6

FINANCING OF PAPER INDUSTRY

6.1 SOURCES OF FINANCE

6.2 RELATIVE IMPORTANCE OF INTERNAL AND EXTERNAL SOURCES

6.3 ROLE AND COMPOSITION OF INTERNAL SOURCES

- 6.3.1 Paid-up Capital
- 6.3.2 Shareholders' Reserves
- 6.3.3 Provisions
- 6.3.4 Role of Retained Earnings
  - 6.3.4.1 Profits Retained as percentage of PBT
  - 6.3.4.2 Profits Retained as percentage of PAT
- 6.3.5 Contribution of Internal Sources to Gross Capital Formation
- 6.3.6 Contribution of Internal Sources to Gross Fixed Assets

6.4 ROLE AND COMPOSITION OF EXTERNAL SOURCES

- 6.4.1 Borrowings
- 6.4.2 Trade Dues/Credit and Current Liabilities.

6.5 SUMMING-UP

6

FINANCING OF PAPER INDUSTRY

This chapter aims at identifying the various sources of finance available to paper industry in India. An attempt is also made to analyse the changing structure of finance and the role of internal as well as external sources in financing paper industry especially in the sample units covered under the present study.

6.1 SOURCES OF FINANCE

The funds required for investment in fixed and current assets by the paper mills in India are obtained from many sources. They are : (i) issue of shares to public, (ii) creating reserves through ploughing back of profits, (iii) borrowing from the public and banks in the form of debentures, (iv) loans and deposits and accumulation of account payable in respect of current liability, in respect of taxation and benefits to employees, and (v) credit obtained from suppliers of raw materials and stores. These can be divided into internal and external sources. Internal finance represents the sum of (i) paid-up capital, (ii) reserves and surplus (amount transferred during the year to various reserves), (iii) provision for depreciation, (iv) tax provision, (v) net of advance income-tax, and (vi) other non-current provisions.

Internal sources comprise the funds that are generated by a company within itself. Internally generated funds have contributed enormously to the financing and growth of companies in recent times. A great merit of having internal funds is their low relative cost. The permanence of such funds minimises solvency risks too. The economic justification of any organisation lies in its contribution to economy. The generation of internal funds clearly shows health and buoyancy of a good corporation. Internal sources are very much needed for expansion, diversification of the activities of the organisation.

It may be noted here that there has been considerable controversy on the role of internal finance as a secular force. Linter (1960), for instance, observed on long-term trend towards increasing reliance upon internal funds [1]. Using evidence of the secular stability of the ratio of new common stock to all new security finance and assuming that short-term financial trends were irrelelvant, Miller (1963) hypothesized that the ratio of new common stock to total new corporate finance is stable and finally infers that the corporate prosperity to save remains essentially unchanged. Burns on the contrary, argues that the growing importance of internal financing has reduced the reliance of business firms on externally raised capital so that they are hedged effectively against the ordinary fluctuations in the credit markets. Similar studies of the Indian corporate sector have been far too scanty. The studies on corporate savings by Braj Kishore [2], Sastry and Krishna Murthy [3], Rao and Sharma [4] are relevant in this context. It is an established fact that internal financing constitutes a substantial portion of financing for a number of reasons :-

1. It is an inexpensive method of acquiring funds.
2. Ploughing back of earnings avoids taxation leakage, and
3. It stimulates a high growth rate [5].

External funds, on the other hand funds raised through various means such as a) new capital issues, (b) borrowings consisting of borrowings from banks, special financial institutions, government and others, (c) trade dues and other current liabilities, and (d) miscellaneous non-current liabilities. External sources of finance have always played an important role in financing paper industry in India. During the last ten years the external sources, on an average have contributed around 48.7 per cent of the total funds.

6.2 RELATIVE IMPORTANCE OF INTERNAL AND EXTERNAL SOURCES

Data on the relative importance of internal and external sources of funds in the total sources for the sample units during the period under study are presented in Table - 6.1.

Table 6.1 Share of Internal and External Sources of Finance

(Rs.in Crores)

Year	Internal Sources	External Sources	Total	% Share of Internal Sources	% Share of External Sources
1	2	3	4	5	6
1980-81	171.4	161.8	333.2	51.44	48.56
1981-82	182.6	250.9	433.5	42.12	57.88
1982-83	291.1	322.2	613.3	47.46	52.54
1983-84	204.5	318.6	523.1	39.09	60.90
1984-85	485.9	354.5	840.4	57.84	42.17
1985-86	583.2	375.4	958.6	60.83	39.16
1986-87	570.4	431.4	1001.5	56.93	43.06
1987-88	538.9	426.5	965.4	55.82	44.17
1988-89	555.0	551.0	1106.0	50.18	49.81
1989-90	605.9	561.3	1167.2	51.91	48.08
Average of :					
1980-85	267.1	281.6	548.7	47.6	52.4
1985-90	570.7	469.1	1039.8	55.1	44.9
Average of :					
1981-90	418.9	375.4	794.3	51.4	48.7

Source : Computed.

