

Exit Policy and its impact on Increasing Inefficiency in Indian Economic System

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ABSTRACT

The expression 'Exit Policy' has gained much currency in India since the second half of 1991. Exit policy is an important element of structural adjustment programme for Indian economy. To some it meant that the title of policy yet to be formulated to others, a sanctions to demand legislative changes in employment security provisions; to yet others, it meant creations of safety nets and mobilization of resources to fund separation costs as a price for mitigating potential upheaval. India is famous for having many sick industries but no sick industrialists.

This paper deals with how in availability of proper and easy exit norms are degrading the working of current economic system and the effectiveness of measures taken by government in recent times.

1. Introduction

The Economic survey 2015-16 invoked the legend of the Charkavyuha from the Mahabharat describing the ability to enter but not exit, with seriously adverse consequences. According to it, the Indian Economy has made great strides in removing barriers to entry for firms but less in relation to exit. Thus over the course of six decades the Indian economy has moved from **Socialism with limited entry to Marketism without exit**. This view is supported by **Doing Business Report 2018** released by World Bank which ranks India @100 in resolving insolvency.

2. Review of Literature

Likening the **Indian Economy** in the 21st Century to the Charkavyuha legend of the Mahabharata- the ability to enter but not exit-The Economic survey 2015-16 cautioned that the country is facing adverse consequences due to the lack of a way out for killed ventures.

The survey tabled in Parliament by Finance Minister Arun Jaitley said the government is looking to facilitate exit through a host of initiatives, including the new bankruptcy law, rehabilitation of stalled projects proposed changes to the **Prevention of Corruption Act** as well as broader JAM (Jan Dhan, Adhaar and Mobile Governance) agenda.

"The Charkavyuha legend from the Mahabharat describes the ability to enter but not exit, with seriously adverse consequences. It is a metaphor for the workings of the Indian economy in the 21st century. The legacy of several decades of economic policy making", the survey said.

3. Objectives and research methodology of the Study

The Research is based on secondary sources that has been collected from issues of R.B.I., Economic Survey Yojana, Press Information Bureau, Kurukshetra etc.

- The objective behind the research is to find out the problems faced by sick industries to exit, in absence

of proper exit norms. Provided after the liberalisation in 1991.

- The reason behind the problem of increasing NPAs with the bank.
- The steps taken by the Government to address the problem and how nation will have better position on the "Ease off Doing Business" ranking as all this will decide the position of India in Global market.

4. What is a Chakravayuh Problem?

- A market economy requires unrestricted entry of new firms new ideas and new technologies so that the forces of competition can guide capital and labour resources to their most productive and dynamic uses.
- But it also requires exit so that resources are forced or enticed away from inefficient and unsustainable uses.
- Joseph Schumpeter expounded the concept of "**Creative Destruction**", "*The process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating the new ones*".

5. What is the exit policy ?

The introduction of reforms in India and the consequent liberalisation of the economy has exposed the entrepreneurs to an ever increasing competition. Since then, several policy measures have been undertaken by the Government in order to enhance the global competitiveness of the Indian companies. One of the important sets of Policy measures relates to reform in the labour sector. But the most contentious issue in this sector which still remains unaddressed is that of Exit Policy. This is because the companies have been arguing for a flexible exit policy while the labour unions have been against such a step because of their fear of loss of job security. But a liberal policy towards the entry and expansion of firms would be beneficial only if it is accompanied with a rational policy towards the exit of unviable firms. It is necessary

condition for inducing competition and enhancing the efficiency of resource use.

The term 'exit' is the obverse of the term 'entry' into industry. It refers to the right or ability of an industrial unit to withdraw from or leave an industry or in other words to close down. The proposal to introduce an exit policy was first mooted in 1991 when it was felt that without labour market flexibility, efficient industrialisation would be difficult to achieve. The need for such a policy arises as a result of modernisation, technology upgradation, restructuring as well as closure of industrial units. Such a policy will allow employers to shift workers from one unit to another and also retrench excess labour. In India, the **Industrial Disputes Act, 1947** put restrictions on employers in the matter of reducing excess staff by retrenchment, by closure of establishments and the retrenchment process involved lot of legalities and complex procedures. Also any plans of retrenchment and reduction of staff and workforce are subjected to strong opposition by trade unions.

The key consideration in evolving a practical industrial exit policy is the protection of the legitimate interests of workers, both in the public and private sector.

