CHAPTER I

INTRODUCTION AND DESIGN OF THE STUDY

1. Introduction
2. Statement of the Problem
3. Objectives of the Study
4. Methodology
5. Operational Definitions
6. Review of Related Literature
7. Significance of the Study
8. Limitations of the Study
9. Chapter Scheme
1. INTRODUCTION

Industrialisation is widely recognised as one of the means to usher in economic and social transformations. It is essential not only for the generation of employment and the achievement of industrial self-sufficiency but also for the accelerated development of agriculture and other sectors. In addition, it accelerates economic growth, increases national income and promotes entrepreneurship.

Industry in India can be broadly classified as public sector, private sector, joint sector and co-operative sector on the basis of its ownership. According to size it is classified as tiny sector, small scale sector, medium scale sector and large scale sector.

In India small scale industries play a significant role in the economic development by contributing considerably in terms of production, employment and exports. The total production of small scale units was anticipated to increase from Rs. 2,09,000 crore in 1992 - 93 to Rs. 2,38,263 crore in 1993 - 94, recording a growth of 5.6 \% \textsuperscript{1}. It is estimated that modern small scale industries provide employment to 139 lakh people\textsuperscript{2}. The exports by the modern small scale industries to the tune of Rs. 22,764 crore, were almost one third of the
India is a developing country with a large population. Hence, small scale industries are imperative to create larger employment opportunities, promote decentralisation and dispersal of industries, achieve diffusion of power, promote entrepreneurship, develop agro-based and ancillary industries, improve the quality of the products and step up the production of essential articles and those having potentiality for exports.

The small scale industries are poorly placed in the matter of capital formation as they are not in a position to plough back much into the business because of limited profits. Hence small scale units in India have to depend on external sources like Commercial Banks, Financial Institutions and Indigenous Sources like money lenders and friends and relatives.

The institutional structure for the flow of credit to the small scale sector comprises of two institutions at the apex level viz., Industrial Development Bank of India (IDBI) and National Bank for Agricultural and Rural Development (NABARD). Recently the Small Industries Development Bank of India (SIDBI) has been set up to function as a separate apex bank which is a subsidiary of the IDBI.
2. STATEMENT OF THE PROBLEM

Large scale and medium scale industries are in an advantageous position of raising the funds through capital market and money market. The small scale units are being set up by the entrepreneurs on proprietary and partnership forms of organisation. They have to raise term loan and working capital loan from the State Financial Corporations, Commercial Banks, Co-operative Banks and Regional Rural Banks. At times they obtain financial assistance from indigenous sources.

Though the small scale units receive financial assistance from the above said sources, they face a number of financial problems such as (i) severe erosion of the liquidity position due to credit squeeze and rise in interest rates, (ii) inadequacy of working capital and term loans. (iii) cumbersome procedural formalities in obtaining funds from financial institutions and banks, (iv) bureaucratic controls and long delays in sanctioning credit, (v) narrow credit worthiness in the money market and capital market due to limited resources.

A recent study of the Government of Tamil Nadu reveals that between 1980-81 and 1988-89 the average rate of growth of the SSI units had increased by 15.2 % with regard to number of units and by 19.9 % in respect of
productive capitals. While about 75% of the advances made by the banks for industrial development had gone to big industries, the small scale units had been able to get only 25%. It has been estimated that there is a shortage of Rs. 12,000 crore in the working capital requirements of the small scale industries.

In the light of the above facts, it is of considerable interest to know what are the various measures taken by the Government both at the Centre and at the State to assist and promote small scale industries. Coimbatore is a leading industrial belt in Tamil Nadu. The number of small scale units keep on increasing at a steady rate resulting in more demand for funds. If this is so, how far the organised sector is able to meet the financial requirements of the small scale units?

The lending institutions mainly consider the financial efficiency of the borrowing units. In this context, how far the sample units are financially sound? There are different sources of finance to small scale units. Utilisation of a particular source is associated with several factors. Hence, it is desired to know what principal factors determine the level of utilisation of funds.
3. OBJECTIVES OF THE STUDY

In order to find out answers to the questions raised above, this study has been undertaken with the following objectives.

(i) To study the concepts of small scale industry and to review the progress of small scale industries in India and Tamil Nadu.

(ii) To examine the Government's measures and the role of various funding agencies in assisting and promoting small scale industries in India and Tamil Nadu.

