CHAPTER III

THE ROLE OF GOVERNMENT IN MODERNIZATION

It is obvious that the role of the government is important with respect to industrial development and modernization in an underdeveloped economy. And this chapter gives a brief account of the possible steps that a government can take to encourage the modernization and development of an industry before outlining the policy of the Government of India with respect to modernization of the leather industry since 1973 so as to provide the background for the study of entrepreneurship and modernization of industry. It should however be mentioned here that the government policy in this regard had as its aim the modernization of the leather industry for increasing the value of exports.

Policies for Industrial Development and Modernization

Modernization is one of the phases of industrial development. The experience of developing nations has shown that government policy when oriented towards well-defined objectives can have a substantial influence on the resources, incentives and barriers related to the innovative process
in industry. This section gives a brief outline of government policy measures that could contribute to a significant progress in industrial development and modernization. These measures can be grouped broadly into management improvement measures and developmental facilities¹.

**Management Improvement Measures**

**Industrial research and advisory services.** While large firms can afford research by qualified specialists small firms cannot. Hence the government has to establish industrial research institutes whose findings would be available to all types of firms, large or small. The research institute should have an effective extension service to communicate its research findings to firms and demonstrate their utility and there should be free and frank flow of ideas between the two each understanding the point of view of the other clearly. Units in different places may face different production problems because of factors like the climate, quality of water and raw material, type of labour and size of output, and the research should yield appropriate technology for each unit, taking into account both productivity and economy. A technical information bank

may be built up and made available to firms for immediate consultation for instant trouble-shooting. The research scientists are ideal for industrial advisory service. The need for extension and counselling services by research scientists and technologists arises because the small firm lacks management specialization. The entrepreneur-manager of a small firm may have assistants or partners with some special knowledge, but generally he himself has to make most of the firm's decisions covering such diverse fields as product planning, production techniques, purchasing, sales, personnel, labour relations, and finance. In a large firm these functions may be handled by specialists, but in a small firm he does them himself and so he needs advice from consultants, particularly economic guidance on promising new lines of manufacture, technical advice on choice of machinery and process and better use of machines and materials, and counselling on production and business management matters like plant layout, costing, marketing, financing, labour relations and personnel management.

Training of entrepreneur-managers and supervisors.

Formal and informal training programmes for small manufacturers may be introduced including short courses, self-education aids and apprenticeship training, particularly with respect to work study, costing, budgetary control and inventory
management. The course materials should deal adequately with key problems that are known to arise often in small firms and should pertain to the industry concerned. The trainers may be part-time instructors consisting of private management consultants, government's extension officers, successful local industrialists, and university personnel. Universities may also run business management courses either of a general nature or pertaining to specific businesses for potential or existing entrepreneurs. Well-written manuals may be published for self-education of entrepreneurs.

**Developmental Facilities**

**Development finance.** Adequate access to capital and credit is a key requirement of any industrial programme oriented to development, that is, toward helping existing small enterprises to modernize and grow, and new ones to start. The usual sources of funds for small business in developing countries are the personal savings and business profits of the entrepreneur and borrowings from relatives and friends. Institutional financing for them is far from adequate and is beset with difficulties because the risk on loans to small firms is substantial and the risk is heightened by deficiencies of managerial skill and technical knowledge on the part of small industrialists. But in recent years the banking systems in the developing countries have
been motivated to find a solution to these difficulties. The rules of the Central Bank and commercial banking legis-
lation now encourages bank lending to industry particularly
to small firms. Commercial banks have now become a key
source of short term as well as intermediate term finance of
one to five years, with the development of cooperation between
banks in exchanging information about each other’s activities
and credit insurance and refinance facilities and with the
training of bank officers in industrial finance. And for
medium and long term credit many specialized institutions
have been started mostly by the state which look after other
aspects of development also. Hire purchase and instalment
purchase schemes have also been evolved especially for machi-
nery and equipment.

