CHAPTER - I
INTRODUCTION
Mass poverty, large scale unemployment and growing inequality in income and wealth distribution are the endemic problems of underdeveloped countries. The gap in per capita incomes between the developed and developing countries is largely reflected in and attributable to the disparities in their economic structures. Indian economy is an underdeveloped economy, with vast resources, most of them either unutilised or under-utilised. The economy is basically characterised by high dependence on agriculture. As the agriculture is a seasonal occupation, a major section of the workforce, which too is plentiful, remains unemployed or underemployed. Further, agricultural production is carried out by traditional and out dated methods and techniques, resulting in low agricultural yield. Because of low yield and most unemployment and underemployment, the basic needs of a sizeable proportion of the people always remain unfulfilled. So in a capital scarce and labour abundant Indian economy, the imperative of judicious utilisation of scarce capital resources to provide massive employment to teeming millions of population is more than obvious. In other words rapid industrialisation is the only answer to come out of the present state of disrupted economy.

The industrial sector which possesses relatively high marginal propensity to save and invest, contributes significantly to the eventual achievement of self-sustaining economy. Industrialisation, thus, acts as an instrument both of creating capacity to absorb excess labour power and of catering for the diversification of the market required at higher stages of economic development. The pattern of industrialisation to be adopted has, of course, to be decided in the light of several technical, economic and social factors.

The major objectives of industrialisation are high growth rate, massive employment generation and equitable distribution of income and wealth. Of course, the emphasis shifts from one objective to other with the level of development achieved and improved perceptions. Though the objectives of growth and employment have always assumed much importance, some general issues connected with economic growth like equity and welfare, the national economic independence are given due importance in the process of industrialisation.


Strategies of Industrialisation

Strategies of industrialisation are the long-term overall plans designed to give specific lines on which the future industrialisation should proceed to attain a set of objectives. Strategies of industrialisation vary from country to country and time to time in a given country.

In the industrial development process, one of the strategies of the planners is the selection between large and small scale industries or promotion of both in an integrative manner. The size consideration of an industrial unit gains importance for two reasons. First, its competitiveness in the market and second, its economic efficiency. The success of the industrial unit, largely depends upon its ability to reduce the cost of production per unit of output and maintain its quality of output. However, there is a difference of opinion on the issue whether large or small units are more efficient.

A strong case for large industrial units is built around the following reasons. Large units are more economical in working than small units. They spread the overhead cost per unit of output and derive economy through large scale production. Large units also produce more output and provide more employment than the small units.
The protagonists of small firms are reluctant to accept that the large firms bring in more efficient results. They maintain that much claimed economies of size are due to questionable business practices at the cost of free and fair competition. In small organisations the efficiency in production is attained by intra-plant economies through an effective coordination and supervision. Small units are more flexible and readily adaptable to the changing circumstances. Small firms also conserve non-renewable resources unlike big ones. Small scale units also prevent city-ward migration through balanced regional development. Moreover, they also serve the local needs and make use of locally available resources. The promotion and organisation of smaller units all over the country would lead to production by masses unlike the mass production by a few large industrial giants.

The small scale industries also have an advantage of 'dispersal'. They can be made accessible in the remote rural areas of the country. This would help in reducing the concentration of industries at one place and thus reduce regional imbalances. At the same time they help in drawing

out economic resources such as entrepreneurship and capital. Further, they are labour oriented and hence very much suitable for a country like India to play a catalytic role in the overall economic development.

To sum up, there is need for development of small scale industries in order to:

(1) speed up industrialisation on a decentralised and dispersed basis;

(11) accelerate the rate of economic growth;

(111) provide a massive employment opportunities;

(iv) reduce wide inequalities in income and wealth distribution;

(v) facilitate an effective mobilisation of small and scattered savings for production purposes;

(vi) provide avenues for broad based entrepreneurship; and

(vii) to meet increasing demand for consumer goods.

Thus, the small scale industries have a vital role to play in economic development particularly in a country


like India which is characterised by the underutilised manpower on one hand and scarcity of capital on the other.