(iii) To measure the extent of financial assistance extended by the organised sector to small scale industries with special reference to Coimbatore District.

(iv) To evaluate the financial performance of the selected small scale units.

(v) To analyse the level of utilisation of various sources of finance by the selected units and to identify the factors associated with the level of utilisation of such sources.

(vi) To suggest suitable measures for larger financial assistance and for better utilisation of various sources of finance.
4. METHODOLOGY

(i) Period of the Study

Data relating to the progress of small scale industries and the extent of financial assistance by the organised sector to the small scale units were collected for a period of ten years i.e., from 1983-84 to 1992-93. Data pertaining to the level of utilisation of various sources of finance and the financial performance of the sample units were collected for a period of five years i.e., from 1988-89 to 1992-93.

(ii) Sources of Data

The study is based on both primary and secondary data. Primary data were collected with the help of an interview schedule. Questions relating to the general information of the sample units, their financial performance and their opinion about the lending agencies were asked.

Secondary data were collected from the (a) Annual Credit Plans published by the Lead Bank of Coimbatore District namely Canara Bank, (b) District Action Plan prepared by the District Industries Centre (DIC), Coimbatore and (c) Publications of Small Industries Development Organisation (SIDO), National Small Industries Corporation (NSIC), Tamil Nadu Industrial Investment
(iii) Sampling Design

There are about 5,462 small scale units in Coimbatore Corporation area, of which 9% of them are engineering units. The units which are engaged in job work do not require much working capital since there is no investment in stock. Hence they are excluded from the sample. The study covers the engineering units which are involved in the manufacture of machinery, machine tools, electrical machinery (pumps and motors), basic metal and alloys, equipments and parts. There are 492 units which come under this category. Among them 50 units have been selected (being 10% of the population size) for the study by simple random sampling method.

(iv) Framework of Analysis

The data collected are grouped according to the requirements of the study. Statistical tools ranging from simple descriptive statistics to multiple correlation
and multiple regression have been used wherever necessary and inferences are drawn suitably.

The progress of the small scale industries in India and Tamil Nadu has been analysed with the help of time series analysis. To study the extent of financial assistance to the small scale industries by the organised sector, simple average and compound growth rate have been used. In order to find out the relationship between target and achievement of financial assistance to small scale units, correlation and regression techniques have been used. The financial performance of the sample units has been evaluated through accounting ratios namely profitability ratios, liquidity ratios, leverage ratios and turnover ratios.

In order to assess the extent of utilisation of various sources of finance, an Utilisation Index has been prepared. The borrowings of a unit from a particular source is expressed in terms of percentage of the total borrowings from the three sources. That is,

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Utilisation \text{ Index} = \frac{\text{Borrowing from a particular source}}{\text{Total borrowings from the three sources}} \times 100
\]

The term utilisation index and level of utilisation are used interchangeably in this study.
To ascertain whether there exists differences in the level of utilisation of finance between the groups of units classified based upon the qualitative and quantitative factors, Analysis of Variance (ANOVA) has been administered. For the purpose of identifying the various factors which are associated with the level of utilisation of various sources finance, correlation, multiple correlation and multiple regression have been employed.

The factors identified in order to assess the level of utilisation have been grouped as follows:

A. Qualitative Factors

The following are the qualitative factors.

a) Conditions imposed by lending agencies
b) Sanctioning procedure
c) Time taken for sanctioning the loan
d) Adequacy of the amount sanctioned
e) Attitude of the officials
f) Expenses of borrowing
g) Rate of interest
h) Enhancement conceded and
i) Educational qualification of the entrepreneurs.
B. Quantitative Factors

These are the entrepreneurs' personal factors and the financial factors of the sample units. They are,

j) Previous experience of the entrepreneur
k) Size of the unit (in terms of Total Assets)
l) Capacity utilised
m) Annual sales value
n) Profitability (Net profit ratio)
o) Stock turnover ratio
p) Assets turnover ratio
q) Liquidity (Current ratio)
r) Leverage (Debt-equity ratio)
s) Fixed assets to total assets ratio.

It is assumed that the level of utilisation of finance from a particular source may be affected by the above mentioned factors owing to the following reasons.

Qualitative Factors

(a) Where the conditions imposed by the lending agency are rigid, the borrowers cannot obtain the funds required easily. On the other hand, if the conditions are normal the units may not find it difficult to get the required funds easily and frequently.
(b) If the procedure for sanctioning the loan is simple, the borrowing units may be able to get their required finance. However, complicated procedure may impair the borrowings.