The overall pattern of financing of the industry denotes that both internal and external have contributed almost equally for financing paper industry in India, the share of the former being 51.4% and that of the latter 48.7 %. Only in three years out of ten, the external sources outweighed the internal sources. The shares of the external sources was the highest

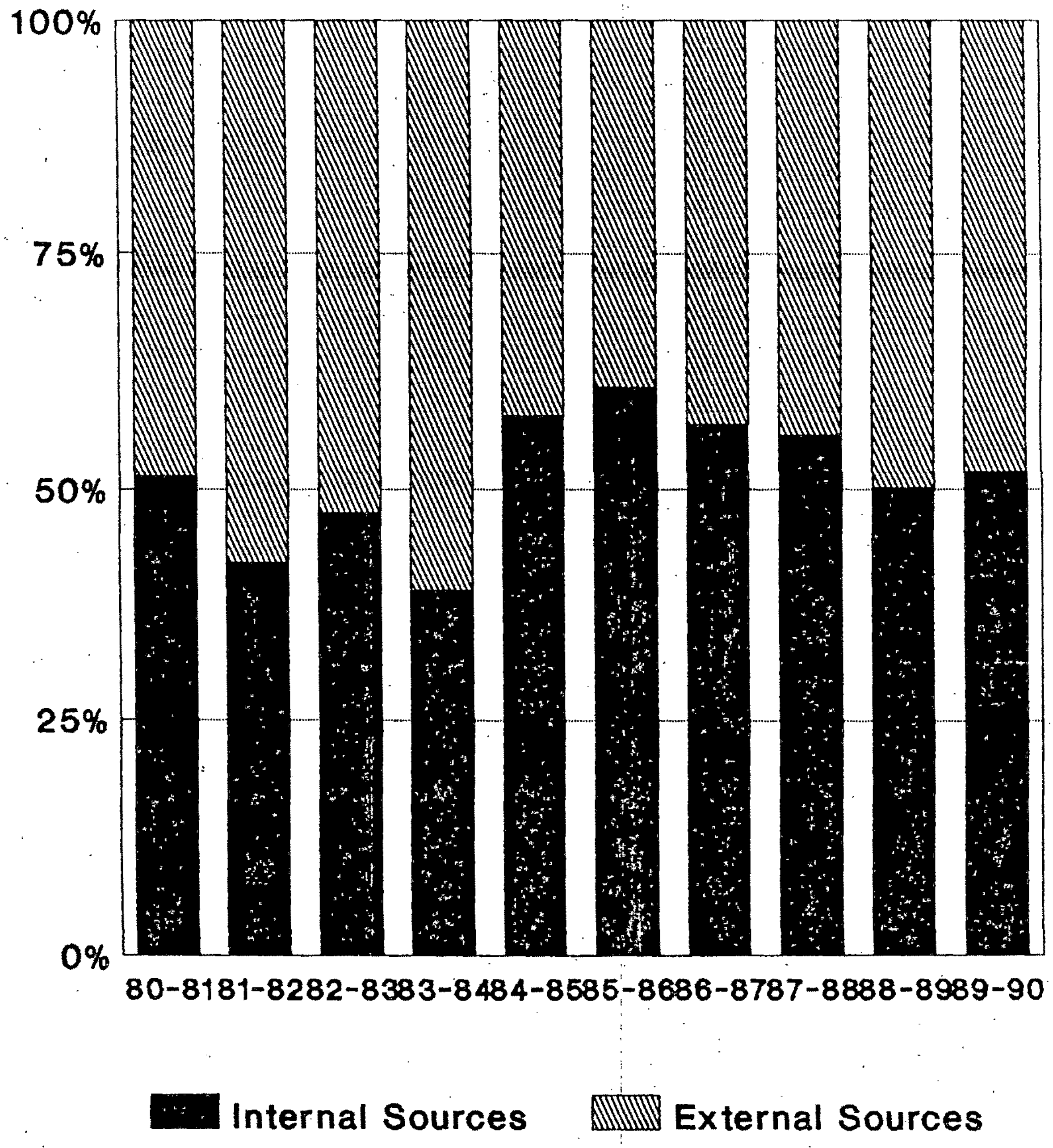

Fig. 6.1 Percentage share of Internal & External Sources of Finance

(60.9%) in 1983-84. However, it is revealed that on the average, the industry has depended more on external sources for its finance in the first half of the period under study and in the second half becomes more self-sufficient so as to depend on intenal sources.

An analysis of the relative importance of the sources of finance by size of mills reveals as follows :-

1. No significant fluctuations are observed in the role of both internal and external sources of finance between the two quinquennial period so far as large size paper mills are concerned.

2. External sources of finance have played a major role during the two quinquennial periods both in medium and small mills.

During the entire span of 10 years of the study period, the contribution of internal sources stood at 51.4%.

6.3 ROLE AND COMPOSITION OF INTERNAL SOURCES

The relative share of the various components of internal funds to total funds for the sample paper mills during 1980-81 to 1989-90 is shown in Table-6.2. It may be pointed out that the share of each component represents the percentage of the respective totals of the three broad categories of mills, viz. Large (L), Medium (M), and Small (S). A component-wise analysis may be made here.

Table 6.2 Composition of Internal Sources of Finance

(In Per Cent)

Year	Paid-up Capital			Shareholder's Reserves			Provision for Taxes			Provision for Depreciation		
	Large	Medium	Small	Large	Medium	Small	Large	Medium	Small	Large	Medium	Small
1980-81	25.5	46.2	74.2	63.3	46.2	12.9	4.0	-	6.5	10.3	7.7	6.5
1981-82	21.5	49.5	84.6	64.2	39.3	-	4.5	-	7.7	9.8	11.2	7.7
1982-83	13.3	49.6	89.3	78.5	33.9	-	0.6	-	7.1	7.6	16.5	3.6
1983-84	19.7	50.0	87.7	62.8	34.5	-	0.1	-	1.8	17.4	15.5	10.5
1984-85	7.9	46.6	89.3	84.3	37.9	-	0.3	1.2	1.0	7.5	14.3	9.7
1985-86	7.5	39.7	89.0	85.0	43.9	-	0.3	2.1	1.0	7.2	14.3	9.7
1986-87	8.9	36.2	30.1	85.0	46.9	63.4	0.2	1.0	0.7	5.9	15.9	5.8
1987-88	9.2	36.2	84.1	83.7	46.4	-	0.3	-	1.9	6.8	-	14.0
1988-89	9.3	22.9	89.6	83.5	58.7	-	0.6	1.4	0.5	6.6	17.0	10.0
1989-90	9.4	72.4	19.6	79.9	-	47.8	2.1	13.8	17.4	8.1	13.8	15.2

Source : Computed from various issues of Bombay Stock Exchange Directory.

