CHAPTER - II

FINANCIAL PERFORMANCE OF ALIGARH LOCK INDUSTRY
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In the preceding chapter, it has been observed that the industry suffers from serious problems which undermine its performance. In the present chapter an attempt has been made to bring out major factors responsible for poor performance.

At the outset, I must admit that the data as presented in the present chapter, were not furnished by the lock industry or published in any issue of the Lock Manufacturers Association. I received little response even from some of the leading firms who I had contacted personally and also sent out the questionnaire (appended to the annexure at the end of the Thesis). However, I succeeded to obtain crude from the office of the Lock Manufacturers Association and the office of Aligarh Industries, which I analyzed scientifically:

\[
\begin{align*}
\text{Annual Manufacturing Cost} &= \text{Rs. 82 Crores} \\
\text{Annual Overhead Cost} &= \text{Rs. 10 Crores} \\
\text{- Total Annual Cost of Production} &= \text{Rs. 92 Crores}^1
\end{align*}
\]

The same sources put the annual turnover of 496 lock units at Rs. 112 crores with capital employed of Rs. 41.00

\[\text{\scriptsize 1. Information gathered by research scholar from Lock Manufacturer's Association, Aligarh in response to Questionnaire, op.cit.}\]
crore, and net profit of 20 crore yields a return of 4% per annum on capital employed. On the face of it, figures furnished by the office of the Manufacturers Association, and incorporated by the District Industries office do not seem to be reliable. In justification of the view, I would cite the opinions of authors on Financial Management that flight of capital from industry is impending if profitability is not more than the opportunity cost. Though the term, 'opportunity cost' itself defined by economists and the Financial Management in different ways. According to Economists, the 'opportunity cost' is the earning from the second best alternative opportunity.

Financial management, proceeding along the hypothesis of the economists, modified the concept by assuming that savings can either be invested in shares and debentures or deposited with banks at certain rate of interest. Income from interest is in the opinion of most authors on the Financial Management, is the opportunity cost. It is also termed as 'implicit cost', to determine a quantitative norm for a business to continue its operations and determine a cut-off line below which shareholders would prefer to withdraw the capital under such a situation they view that the operational efficiency is not upto the mark. The fear of shareholders about profitability falling below the 'opportunity cost does
not argue well for the business enterprise. The financial institutions engaged in investments, as also the individual debenture and shareholders get panicky. To avert the disaster and to ensure a safe return, the investors insist on strict adherence to equity-debt ratio of the loan, form of the management, etc. Of course low profitability in Aligarh Lock Industry, should lead to contraction in face of expansion in the size of the industry, as also to withdrawal of loans and advances, by banks and the other financial institutions. Paradoxically the lock industry has been experiencing in its size. The only inference to be drawn with cognizance is that the Aligarh Lock Industry must be earning a fair return on capital employed.

Apart from the normal return, there is the concept fair return. The term fair return's is defined differently. One view, as expressed by economists, is the return above the 'opportunity cost' viz., the interest obtainable on term deposits, debentures and government bonds. Assuming the interest rate as the minimum return, the entrepreneurs must anticipate a return higher than the prevailing interest as an incentive to investors to assume risk. The second opinion about, opportunity cost', through difficult to interpret and practice, is the return obtainable on investments in other ventures. The scholar, in a bid to avoid complications and simplify the hypothesis compatible with objective of
determining 'fair return' has assumed that role of interest
obtainable on risk free investments would be a logically
sound standard to compare the actual return. Keeping in view
the inconsistency of hypothesis with practice of
entrepreneurs in the lock industry. I have gathered and
analyzed the information from various sources and worked out
the component cost of each of the input with coefficient to
variable cost especially to identify the root causes of poor
financial performance.

**TABLE-2.1**

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Process of Production</th>
<th>Raw Material Cost Per Unit</th>
<th>Labour Cost (Per Unit)</th>
<th>Power and Fuel Cost (Per Unit)</th>
<th>Total Primary Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Mould Designing</td>
<td>0.12 (0.6%)</td>
<td>3.00 (15%)</td>
<td>-</td>
<td>3.12 (15.6%)</td>
</tr>
<tr>
<td>2.</td>
<td>Mould Operations</td>
<td>9.40 (47%)</td>
<td>1.5 (8.75%)</td>
<td>2.35 (11.75%)</td>
<td>13.50 (17.5%)</td>
</tr>
<tr>
<td>3.</td>
<td>Filling and Fitting</td>
<td>-</td>
<td>0.35 (1.75%)</td>
<td>-</td>
<td>0.35 (1.75%)</td>
</tr>
<tr>
<td>4.</td>
<td>Finishing and Polishing (Manual Process)</td>
<td>0.12 (0.6%)</td>
<td>0.50 (2.50%)</td>
<td>0.10 (0.5%)</td>
<td>0.72 (3.6%)</td>
</tr>
<tr>
<td>5.</td>
<td>Finishing and Polishing (Mechanized Process)</td>
<td>0.36 (1.8%)</td>
<td>1.40 (7%)</td>
<td>0.55 (2.75%)</td>
<td>2.31 (11.55%)</td>
</tr>
</tbody>
</table>

**Total Primary Cost**

<table>
<thead>
<tr>
<th>Rs.</th>
<th>Rs.</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.00</td>
<td>7.00</td>
<td>3.00</td>
<td>20.00</td>
</tr>
</tbody>
</table>

(50%) (35%) (15%) (100%)

**SOURCE:** Compiled and computed by the Research Scholar, on the basis of
statistics obtained in response to questionnaire, op. cit.