Hence, the Government policy has been that if a unit can be made economically viable restructuring it and retraining/redeploying the labour, no efforts should be spared to do this. Only in the case of units where even restructuring would not render it economically viable should the option of closure of the unit be allowed. Even here to minimise the adverse effects like social security nets insurance schemes and other employee benefit schemes as well as creation of a fund to pay retrenchment benefits to employees have been in place. Some of the measures introduced are:-

- The most important measure is the introduction of **Voluntary Retirement Scheme (VRS)**. It was introduced as an alternative legal solution to solve this problem. It is the most humane technique to provide overall reduction in the existing strength of the employees. It is a technique used by companies for trimming the work force employed in the industrial unit. It is now a common method used to dispense of the excess manpower and thus improve the performance of the organisation. It is a generous, tax free severance payment to persuade the employees to voluntarily retire from the company. It is also known as '**Golden Handshake**' as it is the golden route to retrenchment. VRS allows employees including those in the government undertakings, to offer voluntary retirement schemes to off load the surplus manpower and thus no pressure is put on any employee to exit. These schemes are not subjected to vehement opposition by the Unions, because the very nature of its being voluntary and not using any compulsions. It was introduced in both the Public and Private Sectors. Public Sector undertakings, however have to obtain prior approval of the government before offering and implementing VRS.

A business firm may opt for a voluntary retirement scheme under the following circumstances:-

- Due to recession in the business.
- Due to intense competition, the establishment becomes unviable unless downsizing is resorted to.
- Due to joint-ventures with foreign collaborations.
- Due to takeovers and mergers.
- Due to obsolescence of product/Technology .
- In order to protect the interest of workers. Government had set up a **National Renewal Fund (NRF)** in 1992.

The objectives and scope of the National Renewal Fund were:-

- a) To provide assistance to cover the costs of retraining and redeployment of employees arising as a result of modernization, technology upgradation and industrial restructuring.
- b) To provide funds, where necessary, for compensation of employees affected by restructuring or closure of Industrial Units, both in the public and private sectors.
- c) To provide funds for employment generation schemes both in the organized and unorganized sector in order to provide a social safety net for labour needs arising from the consequences of industrial restructuring.

The other important measure taken by government was the Scheme of Counselling, Retraining and Redeployment (CRR) at Central Public Sector Undertakings (CPSUs).

The objective of the scheme is to provide opportunities of counseling, retraining and Redeployment to rationalized employees of Central Public Sector Enterprises (CSSEs) rendered redundant as a result of modernization, technology upgradation and manpower restructuring in the Central PSEs. It consist of three main elements.

Counseling: is the basic pre-requisite of the rehabilitation programme of the displaced employees. The displaced employees need psychological counselling to absorb the trauma suffered by them due to the loss of job and resulting challenges both for himself and for the members of his family. The needs to be made aware of the new market opportunities so that he may, depending upon his aptitude and expertise, take up suitable economic activities.

Retraining:- is to help the rationalized employees in rehabilitation. The trainees will be helped to acquire necessary skills/expertise/orientation to start new activities and re-enter the productive process after loss of their jobs.

Redeployment:- of such rationalized employees in the production process through the counseling and retraining efforts. At the end of the programme they should be able to engage themselves in alternate vocational courses for self-

employment. Whereas there cannot be any guarantee that the rationalized employee will be assured of alternate employment, yet possible help from the identified nodal training agencies as well as from the concerned central public sector undertakings (CPSUs) would be extended to them for starting new avocations.

The Scheme was introduced by the Department of Public Enterprises (DPEs) and has been assigned the responsibilities of implementing the scheme through its CRR Cell. For carrying out various activities for implementations of CRR Scheme, many Nodal Training Agencies have been set up which have several employees Assistance Centers located all over the country to meet the training needs under the Scheme.