6.3.1 Paid-Up Capital

This consists of equity and preference share capital. Data on the share of equity and preference capital in total capital presented in Table - 6.3 reveal that more than 90% is contributed by equity and the rest is by preference share capital. This is so for all categories of mills. However, paid-up capital as a whole to total internal sources played an insignificant role in case of large paper mills. The role of the same in case of small mills is recognizable. Its share has varied between a low of 19.6% and a high of 89.6% during the period. The contribution of paid-up capital to total internal sources in case of medium mills has remained within 50% except during 1988-89 (Table - 6.3).

Table 6.3 Share of Equity and Preference Share Capital

Year	Equity				Preference				Grand Total
	Large	Medium	Small	Total	Large	Medium	Small	Total	(Col 5 plus 9)
1	2	3	4	5	6	7	8	9	10
1980-81	32.5 (82.1)	4.8 (12.1)	2.3 (5.8)	39.6 (92.5)	3.1 (96.9)	0.1 (3.1)	-	3.2 (7.5)	42.8
1981-82	33.2 (81.6)	5.2 (12.8)	2.3 (5.7)	40.7 (92.7)	3.1	0.1	-	3.2 (7.3)	43.9
1982-83	33.9 (80.7)	5.6 (13.3)	2.5 (6.0)	42.0 (92.9)	3.1	0.1	-	3.2 (7.1)	45.2
1983-84	33.9 (77.4)	7.4 (18.0)	2.5 (5.6)	43.8 (93.2)	3.1	0.1	-	3.2 (6.7)	47.0
1984-85	33.9 (75.8)	7.5 (16.8)	3.3 (7.4)	44.7 (93.3)	3.1	0.1	0.01	3.2 (6.7)	47.9
1985-86	39.2 (78.4)	7.5 (15.0)	3.3 (6.6)	50.0 (94.0)	3.1	0.1	0.01	3.2 (6.0)	53.2
1986-87	44.9 (80.2)	7.5 (13.4)	3.6 (6.4)	56.0 (94.6)	3.1	0.1	0.01	3.2 (5.4)	59.2
1987-88	44.9 (89.3)	1.8 (3.6)	3.6 (7.1)	50.3 (94.2)	3.1	NA	0.01	3.1 (5.8)	53.4
1988-89	44.9 (79.8)	7.8 (13.8)	3.6 (6.4)	56.3 (94.6)	3.1	0.1	0.01	3.2 (5.4)	59.5
1989-90	52.5 (84.8)	8.4 (13.6)	1.0 (1.6)	61.9 (95.1)	3.1	0.1	-	3.2 (4.9)	65.1

Note : Figures within parantheses indicate the share to total in each broad class.
' - ' indicates NIL

Source : Computed.

An analysis of the data on equity capital of all the sample units covered under the present study reveals that the share of the large mills was very high and that of the small mills was minimal. So also the case in the preference share capital. Between equity and preference capital the former has played the most important role in the financing of paper industry.

6.3.2 Shareholders' Reserves

The shareholders' reserves comprise Share Premium Reserve, Sinking Fund and Redemption Reserve, Investment Allowance Reserve/Standard Development Rebate Reserve, and Free Reserve and Surplus. All the relevant data put under this head are shown in Table - 6.2. It is seen that the Shareholders' Reserves in case of large mills have played a very significant role in financing paper industry in the sample sector. Their contribution to the total internal funds has ranged between 63.3% and 85.0%. However, a declining trend was observed in their role since 1986-87. In case of medium mills, the Shareholders' Reserves gained importance in 1988-89. It is not possible to trace their relative role in the small paper mills due to absence of data.

6.3.3 Provisions

Provisions play an important role in internal funds of any industry. Provisions include depreciation provision and taxation provision. According to Section 205 of the Companies Act, 1956 companies are required to provide depreciation either on written down value or straight line basis or any other basis approved by the Central Government [6]. On the other hand, under the Income Tax Act, 1961, depreciation is allowed on the straight line basis only in respect of ocean-going ships. For all other depreciable assets it is allowed on the basis of written down value [7]. The present provision of depreciation by companies is based on the historical cost basis and they write off the value of the assets over their life according to the straight line method as diminishing value method is not adequate due to persistent inflation in the Indian economy. This can be observed from the data presented in Table - 6.2.

The item "Provisions" for this study consists of provision for taxes and for depreciation. The "Provisions for taxes" have not been very effective for the large mills covered under study. In case of medium and small mills it was during 1989-90 that their percentage share to total internal funds stood at 13.8 and 17.4% respectively. So far as the provision for depreciation is concerned its role in case of the medium mills was more important than in the large and small mills. (Table-6.2).

