CHAPTER VI

PROBLEMS OF FINANCING SMALL SCALE INDUSTRIAL UNITS FACED BY THE BANK

6.1 INTRODUCTION

For, over four decades, small scale industries were considered as the backbone of industrial environment and also of Indian Economy. These industries are considered as harbingers of economic progress and responsible for transformation of traditional economy into industrial one. Over the last three decades, small scale sector has registered significant growth and played a vital role in the process of industrialisation of the country and, at present, constituting one of the fastest growing segment of the country. In the last two decades banking sector has undergone a thorough change.
in its objectives, outlook and operation. The working group set up by the Reserve Bank of India on priority sector lending had stressed the need to pay increased attention to the underprivileged. The call for financial needs of hitherto neglected sector is now well attended. Small sale industries assist the Government in minimising the problems of unemployment and social equity, which the country has inherited for colonial past, but it has been limping for the past few years. Though the banks come forward to assist the small scale industries, they are facing enormous problems of their own, while extending financial assistance to them. This chapter highlights the problems faced by the bank when giving credit facilities to small scale industrial units.

6.2 INADEQUATE SUPPLY OF BASIC INFORMATION

The inadequate supply of basic information for lending is a stumbling block
which stands in the way of the bank's advances to the small scale sector, particularly in Government Schemes. For example, under Self Employment for Educated Unemployed Youth Scheme (SEEUY), the Task Force at District Industries Centre (DIC) is the authority to interview, select and send a list of persons to the banks for financial assistance. As such, the Task Force interviews a large number of applicants, say 200 to 300, in a day. So it is hardly possible to scrutinise the important facts (technical know-how and experience in the concerned field, managerial skill, financial background of the applicant, economic viability of the project presented by the applicant, etc) which are the basis for determining the survival of the units. Without giving due importance to the above mentioned important facts, the Task Force recommended a list of interviewed persons to the bank. Among the recommended applicants, most of them are fresh entrants who have only inadequate information about the project. As the bank has to dispose the application within a very short
period, say 15 days to 30 days, it has no time to assess the economic viability of the units for which credit facilities are provided. This handicap affects the efficient operations of the bank with regard to recovery of loans.

In order to overcome this handicap, technically qualified experts may be depicted for Task Force to guage the technical know-how and experience of the persons in the project for which they require bank loans. Recommendations of the Task Force should include the opinions of such experts, containing adequate information. Further, the number of persons interviewed per day should be reduced to 30 to 40.

6.3 SEEK GOVERNMENT WAIVER

There is a general expectation among the borrowers of Government Schemes like IRDP, DIR, SEEUY, SEPUP and SUME that their loans would be waived in due course, as done in the
case of small farmers. Anticipating such waiver, some of the borrowers are reluctant to repay the loans, inspite of their successful business operations.

It is recommended that the bank should take efforts in convincing the borrowers that the waiver is only for small farmers and not for small entrepreneurs. Borrowers should be strongly instructed that money borrowed is definitely to be repaid and any default would tantamount to legal proceedings and denial of further accomodation.

6.4 PRIORITY TO MONEY LENDERS

Most of the borroweers are caught into the clutches of private money lenders and avail loan facilities from them at exorbitant rates of interest. As and when the repayment problem arises, they prefer to repay the money lenders
for two reasons. One is they do not want to severe the relationship as money lenders lend at the convenience of the borrower and the second reason is the fear of reprisals by the latter's muscle men. So, the borrowers' hard earned money are sucked by the money lenders first and they have nothing left over to repay the bank loans.

Bank should convince the borrowers on the evils of exploitation by money lenders and also bank should be empowered to execute the properties of the defaulting borrowers directly without going through courts.

6.5 POOR EQUITY BASE

Many of the small scale industrial units have started their ventures with limited financial resources. A major part of their capital structure is in the form of borrowed capital. Because of this poor equity base,
normally, the small scale units commence with heavy interest burden, which, in turn, does not give them, any inherent strength to withstand troubles during periods of difficulty. It affects all expectations of the units. Inspite of the fact that their projects are viable, the unexpected interest burden prolongs the years of breakeven. In turn, they are not able to repay the loans taken from banks, forcing the latter to have overdues.

The small entrepreneurs should bring in more owned capital and also build up their equity base, earning more operational surplus and retaining a larger portion of the same in the form of Reserves and Surplus. Banks, in turn, should ensure that loans are sanctioned to units with higher equity base.
6.6 SEVERAL ACCOUNTS WITH SEVERAL BANKS

Some of the small scale industrial units keep several accounts with several banks in the town and hide important financial dealings from the bank, such as routing the sale proceeds through different accounts at different times so as to suit their conveniences. It is highly difficult for the bank to have an effective follow-up. If at all there is an effective follow-up system, the bank would be ineffective due to lack of financial discipline on the part of the borrowers.

It is recommended that banks could insist upon the submission of SSI Registration Certificate at the time of opening any kind of account. The banks should enter necessary particulars like name of the financing bank, limit sanctioned, date of sanction and type of financial assistance provided, on the reverse side of the certificate. If a bank finds the
name of other bank at the time of opening an account, the latter bank should not open any account for the unit and should not have any dealings with it.