However, many developing countries have realized that
the financial problems of small manufacturers in many cases
are hardly financial. In these cases, shortage of finance
is a symptom of other problems like poor planning, outmoded
technology, ineffective marketing, bad product quality, lack
of cost accounting and so on. In these cases, no purely
financial solution will really help; what is needed here is
the evolution of a combination of financing, technical,
managerial and marketing assistance.
Industrial estates. Small scale entrepreneurs in developing countries have an acute difficulty in getting a suitable factory site and building in a suitable locality with transport, water, electric supply, sewage disposal and other services and building with adequate ventilation, light and space. Hence the government builds an industrial estate consisting of well-provided factory premises and allots them to small entrepreneurs on a rental or hire purchase basis such that there is no need for them to lock up a large capital in the building or spend their time and energy in getting title to land, designing and constructing the building and arranging for road, power, water and drainage. The clustering of several similar or complementary business in an estate confers on them many benefits of concentration.

Common facility services. There are many industries where certain support-type or jobbing activities can be done for small factories by a common facility centre. For example, a number of manufacturers in a light industry can have their electroplating or tool or die-making done in a common facility centre. In Japan thousands of common facility cooperatives have been organized by the voluntary action of small entrepreneurs in industries like textiles, ceramics and wood-processing often with governmental assistance. The cooperative or privately-owned common facility centre is preferable to a
government-owned unit because government procedures are inherently unsuitable for rapid and flexible work and pricing decisions, the hallmark of competitive jobbing units. The government organization is however suitable for testing laboratories which charge standard fees for service in a routine manner.

**Procurement of materials and equipment.** Most developing economies face on account of their foreign exchange difficulties chronic and heavy shortages of industrial raw materials and equipment that have to be imported. While large firms plan their purchases better and make bulk purchases or have sufficient political and financial influence on the government or trading network to acquire the materials, smaller firms are not so fortunately placed. When the government introduces a control on the product in such a situation to help the small firm, occasionally the product goes into the black market and the small firm is forced to pay a still higher price and gets a smaller quantity than earlier.

To solve this problem, the small firms' association may be allowed to acquire the scarce materials or equipment for equitable distribution between the member firms. The government may offer suitable incentives for the local production of these items or take over their import and distribution
itself. If local production of these items is encouraged by tariff protection it has to be seen that their quality is upgraded quickly and prices kept in check so as not to handicap the industry using them. The government should also encourage the entry of adequate producers and distributors in order to avoid monopolistic control of supply channels for these important materials or equipment.

Marketing aids. The small industrialist in a developing country, especially if he starts making a more finished product from the stage of making a less finished product, very often fails in his marketing. Such entrepreneurs can be helped in a number of ways. A first step would be to compile and publish trade directories in which information about small manufacturers is provided classified productwise and listed alphabetically to guide the enquirers to potential suppliers. The small entrepreneurs may also be assisted to make advertisements in trade journals, particularly foreign, if the product can be exported. The small firms need market research to reveal trends in consumer demands and test the market for new products. Often a government development agency must take the lead in initiating market analyses and disseminating market information specially useful to small firms. Primarily, the marketing position of small entrepreneurs should be strengthened in normal commercial
channels, whether domestic or export, by arranging for contacts with buyers. In the cases of export goods, occasionally government may take over the export trade on behalf of small firms, particularly with respect to the trade with communist countries. A suitable export incentive in the form of subsidy, air freight discount, duty drawback or import entitlement may be granted in order to cheapen the product of the small firm so that it is easier for the firm to make good sales.

**Inter-firm contacts and assistance.** If large and small firms are complementary to each other they benefit mutually. Hence government agencies and associations of manufacturers may foster their linkage. Their advisory services may bring the two into contact with each other so that small firms can take up subcontract work of large firms and the latter provide the necessary technical assistance to the former. In Japan it is common for small firms to get government loans or other incentives to equip themselves with such machinery and equipment as are necessary to meet the requirements of large firms nearby which are modernizing themselves. This, however, calls for close cooperation in planning such modernization between the small firms, their banks, the large firm, and the government development agency. Such inter-firm relationship will have to be voluntary and based on mutual confidence and their
success depends on the quality of the subcontract work and reliability of deliveries by the small firms and assurance of work by the large firms.

While a number of measures that can be adopted by the state to encourage modernization of industry have been listed above, the Government of India has been overwhelmingly depending on measures of export control and incentives for bringing about a rapid modernization of the leather industry as explained in the next section.