The earlier development planning in India, by keeping its heavy emphasis on the development of modern large scale industry, failed to solve the problems like balanced regional development, gainful employment to tens of millions of labour force, equitable distribution of benefits of industrialisation, etc. The industrial development mostly confined to a few enclaves of metropolitan cities and big towns in the midst of ocean of hinterland to which the benefits of industry have hardly percolated. Thus it has been realised later that the process of industrialization could not be set on the pattern of western countries. Because, India is a vast and over-populated country with wide regional imbalances and scarcity of capital. Further, the welfare objectives enshrined in the constitution imply that in the process of development, the small man's welfare is to be given top priority. The guiding principle of the socialistic pattern of society also dictates that the small scale industries should be considered as the means to achieve equitable growth. Accordingly, increasing attention has been given to the development of small scale industries since the beginning of the second five year plan. This is evidenced in larger plan
allocations to the small scale sector and in wide ranging incentives and support programmes. Under the Industrial Policy Resolutions, the special role assigned to the small scale industries envisages: (i) creation of employment opportunities on a massive scale at relatively small capital outlay; (ii) meeting a substantial part of the increased demand for consumer goods and simple producer goods; (iii) facilitating the mobilisation of local resources which would otherwise remain unutilised; and (iv) removal of regional imbalances.

Definition of Small Scale Industries

The definition of small industry is an important aspect because it identifies the target groups for government policy. According to Fiscal Commission (1949-50), small scale industry was one which was operated mainly with hired labour usually 10 to 50 hands. The first official criterion for small scale industry dates back to second five year plan, when the government adopted the working definition of a small scale unit as a unit with an investment not exceeding Rs.5 lakhs and employing less than


50 persons if using power and less than 100 persons without the use of power. However, on the recommendation of the Federation of Association of Small Industries of India, an apex level organisation of small scale industries set up under the aegis of Ford Foundation Team, only the investment in fixed assets was considered for granting the status of small scale unit. Accordingly the small scale unit was defined as the one having investment in plant and machinery not exceeding Rs.7.5 lakhs.

As the growth of small scale units gained momentum, suitable revision of the definition was felt necessary. In other words, from time to time, there have been many changes in the ceiling limit of investment in plant and machinery. Since the investment for organising the production of ancillaries and components on efficient lines in certain industries would be of much higher order, the Government of India revised the definition of small scale unit in 1975. Under the revised definition a small scale unit is an undertaking having investment in plant and machinery not exceeding Rs.10 lakhs. The Government also defined an ancillary unit as an undertaking having investment in plant and machinery not exceeding Rs.15 lakhs. Further, within the small scale sector new sector called "tiny" sector was evolved with a capital outlay of Rs.1 lakh.
The Industrial Policy Resolution of 1977 modified the definition of small industry. According to the new definition, all the units having investment in plant and machinery up to Rs.20 lakhs were considered under small scale category, whereas in case of ancillaries, the investment ceiling was up to Rs.25 lakhs. The ceiling of investment in tiny sectors was also fixed at Rs.2 lakhs. In 1982, the definition was further extended to include service oriented enterprises which were not engaged in purely trading or commercial activities. Further, in 1985 the government raised the ceiling of thrust investment in plant and machinery from Rs.20 lakhs to Rs.35 lakhs, and from Rs.25 lakhs to Rs.45 lakhs in respect of ancillaries.

The latest classification and definition are mentioned as below:

(1) Small Scale Industries

Undertakings having investment in fixed assets in plant and machinery whether held on ownership terms or by lease or by hire purchase not exceeding Rs.60 lakhs.

(11) Ancillary Industries

Undertakings having investment in plant and

machinery not exceeding Rs.75 lakhs with the following features: (a) the investment in plant and machinery whether held on ownership terms or by lease or by hire purchase, does not exceed Rs.75 lakhs; and (b) the undertaking is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling or intermediates, or the rendering of services, and the undertaking supplies or renders or proposes to supply or render at least 30 per cent of its production or services, as the case may be, to one or more other industrial undertakings.