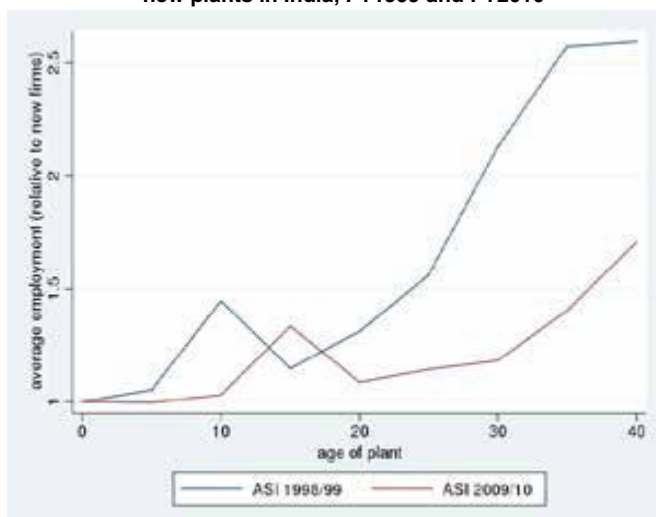
6. The Present Scenario

In India, there are sectors in which exit is not a first order problem for example IT Services and e-commerce, evidence most recently in the dynamism displayed in relation to start-ups in India. The Chakravyuha Challenge is more a feature of the relatively traditional sectors of the economy but is not restricted to the public sector-indeed, impeded exit in the private sector is becoming a major challenge.

7. Magnitude of the Problem

In principle, productive and innovative firms should expand and grow, forcing out the in productive ones. So surviving firms should be much larger than new ones. In the us the average 40 year old plant is 8 times larger (in terms of employment) than a new one. But in India in 2010. The average 40 year old plant was only 1.5 times larger than the new one. Worst part is that a decade back they were 2.5 times larger i.e. **inefficient firms are not allowed to exit and they remain small.** Taken together, these charts shows that there are not enough big firms and too many firms that are unable to grow, the latter suggesting that there are problems of exit.

Average employment of old and new plants in India, FY1999 and FY2010



8. What are the cost of impeded exit?

The lack of exit creates atleast three types of costs :-

1. Fiscal Cost:-

- Exit is impeded often through government support of inefficient firms either through explicit subsidies (bailouts) or implicit ones (free power, reduced tariff, interest subvention etc).
- High subsidies → high borrowings → high fiscal deficit (leading to twin deficit problem) → high debt → high interest cost.
- Add to this the tax revenue forgone, if efficient firms were allowed to take their place i.e. Double whammy of low tax and high subsidies.

2. Economic Cost:

- Market economy is supposed to allocate resources/factors of production (capital and labour) in the most efficient way towards most profitable ventures.
- Lack of exit leads to misallocation of resources with enormous costs for a capital starved country such as India.
- Over hang of stressed assets on corporate and bank balance sheets reflect the same problem (twin balance sheet challenge) of difficulty of apportioning costs of past mistakes.

3. Political Costs:

The lack of exit can also have considerable political costs for governments attempting to reform the economy. The benefits of impeded exit often flow to the rich and influential in the form of support for "sick" firms. This give expression that government favours large corporates, which politically limits the ability to undertake measures that will benefit the economy. Such as No action against willful defaulters, shows the erosion of legitimacy of regulatory institutions such as RBI.

9. What causes an exit problem?

In India exit problem arises because of three types of reasons, What might be called the three I's : Interest institutions and ideas/ideology.

1. **Interest** : The most obvious and powerful reason for the lack of exit is the power of vested interests, Which is aggravated by certain imbalance or asymmetry that counters greater power on concentrated produces interests in relation to diffused consumer interest.
 - Trade liberalisation because the beneficiaries are consumers (diffused consumer interest) and the losers are few producers each of whom stands lose by a lot (concentrated producer interest). The latter will be more influential as they are backed by financial power. One good example of interest groups blocking reforms comes from introducing JAM for MGNREGA expenditure.
 - In case of administrative schemes, vested interest often create market of their own. Planning their actions to benefit from it: put differently. This is a case of supply creating its own demand. The Scheme becomes a way of granting favours. Finally, bureaucratic inertia perpetuates persistence persistence.

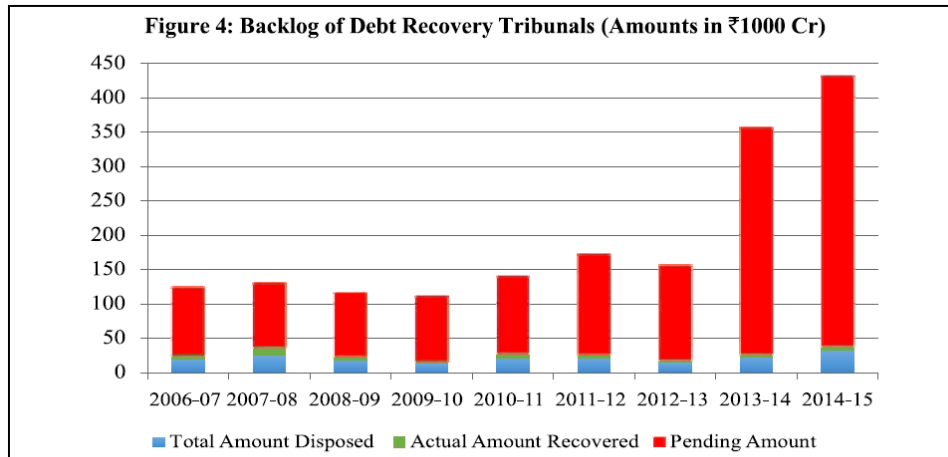
- Another problem is the longevity of schemes. 50% of the schemes are 25 years old which are almost irrelevant according to the needs of today. For ensuring relevance extra vigilance is required that should probably increase in proportion to the longevity (for these reasons only concept of ZERO BASED BUDGETING was introduced).