Government of India's Policy since 1973

Basically the modernization of the leather industry since 1973 is a development induced by government policy the details of which are given below.

Leather and leather goods hold a high rank among India's exports. During 1972-73 they ranked second to jute in the value of exports. But then over 85 per cent of this consisted of semi-finished leather, and the share of finished leather and leather goods was less than 15%. The year 1972 was a boom year for the industry with prices and foreign demand rising to a record high level. The rise in prices increased the cost of the raw material and created a shortage of supply of tanned leather for domestic manufacturers of shoes and
leather goods. They campaigned for stringent measures for restricting the export of vegetable tanned and wet blue hides and skins. Earlier, in 1969, a survey by the United States Agency for International Development had pointed out the potential for the export by India of finished leather and leather goods. The Survey Report¹ had suggested a deliberate diversion of unfinished leather export into finished leather, footwear and other leather goods so that the added value by such conversion will increase the foreign exchange earnings of the country. So, by 1972, the Government of India realized that the time had come to intervene in order to change the production and export pattern of leather and appointed a committee under the chairmanship of Dr Seetharamiah the then Director General of Technical Development, Government of India to suggest steps necessary for a speedy switchover of leather exports from semi-finished hides and skins to finished leather, footwear and leather manufacturers. The members of the Committee included one of the tanners in our study, T. Abdul Wahid. It was called the Committee on the Development of Leather and Leather Manufacturers for Export and is shortly referred to as the Seetharamiah Committee.

Recommendations of the Seetharamiah Committee. The Committee in its report of December, 1972, suggested that 75 per cent of the 1971-72 level of exports of semi-tanned leathers should be converted into finished leathers and products within a period of 8 to 10 years. With this end in view the committee recommended the following measures.

(i) Export duty. A minimum of 10 per cent duty may be levied on exports of semi-finished leather.

(ii) Export restriction. The export of semi-finished leather may be brought under the quota system. It should be initially brought down to the 1971-72 export level and then progressively reduced. Smaller tanners should be protected by fixing a floor limit for the quota.

(iii) Export ban. Export of all types of raw hides and skins may be banned as from 1-1-1973.

(iv) Creation of infrastructure. Finishing centres may be set up in areas where there is concentration of tanneries. New entrepreneurs should be encouraged to finish leather starting with semi-finished leather. Large industrial houses and firms with foreign management or collaboration should be prescribed a substantial export obligation.
(v) **Cash subsidy.** Cash subsidy up to 15 per cent against exports of finished leather and leather manufactures may be given for buying land, building and machinery for manufacturing the above or to repay loans taken from financial institutions for the purpose.

(vi) **Trade plans.** The Government of India should prefer the export of finished leather to semi-finished leather when signing trade pacts with East European countries and gradually reduce the share of the latter in the deals.

(vii) **Import replenishment.** Import replenishment for both E.I. and wet blue chrome leather may be at 3% with a compulsory provision that 50 per cent of the replenishment should be used for the capital cost of modernization of the exporter's tannery.

(viii) **Air freight subsidy.** For both finished leather and footwear, the air freight subsidy should be 15% of the F.O.B. value of exports.

(ix) **Import duty on pickled skins.** The import duty on pickled skins may be abolished immediately.

(x) **Excise duty on footwear.** The excise duty on footwear made by small units should be abolished immediately.

(xi) **Merger of export promotion councils.** The two export promotion councils may be merged into an enlarged
'Export Promotion Council for Leather and Leather Manufactures'. Its headquarters may be at New Delhi with branches at Madras, Kanpur, Bombay and Calcutta.

**Regulatory measures adopted in 1972-73.** Simultaneously with the submission of the Seetharamiah Committee's Report came the announcement by the Government of India of the canalization of semi-tanned leathers through the STC with effect from 14-12-1972. The STC was to collect a 1% service charge on these exports. The tanners and leather exporters considered the STC as their rival as it was already engaged in the export of semi-processed skins to the communist countries and strongly objected to canalization through the STC and to the grant to it of any power to regulate their exports. The tanners in South India, West Bengal and Kanpur then decided to observe a week's hartaļ¹. The hartal plan was dropped after the Government announced its decision not to entrust the job of export regulation to the STC. Large tanners like T. Abdul Wahid who held influential positions in the industry then persuaded the leather trade to accept the export regulation.