(iii) Tiny units

Undertakings having investment in fixed assets in plant and machinery not exceeding Rs.5 lakhs and situated in rural and backward areas having a population upto 50,000 as per 1981 census.

(iv) Small Scale Service Establishments

Establishments/enterprises engaged in personal or household services in rural areas and towns with population of 5 lakhs or less, and having investment in plant and machinery not exceeding Rs.2 lakhs.

The small scale industries can be divided into organised traditional industries and organised modern small
scale industries. The traditional small scale industries include khadi and handloom, village industries, sericulture, handicrafts, coir, etc. These industries are mostly labour intensive and based mostly in rural and semi-urban areas. The modern small scale industries are more urban oriented and relatively more capital intensive with heavy machinery and modern equipment.

Financial needs of Small Scale Industries

Finance is the life-blood for any economic activity. It facilitates the process of economic growth and development. When finance is easily available, industrial development can be accelerated as the participation of new entrepreneurs in economic activities depends upon the sources of access of funds on reasonable terms and conditions.

The financial requirements of small scale industries may be broadly classified into fixed capital and working capital. The first category needs resources to be deployed for a long period and the second category involves

resources for a short-period. The long term finance is needed for creating assets like land, buildings, plant and machinery, etc. The short term finance is needed for purchasing of raw materials and for meeting day-to-day requirements of business. The fixed capital requirements are usually met by issue of shares and debt securities. Equity capital of small scale units is generally provided by the entrepreneurs themselves. The entrepreneurs often supplement their own contribution by the funds raised from their friends and relatives. The small entrepreneurs also borrow on long term basis from the financial institutions and others to meet their fixed capital requirements. The working capital requirements are met by drawing on: (i) owner's funds; (ii) funds from operations; (iii) long term borrowings; (iv) spontaneous financing (e.g., trade creditors), and (v) short-term borrowings from commercial banks and others. The working capital is required to purchase raw materials, stores and to maintain required level of inventory. It is also required to maintain cash balance and also to make credit sales to customers. Further, all the day to day financial requirements of the business are met out of the funds drawn on working capital. The level of working capital in an organisation depends upon the length of the operating cycle, nature of the business, capital market situation, etc.
Inadequate working capital is one of the main problems of many industrial concerns, more so in the case of small scale industrial units. It is because the working capital proportion in small scale organisations is more as compared to the large industrial concerns. In fact, the principal need of small enterprises is working capital. The financial problem in small scale units is aggravated by the tendency that their suppliers mostly demand immediate cash payments and whereas their customers often insist on credit sales. This creates an additional problem of working capital finance in the small scale sector.

Thus most small scale industries suffer from financial problems despite their important role in generation of income and creation of large scale employment. The reinvestible funds generated by the small enterprises are meagre and consequently their ability to self finance their growth is limited. Thus, the availability of external finance is of crucial importance for the growth and development of small scale industries. However, the small scale industrial units do not have access to the organised capital market because they are mostly organised on proprietary or partnership basis, and are of very small size. Their access to institutional sources of finance was also limited because of many procedural wrangles. Before the
nationalisation of the commercial banks in 1969 the small scale units were not having much dealing with commercial banks. The small entrepreneurs mostly depended upon the unorganised financial agencies. Put differently, the small units depended more on their own funds and borrowed funds from non-institutional agencies, as the institutional agencies were generally reluctant to advance money to the small units. The main reason for step motherly treatment of small scale industries by commercial banks was that the small units were not in a position to offer the guarantee as demanded by the banking sector. Even when small loans could be raised from the government agencies, the procedure was so cumbersome that most of the entrepreneurs, who were either illiterate or semi-literate, avoided borrowing from government agencies.

The D.R. Gadgil Committee observed that there was 'uneven distribution of credit to different economic sectors and virtual non-availability to certain types of borrowers. The sectoral distribution of credit by commercial banks is weighted in favour of large-scale industries, wholesale

trade and commerce rather than agriculture, small scale industry, retail trade and small borrowers.