**N.B.:** Figures in parenthesis indicate co-efficient of correlation
with size of output.
Let us examine, in the first instance, the component of 'Prime cost', also termed in Accounting as Prime Cost or in Economics the 'variable cost'. The data furnished by entrepreneurs were crude which I arranged to suit the norms of financial management. The entrepreneurs and volunteered to divulge information about the capital employed (fixed investment), sales turnover, the total wage bill, the material cost and the selling price. I made stupendous efforts to acquaint myself with the process of production in order to compute aggregate labour cost, raw materials, fuel cost. I too work out the per unit cost. Following are the formulae to compute the component cost of the direct cost. The analysis presented in the Table No.2.1 reveals the raw

### TABLE-2.2

<table>
<thead>
<tr>
<th>Components of the Overhead Cost</th>
<th>Per Unit Cost (Rs.)</th>
<th>Per Cent of Total Overhead Cost</th>
<th>Total Overhead Cost (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>1.60</td>
<td>40%</td>
<td>1.60 (40%)</td>
</tr>
<tr>
<td>Depreciation</td>
<td>1.00</td>
<td>-25%</td>
<td>1.00 (25%)</td>
</tr>
<tr>
<td>Rent Rates and Insurance</td>
<td>1.00</td>
<td>25%</td>
<td>1.00 (25%)</td>
</tr>
<tr>
<td>Salaries</td>
<td>0.40</td>
<td>10%</td>
<td>0.40 (10%)</td>
</tr>
</tbody>
</table>

**SOURCE:** Compiled and computed by Research Scholar.
material cost is invariably the single most important input
cost claiming 85% of the total primary cost together with
labour cost followed or 15% for the fuel and power.

It is evident that raw material alone account for 50%
of the Direct Cost and 42% of the total cost of production
(including the Indirect Cost), followed by labour which costs
35% of the Direct Cost), and 29% of the total manufacturing
cost. Power and fuel account for 15% of the total 'Primary
Cost and 12.5% of the total manufacturing cost. I am tempted
to suggest that the industry capital efficiency would improve
provided entrepreneurs adopt modern techniques of production
and management for higher labour productivity and manage
cash-flows to reduce cost of capital.

The primary cost of production leaves a profit margin
of 30% which is depressed to 10% after accounting for
overhead cost comprising rent, rates and insurance,
salaries, depreciation, interest etc. The high equity debt
ratio and high safety margin insisted upon the banks are
responsible for as much cost of borrowed capital as 40% of
the Indirect Cost and 8% of the total manufacturing cost. The
cost can hardly be expected to get reduced without generating
surplus and expanding equity base. Rent, rates and insurance
are coextensive of the added and profit which are not quite
substantial. Loans are found costlier then proprietors
capital as evidence by 25% as the cost of borrowed capital, a paradox in business in view of interest which is usually a cheaper source of capital.

Depreciation, an item of 'indirect cost' permissible for deduction from profit for income tax purpose and also the cost of capital used up in the process of production for appropriation to consumers is 25% of the indirect Cost and 4.2% of the total cost. A glance at the sales turnover of Rs.63.69 crores would yield Rs.2 crore annually to recover the cost of plant in 10 years. However, there is a strong opinion to compute depreciation and the return on investment on time-scale or time value of money in capital budgeting. Modigliani and Miller's hypothesis support to time value. It is found in the course of study the lock industry has not acquired the skill and experience to undertake the exercise of project financing on the basis of time value of money.

Aligarh Lock Industry, being predominantly a cottage industry, has still to employ staff for supervision, control and maintenance of important records. The industry does not have experts the import professional was immigrant.

The resume of cost and project below costs a gloom on the industry's future prospects:
Profit = Average Selling Price - Average Total Cost per Unit.

\[ \text{Profit} = 26 - 24 = Rs. 2 \text{ per unit} \]

Total Profit of the Industry = Rs. 500/26 (Sales/Selling Price)

\[ \text{Total Profit} = 19.2 \text{ Crore units} \]

\[ \text{Total output} \times \text{Average Profit} = 19.2 \text{ crore} \times 2 \]

\[ = Rs. 38.4 \text{ Crore} \]

Profitability = \[ \frac{38.4 \text{ Crore \ (Total Profit)}}{500 \text{ Crore Capital Employed}} \]

\[ = 7.68\% \]

A crystal clear view emerges to reveal that the Lock Industry is not earning a fair rate of return because the interest obtainable on debentures, bonds and fixed deposits is higher than the profitability of the Aligarh Lock Industry - rate of interest ranges from 12.5% and above.

The above analysis would not be of much academic use if analysis is not undertaken to reveal profitability of units on the basis of size of the unit. I have ventured below the analysis of unit on the basis of the size of units to highlight economics of scale and the impact of changes in the form of organization and management.

Aligarh Lock Industry is heterogeneous, comprising timing and scale units. The artisan proprietors employ
capital of less than Rs.20000 and the capital of small scale units does not exceed Rs.35 lakhs. It would not be advisable to list the capital employed and its development in 3000 units, both cottage and small, for working out ratio of capital to return. For a fair empirical study, I have selected 100 units. The analysis is aimed to establish correlation between the size and profitability.

**TABLE-2.3**

<table>
<thead>
<tr>
<th>SIZE OF UNITS AND PROFITABILITY IN LOCK INDUSTRY</th>
<th>(Rs. in lakh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Employed</td>
<td>No. of Unit</td>
</tr>
<tr>
<td>Upto Rs.7</td>
<td>60</td>
</tr>
<tr>
<td>7 - 14</td>
<td>20</td>
</tr>
<tr>
<td>14 - 21</td>
<td>8</td>
</tr>
<tr>
<td>21 - 28</td>
<td>6</td>
</tr>
<tr>
<td>28 - 35</td>
<td>6</td>
</tr>
</tbody>
</table>

**SOURCE:** Compiled and computed by the Research Scholar. Primary data collected in the course of present study.

The foregoing table includes 100 units divided into five groups on the basis of capital employed. The survey reveals that 60 out of 100 units (or 60%) are working with small capital of upto Rs.7 lakhs. Debt and equity stands in the ratio 3:2. There are 20% of the units with the total
capital employed from Rs.7 lakhs to Rs.14 lakhs, equity and
debt being in the ratio of 4:3. Capital ranging from Rs.14
lakhs to Rs.21 is employed in 8% of the units. The 6 units
(or 6% of the units) employ capital from Rs.21 lakhs to Rs.28
lakhs. The last 6 units employ capital from Rs.28 lakhs to
Rs.35 lakhs.

Primary data, duly verified, checked and confirmed by
audited accounts, income tax returns, the sale tax office as
well as by the District Industries Office were of little use
for analytical study. Assuming the opportunity cost and the
discounted cost inflows at constant rate. I proceeded to
incorporate the Accounting Profit. I must admit that 50% of
the units in the first range do not maintain proper accounts.
I made use of the income tax returns to find out profit after
payment of interest and taxes. I classified information,
gathered from 100 units.

