CHAPTER VIII
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SUMMARY OF FINDINGS AND RECOMMENDATIONS

I

SUMMARY

In a capital, scarce and labour-abundant country like ours, wedded to the twin objectives of growth and social justice, small scale industries have come to occupy a pivotal role in the industrialisation of the economy. They serve as harbingers of economic progress and act as catalytic agents for the transformation of traditional society into a modern one.

Realising their importance both Central and State Governments have taken several measures to encourage the small scale sector. The increasing allocations made in the successive plans, cheap credit on a priority basis, tax benefits, subsidies, concessions on import of raw materials and machinery, reservation of several items for exclusive production etc., reflect the promotional and protectionist policies adopted by the Government towards the development of this sector. As a result of these
policies, the small scale sector has emerged into an important segment of the industrial structure of the country, providing employment to about 9 million people, earning foreign exchange to the tune of Rs. 2,750 crores and contributing 40 per cent to industrial production.

Because of this dynamic role played by the Small Scale sector of industry, many studies have been undertaken to assess the role of Small Scale Industries in the economy and to evaluate its performance, problems and prospects. Most of these studies have pointed out that finance is one of the major problems faced by the Small Scale Industry. Unfortunately, however, they have not paid adequate attention to the managerial aspects of finance which according to us, are of crucial importance not only for starting a unit, but also for ensuring its survival and growth in later years.

The present study had been taken up with the following specific objectives:

1) To identify and evaluate the various sources of finance both long-term and short-term tapped by the small units.
2) To find out the problems faced by the units while raising finance from Institutional and non-Institutional sources.
3) To study the manner in which the funds of the business have been deployed.

4) To examine the policies, procedures and practices followed by Small Units in managing their finances.

5) To evaluate the performance of the units in the light of well known principles of financial management.

6) To make suggestions for improving the management of finance.

**METHODOLOGY:**

With the above objectives in view, a field survey was conducted in Bellary district of Karnataka State. The units for the study were selected on the basis of two-stage stratified random sampling. At the first stage, the units were classified according to investment into 5 groups, ranging from Rs. 1 lakh upwards with intervals of Rs. 5 lakhs each. The units with a total investment of less than Rs. 1 lakh were dropped, as they were managed mostly by illiterates who did not maintain proper records, books of accounts etc. At the second stage, units were classified according to the product manufactured into two broad categories — agro based and non-agro based. Keeping in
view these two criteria 120 units were selected at random for an in-depth study from the list of registered units collected from the District Industries Centres, Bellary. 19 units could not supply the required information and had therefore to be kept out at later stages. The sample that finally emerged thus consisted of 101 units.

The data collected from the sample units was analyzed separately for different groups — agro based, non-agro based and investment based. While analyzing the data, statistical tools like averages, percentages, and ratios were used for comparison over time and across units.

FINDINGS:

Our initial attempt in the enquiry was to assess the various sources of finance raised by the units. Before actually making an attempt in this direction, we were tempted to know whether the owners/managers of the units were aware of the institutions supplying both long-term and short-term finance. Our study revealed that there was a high degree of communication gap. It was rather distressing to note that 98 per cent of units were not aware of institutions like National Small Industries
Corporation (NSIC), and Karnataka State Small Industries Development Corporation (KSSIC), engaged in the supply of term finance through hire purchase facility. The units were also totally unaware of Industrial Co-operatives and Regional Rural Banks engaged in the supply of short-term funds.

While assessing the various sources of finance raised by the sample units we found that 30 per cent of units did not approach any financial institutions for term finance because of complicated procedures, and the numerous documents which had to be submitted along with the loan applications etc. A majority amongst them (about 60 per cent) were afraid of external interference in their affairs and therefore preferred to stay out.