Institutional Finance To Small Scale Industries

As mentioned earlier, the conventional banker being purely security oriented, did not evince interest in the development of small scale industries. However, during the second five year plan it was felt by the authorities that the commercial banks had to take interest in financing small scale industries. It was the State Bank of India which instituted for the first time a pilot scheme to meet all types of credit requirements of small scale industries under liberalised rules and procedures. After the nationalisation of commercial banks in 1969, other commercial banks have also made efforts to support the development of small scale industries. To focus attention on the credit needs of certain neglected sectors of the economy and to ensure adequate credit facilities to them, the Government has evolved the concept of priority sector. The priority sector covers agriculture, small scale industries, industrial estates, road and water transport operators, retail trade, small business, professionals and self-employed persons.

housing and consumption. To ensure adequate credit flow to the priority sector, the Government stipulated that the banks should extend credit to the priority sector to the extent of at least 40 per cent of their total outstanding advances. Apart from these stipulations, the Government took several important measures like provision of refinance at concessional rates of interest, provision of guarantee cover, provision of consultancy facilities and technical expertise to the banks for evolving suitable lending programmes, etc.

When the commercial banks in India were traditionally confined their role for meeting the short-term requirements of trade and industry, it was felt necessary to set up specialised institutions for meeting the medium and long-term financial requirements of the industry. The Industrial Finance Corporation of India (IFCI) was established in 1948 to extend medium and long term credit to industrial undertakings. In fact, the establishment of IFCI marked the beginning of the era of development banking in India. At the state level, as a counterpart of IFCI, state financial corporations were established under the State Financial Corporations Act 1951. The State Financial Corporations are expected to cater to the financial and promotional needs of medium and small enterprises. The
Industrial Credit and Investment Corporation of India (ICICI) was established in 1955 in order to diversify the development banking in India. The ICICI was a pioneer in many areas of capital market development in India. The Refinance Corporation of Industry (RCI) was established in 1958 to provide refinance facilities to banks and state financial corporations against term loans granted by them to medium and small scale industries. However, the most important landmark in the area of development banking in India was the establishment of Industrial Development Bank of India (IDBI) in 1964 as a subsidiary of the Reserve Bank of India. The RCI was merged with IDBI in 1964. The IDBI is an apex institution in industrial financing. It not only provides finance but also coordinates the activities of all term lending institutions. In the form of regional institutions, State Industrial Development Corporations (SIDC), and State Industrial Investment Corporations (SIIC) were created to assist faster industrial development in the country. To assist exclusively the small scale industries, the National Small Industries Corporation Limited (NSIC) was established in 1955. The main function of NSIC is to aid, counsel, and finance the small entrepreneurs in setting up industrial units. As time passed, the emphasis of term lending institutions has changed from financing to development. In pursuance of the new policy, the National
Industrial Development Corporation (NIDC) was established in 1954. The NIDC, besides providing finance, aids and assists the entrepreneurs in setting up industrial units. The NIDC has now been converted into a consultancy organisation. It provides consultancy services for industrial development in the country.

The Export-Import Bank of India (Exim Bank) was set up in 1982. The main objective of Exim Bank is to provide financial assistance to exporters and importers. It also coordinates the working of other institutions engaged in financing exports and imports. The Exim Bank also provides refinance facilities to commercial banks and other financial institutions against their export-import credit.

The Small Industries Development Bank of India (SIDBI) was established in 1990 as a subsidiary of IDBI. The SIDBI administers both the small industries development fund and the national equity fund for providing equity support to tiny and small scale sector.

Apart from providing developmental finance to small scale industries, the financial institutions including commercial banks have taken over a large number of functions such as development of entrepreneurship, provision of technical and management consultancy, etc.
EXISTING LITERATURE : A REVIEW

A good number of studies have been conducted by several individuals and institutions on small scale industries with reference to their financial as well as other related aspects. An attempt is made in the following lines to review some of such studies.