The profit in absolute terms is positively related to
the size of capital employed. Average profit of 60% of the
units in 1981-88 amounted to Rs. 1.56 lakhs which increased
to Rs. 9.10 lakhs for those units in the capital range from
Rs.28-35 lakhs. Profitability is, however, not in tune with
the amount of capital employed. 60% of the smallest units had
earned profit at the rate of 31.2% in 1987-88, and 3.5% was the profitability of 6% of units capital ranging from Rs.21 lakhs to Rs.23 lakhs. The units with largest capital from Rs.28-35 lakhs earned less return viz. 26%. And the 28% of the unit ended with profitability of 18.57%, return and size of capital cogently.

It is worth citing that profitability is the function of net revenue and the total capital employed. This concept is derived from economic parameter of entrepreneurial behaviour which is couched in terms of 'Maximum Profit'. The concept of 'Maximum Profit, though widely acknowledged and accepted as a basis to postulate the theory of output and input relationship, has come to be replaced in financial management with maximization of shareholders wealth. The project, before acceptance, is scrutinized on the basis of the maximization of the firms net worth or firm's value. In Assure Salmon's own words, the new concept of maximization of net worth has all the advantages which are turned to good account of the management efficiency, investors motives and evaluation of the project. The method to find out the net worth is capital (equity) minus outsides liabilities, in other words capital or owned funds go up with higher growth of profitability.
The project, in order to attain and serve the above objective, is of course acceptable if expected return during the life of the project is higher than the cost.

Excess of anticipated income from a project or a set of projects alone is not the criterion to accept or reject the project. There are two other main considerations to satisfy the share-holders, the creditors and the management: risk and time value of money. Investors are averse to risk but, at the same time, keenly desirous of high return. These are the two self-contradictory motives to be suitably reconciled. Risk is minimum in investment with statutory obligations for payment and repayment of the interest and the principal, viz. loan, in that case, return is minimum. Risky investment yield highest return. The term risk is different in connotation and application in financing from its literal sense. In financial management uncertainty about future income from a project is, in real sense, synonymous with risk. These elements add to risk. A distant future is unpredictable for income as against the short-term. Therefore, long period realization and accrual of income is supposed to be more uncertain and risky than the risk of the later case.

To incorporate the three main elements of maximum net worth or value of the firm, 'the financial management
estimate the anticipated income, discounts the same at an appropriate rate for uncertainty and compares the definite anticipated income with the cost of the project. The formula to find out the end-result of any investment in a new project or the going-on project is as follows:

\[ W = \frac{A_1}{(1 + K)} + \frac{A_n}{(1 + K)} - C \]

- **W** = Symbolise the net worth of the firm

- **A_1 + A_n** = Indicates anticipated income in each period of time.

- **K** = is the discount rate which the investors determine and supply to avoid risk and find out the present value of the anticipated income.

To illustrate the foregoing postulation, let us suppose A, K and C as follows:

\[ W = \frac{20000}{(1 + .10)} + \frac{50000}{(1 + .20)} - 30000 \]

\[ = 18181 + 41667 - 30000 \]

\[ = 59848 - 30000 \]

\[ = 29848 \]
The simple illustrations worked out about yields profitability of 99.49%. There are two theoretical possibilities, either to accept it because the return is above zero or to reject the project if investors anticipate a higher yield viz. 105% or above.

The theory explained above quite tersely requires to investigate systematically as to whether the existing yield of different size of lock units would actually satisfy the investors. Would they not like to take on new investments and join other industries in anticipation of higher yield.

In contrast with the modern approach to cost and return at discounted value and the traditional concept of return in accounting terms. It is obvious from the foregoing illustration is that anticipated return undiscounted for risk is Rs.20000 in the first year and Rs.50000 in the second year which put together for two years, amount to Rs.70000 as against the capital cost of Rs.30000 of the project, yielding the return of 133% which after discounting for risk, gets reduced to 99.40%.

The Research Scholar examines results of below present value of return of 100 units:
TABLE-2.4
PRESENT VALUE OF INCOME OF ALIGARH LOCK INDUSTRY 1988-89

<table>
<thead>
<tr>
<th>Capital Employed</th>
<th>No. of Units</th>
<th>Equity</th>
<th>Other Funds</th>
<th>Profit After Interest &amp; Taxes</th>
<th>Discount</th>
<th>Present Value of Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 7</td>
<td>60</td>
<td>2</td>
<td>3</td>
<td>1.56</td>
<td>30</td>
<td>1.20 (24%)</td>
</tr>
<tr>
<td>7 - 14</td>
<td>20</td>
<td>8</td>
<td>6</td>
<td>2.60</td>
<td>25</td>
<td>2.08 (14.90%)</td>
</tr>
<tr>
<td>14- 21</td>
<td>8</td>
<td>9</td>
<td>12</td>
<td>3.90</td>
<td>20</td>
<td>3.25 (19%)</td>
</tr>
<tr>
<td>21- 28</td>
<td>6</td>
<td>12</td>
<td>16</td>
<td>8.84</td>
<td>15</td>
<td>7.70 (28%)</td>
</tr>
<tr>
<td>28 - 35</td>
<td>6</td>
<td>14</td>
<td>21</td>
<td>9.10</td>
<td>10</td>
<td>8.30 (25%)</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SOURCE: Compiled and computed by the Research Scholar on the basis of figures furnished in the preceding Table No.2.4.

NOTE: The discount rate has been used to exclude riskness in the business operations.