Of the remaining units that approached financial institutions, 30 borrowed from NSIC, 35 from commercial banks and about 6 from other sources. 48 per cent of the units reported that there was no problem in getting finance from financial institutions except delay in the release of funds. In the remaining units it was found that 20 per cent of the units experienced problems like complicated procedures, 11 per cent complained about inconsistent behaviour of officials in charge in appraising
the project. About 10 per cent expressed their disappointment in procuring the required number of documents which are necessary for getting the funds. There were also units which could not muster and offer adequate security/surety acceptable to the institutions. Another interesting revelation was that the officers incharge of project appraisals sometimes did not have thorough knowledge of the project and were rejecting the proposals/projects on flimsy grounds.

Our enquiry did not stop here. We probed further to know how these funds were utilised by the borrower units. The study revealed that about 68 per cent of the units under agro based and 77 per cent under non-agro based, had utilised the funds in acquiring fixed assets. About 11 per cent of the total number of units utilised the funds in acquiring both fixed assets and inventory, and 4 per cent of the units diverted these funds to sister concerns. Thus, in spite of strict control, 25 per cent of the units had committed default in the utilisation/application of funds.

Retained Profits generally constitutes an important source of internal finance. However, the study reveals that about 72 per cent units under agro based group, and non-agro
based group however did not have any provision for retention of profits. Of the units that retained profits, 60 per cent retained less than 10 per cent of profits.

A comparative study of agro based and non-agro based groups in respect of capital structure showed that of the average total capital employed, equity constituted 64 per cent including reserves of 3 per cent and long term borrowings accounted for 35 per cent in the case of agro based units. For the non-agro based units, equity accounted for 61 per cent including reserves of 6 per cent and long-term borrowings accounted to 29 per cent of the total capital employed.

Analysis along different investment groups showed that, on an average, 80 per cent of the total funds had come from equity and 20 per cent from long-term borrowings in Group I; whereas in Group V, the respective contributions stood at 77 per cent and 43 per cent. Thus smallest among small units depended more on self-finance for additional capital requirements than the larger units. They lacked the capacity to offer the required security for the loans and were rather suspicious of external references in case they borrowed from outside sources.
The Debt-Equity ratio for the agro and non-agro based groups came to 0.56 and 0.63 respectively. This implies that they were trading on 'Thick Equity'. The ratio was less than 1 even for the largest investment groups.

A majority of the owners/managers did not have a clear-cut idea of the cost of capital. The concept of 'opportunity cost' was unknown to most of them. Some considered costs only in terms of interest paid on borrowings. The 'Imputed' value of interest on owned funds was seldom taken into account.

The amount and composition of short-term funds differed from one group to another and from one unit to another even in the same group. It comprised about 50 per cent of total funds in agro based group and about 46 per cent of total funds in the non-agro based group. An investment wise analysis showed that the contribution of short-term sources came to 61 per cent of total funds in Group V, compared to about 37 per cent in Group II and III, and 30 per cent in Group I and IV.

On an average 56 per cent of short-term finance had come from trade credits in agro based units, compared to only 38 per cent in the non-agro based group. Trade Credits accounted
for 50 per cent of short-term funds in Group V, compared to about 30 to 35 per cent in other groups. The credit period in agro based industries generally extended from 15 to 30 days, compared with 8 to 15 days in non-agro based group. Some of the units in the latter group had to pay cash against delivery, and some had to make the payment even in advance.

35 per cent of short-term funds in agro based group and 32 per cent in non-agro based group have been contributed by banks. They provided 35 per cent of short-term requirements to the units in Group I, II and V.

It has been noticed that of late the role of other sources of short-term finance like local finance corporations, friends and relatives and accruals is gradually declining. It appears that the sample units are cautious about the cost, though borrowings from these sources do exist under some critical situations.

A review of working capital finance showed that about 1/3 of working capital requirements in agro based and 1/4 in non-agro based units has been provided by Banks. Similarly, an analysis on the basis of investment showed that in higher investment groups namely group IV and V about 1/3 of working capital finance is provided by the same source.
Another popular source of working capital finance close to Banks was Trade Credit. It has contributed about 53 per cent of working capital requirements in agro based units compared to only 32 per cent in non-agro based units. Further, on the basis of investment it was found that group II had highest contribution from this source amounting to 64 per cent compared to 47 per cent of group V and 30 per cent of Group I.