6.3.4 Role of Retained Earnings

Retained earnings represent the undistributed profits of a company from whatever source they are derived. Though the amount of retained earnings or undivided profits may be logically available for dividend declaration, it merely represents the amount already ploughed back into the business to effect an overall increase in the net assets. The retained earnings help a company in its development programmes as well as in other spheres of financial management. For example, funds accumulated under dividend equalisation funds enable the management to maintain a stable dividend policy. The funds also enhance the credit worthiness of the company and make trading on equity possible.

Retained profits are utilised for substituting external finance such as retiring debentures, building up sinking funds and redeeming other debts and loans. Retained earnings may enable an industry to withstand downswings in the business cycle. With the help of retained earnings, it may be possible to dispose of tensions which are temporarily created during the lean years. Secondly, an industry may implement schemes for modernisation by utilising accumulated profits. It may successfully deal with problems like depreciation, replacements, and obscelescence. Finally, during critical days it may get sufficient time-lag to adjust or readjust itself without affecting stockholders, creditors, etc. [8].

So far as the paper industry is concerned, the role of retained earnings can be examined in two ways :

a) the retained earnings in relation to profits before tax(PBT), which gives an idea of the amount of profits that have been retained, and

b) the percentage of retained earnings to profits after tax (PAT), which gives an idea of the rate of savings and other dividend ratios.

6.3.4.1 Profits Retained as Percentage of PBT: It was discovered by this study that the relationship between profits retained and profits before tax (PBT) in paper industry, there is no definite trend observable in the large and medium mills (Table - 6.4). Among the sample large mills this ranged between 4.1% in 1983-84 and 72.0% in 1985-86 average being 42.7 and 43.9 for the large and medium mills respectively. The medium mills in this respect enjoy a more comfortable position. It was more than 70% in four out of ten years in case of medium mills. Negative growth is observed throughout the period particularly among the small and medium mills in three years i.e. 1981-82, 1982-83 and 1987-88. Hence data for small mills are excluded from the Table - 6.4. This implies that some medium size mills and all small mills could not accumulate any reserves during the period under study. On enquiry it was found that these mills used the past reserves for the payment of dividend due to continuous losses.

6.3.4.2 Profits Retained As Percentage of PAT : Profits retained as percentage of PAT can also be studied from the data presented in Table - 6.4. As it can be observed, the profits retained as percentage of PAT, on an average was 48.1 and 56.9 for large and medium paper mills respectively. The same was negligible or negative in case of small mills. 1987-88 was a bad year for the paper mills covered under the study. In terms of profits retained as a percentage of PAT the medium-sized mills have fared well compared to large mills. The most important reason for this was that medium mills enjoyed concession in excise duties whereas large mills did not.

On the whole, the analysis of retained profits as percentage of PBT and PAT shows that the paper industry could not retain any significant amount due to marginal profits after payment of taxes. The reasons for inadequate "retained earnings" was perhaps occasioned by low profits, high taxation and high dividend distribution. Necessary data on PBT, PAT, etc. are presented in Table - 6.4. Since the retained profits in the small mills were either negligible or nil, data on the same have not been exhibited in the Table.

Table 6.4 Profits Retained as Percentage of Profits Before Tax(PBT) and Profits After Tax(PAT)

(Amount in Rs. Crores)

Year	Profits Retained		Profits Before Tax		Profits After Tax		Profits Retained as % of PBT		Profits Retained as % of PAT	
	Large	Medium	Large	Medium	Large	Medium	Large	Medium	Large	Medium
1980-81	12.1	1.2	30.6	14.1	24.3	1.4	39.5	8.5	49.8	85.7
1981-82	7.2	NC	21.7	NC	14.0	NC	33.2	NC	51.4	NC
1982-83	7.9	NC	16.6	0.3	14.8	0.3	47.6	NC	53.4	NC
1983-84	0.3	0.8	7.3	1.1	7.1	1.1	4.1	72.7	4.2	72.7
1984-85	16.9	2.3	25.7	2.9	24.2	2.7	65.6	79.3	69.8	85.2
1985-86	23.6	2.4	32.8	3.3	31.0	2.9	72.0	72.7	76.1	82.8
1986-87	7.7	1.5	14.9	2.2	19.3	1.9	51.7	68.2	40.0	78.9
1987-88	NC	NC	10.6	NC	1.2	NC	NC	NC	NC	NC
1988-89	9.4	2.4	19.7	3.8	16.7	3.2	47.7	63.2	56.3	75.0
1989-90	54.8	7.4	83.5	10.0	68.3	8.3	65.6	74.0	80.2	89.2
Average of										
1981-85	8.9	0.9	20.4	3.7	16.9	1.1	43.6	24.3	52.7	81.8
1986-96	19.1	2.7	32.2	9.6	27.3	3.3	59.1	28.1	70.0	81.0
1981-90	14.0	1.8	26.3	6.6	22.1	2.2	53.2	27.3	63.3	81.8

Note : NC - Not Calculated
Source : Computed.

6.3.5 Contribution of Internal Sources to Gross Capital Formation :

Companies generally use internal funds for financing long-term requirements like acquiring fixed assets any replacing the old and/or worn-out fixed assets by new ones. The undistributed profits are an important source of capital for expansion purposes without touching its assets. A company may use these resources for internal expansion, rationalisation, and other development schemes. Additions to the fixed assets of a company are also made possible by investment of its accumulated earnings. It is therefore worthwhile to examine as to what proportion the total capital formation in paper industry was financed by internal sources even though it may not be quite realistic to associate specific sources of funds with specific uses. Internal sources as percentage of total gross capital formation in the sample units of the paper industry in India are shown in Table - 6.5.