The stage has been set to find out the difference in return in real terms, after accounting for risk and the effect of inflation. It is worthwhile to arrange profit and the return in the following table:
## TABLE-2.5

**COMPARATIVE ANALYSIS OF THE ACCOUNTING RETURN AND THE PRESENT VALUE OF RETURN, 1988**

(Rs. \text{akh})

<table>
<thead>
<tr>
<th>Capital Employed (Avg.)</th>
<th>No. of Units</th>
<th>Accounting Profit After Int. &amp; Taxes</th>
<th>Present Value &amp; Int. Return</th>
<th>Accounting Return of Present Value %</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 7</td>
<td>60</td>
<td>1.58</td>
<td>1.20</td>
<td>31.20</td>
<td>24.00</td>
</tr>
<tr>
<td>7 - 14</td>
<td>20</td>
<td>2.60</td>
<td>2.08</td>
<td>18.57</td>
<td>14.90</td>
</tr>
<tr>
<td>14 - 21</td>
<td>8</td>
<td>3.90</td>
<td>3.25</td>
<td>18.57</td>
<td>19.30</td>
</tr>
<tr>
<td>21-28</td>
<td>6</td>
<td>8.84</td>
<td>7.70</td>
<td>31.57</td>
<td>28.30</td>
</tr>
<tr>
<td>28-35</td>
<td>6</td>
<td>9.10</td>
<td>8.30</td>
<td>26.00</td>
<td>24.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>26.00</strong></td>
<td><strong>22.53</strong></td>
<td><strong>25.18</strong></td>
<td><strong>22.00</strong></td>
</tr>
</tbody>
</table>

**SOURCE:** Compiled and computed by the Research Scholar from primary dated collected in the course of present study.

The cash-flows from business operation have been discounted to present value at the prevailing bank interest. The exercise in introducing the modern concept of financial management has proved that investors stand to realize a return of 22% on investment in the lock industry, or average, in contrast with 22.53% from alternation investment. The

1. The return on investment in light Engineering Industry.
return gets reduced as a result erosion of purchasing power in the business income due to inflation at 5% per annum.

Further analysis of the data brings forth the fact that the resources have been used efficiently in small units with capital employed upto Rs.7 lakh as evident from which is 24% and medium units employing capital from Rs.2 lakh to Rs.28 lakh yielding return of 28% as against the return of 24% for large units.

Other things being the same, the leverage seems partially to boost profitability (Table No.2.5). Invariably, all the units, irrespective of the size, have been employing varying borrowed funds. In case of the small units, equity-debts ratio stands at 2:3, 4:3 in the case of the medium units and 3:4 in the case of large units.

The causes to the negative effect on profitability are the outcome of committing a substantial part of their funds to financing the current assets and their inability to reduce inventories and fixed charges of interest and repayment of loans. This, of course, accounts for low profitability for below the return on average, viz, 24% at present value. It calls for a fresh look at allocation of funds, to satisfy investors finally to serve the growth in future.
A comparative analysis of the lock industry's profitability is presented below to reveal the impact that the lock industry of resources and their used in the following Table No.2.6.

### TABLE 2.6

**INDUSTRY WISE ANALYSIS OF PROFITABILITY, 1987-88**

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Industry</th>
<th>% Average Accounting Profitability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Chemical Industry</td>
<td>35.00</td>
</tr>
<tr>
<td>2.</td>
<td>Light Engg. Industry</td>
<td>34.00</td>
</tr>
<tr>
<td>3.</td>
<td>Bicycle Ancillary Industry</td>
<td>33.00</td>
</tr>
<tr>
<td>4.</td>
<td>Paper Industry</td>
<td>34.00</td>
</tr>
<tr>
<td>5.</td>
<td>Packing Industry</td>
<td>33.00</td>
</tr>
<tr>
<td>6.</td>
<td>Printing Industry</td>
<td>32.00</td>
</tr>
<tr>
<td>7.</td>
<td>Miscellaneous Industry</td>
<td>30.00</td>
</tr>
<tr>
<td>8.</td>
<td>Lock Industry</td>
<td>22.53</td>
</tr>
</tbody>
</table>

**SOURCE:** Compiled and analysed from primary data by the Research Scholar, collected in interviews and the questionnaire, APPENDIX XI.

The obvious conclusion on the basis of the data in the foregoing table is that capital efficiency of the lock industry is the lowest. The gradual decline in profitability dissuades the investors to commit some compile in the lock
industry, to take up projects for modernization, renovation and innovation.

SOURCES OF FUNDS

Sources of funds, as discussed earlier, include the equity or proprietors capital, loans and internal surplus. Though a large number of financial institutions operate both in the public and private sectors, the Aligarh Industry is unable to obtain sufficient funds from these institutions. Reasons for insufficient supply of capital are attributable to unorganized character of the industry, owned by independent artisan proprietors or those working in cottage units for others.

There is little evidence to suggest that substantial facilities have been availed of by way of hire purchase, procurement of raw-materials, financial assistance for investment in modernisation, expansion, renovation or for the establishment of new lock firms which the state government is supposed to provide.

Aligarh Lock Industry taps the traditional sources of funds and commercial banks. The role of such public financial institutions as U.P. Small Industries Corporation Ltd., U.P. State Industrial Corporation, U.P. State Financial Corporation, Industrial Finance Corporation of India is
almost negligible in providing loans on long-term basis to Aligarh Lock Industry. Detailed account of various financial agencies is attempted below:

Loan From relatives and Friends:

It is observed in the course of survey that there is hardly any exception to loans from friends, relatives and money lenders because banks and the other financial institution regard loans to them unsafe. They do not maintain the books of accounts to reveal the financial position and operating results. Such units do not hold, fixed and current assets of substantial value for security to obtain loans. Personal loans are usually granted against guarantees of reputed guarantors. The small units are not successful in furnishing guarantors. As a consequence, they have to rely on limited financial assistance from friends relations and money lenders. Though they are remarkably experienced in the lock making and able to market them, the inadequacy of funds for the raw-materials, implements, tools or to build up inventories for wider market is the formidable constraint. It is worth recommending that such units should be recognised on cooperative basis with activities extended to the area of financial management.
Money lenders and Traders:

Money lenders and traders are the traditional financiers of the small entrepreneurs, especially the artisan-proprietors in the lock industry. Such entrepreneurs frequently resort to mahajans for short term loans to meet current liabilities, viz, raw-materials, payment of interest, salaries and wages, etc.

