirements of its customers.
- ★ Cordial Industrial relations - There has been no strike or lockout during the last several years.

Weaknesses

- ★ Weak promoter - RDPL is promoted by IDPL, which is a sick PSU and is under the purview of BIFR. Due to this, it is unlikely that RDPL will get any financial support from its parent for future expansion plans.
- ★ Concentrated sales - Institutional purchases account for majority of RDPL's sales. This leads to a concentration risk. In case of removal of purchase/price preference by Government Institutions, RDPL may face difficulty in selling its products.

- ★ Limited R&D - RDPL mainly focuses on single drug formulations and does not have technical expertise to introduce multi-drug formulations.
- ★ RDPL mainly manufactures single drug formulations.
- ★ Weak brand - Company has limited presence in the open market and its products are sold as generic-generic drugs (The products which are manufactured from generic drugs and sold under the generic name, e.g. Paracetamol is sold as Paracetamol and not as brand name say 'Calpol' as sold by Glaxo).
- ★ Partial WHO-GMP compliance – Company is not fully WHO-GMP compliant thereby restricting its ability to export its products.
- ★ Financial performance is below industry standards.

Opportunities

- ★ Contract manufacturing - Cheap labour and raw material sources offer excellent opportunities for domestic companies to undertake contract manufacturing for foreign firms. RDPL can utilise its spare capacity for this purpose.
- ★ As mentioned earlier, many drugs are going off-patent (approx. \$42 bn) in the next few years. This provides excellent opportunity to Indian drug manufactures to produce these drugs.
- ★ Exports - By becoming WHO-GMP compliant, RDPL can venture into exports of its products to third world countries.
- ★ Product diversification – RDPL's manufacturing facilities are flexible and, therefore, it can diversify into lifestyle segment, which is growing at a higher rate.
- ★ Increase institutional sales by targeting more and more states.

Threats

- ★ Closure of IDPL – As mentioned earlier, IDPL is a sick company and has been referred to BIFR. IDPL is the majority shareholder in RDPL. Any

decision to wind up the operations of IDPL may affect future expansion plans of RDPL.

- ★ Institutional sales – Majority of RDPL’s sales is to Government institutions. Removal of price preference by these institutions may affect financial performance of the company.

DISINVESTMENT CONSIDERATIONS

RDPL is a medium sized pharmaceutical formulations manufacturing company. Profitability of RDPL during last five years is given below:

Table 10 - Profitability of RDPL during last five years

(%)

Year	2001-02*	2000-01	1999-00	1998-99	1997-98
Operating margin	9.0	5.8	7.0	5.7	7.4
Net profit margin	5.2	2.7	3.7	2.9	4.1

*Provisional

Source: CARE

From the above it may be seen that the operating profit margins of RDPL are generally around 6 -7%.

A comparison of the current selling prices of top ten products (by sales value) of RDPL with market prices (excluding the dealer’s margin) has been made. These top ten products account for more than 60% of the total sales of RDPL. Influence of parameters such as supplied quantity, packing cost, excise duty, Central and State sales tax, bulk discounts, etc. in the market prices, have not been factored in, as information on them were not available. This aspect will have to be borne in mind while drawing conclusions from this analysis.

The comparison reveals that the selling prices of RDPL’s products are broadly comparable to the market prices.

A comparison of RDPL’s cost structure with a sample set of 31 small-medium scale companies in the pharmaceutical industry is given in the table below:

Table 11 – Cost Comparison

(Paise)