It can be observed from the data that the internal sources have positively contributed toward accumulation of a major portion of gross capital formation in the mills covered under the study. The contribution was as high as 52.8%. During the quinniquenal period 1981-1985 their contribution to gross capital was 48.7% and during the later half of the decade it was 54.9%. It is also seen that internal sources contributed a maximum of 60.8% during 1985-86 and a minimum of 39.1% during 1983-84.

6.3.6 Contribution of Internal Sources to Gross Fixed Assets :

The contribution of internal sources as percentage of gross fixed assets can also be seen from Table - 6.5. The internal sources contributed more than 50% in 5 years out of 10 years for financing gross fixed assets. On an average, fixed assets were financed to the extent of 51.5% during the period under study. A declining trend was noticed for the later part of the second half of the period.

Table 6.5 Internal Sources as Percentage of Gross Capital Formation and Gross Fixed Assets.

(Rs. in Crores)

Year	Internal Sources	Gross Capital Formation	Gross Fixed Assets	Internal Sources as % Gross Capital Formation	Internal Sources as % Gross Fixed Assets
1	2	3	4	5	6
1980-81	171.4	333.2	349.7	51.4	49.0
1981-82	182.6	433.5	443.5	42.1	41.1
1982-83	291.1	613.3	496.3	47.5	58.7
1983-84	204.5	523.1	554.6	39.1	36.9
1984-85	485.9	840.4	874.2	57.8	55.6
1985-86	583.2	958.6	980.2	60.8	50.5
1986-87	570.4	1001.8	1018.8*	56.9	56.0
1987-88	538.9	965.4	995.5	55.8	54.1
1988-89	555.0	1106.0	1164.8	50.2	47.7
1989-90	605.9	1167.2	1255.7**	51.9	48.3
Average of					
1980-85	267.1	548.7	543.7	48.7	49.1
1986-90	570.7	1039.8	1082.9	54.9	52.7
Average of					
1981-90	418.9	794.1	813.3	52.8	51.5

* Excluding 3 medium mills and
** Excluding 3 small mills for which data were not available.

Source : Computed

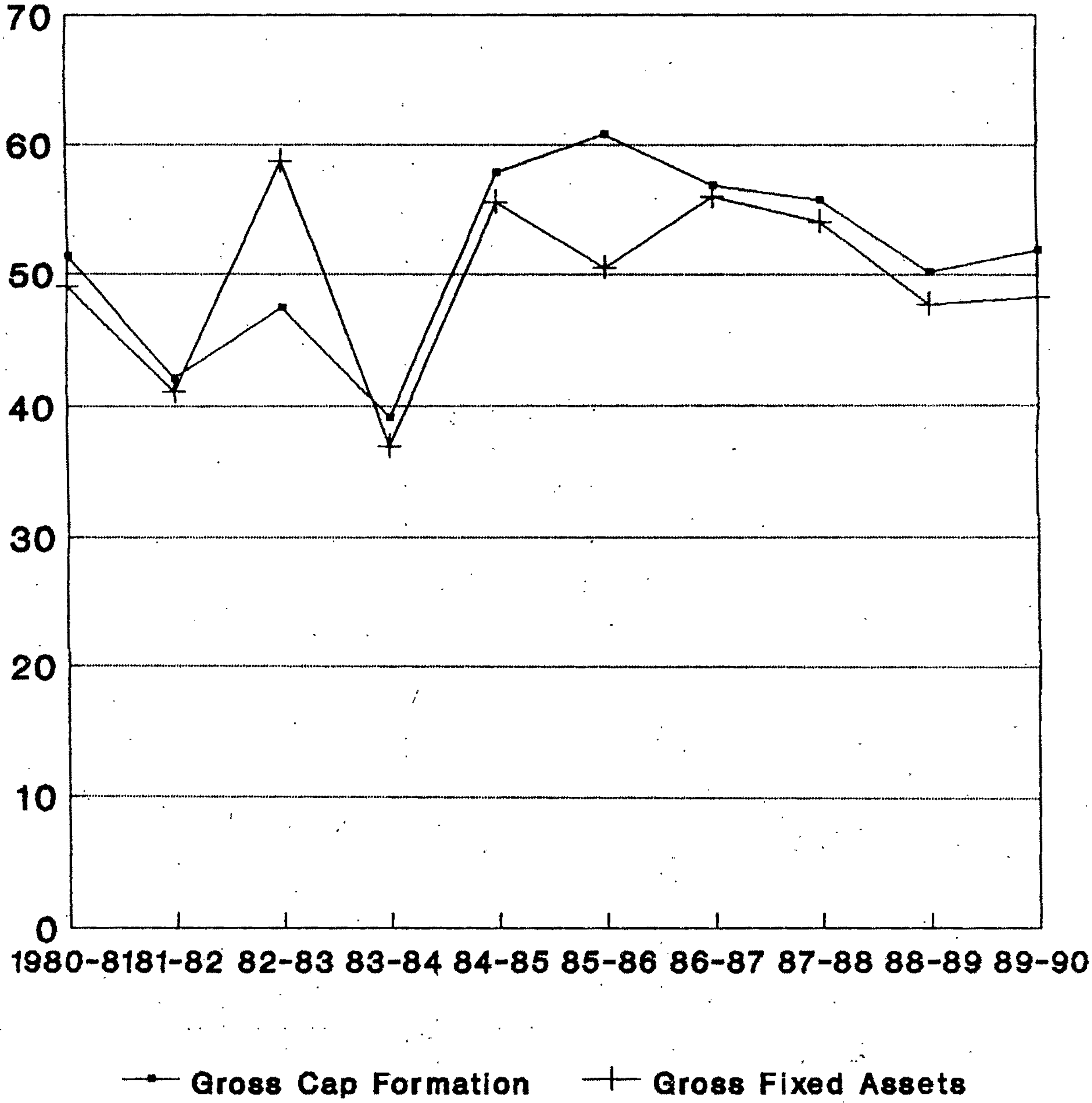

Fig. 6.2 Internal Sources as percentage of Gross Capital Formation & Gross Fixed Assets