The loans from indigenous bankers and money lenders involve high cost since they charge very high rate of interest. It is argued that interest charged by money lenders amount to exploitation of the poor artisans. The money lenders do not offer the loan to the poor small artisan proprietors without a security. Traders who are the buyers of the products of the small artisans advance post-dated cheques; maturity coinciding with the date of delivery of goods. Mahajans accept the traders post-dated cheques and obtain, in addition, a pro-note or hundi from the artisan proprietors when the loan is advanced. By virtue of post dated cheque, traders are liable for the loan, and by virtue of the hundi the artisans are held accountable for interest and the principal.

It may be observed, in this context, that the money lenders accept the railway receipt and the road-transport
receipt as security. In such cases the money-lenders prefer to maintain a security margin from 30% to 40% of the value of goods hypothecated or mortgaged.

The money lenders who so advance the money do not discharge the borrower if the money is paid earlier than the date of maturity. They charge interest for the whole period of the loan.

Commercial Bank:

Trader and manufacturers provide, as a normal practice, short-term loan against the security of inventories. They do not advance equal to the value of goods hypothecated or mortgaged. A margin to cover risks arising from fluctuations in the market value of goods is always retained by the commercial banks. Such loans are terminable during the period of operating cycle ranging from 3 months to 6 months. Banks accept constructive delivery in cases of goods hypothecated as security for loans. In such cases there are chances of fraudulent practice by borrowers who may commit the same goods as security for loans from alternative sources. To avoid loss from similar frauds, banks take the precaution of putting up a sign board on godowns of the manufacturers proclaiming the banks charge on goods. It is worth nothing that banks as pledge incur the right to restore the goods to borrowers on discharge of the liabilities. In other words, banks are accountable for any loss of the value or quantity
till the goods are restored to borrowers. Hence, it is advisable to prepare inventory list and carry on periodic inspection to ensure that the goods are not lost. However, banks have the right to recover charges from the borrowers incidental to safe-custody of the goods. When such goods as plants, machinery or vehicles are hypothecated, it is incumbent on the borrower to acquaint the banks with details about the technical procedures in respect of their proper maintenance. The problems involved in hypothecation have led the commercial banks usually to accept mortgage of the tangible properties of the borrowers as security against loans and advances. Under mortgage, borrower is allowed to process raw-materials or semi-finished goods as well as to dispose of the finished goods with periodical report to banks. The sale proceeds are deposited in the loan account for adjustment against debit balance.

The borrower offers general charge or specific charge against the assets as security for loans. Both the charges have diverse implications. In case of general charge, the assets as security for loans. Both the charges have diverse implications. In case of general charge, the asset remains mortgaged to banks until the entire debit balance due to all loans obtained by borrowers from time to time are cleared. The specific charge is effective so long as the specific
loans obtained against a particular loan is obtained, the subsequent loans will not automatically create charge against the said asset.

Besides, collateral loans, non-collateral loans are becoming quite popular with banks enjoying refinance facilities from specialised institution. It is an open secret that institutions functions as guarantor on limited scale in the case of well reputed and financial by sound organization. The benefit of the 'RBI's bill scheme has not percolated down to small units their bills are not included in the approved list.

It may be inferred that Aligarh Lock Industry which, as stated earlier, is composed of a large number of unorganised units receives marginal credit facility to fulfil its capital expenditure requirements. Nevertheless, a number of banks which operate in the district are engaged in financing the industry, though handicapped by deficiencies of the lock industries poor organization and weak financial capital structure.

It would be interesting to analyse the loans and advances by different banking institutions.
State Bank of India:

State Bank of India, since its inception in 1952, is an effective instrument in the investment of savings — both of the household and the public sectors — in tune with plan priorities. Rural credit survey committee, 1949, had emphatically underlined the need for credit to priority sector, especially the cottage and the tiny sectors.

The bulletins and reports published by the Reserve Bank of India about credit allocation by the State Bank of India and its subsidiaries indicate more loans advanced to priority sectors. It is estimated that 30 per cent of the loans is advanced to small scale industries, 20 per cent to agriculturists, 40 per cent to government and 10 per cent to large and medium scale industries. Of the total loans to different sectors, State Bank of India and its subsidiaries alone share 40 per cent. The State Bank of India is under statutory obligation to charge differential rates. In case of small industries, lower rates are charged on loans.

Though a commercial bank, the State bank of India is different from others in-as-much as its legislation is liberal in the procedure and forms of loans to small industries. Apart from direct assistance and provision of loans, the State Bank of India is allowed to be promoter of specialised
financial agencies sponsored by the local, state or central government. Its lending operations are not restricted by the usual conditions in respect of duration or similar other conventions. In my opinion, State Bank of India has the precedence to claim the position of a pioneering institution next to none.

Working of the State Bank of India in Aligarh is however, not upto the mark. The lock industry's requirements for credit are of the order of Rs. 41 crore per annum. The bank supplies credit of Rs.42 Lakh yearly to 150 out of 3000 units.

TABLE 2.7

YEAR-WISE BREAK-UP OF THE LOANS TO THE LOCK INDUSTRY BY STATE BANK OF INDIA (1981-82 - 1989-90)

<table>
<thead>
<tr>
<th>Years</th>
<th>Units</th>
<th>Outstanding Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82</td>
<td>203</td>
<td>21,30,000</td>
</tr>
<tr>
<td>1992-83</td>
<td>103</td>
<td>32,84,000</td>
</tr>
<tr>
<td>1983-84</td>
<td>117</td>
<td>408,82,000</td>
</tr>
<tr>
<td>1984-85</td>
<td>115</td>
<td>480,76,000</td>
</tr>
<tr>
<td>1985-86</td>
<td>119</td>
<td>6,39,91,000</td>
</tr>
<tr>
<td>1986-87</td>
<td>110</td>
<td>6,12,84,000</td>
</tr>
<tr>
<td>1987-88</td>
<td>110</td>
<td>6,12,84,000</td>
</tr>
<tr>
<td>1988-89</td>
<td>83</td>
<td>6,00,00,000</td>
</tr>
<tr>
<td>1989-90</td>
<td>89</td>
<td>6,00,22,000</td>
</tr>
</tbody>
</table>

SOURCE: Information gathered and analysed by the Research Scholar from State Bank of India, Aligarh.
The precise inference from the average number of units and the amount of credit marks a distinctive deviation in the Bank's normal functioning in Aligarh vis-a-vis the lock industry. In Aligarh, the Bank strictly follows the conventional rules of safety, liquidity and return. To return safety, it excludes all the cottage units without current and fixed assets, and normally such units, far exceed the organised sector of the lock industry (496 registered units as against 2504 unorganised owned by artisan proprietors). In case of organised units too, a declining trend can be perceived, viz., 203 units which received loans went on declining till it reached 89 in 1989-90. The statistics pertaining to outstanding loans furnish definite answer to restrictive credit policy of the bank. In the short period of 10 years, loans outstanding amounted to Rs. 6 crore. It is an alarming rate of the growth of outstanding loans which might have forced the State Bank of India to cut down the loan limits to smaller number of units.