In 1973 the Government of India imposed quotas on

¹hartal: closure of units
individual firms on their export of semi-finished leather and they were administered by the Controller of Exports. Its declared aim was to progressively reduce the quotas every year till the export of semi-finished leather was reduced to 25% of the 1971-72 level in the course of five years. Simultaneously the Government of India imposed a 10% export duty on semi-finished leather and granted a cash subsidy of 5% on the value of finished leather exports. In January 1974 the export duty on semi-finished leather was raised to 20% to exert further pressure on tanners to modernize their tanneries. Small non-exporting tanners were also asked to register with STC and were issued quotas for export of semi-finished leather. After fixing a floor level for the exports by individual tanners their quotas have been progressively reduced every year. Air freight subsidy was given to finished leather and manufactures. Duty drawback was granted on all leather exports and import replenishment was also made available.

Further regulatory measures. The year 1976 was again a boom year for leather exports. The footwear and leather goods manufacturers found their raw material getting scarcer and costlier and pleaded for further cuts in exports of

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semi-tanned skins, while the tanning industry was pressing for the creation of the necessary infrastructure for expanding the production of finished leather. Then the Government of India adopted the following measures. (a) It enlarged the list of machinery to be imported under UGL to include 24 items of tanning machinery and 54 items used by footwear and leather goods sector; (b) It formed the Bharat Leather Corporation with its headquarters at Agra with a capital of Rs 5 crores; (c) A deduction on account of investment allowance was allowed at the rate of 25% for finished leather and leather goods industry and footwear of leather while computing income tax payable by the concerned manufacturer; (d) The STC was authorized to utilize Rs 3 crore from its Leather Development Fund to set up and equip 5 common facility centres, one each in U.P., Bihar, West Bengal, Andhra Pradesh and Tamilnadu, (e) A further slash of quotas were made for export of semi-tanned leather; (f) Export duty on semi-finished leather was raised from 20 to 25% and (g) the cash subsidy on finished leather was raised from 5 to 10%.

In 1978 the Government reduced the import duty on F.O.B. value of many machines required for making finished leather and leather goods from 40% to 25%. But the duty on chemicals imposed to protect the indigenous chemical industry remained high ranging from 60 - 200% and the leather industry
was pleading for a reduction in this also. After some hesitancy the Government of India reduced the duty on these chemicals and footwear components to 40% in 1979.

Thus the Government of India has been adopting since 1973 a package of fiscal measures and physical control with the aim of achieving a considerable degree of modernization of the industry over a short period so that it will export value-added products.

Conclusion

In this chapter was examined the scope for the role of the government in encouraging the modernization of industry. Based on the development experience of different nations, the measures that the state can adopt for encouraging modernization of industry by its entrepreneurs may be classified broadly into management development schemes and industrial development assistance. The latter measures, among others, would include arrangement of finance, provision of common facility services, help in procuring materials and equipment and in marketing the output. However the Government of India was keeping in mind the increase in value of leather exports and not of domestic sales as the main aim and so it has been predominantly depending on the physical regulation of exports and the provision of export incentives for bringing about a
rapid modernization of the leather industry in India. The basic content of the Government policy in this regard was described in this chapter because in most cases tanners had modernized after this intervention and the circumstances compelling the modernization have to be appreciated before an attempt is made to explain any difference in the pace of modernization by the tanners. Chapter VIII entitled 'Infrastructure for Modernization' would deal with the role played by government sponsored institutions in assisting the modernization of the tanning industry particularly with respect to matters like transfer of technology, finance, marketing and effluent control.

An earlier study by the researcher in 1978 found that the impact of the Government policy was not uniform as between different tanners and the basic aim of this project is to explain this lack of uniformity. Before an analysis is attempted to explain it case histories of industrial modernization by the chosen sample of tanners is given in the next two chapters. Chapter IV that follows relates to the fifteen earlier modernizers and Chapter V deals with the other fifteen, the later modernizers and laggards.