Bagwati Prasad and K. Eresi made an empirical study on "Fixed Assets Management - An Unknown Dimension Leading to Sickness in Small-Scale Industries". The study attempted to examine the following issues:

1. What is the extent of investment in fixed assets in small scale industries?
2. How have they been financed?
3. How have they been managed?

A sample of 101 small scale units in Bellari district of Karnataka state has been drawn for the study. The main findings of the study are as follows:

1. The investment in fixed assets accounted for 41 per cent of the total investment.

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(11) Equity and long-term sources of financing have almost entirely been responsible for the acquisition of fixed assets; and

(111) Higher investment group has utilised the fixed assets more efficiently as compared to others.

The study concentrated only on fixed assets management and made a passing reference to working capital management which is an important aspect of small industry management.

16 S.M. Patta Naik conducted a study on "Development Strategy for Small Industries" to understand the structure of engineering industries from economic and organisational points of view. One hundred forty nine small scale engineering industries in Karnataka state were surveyed for the study. The important findings of the study are as follows:

(1) A large number of units (88 per cent) had a production capital (fixed capital + working capital) varying between Rs.10,000 and Rs.20,000 per employee, revealing low capital-labour ratio;

(11) More than three-fourths of the total sample units borrowed between Rs.10,000 and Rs.5 lakhs. But in the higher ranges of over Rs.5 lakhs, it was 14.74 per cent. A large number of units (118 units out of 149) borrowed from commercial banks, 6 from other financial institutions, and the rest from unspecified sources;

(111) The consumer goods, intermediate goods and job work units are predominantly managed by proprietors or single entrepreneurs, while capital goods units by partnership firms; and

(iv) Eighty per cent of the units in consumer goods, 75 per cent in intermediate goods, 67 per cent in job works, and 72 per cent in capital goods sector reported that securing credit from various financial institutions had not been a problem to them. But obtaining credit in adequate amounts was still a problem due to lack of collateral security, margin money, absence of reference, ineligibility and procedural difficulties.

The study was primarily restricted to engineering industries and the main focus was also on developmental aspects of small-scale industries.

The State Bank of India conducted a survey of small-scale industries at four centres, viz., Sangali, .........................................

Varanasi, Rajkot and Ranchi to assess the potential for financing the small-scale sector.

It was found that out of 1,356 units surveyed, as many as 1,007 (74 per cent) did not have any borrowed arrangements with commercial banks. Of these 1,007 units, 532 units (53 per cent) expressed their willingness to borrow from commercial banks. And 475 units were reluctant to borrow from banks. Further, it was found that the bigger the size of the unit, the greater was its keenness to seek funds from banks. Thus, the study was more of exploratory nature and thus failed to investigate into specific financial problems of small-scale industries.

In view of the growing involvement of banks in financing small-scale industries, a country-wide sample survey of small-scale industrial units assisted by the banks was organised by the RBI in collaboration with commercial banks.

18 The study sought to examine from the demand

side, the extent to which financial institutions could meet the requirements of small-scale industries and from the supply side, it analysed the deployment of credit to these industries according to the size of the units, their location, type of organisation and the like. The main findings of the study are as follows:

(1) Internal resources formed a smaller proportion of total net assets for small scale units than for medium and large-scale units;

(ii) Borrowings and trade credit were higher in small scale industries than in medium and large-scale industries;

(iii) Within the small scale sector, the use of institutional credit was more in the case of large size units - the units which employed 21 and above persons, and the partnership concerns;

(iv) A major portion of the institutional credit was deployed in other than backward districts; and

(v) The conventional small scale industries such as grain mills and oil mills resorted to non-institutional credit to a greater extent than others in the small scale sector.

The study concentrated more on sources of financing rather than on financial problems of small-scale industries.
The Small Industries Extension Training Institute conducted a study on "Impact of Concessional Finance on Industrial Development of Backward Areas". A sample of 130 small entrepreneurs was selected for the study. It was observed that the entrepreneurs resented the procedural delays in sanctioning of loans, and insistence on collateral security, solvency certificate, etc. In the case of raw material, the problem was not so much as to the availability than to its distribution. As regards the underdeveloped areas, it was observed that the growth in number of units and increase in fixed capital alone may not create the necessary impetus for growth unless considerable productivity changes are also effected through fuller capacity utilisation. The causes for underutilisation of capacity were mostly insufficient demand and inadequate financial resources for working capital.