Credit policies are controlled and regulated qualitatively and quantitatively both by the Reserve Bank of India, insistence on collateral securities or guarantors' security are some of the handicaps for a large number of
small units. Increasing sluggish domestic demand and longer operating cycle are equally responsible for the inability of the industry to measure up to the commercial lending principles of State Bank of India. The credit instruments in vogue in Aligarh Lock Industry are not approved by the Reserve Bank of India for loans and advances. The smaller number of units now availing of the S.B.I.'s credit facilities are also accounted for by drastic changes in the operation of the overdraft. Under the new directives of the RBI, rooling-over of the short-term credit, both overdraft and cash credits, is prohibited, to conserve monetary resources, a short term credit requirement is to be submitted every quarter of the year. The unutilised balance of the overdraft, is liable to interest payment by the borrower. The measures which are intended for financial discipline have discouraged the entrepreneurs in the Lock industry owing to rising cost of funds in comparison to sluggish rate of return.

Hundis and Bill of exchange are to large extent discounted with the State Bank of India. The scholar, in spite of questionnaires and interviews, has not succeeded to elicit information about the investment of S.B.I.'s funds in
the Lock industry’s bills of exchange and the Hundis. Of course, the SBI’s management was categorically against purchase of post-dated cheques owing to risk not covered under the Banking, Companies Act.

The credit flows from the State Bank of India of the Lock Industry have been also affected since emphasis on credit for the development of rural economy. Its advantage could not be availed of by the Lock industry which is localised in the Aligarh town.

**Canara Lead Bank, Aligarh**:

Canara Bank assumed crucial role in the development of small units and those in the priority sector. It was established in Aligarh in 1971 and has since opened 11 branches in the district. It has, perhaps, relatively short period of actual functioning since its inception, viz. 1906. The remarkable position that the Canara Bank has now come to occupy is that of being a lead bank. As such, it is committed to the national objectives of the credit policies.

The following objective norms have been specified by the Ministry of Finance, in consultation with the Banking Department of the Reserve Bank of India, in pursuit of the Seventh Plans targets for several areas.
TABLE 2.8
YEAR-WISE BREAK-UP OF THE LOANS TO THE LOCK INDUSTRY BY CANARA BANK
(1981-82 - 1989-90)

<table>
<thead>
<tr>
<th>Years</th>
<th>Total No. of Account</th>
<th>Loan outstanding loans</th>
<th>No. of A/cs Outstanding of Lock Industry</th>
<th>Outstanding Loans of Lock Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82</td>
<td>310</td>
<td>2.00</td>
<td>298</td>
<td>1.69</td>
</tr>
<tr>
<td>1982-83</td>
<td>370</td>
<td>2.60</td>
<td>300</td>
<td>1.71</td>
</tr>
<tr>
<td>1983-84</td>
<td>390</td>
<td>2.70</td>
<td>317</td>
<td>1.97</td>
</tr>
<tr>
<td>1984-85</td>
<td>410</td>
<td>2.95</td>
<td>329</td>
<td>1.98</td>
</tr>
<tr>
<td>1985-86</td>
<td>429</td>
<td>3.25</td>
<td>365</td>
<td>2.32</td>
</tr>
<tr>
<td>1986-87</td>
<td>446</td>
<td>3.75</td>
<td>387</td>
<td>2.86</td>
</tr>
<tr>
<td>1987-88</td>
<td>492</td>
<td>4.00</td>
<td>400</td>
<td>3.75</td>
</tr>
<tr>
<td>1988-89</td>
<td>486</td>
<td>4.69</td>
<td>419</td>
<td>3.70</td>
</tr>
<tr>
<td>1989-90</td>
<td>489</td>
<td>4.41</td>
<td>390</td>
<td>3.09</td>
</tr>
</tbody>
</table>

Source: Information gathered by research scholar from Canara Bank, Aligarh.

Credit has to be supplied to the priority sector in precedence to the organized sectors. Credit policy lays down that 40 per cent of the total advance should be earmarked for the priority sectors, including the cottage, and small units. In pursuance of the objective, the lead Bank (Canara Bank) kept up the growth rate of credit to small units. In 1982 credit of Rs.2 crore was provided to small units. The trend
steadily continued to move upward by leaps and bound till it was twice as much in 1988.

The credit expanded at an annual rate of 28.6%. The other salient feature of credit allocation, as revealed by the number of units in the table No.2.5, is 99 per cent of lock units claiming 90% of the total advances. In 1982, 298 lock units out of 30 had received loans of Rs.169.24 lakh, or 80% of the total, viz., Rs.2 crore. The same is true of allocation of credit of Lock industry in 1989-90, viz., 80% of the total.

The Lead Bank (Canara Bank) undertakes to provide each credits and terms loans both to finance working capital as well as the fixed investments. In the provision of loans, safety takes precedence over social objectives. Little non-collateral loans are provided to ensure safety of public funds or investments in bills of exchange unsupported by credit worthy guarantors.

For cash credit and overdrafts, the Canara Bank insists on hypothecation or pledge of current assets, such as inventory of raw-materials, semi-finished goods and the finished goods. The procedure, rules and regulations do not furnish any concrete safety margin for advances against collateral securities. By convention, the Canara Bank follows
unsteady policy in this regard, which in my opinion, is inimical to the investment projects of the small units specially. This inference by the author is corroborated by 10% of the units in the lock industry availing of credit facilities - 310 to 492 of 3000 units approximately. It is worth relaxing the rules for the provision of credit.