(c) Borrowers may be willing to borrow to a larger extent from that source which takes a short period for sanctioning of loans. Where the time taken for sanctioning the loan is long, the quantum of borrowing may be less.

(d) Inadequacy of the amount sanctioned will result in less utilisation of funds from that particular source. Level of utilisation may be high if the amount sanctioned is adequate.

(e) The units may prefer to borrow much from that source whose officials' attitude is courteous. Indifferent attitude of the officials of the lending agency may affect the extent of borrowing from that source.

(f) Where the expenses of borrowing (documentation fees and other expenses) differ among the different sources, the units may prefer to borrow from that source where the expenses will be low.

(g) Generally the rate of interest charged by the banks and financial institutions is lower than the rate of interest charged by the indigenous bankers. Hence, the small scale units are likely to borrow from banks and financial institutions to a greater extent.
(h) If the enhancement conceded by a lending agency is adequate the level of borrowing may be much. On the other hand if it is inadequate or turned down, the units may prefer to utilise other sources.

(i) Expansion of units may be resorted to a greater extent by technically qualified entrepreneurs than the non-technically qualified entrepreneurs. This is likely to lead to differences in the financial requirements between these two types of entrepreneurs.

Quantitative Factors

(j) Entrepreneurs with previous experience may have better knowledge of the different sources of finance and this helps them to utilise the advantageous source to a greater extent.

(k) Financial requirements of a unit depends on the size of the unit. Large sized units are likely to have greater financial requirements as compared to the smaller ones.

(l) Working capital needs of a unit depend on the level of capacity utilised. The higher the level of capacity utilisation, the greater is the working capital requirement leading to greater level of utilisation.
Aggregate sales value is an important element which determines the financial requirements of an enterprise. Large volume of sales is to be supported by an adequate production. Further, the RBI has directed commercial banks to provide 20% of the sales value as working capital loan to small scale units.

Repayment capacity of the units depends on the rate with which the profits are earned. Units with adequate profit can have higher level of utilisation since the lending agencies may be ready to grant the loan.

Stock turnover ratio indicates the speed with which stock is converted into sales. A high stock turnover ratio leads to higher level of production making it necessary to procure raw materials in bulk. This is likely to lead to higher level of utilisation.

Assets turnover ratio indicates the efficiency of the utilisation of assets. A high ratio may be a result of large turnover or lower value of total assets. Both necessitate high level of utilisation.

Lending agencies, especially short term creditors, extend financial assistance on the basis of the short term financial strength of the borrowers. The current ratio measures the short term liquidity position. Hence units with a better current ratio may be in a position to utilise external sources of finance much.
(r) Debt-equity ratio measures the creditors' interest in the firm. A high debt-equity ratio indicates greater utilisation of external funds.

(s) Acquisition of fixed assets necessitates utilisation of term finance either from banks or financial institutions. Hence the proportion of fixed assets to total assets may affect the level of utilisation.

5. OPERATIONAL DEFINITIONS

(i) Small Scale Industries

Small scale industries have been defined mainly in terms of value of investment in plant and machinery. Modern small scale industries mainly use power operated appliances and machinery and have some technological sophistication and are generally located close to large urban industrial centres.

As per the notification issued by the Government of India, a small scale industrial undertaking is one in which the investment in plant and machinery whether held on ownership terms or on lease or by hire purchase does not exceed Rs. 60 lakhs. The limit is Rs. 75 lakhs in case of an undertaking which exports at least 30% of the annual production by the end of the third year from the date of its commencing production. The term 'small scale
industry' and 'small scale unit' are used interchangeably in this study.

(ii) Tiny Enterprises

A tiny unit is one in which the investment in plant and machinery does not exceed rupees five lakhs.

(iii) Small Scale Sector

It includes modern small scale industries, handloom, cottage, Khadi and village industries, road transport operators, retail trade and small business.

(iv) Priority Sector

As per the RBI directives, from time to time, priority sector consists of Agriculture and Allied Activities, Small Scale Sector and Services which include professionals and self-employed, education, rural housing and consumption loans to weaker sections.

(v) Engineering Industry

It includes industries which are engaged in the manufacture of machinery, machine tools and parts, electrical machinery, apparatus and appliances.
(vi) Bank Finance

It refers to the volume of financial assistance in the form of term loan and working capital loan obtained from commercial banks.