6.4 ROLE AND COMPOSITION OF EXTERNAL SOURCES

External sources have also played an important role in financing paper industry in India. During the last decade the external sources on an average, contributed around 49 per cent of the total funds (Table - 6.1). The share of external sources as percentage of the total sources have increased from 39.16% in 1985-86 to 60.9% in 1983-84. It has remained increasing since 1985-86 except in the last year of the period under study.

Borrowings, trade credit and miscellaneous current liabilities comprise the principal component of external fund for the paper industry in India.

6.4.1 Borrowings

Borrowings have always played an important role in financing paper industry in India. All debt finance is an exclusively external source. It represents the financial claims of outsiders over business. Debt could either be short-term mostly comprising bank loans and other short-term loans which have been brought under `loans and advances' or long-term consisting of debentures and other long-term loans such as lease finance, mortgage loans, and loans by special financial institutions.

It can be seen from the data presented in Table - 6.6 that loans and advances constituted, on an average, 26.5% of the total external sources. Debentures and other long-term loans constituted 20.2%. Since 1985-86 loans and advances have been playing an increasing role. Their contribution to total external sources which was 23.9% in 1984-85 shot up to 30% in 1989-90.

Table 6.6 Composition of External Sources of Finance

(Percentages only*)

Year	Loans & Advance			Trade Creditors			Misc. Current Liabilities and Provisions			Debentures & other Long-term Loans		
	L	M	S	L	M	S	L	M	S	L	M	S
1980-81	65.9	31.7	2.3	83.5	12.7	3.8	46.0	44.1	9.9	14.0	-	-
1981-82	70.5	27.3	2.1	87.2	9.4	3.4	75.3	17.8	6.9	22.6	-	-
1982-83	77.8	19.9	2.3	89.4	8.1	2.5	67.8	22.2	10.0	20.5	-	-
1983-84	78.7	18.9	2.4	89.6	8.0	2.4	68.1	23.8	8.1	17.7	-	-
1984-85	74.1	22.6	3.3	89.4	6.9	3.7	60.7	26.8	12.5	19.2	-	-
1985-86	73.6	22.7	3.7	86.4	8.1	5.5	59.3	25.7	15.0	17.4	-	-
1986-87	74.9	20.9	4.2	80.4	14.2	5.3	53.9	29.1	17.0	19.5	-	-
1987-88	92.6	2.7	4.7	91.7	1.5	6.8	70.4	4.8	24.8	24.5	-	-
1988-89	78.6	18.2	3.2	87.0	7.3	5.7	52.2	30.2	17.6	21.5	-	-
1989-90	83.1	16.1	0.8	90.9	6.6	2.5	68.4	31.6	-	21.1	-	-

* % Out of total of external sources.

Source : Computed

Table 6.7 Share of Borrowings as Percentage of Total Sources and Total External Sources.

(Amount in Rs. Crores)

Year	Total Borrowings	Total Sources	Total External Sources	% of borrowings to Total Sources	% of borrowings to Total External Sources
1980-81	85.6	333.2	180.9	25.7	47.3
1981-82	108.0	433.5	264.1	24.9	40.9
1982-83	126.3	613.3	282.5	20.6	44.7
1983-84	150.3	523.1	335.8	28.7	44.8
1984-85	161.7	840.4	374.8	19.2	43.1
1985-86	164.8	958.6	397.1	17.2	41.5
1986-87	208.6	1001.8	457.4	20.8	45.6
1987-88	219.9	965.4	429.6	22.8	51.2
1988-89	291.5	1106.0	581.4	26.4	50.1
1989-90	301.8	1167.2	589.9	25.9	51.2
Average of 1981-86	126.4	548.7	287.6	23.0	44.9
1986-90	237.3	1039.8	491.1	22.8	48.3
1981-90	181.8	794.2	389.3	23.0	46.7

Source : Computed.

The data presented in Table - 6.6 and Table - 6.7 show that total borrowings as percentage of total sources of funds increased phenomenally from 17.2% in 1985-86 to 25.9% in 1989-90. During the first quinquinniun the same was 23.0% and 22.8% in the second quinquinniun. On the other hand, borrowings as percentage of total external sources contributed around 44.9 per cent during 1981-85 and shot up to 48.3% during 1986-90. Thus it can be said that borrowings have played an important role in financing the paper industry in India.