Seasonal changes in the lock industry's demand for credit could not be evaluated due to difficulties in the collection of data. However, on the basis of information gathered from entrepreneurs, traders, etc. festival occasions and the last quarter of the year (September to January) are the peak periods of business activity for the lock industry. Though the Canara Bank in consortium with other commercial banks may expand its investment portfolio, it partially fulfils the requirement due to limited types of the credit instruments, viz., B/E and Hundis. As stated in the foregoing paragraphs, the postdated cheques are the commonly acceptable securities for credit sales to established traders.

Besides, low credit worthiness of the cottage and small units in terms of the net current assets (Current Assets-Current Liabilities), the cost of loans which is subject to frequent revision discourages financing long-term projects,
i.e., investments in fixed assets, modernisation, expansion, renovation or innovation. The current rate of interest varies from 12% to 14.5% according to the amount of loan and its duration. It is suggested that reduced interest rates would help the lock industry generate its internal resources for financing the working capital as well as fixed capital requirements. In parity with 10% rate of interest for public sector, small units should also be allowed the benefit of subsidised loans to serve the social objective of efficiency and redistribution of incomes.

Reluctance of the lead Bank, as also that of the other commercial banks, to expand credit facilities to the lock industry is accounted by fast accumulating arrears. Total arrears till December 1987 stood at staggering amount of Rs. 154 crore, of which Canara Bank’s outstanding loans alone amounted to Rs. 26 crores (for 17% approx.). The classification of outstanding loans by nature of small units could not be presented owing to the Bank’s inability to give categorical information. It is my observation that, of all the manufacturing industries, lock industry, specially the cottage units, are not faring well. As such, they should account for most of the default in repayment of loans.

Canara Bank has to fulfil its commitments to export on priority basis together with special allocations to
agriculture, self-employment schemes in rural and semi-urban areas. The Bank advances 10% of the loan to Agriculture 10% to weaker section for self-employment and 10% of loan at differentialist rate of interest to marginal farmers and artisans. It is generally believed that planned allocation of credit can help the economy attain higher growth rate. The assumption finds expression in quantitative terms of the Five Year Plan's predetermined targets for different sectors. Experience with planning brings forth deficiencies in achievements due to rigidities and lack of alternative policies to make best use of the financial resources. I am convinced that there should be flexibility in the scheme of credit-allocations specially to improve marginal efficiency of capital in the Lock Industry. It is recommended that the liberal credit policy for the lock industry should include waiver of the guarantees, securities and insistence on credit-worthiness in determining the quantum of loans.

Punjab National Bank, Aligarh:

This bank has two offices in the town in the civil lines and the city (Railway Road). The scholar visited both the offices and contacted the Field Officers at both the branches. The information supplied by the bank are not adequate and consistent with my inquiry to make any definite observation or suggestions. However, the first-hand data so
collected after much persuasion are presented and classified in the table below:

**TABLE 2.9**

YEAR-WISE BREAK-UP OF THE LOANS TO THE LOCK INDUSTRY BY PUNJAB NATIONAL BANK

(1981-82 - 1989-90)

<table>
<thead>
<tr>
<th>Years</th>
<th>Total No. of Account</th>
<th>Loan outstanding</th>
<th>No. of A/cs of Lock Industry</th>
<th>Outstanding Loans of Lock Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82</td>
<td>36</td>
<td>5.96</td>
<td>21</td>
<td>2.30</td>
</tr>
<tr>
<td>1982-83</td>
<td>36</td>
<td>5.94</td>
<td>33</td>
<td>4.78</td>
</tr>
<tr>
<td>1983-84</td>
<td>42</td>
<td>6.93</td>
<td>40</td>
<td>6.39</td>
</tr>
<tr>
<td>1984-85</td>
<td>51</td>
<td>15.39</td>
<td>47</td>
<td>14.80</td>
</tr>
<tr>
<td>1985-86</td>
<td>59</td>
<td>18.79</td>
<td>49</td>
<td>15.23</td>
</tr>
<tr>
<td>1986-87</td>
<td>91</td>
<td>21.62</td>
<td>50</td>
<td>13.91</td>
</tr>
<tr>
<td>1987-88</td>
<td>86</td>
<td>21.89</td>
<td>35</td>
<td>18.76</td>
</tr>
<tr>
<td>1988-89</td>
<td>104</td>
<td>25.78</td>
<td>100</td>
<td>20.19</td>
</tr>
<tr>
<td>1989-90</td>
<td>101</td>
<td>32.96</td>
<td>91</td>
<td>29.76</td>
</tr>
</tbody>
</table>

Source: Information gathered and analysed by the research scholar from Punjab National Bank, Aligarh.

In all, the bank provided credit to 36 units in 1983-84 which however, increased to 86 till August 31, 1988. Predominance of loans to small units is not discernible from the sets of data until it is compared with other borrowers.
In the course of inquiry from the Bank, I was able to elicit information that the bank assigns more weightage to merchants and those in the marketing in the provision of cash credits and overdrafts. Though they were reluctant to elaborate the determinants of the current credit policy which, in my opinion, is wide apart from nations objective—social and national economic objectives. On the basis of my hypothesis, I am tempted to remark that the bank, though nationalised, prefers short-term advances to merchants with large inventories and a trade cycle not longer than a fortnight. It ensures quick recovery of loans with interest income. It may also be added, as revealed by banking sector, the Punjab Bank is one of those bank in the town which participates prominently in call money market.

A similar pattern obtains in credit assistance to lock units. In spite of the limitations arising out of bank's reluctance to furnish complete information, I venture to remark that, in 1989-90, outstandings amounted to Rs.29.76 lakh. There should be suitable changes in the lending and invest activities vis-a-vis the Aligarh Lock Industry.