The study confined itself to backward areas, and it also failed to look into unit level financial problems of small scale industries.

Technical Consultancy Organisation (KITCO) conducted a study on various problems faced by small scale industries in three states viz., Kerala, Karnataka and Andhra Pradesh. It was observed that the most serious problem faced by the units was inadequacy of working capital. About 69 per cent of the units in Kerala, 44 per cent of the units in Karnataka, and 52 per cent of the units in Andhra Pradesh had been facing the problem of inadequacy of working capital. The next serious problem was marketing, as 30 per cent of the units in Kerala felt it as a serious bottleneck in their growth. Non-availability of raw materials also affected the productivity of several units in all the states, especially in industry groups such as metal products in Kerala; chemicals, rubber, plastics, and metal products in Karnataka; machinery and parts, metal products, and chemicals in Andhra Pradesh. It was also observed that the delay in getting timely finance also hampered the productivity of the units and thus led to high cost of production. Thus, the study was a comprehensive one, attempting to identify the various bottlenecks in the growth of small-scale industries.

STATEMENT OF THE PROBLEM

Of the several problems faced by the small-scale industries, the problem of financing is the most serious one, drawing attention of the policy makers, entrepreneurs, and others concerned. It is observed in several quarters that many units have become sick because of lack of adequate finance and improper management of finance. So the present study is an attempt to investigate into various financial needs of small-scale industries. Further, the study would assess the role of institutional agencies in financing the small-scale industries.

OBJECTIVES OF THE STUDY

The objectives of the study are as follows:

(i) to identify the various financial needs of small-scale industrial units;

(ii) to examine the different sources of finance to small-scale industrial units;

(iii) to evaluate the assistance extended by institutional financial agencies to small scale industrial sector;

(iv) to investigate into various problems faced by SSI units in getting assistance from institutional financial agencies; and

(v) to offer suggestions for strengthening the
role of institutional financial agencies in the development of small-scale industrial sector.

SCOPE OF THE STUDY

The study limits itself to the financing of small-scale industries in Chittoor district. However, the non-financial aspects are also touched upon as they are interrelated with the main theme. Further, the study is confined to manufacturing units in the small scale sector.

SAMPLE DESIGN

As on 31st March 1991 there were 2463 small scale manufacturing units in the district. A sample consisting of 246 units has been drawn by following the stratified sampling technique. All the small-scale manufacturing units have been primarily stratified on the basis of nature of their products. From each of the stratum, 10 per cent of the units have been randomly selected, thus making the total sample of 246 units.

DATA BASE

The required data for the study have been collected both from primary source as well as secondary source. The sample units have constituted the primary source of data, and the units were approached with a pre-tested research schedules. The various publications of the Reserve Bank of India, Government of India, Government of Andhra
Pradesh, National Institute of Small Industry Extension Training (NISIET), etc., have constituted the secondary source of data.

CHAPTER SCHEME

The thesis is divided into six chapters.

The first chapter covers the introductory part of the study, including the review of literature and the methodology of the study.

The second chapter outlines the various organisations involved in financing the small scale industries. The various programmes and schemes under which the small scale sector is assisted by the financial institutions are discussed here. Further, the trend and pattern of institutional finance to small scale industries at macro level are also studied here.

The third chapter discusses the institutional finance to small scale industries in Chittoor district. It also elaborates the institutional arrangements at the district level to assist the development of small scale industries.

The fourth chapter presents the analysis of financial structure of small scale industries (sample units) in Chittoor district. The financing pattern of small scale
Industries is also discussed in this chapter.

The problems of small entrepreneurs in obtaining funds from banks and other financial institutions are studied in the fifth chapter.

The sixth chapter summarises the whole thesis and presents the main conclusions of the study. The suggestions of the researcher are also incorporated in this chapter.