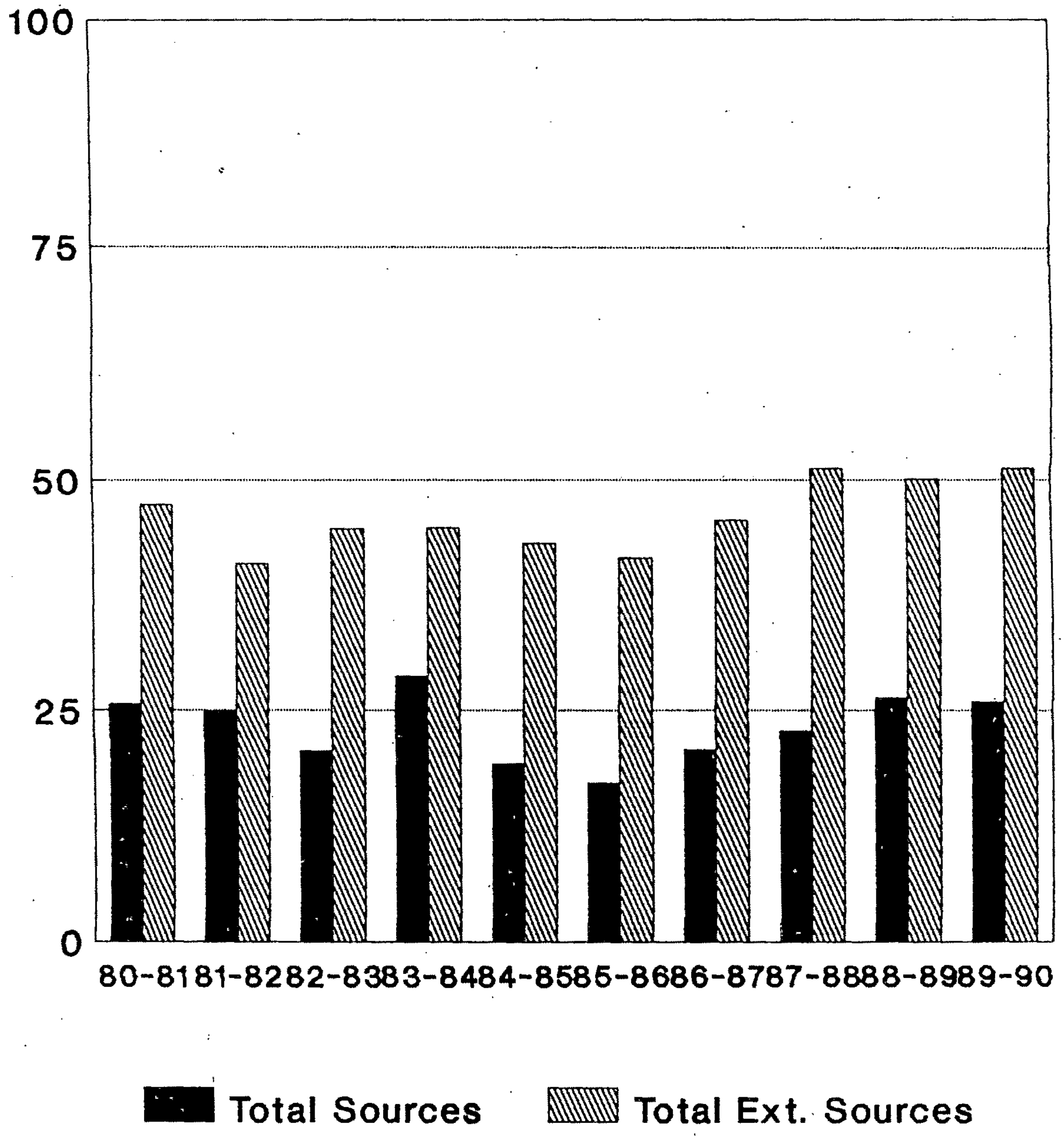

Fig. 6.3 Share of Borrowings as Percentage of Total Sources & Total External Sources

Though the share of bank borrowings in the total sources and total external sources have not been calculated it is observed that the commercial banks have traditionally been known to supply short-term funds primarily to meet the working capital needs of business enterprises. Until recently they confined themselves exclusively to short-term financial activity of corporate sector and abstained offering any long term financial help. However, of late the scenario has changed as banks have ventured into new lines of activity and are extending financial support to cover term capital needs of industrial enterprises.

To augment the limited resources of Indian capital market for the long-term requirements of industrial and commercial undertakings, the government started setting up a network of financial institutions after the country's independence. The Industrial Finance Corporation of India was started in 1948 for meeting the long and medium term financial requirements of new undertakings and for expansion, modernisation, and renovation of the exising units. At the State level, similar financial institutions known as the State Financial Corporations were set up since 1951 to extend the "benefits of term loans to medium and small industrial undertakings scattered in large number all over the country" [9]. Several financial institutions called "development banks" have since been established in the public sector. These include LIC (1956), UTI (1964), IDBI (1964), GIC (1973), IRBI (1971),, ICICI(1985), etc.

However, it may be pointed out that the recommendations of various committees including Dahejia [10], Tandon [11] and Chore Committees on the financing of working capital by commercial banks made the industry depend less on the banks and forced them to reduce their reliance on bank borrowings.

6.4.2 Trade Dues / Credit and Current Liabilities

Trade credit is an extensively used form of finance which meets seasonal and temporary exigencies in business activity. By its nature trade credit involved a short postponement of payment after delivery by the supplier. It is also termed as 'suppliers' credit which is often provided through an open account system (not requiring a formal debt instrument to be signed by the debtors), promissory notes (which formally acknowledge the debt) or trade acceptance.

The relative role of trade credit/dues and miscellaneous current liabilities can be studied with the help of data presented in Table - 6.8.

Table 6.8 Share of Trade Creditors and Miscellaneous Current Liabilities in Financing Paper Industry.