Cost per rupee of net sales	Sample Set			RDPL		
	2001	2000	1999	2001	2000	1999
Manufacturing cost						
Raw materials and stores	60.65	57.74	58.54	65.47	73.07	73.25
Raw material	47.79	45.45	45.9	56.32	43.94	66.63
Stores and spares	0.56	0.63	0.76	0.33	0.15	0.25
Packaging goods	3.6	2.86	4.11	8.82	7.35	6.38
Purchase of finished goods	8.7	8.79	7.76	0.00	21.62	0.00
Power and fuel	4.35	4.35	5.16	2.25	1.49	1.23
Wages and salaries	5.24	5.97	6.37	18.37	11.87	14.32
Other operating expenses	4.12	4.54	4.83	1.79	0.97	1.11
Depreciation	2.81	2.71	2.83	0.65	0.50	0.51
Cost of production	77.18	75.31	77.74	88.53	87.90	90.42
Change in stock of finished goods	-1.15	-0.94	-0.75	0.03	0.06	-0.53
Selling costs	7.29	5.72	5.31	1.74	2.50	1.22
Advertising and marketing	5.59	4.26	3.57	0.63	0.36	0.42
Distribution	1.46	1.36	1.4	1.12	2.14	0.80
Bad debts	0.24	0.1	0.35	0.00	0.01	0.01
Cost of sales	83.32	80.1	82.3	90.30	90.46	91.11
Administrative and overhead costs	8.18	9.09	9.43	3.88	2.50	3.16
Total cost	91.5	89.19	91.73	94.18	92.96	94.27
Operating profit	8.5	10.81	8.27	5.82	7.04	5.73
Net sales	100.00	100.00	100.00	100.00	100.00	100.00
No. of companies	31	31	31	1	1	1

Source: CARE

The exercise reveals that operating profit margins of RDPL are lower than that of its peer group from the private sector. This is mainly due to higher raw material and manpower costs. While average salary and wages for the industry are around 5%, the same is almost two/three times for RDPL. Since the average salary levels in RDPL are not high, this points towards excess manpower. The selling and distribution cost of RDPL is very low as compared to the industry.

This is because RDPL targets mainly institutional customers, who are a few in numbers. If RDPL decides to enter the open market, its marketing cost is likely to go up, mainly because formulations are targeted to large population of doctors and patients. This may result in further increase in its cost of sales.

As mentioned earlier, RDPL depends heavily on Government institutions for selling its products and its open market presence is negligible. However, to overcome this, RDPL is planning to enter the open market with new products like lifestyle related drugs.

Some of the factors determining success of any pharmaceutical company in the open market are as follows:

- ★ cost competitiveness;
- ★ extensive distribution network;
- ★ branded products; and
- ★ ability to introduce new drugs quickly.

As already discussed, RDPL needs to improve its cost competitiveness.

Branded products:

Majority of RDPL's sales is to the Government institutions, where it enjoys purchase preference. This makes selling activity of RDPL similar to that of selling of bulk drugs. In case of bulk drugs, the buyers are a few in numbers and the manufacturer builds and maintains good relationship with few customers whom he supplies regularly. As regards selling of formulations in the open market, the products are targeted to large population of physicians and individuals. Thus, the market for formulation is widely distributed and brand equity needs to be created. RDPL, which is mainly concentrating on institutional sales, does not have popular brands in its portfolio to succeed in the open market. Hence, creating popular brands will be a major challenge for RDPL.

Inability to introduce new drugs quickly:

RDPL mainly caters to Government institutions. Over the years, the type of drugs required by these institutions have remained more or less same (mainly anti-infective drugs). As a result, only limited effort was required from RDPL to introduce new drugs. The company may be able to introduce new drugs in the

market through molecule acquisition or its own R&D. This would require investment in R&D and technical expertise. RDPL's success in the open market will depend on its ability to overcome the above mentioned weaknesses quickly.

To overcome above weaknesses, RDPL requires substantial investment in technology, manufacturing facilities and distribution network. Therefore, financial strength of RDPL will be crucial in deciding its future course of action.

Considering the present state of its majority shareholder i.e. IDPL (a sick company), it seems that, in future, RDPL will have to depend on its other promoter i.e. RIICO for funding expenditure. The operations of IDPL are closed except for marginal production in some units. The company was referred to BIFR for revival in 1992. Till the end of November 2002, BIFR was not successful in finalising a rehabilitation package for IDPL. This underlines RDPL's dependence on RIICO for future investments.

The Indian pharmaceutical industry is highly fragmented with more than 23,000 licensed pharmaceutical manufacturers, mostly in the private sector.

However, almost 90 % of the market share is with top 100 players. The large number of players has made the industry highly competitive. It may be noted that India is largely self sufficient in case of formulations and more than 85% of the formulation production is sold in the domestic market. The companies present in this sector produce large range of formulations. Many of them have integrated backwards and are also producing bulk drugs. Some of the companies are even exporting their products, largely to developing countries. The manufacturing facilities of such companies either have USFDA approval or are WHO-GMP compliant. Companies with such capabilities form a large part of the formulation industry.