Amongst other sources of finance local finance corporations was a significant source contributing on an average about 12 per cent in non-agro based units as against 5 per cent in agro based units. An investment wise analysis showed that units in Group I, II and III depended more on this source compared to others. It appears that the problem of security and surety in case of term-finance lending institutions must have made the units to approach these corporations for short term funds.

No unit had obtained loan from co-operative bank or Regional Rural Banks.

The structure of Assets in agro based units showed that of the total assets Fixed Assets constituted 44 per cent, Current Assets 55 per cent, and Other Assets 3 per cent. The corresponding percentages were 39, 56 and 5 in non-agro based
units. On the basis of investment, the units in Group V had only \( \frac{1}{3} \) of total capital blocked in fixed assets compared to \( \frac{1}{2} \) in all other groups. This showed that the owners/managers of small units did not give adequate thought before acquiring fixed assets. In most of the cases investment in fixed assets was based on emotional responses. They suffered from demonstration effect and possessive instincts.

Plant and Machinery constituted only 55 per cent of total fixed assets in agro based group, compared to 67 per cent in the non-agro based group. Land and Building constituted another important fixed asset accounting for 45 per cent of total investment in fixed assets in agro based group. By contrast, the funds blocked in this asset amounted to only 32 per cent of fixed capital employed by non-agro based units. An investment-wise analysis showed that almost 50 per cent of the funds were blocked in this asset in Group II followed by 43 per cent in Group V and 41 per cent in Group III. Investment in Furniture and Fixtures constituted less than 1 per cent of the total fixed assets, irrespective of the industry and the investment Group to which the units belonged.

The ratio of sales to fixed assets showing their turnover stood at 4.20 in agro based group and 4.53 in non-agro based
group, compared to State average of 4.069. Units falling under Investment Group V turned over their fixed assets at an average rate of 6.61 per annum. This indicates that units in the highest investment group had utilised their fixed assets more effectively, compared to units in the lower investment groups.

Equity and long-term borrowings, put together had provided sufficient funds not only to acquire fixed assets but also to meet a part of working capital requirements. In the case of Cotton and Ginning and Pressing Units, and Chemicals, a portion of the fixed assets was financed by short-term funds in the initial years of the study. This indicates lack of financial maturity on the part of these units. The proportion of the fixed assets financed by the short-term funds however, was very low.

93 per cent of agro based units and 59 per cent of non-agro based units did not have any depreciation policy. Depreciation was often charged arbitrarily to temper with profits. Instead of treating depreciation as a necessary element of cost, it was often determined by the profits available.

The management of current assets like Cash, Accounts Receivable and Inventories, showed wide variations in between
different units, 80 per cent of the units held cash to meet their current obligations under both agro and non-agro based groups. This percentage declined from 96 per cent in Investment Group I to 60 per cent in Group V.

The units under different groups were not preparing Cash Plans or Cash Flow Charts, consequently the units had failed to synchronise their cash flows and had to borrow at times indiscriminately from local finance corporations, and friends and relatives at usurious rates of interest. Most of the units were suffering from cash crises and were on the brink of technical, if not actual insolvency.

Accounts receivable constituted 50 per cent of current assets both in agro based and non-agro based groups. 30 days credit was granted by 79 per cent of agro based units and by 67 per cent of non-agro based units. Cash discount was offered by 30 per cent of non-agro based units if the payment was made within 10 days. In the agro based units this practice was not observed, for collecting credit information 57 per cent of agro based units depended on their brokers/agents, whereas in non-agro based group 77 per cent depended on trade references. In regards to collection policies, most of the units relied on moral
persuasion and compromises. The owners/managers were ignorant of Ageing Schedule of Debtors. They prepared a list of debtors called "Taski Patti" which did not show the 'age' of debtors. Due to laxity in collection policy, bad debts percentage amounted to about 5 per cent in all groups. The average collection period stood at 49 days in agro based group, compared to 61 days in non-agro based group. During the period under review we found that growth of receivables was much higher than the growth of sales in almost all cases. This is the result of liberal credit policies followed by the units under competitive pressure.