Example of weak institution are legal procedures that increases the costs-time and financial costs. One such example is inefficiency of debt recovery tribunals (DRTs), they perform the role of helping financial institutions to recover bad debt quickly and efficiently. But with rising NPA's (non-performing assets) recourse to DRTs has increased dramatically.

- Institutions-** The interesting even paradoxical fact about India today is that the problem arises from a combination of both weak and strong institutions.

Another example is simply the inability to punish wilful defaulters.

Weak Institutions:-



Source: Ministry of Finance.

Strong Institutions:-

Strong but inflexible institutions are unable to make risky decisions when departures from strict principles may be necessary for the economy.

3. Ideology/Ideas:-

- The founding ideology of socialism makes it difficult to phase out entitlements even as those intended for the poor end up accruing to the relatively better off.
- Example-Interventions in agriculture and all the anti-poverty programs, once set in place, are very difficult to reverse.

10. How to address the problem?

There are five possible ways to address the problem-

- Avoid exit through liberal entry-** i.e. promoting competition via private sector entry rather than change of ownership from public to private. Eg- BSNL, MTNL were not privatized but liberal entry to private telcos.

Advantages- It bypasses opposition from managers as well as labour interests.

- Direct Policy Action:-** i.e. having better laws to expedite exit and strengthen institution by empowering bureaucrats.

Govt response:-

- To address the Chakravayuh challenge or the Exit problem, insolvency & Bankruptcy Code 2016 was enacted. This will solve the problem of weak institution. Also, amendment has been made to the IBC, 2016.
- India improved its position on the 'Ease of Doing Business Ranking, 2018. The improvement was basically noticed after the government put into effect the IBC with a regulator Insolvency and Bankruptcy Board of India (IBBI), 2016, as well defined and time bound norms for entry and exit are considered key to Ease of Doing Business.
- In order to overcome lower profitability of Public Sector Banks due to delay in approvals and land acquisition, low global and domestic demands. The G.O.I. in 2015 developed what is popularly known capitalisation and revamping of PSBs.
- Other actions are Amendment to prevention of corruption act (Solve strong referee institution problem), reforms in PP (Kelkar Committee Report).

3. Technology and the JAM Solution-

Increase the use of technology as it has two broad benefits.

- lowering human discretion and the layers of intermediaries.
- Changing the old ways of doing business. Example of such solutions are Direct Benefit

Transfer (DBT), JAM (Pradhan Mandtri Jan Dhan

Yojana + Adhaar + Mobile (Digital India)] etc.

**Table : Status of Pradhan Mantri Jan Dhan Yojana
(As on December 6, 2017)**

Bank Name/Type	Number of Beneficiaries			Deposits in Accounts (Rs. Crore)	Number of Rupay Debit Cards issued to beneficiaries
	Rural	Urban	Total		
Public Sector Banks	13.3	11.5	24.8	55646.6	18.6
Regional Rural Banks	4.2	0.8	4.9	12033.9	3.6
Private Sector Bank	0.6	0.4	1.0	2160.6	0.9
Grant total	18.1	12.7	30.7	69841.2	23.1

Source GOI- <https://pmjdy.gov.in/account>

4. **Increasing Transparency-** In relation to agriculture, government should highlight the economic, social, environmental and health costs and benefits.
5. **Exit as an opportunity:-** Showcase exit as an opportunity towards a better tomorrow e.g. If employees of a public sector firm opposes its privatisation than in those cases, resources earned from Privatization could be earmarked for employee compensation and retraining.

11. Conclusion:

The study focused the problem of weak exit norms which are creating undue pressure on the economy and the inefficient uses of the available resource. But the recent development taken by the government to provide the case of entry as well as exit has taken India to new global heights. We still have many other forgoes to achieve. Financial literacy is a constant challenge and many other. The steps are taken to break this Chakravayuh that will be beneficial in the future.

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