While processes involved in producing bulk drugs are technology intensive, processes involved in producing formulations from bulk drugs are not that technology intensive. The formulation manufacturers generally employ multipurpose and flexible machinery, which allows them to manufacture a variety of products. However, certain highly specialised products require specialised technology and equipment. The low capital cost of process perhaps explains presence of innumerable small and medium scale units in the formulation segment.

As mentioned earlier, RDPL mainly manufactures generic drugs and it has very limited product development capacity. In future, with adoption of new patent laws under WTO, the medium sized companies are expected to concentrate on

manufacturing generic products efficiently. This will make the generic products market extremely competitive. Considering the present performance of RDPL, it appears that the company does not possess the skill set required for survival and growth in the changing business environment.

RPDL mainly supplies its products to state government institutions and its supply to GoI forms a small part of its turnover. Also, purchases of GoI from RDPL are not regular. It is felt that, in view of the fairly developed stage of domestic formulations industry, involvement of GoI in the drug manufacturing activity may not be necessary. The small size of operations of RDPL (annual sales of Rs.166 mn in FY2002) also does not justify the continued involvement of GoI in the company. Besides, involvement of GoI in companies like RDPL is also inconsistent with the policy of restricting Government ownership to sectors of strategic importance only.

Also, in the event of sale of IDPL's assets or winding up of IDPL's operations, IDPL would be required to divest its holding in RDPL. Sale of IDPL's investment in RDPL will require approval of BIFR. Since IDPL's shareholding in RDPL is an asset of IDPL, BIFR will be concerned with realising fair value for the assets.

In view of these factors, it is felt that entire stake of IDPL in RDPL should be divested. The following options have been considered for disinvestment of stake of IDPL in RDPL.

Option I - Sale of entire stake of IDPL to RIICO.

Option II - Sale of entire stake to a strategic investor .

Option I - Sale of entire stake to RIICO

RDPL is a JV between GoI (through IDPL) and RIICO. As an ethical business practice when a shareholder in a JV seeks to exit, the first right of refusal is given to the other shareholders. Hence in this case also, GoI may offer its entire stake to RIICO.

The basic objective of setting up RDPL was to ensure availability of quality drugs to Government hospitals in the State of Rajasthan. Over the years, RDPL has supplied drugs not only to GoRJ but also to other States. The acquisition of GoI stake by RIICO would make it a fully owned subsidiary of GoRJ. But ceasing to remain as a Central PSU, RDPL may face problems in selling its products to Government Institutions in other states. However, such losses may be

compensated through sales in the open market. RIICO is essentially an area development/lending agency of the state Government and it may not possess the skill set required to guide RDPL's entry in the open market.

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

As mentioned already, RDPL's open market presence is negligible and Government institutions purchase most of RDPL's products. Due to these reasons, the management is not exposed to the dynamics of the open market.

As such, RDPL does not possess the skill set required to enter the open market. It also requires substantial investment to improve its operations, which IDPL cannot provide. Induction of strategic investor will provide necessary skill set and additional capital to upgrade the manufacturing facilities.

The prospective investors in RDPL could be bulk drug manufacturers/suppliers, formulation manufacturers/suppliers.

In case a bulk drug manufacturer acquires IDPL's holding in RDPL, it would result in forward integration. For formulations manufacturer, it would provide additional manufacturing capacity.

Hindustan Latex Ltd. (HLL), a central PSU, has reportedly evinced interest in acquiring IDPL's share in RDPL. However, such a move would result in mere transfer of ownership of RDPL from one PSU to another and may not address the basic problem of RDPL i.e. need to improve cost competitiveness.

RECOMMENDATIONS

In light of the analysis above, the Commission recommends that the entire stake of IDPL in RDPL should be offered to a strategic investor through the competitive bidding route. In case RIICO is interested to exit simultaneously from RDPL, 100% disinvestment of RDPL's shares is recommended.

As indicated earlier, since IDPL is under the purview of BIFR, disposal of its holding in RDPL will require prior approval of BIFR.

* * * * *