(vii) Institutional Finance

It means the volume of financial assistance in the form of term loans received from financial institutions such as Tamil Nadu Industrial Investment Corporation (TIIC), National Small Industries Corporation (NSIC) and Small Industries Development Corporation (SIDCO).

(viii) Indigenous Source of Finance

It refers to the volume of financial assistance obtained from indigenous sources such as Money Lenders, Private Finance Companies, Chit Companies and Friends and Relatives.
6. REVIEW OF RELATED LITERATURE

A number of studies have been carried covering the various aspects related to small scale industries. A brief resume of some of the studies carried out is given in the following paragraphs.

Dr. Thanulingom, N.12., in his study entitled "Small Scale Engineering Industry and its Inter-relationship with Large Scale Industry" found out that technical qualification of the entrepreneurs, nearness to large scale units, nature of product of small scale units and previous employment of the entrepreneurs are some of the factors which influence the degree of inter-relationship of small scale units with large scale industry.

The study entitled "Marketing Management In Small Scale Industry", carried out by Dr. Krishna Mohan13, analysed the factors like product policies and development, pricing practices, channels of distribution and promotional mix strategies, personal selling, advertising and sales promotion methods of the small scale industries.

A study conducted by Satyanarayana, G.14 entitled "The Problems and Prospects of Small Ancillary Industrial Units" outlined the rationale of ancillary industrial development and examined the parent-
ancillary relationship among the large scale industrial units.

Dr. Surya Prakash Rao in his study entitled, "Human Resources Management in Small Industry", found out that employers' knowledge of human resource planning is limited and is of the opinion that human resource planning is not essential in small industry. Experience and competence and recommendations are the guiding factors in selective decisions. Participative schemes and profit sharing plans are not popular in small scale industry.

The study entitled, "Financial Ratios as Predictors of Borrower's Health - with special reference to Small Scale Industries in India" carried out by Dr. Kaveri, V.S., examined the predictive ability of the ratios keeping in mind the banker-borrower relationship. This study has developed a discriminate model for predicting the borrower's health. This model is of much use to the bankers in managing their accounts of small industrial units.

Balakrishnan, G., in his study entitled, "Financing Small Scale Industries in India", analysed the financial experience of joint stock companies in the small scale sector and found that these had a low profit
earning capacity due to higher cost of production and higher rate of interest.

In his study entitled, "Problems and Incidence of Sickness in Small Enterprises", Dr. Chandra Prasad, J., found that the incidence of sickness is more in capital goods industries. Shortage of working capital, raw materials, power, droughts, floods and credit squeeze of the RBI are the external factors causing sickness. Financing of similar units in the same area, lack of adequate staff, misuse of power by branch managers, eagerness of lending institutions to recover their money first are found to be the major factors contributing to sickness in the units assisted by the Andra Pradesh State Financial Corporation.

Dr. Pattanaik, S.M., in his study on, "Development Strategy for Small Industries", has stated that obtaining credit in adequate quantum is still a problem due to lack of collateral security, margin money, absence of reference, ineligibility and procedural difficulties. The resources gap is accentuated by frequent credit squeeze imposed by Reserve Bank of India, upward revision of raw material prices, the time gap between bank credit enhancement sought and its actual release, overtrading, increase in overhead bills, delay in realisation and finally by diversion of finances for non-business purposes.
The study, "Effectiveness of Bank Financing to Small Industries" by Dr. Subramanya Sarma, M., and Rajalingam, P., reveals that there is significant association between the growth in number of units and growth in amount assisted. Thus, increase in the amount assisted appears to be justified in relation to the increase in units. It has been found that there is no significant association between timely financial assistance and revitalisation from sickness.

Dr. Shashi Bala, in his study "Management of Small Scale Industries" found that small entrepreneurs obtained loans from institutional and non-institutional sources. Among the institutional sources banks constituted the most important source. Loans from them amounted to 90% of total loans. The other institutional sources are the Department of Industries and the Government Corporations. Non-institutional sources comprised of friends and relatives and traders. Among them, traders constituted an important source of credit. The smaller the size of the unit, the greater was its dependence on non-institutional sources.

In the study entitled, "Bank Finance for Village and Small Industries" by Raghava Reddy, G., it was pointed out that village and small scale industries contributed 49% of the net domestic product in the
manufacturing sector but received only 24% of the bank credit going to this sector.