	Percentage of Trade Crs to		Percentage of Misc. Current Liabilities to	
	Total Sources	External Sources	Total Sources	External Sources
1	2	3	4	5
1980-81	15.6	28.7	13.0	23.9
1981-82	18.9	31.1	17.1	28.0
1982-83	15.5	33.6	10.0	21.7
1983-84	21.6	33.7	13.8	21.6
1984-85	16.3	36.6	9.0	20.2
1985-86	15.4	37.2	8.8	21.3
1986-87	16.3	35.6	8.6	18.6
1987-88	15.0	33.6	6.7	15.2
1988-89	17.1	32.6	9.0	17.3
1989-90	16.1	31.8	7.8	18.4
Average of				
1981-1985	17.5	33.4	11.9	9.1
1986-1990	16.0	38.9	8.2	17.4
1981-1990	16.5	33.7	9.5	12.4

Source : Computed.

An analysis of the data reveals as follows :-

1. In relation to total sources of funds, on an average, trade dues have contributed to the extent of 16.5% and the same forms almost one third of the extenal sources.

2. Miscellaneous current liabilities have not played a significant role in financing paper industry during the period so far as the sample units are concerned. However, during the second half of the period the miscellaneous current liabilities have

played a key role in providing external sources of funds.

Thus it is clear that the sample paper units have depended upon trade credit as well as current liabilities to a reasonable extent in financing. However, as a word of caution it may be stated here that though trade credit is a good source of finance, substantial increase in trade credit not followed by a corresponding increase in loans and advances, is likely to create more liquidity problems for the industry.

6.5 SUMMING-UP

For purpose of finance the paper industry depends on internal as well as external sources. The former represents paid-up capital, reserves and surplus, provision for depreciation, tax provision, etc. Borrowings, trade dues/credit and current liabilities comprise the external sources. It is revealed that both internal and external sources have contributed almost equally for financing the Indian paper industry.

Paid-up capital as a source of internal financing has not played a significant role in case of large paper mills. The same has played a significant role in case of small paper mills. On the contrary, the shareholders' reserves have played a significant role in financing the large mills. Their contribution to the total internal funds has ranged between 63.3% to 85.0%. Between the role of "Provisions for Taxes" and "Provision for Depreciation" the former have played a negligible role in case of large mills. The latter have played relatively a more important role in the medium mills.

Retained earnings constitute the undistributed profits which have been ploughed back into the business to effect an overall increase in the net assets. Besides, these help enhance the "credit-worthiness" of a company and make trading on equity possible. They also enable management to maintain a stable dividend policy. This study reveals no definite relationship between profits retained and profits before tax in case of both the large and medium mills. Some of the medium paper mills and all the small mills in the sample could not accumulate any reserves during the period under study. It is revealed that these mills were found to have used the past reserves for the payment of dividend due to the continuous losses. A close look into the retained profits shows that the paper industry could not retain profits owing to the absence of profits after payment of taxes.

It is an admitted fact that the undistributed profits are an important source of capital which allows expansion without touching assets. Usually a company meets its financial needs internally for expansion, rationalisation and other development schemes. It is a good sign that the internal sources have contributed as high as 52.8% toward the gross capital formation in the mills taken for this study. Further, the internal sources have contributed more than 50% in 5 out of 10 years for financing gross fixed assets.

External sources have also played an important role in financing paper industry in India. These have contributed on an average, around 49% of the total funds. Loans and advances constituted on an average 26.5% of the total external sources. Debentures and other long-term loans constituted 20.2%. Borrowings, of late, have started playing a key role in industrial financing.

Until recently the commercial banks had confined themselves exclusively to short-term financial activity of the corporate sector and abstained from term financial activity. They have changed their approach in recent years and have ventured into the new lines of activity of extending financial support to cover term capital needs of industrial enterprises.

NOTES AND REFERENCES

1. Quoted in Kishore Braj, "Corporate Internal Finance- A study of overall Trends and Retentions", **Vikalpa**, Vol. No. 3, Ahmedabad, July 1980, p. 186.

2. **Ibid.**

3. Krishna Murthy, K. and Sastry, D.U. **Investment and Financing in the Corporate Sector in India**, New Delhi, Tata McGraw-Hill Publishing Co. ltd. 1979.

4. Rao, G.N. and Sharma, Y.S.R. "Dividend and Retained Earnings of Public and Private Limited Companies in India: 1955-56. Econometric Analysis", **Reserve Bank of India Bulletin**, June, 1971.

5. Kulkarni, P.V. **Financial Management**, Bombay : Himalaya Publishing House, 1983, p. 567..

6. As amended by the Companies (Amendment) Act. 1988, N. Delhi, Taxman Allied Services Pvt. Ltd., 1988, p.1 and p. 137

7. Prasad, B. **Law and Practice of Income Tax in India**, Aligarh, Navaman Prakashan, 1988-89, p. 279.

8. Cohan, B. Jerome and Robbinno, M. Sidney, The Financial **Manager**, New York : Harper & Row Publishers, 1966, p. 116.

9. IDBI, **Report on Development Banking in India** 1985-86, p. 49.

10. The National Credit Council constituted in October 1968 a Study Group under the Chairmanship of V.T. Dahejia to examine the subject "The extent to which credit needs of an industry and trade are likely to be inflated and how much trends could be checked." This group submitted its report in September, 1969.

11. Reserve Bank of India constituted a Committee to frame guidelines for follow-up of bank credit in 1974 under the Chairmanship of P.L. Tandon. The Committee submitted its report in 1975.

12. The RBI appointed the Chore Committee in March, 1979 under the Chairmanship of K.B. Chore to review the working of cash credit system in recent years with particular reference to the gap between the sanctioned limits and the extent of their utilisation. The Committee submitted its report in 1981.

***