**Syndicate Bank, Aligarh:**

The Syndicate Bank provides term-loans to lock industry usually form 2 years to 5 years. Cash credits and overdraft facilities are made available to traders as well.
TABLE 2.10
YEAR-WISE BREAK-UP OF THE LOANS TO THE LOCK INDUSTRY BY SYNDICATE BANK
(1981-82 - 1989-90)

<table>
<thead>
<tr>
<th>Year</th>
<th>Lock Units</th>
<th>Outstanding Loans Lacs</th>
<th>Traders Thousands</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82</td>
<td>16</td>
<td>5.76</td>
<td>35,000</td>
</tr>
<tr>
<td>1982-83</td>
<td>4</td>
<td>4.00</td>
<td>35,000</td>
</tr>
<tr>
<td>1983-84</td>
<td>3</td>
<td>4.00</td>
<td>35,000</td>
</tr>
<tr>
<td>1984-85</td>
<td>4</td>
<td>4.00</td>
<td>35,000</td>
</tr>
<tr>
<td>1985-86</td>
<td>4</td>
<td>4.00</td>
<td>35,000</td>
</tr>
<tr>
<td>1986-87</td>
<td>4</td>
<td>4.00</td>
<td>35,000</td>
</tr>
<tr>
<td>1987-88</td>
<td>4</td>
<td>4.00</td>
<td>35,000</td>
</tr>
<tr>
<td>1988-89</td>
<td>6</td>
<td>5.00</td>
<td>37,000</td>
</tr>
<tr>
<td>1989-90</td>
<td>7</td>
<td>5.40</td>
<td>36,000</td>
</tr>
</tbody>
</table>

Source: Information gathered and analysed by research scholar from the Syndicate Bank, Aligarh.

The table reveals that, since 1983, the bank provided the term finance to 4 units. The total amount of loans outstanding in 1983 was Rs.4 lakh which increased to Rs.5.4 lakh in 1989-90. I discern that the Bank has been rolling over the amount of the term-loan sanctioned originally. Traders also continued to owe to the Bank the same amount of credit, viz. Rs.36 thousand, during the period under review.

A critique, in normal course, hold three factors to account for a bank's inability to invest in industrial activity, viz. (1) Primary Deposits and heavy withdrawals,
(ii) Inability of borrowers to satisfy the terms and conditions of credit, and (iii) Credit Bank's instruction against the industrial loans. In the case of the Syndicate Bank, neither of the three constraints are relevant. The Syndicate Bank is one of the major nationalised banks money (deposits). It also maintains the statutory reserve and operates in business area as well as in the University campus at Aligarh.

Reserve Bank's directives for regulating credit cannot be assumed to be different from those to other commercial banks. The fourth factor which is characteristic of the Syndicate Bank is that it is still reluctant to open more branches and extend its investment and lending operations in the city. During the last two decades, the bank has opened two branches (one at G.T. Road and the other lately in the University campus). It is, in my studied opinion, quite necessary that Syndicate Bank should lend helping hand to small and cottage lock units in fulfilment of its social obligations to which all the organised banking sector, particularly the nationalised banks, are committed.

CONCLUSIONS

The analytical study in the present chapter corroborate the view that the Lock Industry's profit earning rate is 4%.
On the other hand investment in the commercial industry has yielded 35% of return.

A minute scrutiny of financial management of lock industry shows that they have to maintain a high liquidity of loans which accounts for drain of resources from productive uses. It is worth considering to rely more on equity, internal resources, state financial assistance to small units will go a long way in ameliorating financial problems small units. The funds from state agencies must be provided for modernization, renovation, innovation and expansion. Such measures would of course render the small units economically viable.

The measures, in the opinion of the authors in all manifestations, would have ameliorating affects on the growth of lock units in general.

In conclusion, it may be said of the Investment in Aligarh Lock Industry that the cost of capital is very high as compared with the profitability or return on investment.

The funds available to the industry are largely committed to financing the working capital requirements, e.g., 57% of the capital employed is committed to current session. In the course of study it is discovered that larger share of working capital is the direct attribute of the
insistence of financial institutions and the commercial banks on high level of liquidity.

As regards the sources of capital, it is found that commercial banks and the financial institutions are not inclined to advance loans to cottage units owned by artisans. Such units of the Aligarh Lock Industry are not able to procure adequate funds from them. It is partly attributable to weak credit worthiness and partly to statutory requirement which the financial institutions and the commercial banks have to flow in lending and investment.

In spite of the difficult Investment in Aligarh Lock Industry has been able to maintain a steady growth in capital. In 1982, the total capital employed of 538 units which were surveyed by the author held capital worth Rs.17.50 crore in 1982 which grew to Rs.410 crore in 1988. The banks provided Rs.2.69 crore or 15 per cent of the total investments in 1982. Author could not succeed to obtain information about loans term-wise. That is why classification of bank loans term wise has not been presented in the present study. It would have led the author to establish the role of financial institutions in financing capital formation vis-a-vis working capital. I can only make a fine guess that the bank loans have been largely meant for
working capital and, to some extent, for replacement of machines.

The role of the major commercial banks at Aligarh has been highlighted by the Research Scholar in his study. In 1982, Canara Bank occupied prominent position among the commercial banks in the city; it supplied 62% of the total bank loans in 1982 as against 36% of loans supplied by the SBI, Aligarh and just 2 per cent by the Punjab National Bank, Aligarh. However, the State Bank of India, Aligarh, became the leading commercial bank in respect of loans and advances to the Aligarh Lock Industry in 1988. It supplied 61 per cent of the total bank loans and advances to the industry, followed by the Canara Bank, Aligarh, which supplied 37 per cent and the Punjab National Bank, Aligarh, which still supplied just 2 per cent of the total loans and advances.

The increasing share of SBI, Aligarh, together with the Canara Bank, Aligarh and the Punjab National Bank, Aligarh resulted in higher share of bank loans and advances as a component of capital employed from 15 per cent in 1982 to 25 per cent in 1988.

The study makes it clear that the Aligarh Lock Industry has to rely heavily on traditional sources of funds, viz., friends, relatives and money-lenders. The traditional sources
capital contribute 65 per cent of the total capital employed and the proprietary capital constitutes only 10 per cent of the total investment in the industry.

The impact of heavy reliance on traditional sources of capital raise the cost of capital for the industry which is counter-productive of higher return.

The capital structure has much to account for variation in cost of capital since overall cost of capital is the average cost of equity and debentures. Which fluctuates within the upper limit of the cost of equity and the lower limit of debenture. It would be facile to hasten to infer that the cost of capital infinitely declines with ever growing leverage in capital structure. It is admitted that financial leverage beyond a limit raises the cost. The question is being examined in the forthcoming chapter.