The average Receivables Turnover Ratio in agro based units came to 7.25, whereas it was 5.91 in non-agro based units. Units in Investment Group 9 showed much lower turnover compared to other groups.

Inventory as a percentage of current assets increased from 48.22 per cent to 51.92 per cent during the study period for the sample units taken as a whole, for the agro and non-agro units the increases were from 49.10 to 54.06 and from 47.33 to 49.85 respectively. The reasons for this disparity were found in the motive which inspired stock piling. Nearly 91 per cent of agro based units hold inventory to take advantage
of price changes. On the other hand 55 per cent of the units in non-agro based group held inventory as a safeguard against 'stock-outs'. While acquiring inventory agro based units had not adopted any systematic model because of their seasonal nature, whereas the non-agro based units depended upon intuition and judgement. Durning a couple of units in Food and Beverages and Engineering groups none appeared to be aware of inventory control system like A.B.C. analysis etc. The level of inventory had grown disproportionately, compared to that of sales in almost all cases. This shows that stock piling was governed by considerations other than the actual needs of production or sale.

II RECOMMENDATIONS

Consistent with the objectives of our study, the following suggestions could be offered to improve the financial position of the sample units in various areas. The adoption of the proposed policy measures, it is hoped would increase the liquidity of the enterprises and at the same time enhance the profitability without exposing them to unbearable risks.
1. **Redefinition of Small Scale Industry Units in Terms of Turnover**

There is an urgent need to redefine small scale units on the basis of 'turnover' in place of the present norm of investment in Plant and Machinery. Ceiling on investment in Plant and Machinery puts an embargo on the development of technology and often deprives the unit of producing sophisticated quality goods which can withstand competition in the market. In actual practice investment limits have not been effective due to under valuation practices being adopted by many large scale units with a view to enjoying the status of small units and avail the concessions meant for them. Removal of the investment limit will only lead to an open recognition of this undeniable fact. If a limit is placed on sale, the so-called 'small units' with very high value of turnover will be automatically deprived of the concessions enjoyed by them under the present eligibility rules.

2. **Organisation of Management and Entrepreneurial Development Programmes by DlCs.**

As the nature of management in SSI units is proprietary and not professional, the success depends upon the person running the show. A good entrepreneur can make a sick unit
viable whereas an incompetent one can make even a successful unit sick. Most of the times the critical decisions in the unit are taken on the rule of thumb and intuition. It is therefore, suggested that Management Development Programmes be organised by the district authorities like District Industries Centre (DIC) etc. Such programmes, we hope would prevent sickness and ensure growth of small units, on a stable basis.

3. Establishment of NSIC Branches at District Head Quarters

The financial assistance extended by NSIC has not percolated to interior parts of the country, but has remained confined to metropolitan and cosmopolitan centres. In order to see that the benefit reaches all parts, a branch office may be established at all district head quarters.

4. Simplification of Loan Procedures and Project Appraisals

In the case of institutions engaged in the supply of term finance i.e., K.C.P.C. etc., there is need for simplifying the procedures in extending finance. Besides, the personnel in charge of project appraisal should be given adequate training to upgrade both their knowledge and attitude.
5. **Re-Orientatlon in Bank Lending Policies**

It is seen that banks are conservative in their lending operations to small scale units. The same appraisal methodology is being adopted by the banks both for large borrowers and small borrowers. Besides, these days banks insist on adequate collateral security. Therefore, what is necessary is that banks should lay emphasis on viability of the project and personal qualities of the promoter rather than on security. Further, the banker should monitor the utilisation of loans.

6. **Lower Interest Rates for Small Units**

The general belief that borrowed funds are cheaper than owned funds due to 'tax shield' does not hold particularly true in the context of small units. The tax shield moving in direct proportion to marginal rates of tax and consequently makes the borrowed funds cheaper to a person who pays tax at higher rates. Thus the effective interest rates in respect of SSU are high owing to lower marginal tax rates. Low tax rates which are apparently favourable to small scale units, go against them when it comes to the question of raising funds. Therefore, "Small is Beautiful" certainly will not operate in these cases to the
advantage of entrepreneur. Then what is the way out? Increasing the tax rates to enable small scale units to enjoy the benefit of tax shield is a self defeating proposition. Therefore, it is recommended that the interest rates payable by small scale units should be considerably lowered in order to see that the debt becomes cheaper to them too.