The study, "Institutional Finance to Small Scale Industries", by Dr. Neelamegam, R.,23 suggested that two Industrial Development Banks must be established—one for large scale industries and another for small scale industries. A striking feature is that the suggestion materialised with the establishment of Small Industries Development Bank of India (SIDBI) meant for SSI units in 1990.

In his study entitled, "Problems of Small Scale Industries", Dr. Nelson Samuel, P.,24 analysed the various measures and magnitude of institutional support to the small scale units.

Dr. Ram Dawar,25 in his study entitled, "Institutional Finance to Small Scale Industries" stated that the supply of industrial plant and machinery and equipment on hire purchase has not yet become so popular in India. State Small Industries Corporations (SSIC) could not make much progress in their hire purchase schemes due to lack of funds and bad recovery. In comparison with the term loan scheme of State Bank of India and Andhra Pradesh State Finance Corporation, the NSIC's hire purchase scheme is better in respect of rate of interest,
fees and charges. The control and monitoring methods adopted by the corporations with regard to their hire purchase clients are not much effective in preventing defaults or minimising them.

The Working Group on Small Scale Industries set up by the Administrative Reforms Commission26 stated on the basis of a survey conducted by the Central Small Industries Organisation that on an average only 20% of the credit needs of the small scale sector are being met by institutional sources.

Ram K. Vepa,27 found that despite a well developed institutional framework, it was urban based and comparatively bigger entrepreneurs who obtained bulk of the advances made to the small scale sector.

Dhar, P.N.,28 in his survey in Delhi found that the only source of external finance to the small scale units consisted of friends and relatives and traders.

Inderjit Singh and Gupta, N.S.,29 in their survey in Jammu and Kashmir pointed out the inadequacy of institutional credit and it accounted for only 5.1% of the borrowings.
Misra, J.N.,\textsuperscript{30} in his study in Sangor district found that industrialists preferred private money lender to a co-operative bank, for meeting their needs because of complicated formalities, cumbersome procedures and undue delay.

Ramakrishnan, P.,\textsuperscript{31} in his study in Delhi found that entrepreneurs were prepared to pay or had paid a much higher rate of interest to non-banking sources to avoid bank formalities.

Though the above cited studies have broadly dealt with the institutional assistance to small scale industries, there is no single study covering extensively the level of financial assistance to small scale industries and the factors associated with the level of borrowing. The present study has been carried out to bridge this gap.

7. SIGNIFICANCE OF THE STUDY

The results of the study are likely to facilitate greater and better financial assistance to small scale industries by the lending agencies. The small scale units may also be benefitted by this study by which they can know the means for better utilisation of finance from banks and financial institutions. Further, the study is
likely to serve as a guide to the Government when it decides financial policies affecting the small scale units.

8. LIMITATIONS OF THE STUDY

As the industrial environment varies from place to place, caution may be exercised while extending the findings of the study to other areas. There may be hidden inconsistencies in the financial data provided by the sample units. Accuracy of the data has not been probed into and the data as given have been made use of for the study. The study is an opinion based study and as such the opinions may differ among the entrepreneurs. Financial ratios have been used for assessing the financial performance of the study units. Hence the limitations of ratio analysis are equally applicable to this study also.

9. CHAPTER SCHEME

The report of the study is divided into seven chapters:

The First chapter deals with the introduction and design of the study.

The Second chapter gives an outline of the concepts of small scale industries, their position and progress in India and Tamil Nadu. It also explains the
Government measures and the role of various agencies in assisting and promoting small scale industries.

The Third chapter examines the extent of financial assistance extended to the small scale industries by the organised sector. It also gives an account of the targets of assistance fixed and the actual performance.

The Fourth chapter presents the profile of the Coimbatore district and the sample units.

The Fifth chapter evaluates the financial performance of the sample units. The level of profitability, liquidity, leverage and activity have been examined with appropriate ratios.

The Sixth chapter analyses the level of utilisation of various sources of finance by the sample units and identifies the various factors which are associated with the level of utilisation.

The Seventh chapter recapitulates the findings and suggests various measures for greater financial assistance and better utilisation of the sources of finance.
REFERENCES


2. Ibid., p. 11.

3. Ibid. p. 12.


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25. Dr. Ram Dawar, op. cit., p. 290.