7. **Exemption of Retained Earnings from Taxation**

The safest and surest source of funds for a growing unit is the earnings which are ploughed back into the business. Under the dear money economy every rupee ploughed back makes the unit stronger, stable and less dependent on outside sources both for working capital and fixed capital requirements. There is urgent need at this juncture that the Government should rationalise the tax structure and provide new tax concessions which would go a long way in tempting the units to retain their earnings for modernisation and growth. To begin with profits ploughed back into business should be exempted from tax at a graded scale.

8. **Separate Tax Schedule for Small Scale Industries**

Because of the growing importance of Small Scale Sector in the Indian industry, there is need to have separate schedule
of income-tax rates for taxing the Small Scale Sector. This will bring about uniformity in the tax rates irrespective of the form of organisation like proprietary concerns, partnership firms, etc.

9. **Introduction of Leasing for Plant and Machinery**

The Central and State Financial Institutions (BSIC, KSIC, etc.) at present rendering long-term financial assistance to acquire equipment should explore the possibilities of supplying the equipment on lease basis. This would enable the units to replace worn out plants and at the same time improve their working capital.

10. **Preparation of Regular Budgets by the Units**

The Small Scale Industrialists should be made to realise the importance of 'budgeting' including cash projections on a systematic basis at frequent intervals. This will help to synchronise the cash flows.

11. **Reform of Credit and Collection Policies and Procedures**

Most of the small scale units suffer on account of increasing receivables, sticky accounts, overdue accounts and
bad debts. It is a luxury and the units under reference can ill afford. At present there is no credit rating system nor is there any agency undertaking this type of activity. We are of the opinion that the Local Small Scale Industries Association should disseminate information amongst its members with regard to sticky accounts and doubtful debts. The units may be advised to prepare Ageing Schedule of debtors to keep track of receivables.

12. **Set Off of Dues from Government Against Payables to Financial Institutions**

There are cases where SSUs having supplied goods to Government agencies have to wait for months together for collecting receivables. On the other hand, the same units come under heavy pressure from other Government agencies like institutional financiers for servicing loan. This is a very funny situation where in the Balance Sheet of Small Scale Units Government appears as a debtor and creditor both. We are convinced that such accounts can be squared up without any complications once the receiving party certifies the quality of goods supplied.
13. Improvement in the Mechanism for Supply of Raw Materials

Small Scale Units can also be helped by the Government in maintaining regular supply of raw materials at control prices with streamlined distribution procedure. It will help those units in looking up of funds unnecessarily in such items.

14. Control on the Size and Structure of Inventories

For the purpose of effective production and sales, the inventory should be properly classified into raw materials, finished goods, stores and spares etc. and their consumption is to be monitored specially in non-agro based industries. Further necessary, slow moving and obsolete stocks, parts etc. should be disposed of at even throw away prices to ensure release of funds blocked in such items which will solve working capital problems. In order to have effective control over inventory it is suggested that 'Inventory Report' should be prepared every month by units in which such reporting is adopted only once or twice a year. There is an urgent need to impart the knowledge of various inventory models developed in recent times by material management experts.
15. **Integration of Long-Term Loans with Short-Term Loans**

The present practice of separate financing institutions providing long-term and short-term finance has led to several malpractices. Efforts should therefore be made to ensure proper integration and co-ordination between these activities through the mediation of lead banks in each district.

16. **Establishment of Apex Institution**

There is an urgent need for the establishment of an apex institution on the lines of NABARD with branches all over the States, for the specific purpose of 'monitoring' the impact of institutional finance on the growth of the Small Scale Units in different parts of the country. This may be called by the acronym NABSID (National Bank for Small Industry Development).