6.7 IMAGINARY FIGURES TO AVAIL CREDIT

Some borrowers are furnishing inflated values of the fixed assets with the connivance of the dealers of the machinery to cover the margin money required. On the basis of the inflated value, the bank sanctions an amount which is more than the eligible limit as per the correct price of those assets. This type of sanctioning amount of loan higher than the amounts eligible affects the recovery in two ways. One is even with normal usage of the loan and genuine operations of the business, the borrowing unit may not be in a position to repay the loan as more funds are flown in to the business. Thus, this type of borrowers are tempted to divert the funds for unproductive
purposes, impairing their repaying capacity very much.

The Bank should not only verify the authenticity of amounts of bills and invoices of the assets purchased by the borrowing unit with the suppliers but also the proper valuation of the assets should be ensured by the bank itself through its own experts. In this connection, it is recommended that the bank should have a cell with experts from various fields for this purpose.

6.8 INSUFFICIENT INFRASTRUCTURE FACILITIES

The infrastructure facilities like building, power supply, transportation and godown facilities are not adequate in many units. The godowns in some of the units are not up to the expected standard and safe from the banker's point of view. So, financing against stocks of raw materials, of finished goods would
attract greater risks. The prices sought for these infrastructure facilities are unaffordable. Many new entrants leave the venture in the middle and all the efforts taken by the bank become futile. Moneys invested in these units are not recovered.

The bank should see whether the needed infrastructure is provided for by the units even before sanctioning loan to them. It may not be possible for a new entrepreneur to have a fulfledged infrastructure facilities initially. So the bank can give some concessions in this regard for some period in the beginning. However, the same should be ensured over a period of time.

6.9 DEPENDING UPON OTHERS

Most of the proprietary concerns started their venture without any practical experience and depending upon some key persons
behind the project. That is, the future of the venture depends on the entrepreneurial talents of such key persons. In the absence of such key persons due to sudden demise or otherwise, even well established units have become sick. Such units are facing a lot of difficulty in looking after production, sales, maintenance of accounts, purchase and compliance of rules regarding the repayment of bank loan.

It is recommended that the bank should encourage the eligible family members or other persons who come forward to undertake that venture by providing additional financial assistance and necessary training. So that the gap arising on account of the absence of key person(s) can be filled up.

6.10 PROJECTED FIGURES ARE FAILED

Some of the entrepreneurs are new entrants to the field. They overestimate their
production, sales and earnings in the project report so as to impress upon the bank. Practically, they achieve only less than their forecast. With lower earning capacity, they are not in a position to repay the loan borrowed from the bank.

Data-bank can be created in the bank which could help both the banker and the borrowers to make precise and accurate estimates.

6.11 CONFLICTS AMONG THE PARTNERS

Quarrels among partners are common in partnership firms. Problems arising out of disharmony among partners get accelerated when the units begin to face rough weather. It sometimes involves a change in the constitution and heavy withdrawals by the outgoing partners. So, on account of quarrels among the partners, partnership firms seem much concern to the bank apart from bringing dislocation in the work of
the bank due to frequent changes in the constitution.

Though the bank cannot have any control on it, it is suggested that the bank may try for an amicable settlement by meeting all the partners, particularly the working partners.

6.12 FAILURE TO SUBMIT REQUIRED FINANCIAL STATEMENTS

In the case of new units, for the project appraisal, the financial statements like projected Profit and Loss Account, projected Balance Sheet and Funds Flow statement are to be submitted. Whereas in the case of existing units, Profit and Loss Accounts and Balance Sheets of the preceding three years are required. During the period, if any bulk orders for the products are received, the detailed
information of the order should be furnished by the existing units. These documents are very useful for the bank for analysing the eligibility of the units, before sanctioning the loan required by the units. Many of the units furnish only proforma Profit and Loss Account and Balance Sheet and not audited financial statements. These proforma financial statements do not reveal the correct figures. So the analysis made on the basis of these statements provides incorrect information about the operations and the financial conditions of the units.

It is recommended that the bank should strictly instruct the existing units to furnish only audited financial statements for project appraisal. The bank should make the loans conditional that audited statements will have to be produced when prepared.
6.13 FREQUENT INSISTENCE TO GET STOCK STATEMENTS

After obtaining bank loans, the borrowers are not regularly furnishing their periodical stock statements, renewal papers and other important documents required by the bank. Some of them are not maintaining the minimum stock against the advances. The bank has to insist on them frequently to obtain the periodical statements. This improper submission of needed documents leads the bank to a position in which it cannot claim compensation from the insurance companies for loss in the event of loss or accidents. Under such circumstances the bank is put into troubled water to recover the loan amount from the borrowers who are not prompt in repaying the loan.

The bank can fix a stipulated date for the submission of periodical statements for every unit. If the units fail to submit on the
stipulated date, the operation of their accounts may be suspended until the submission of required statements.

6.14 DIFFICULTIES IN SUPERVISION

It is hardly possible for the Field Officers to have a detailed inspection of all small scale industrial units which are widely scattered from end to end within the limited span of time. Under such situations, it is unable to have detailed verification of stocks to be maintained by the units. So the Field Officers concentrate mainly on those units which are irregular in repayment. In addition, some wilful defaulters try to cheat the bank by changing their location without any information. Searching of their location consumes more time of the Field Officers. Absence of borrower at the factories and the improper maintenance records often make the surprise inspection a
wasteful one. This problem of inspection assumes greater importance. So, it must be attended to immediately.

It is suggested that more number of Field Officers may be appointed or inspection dates of existing Field Officers may be increased to cover the entire SSI units as per the RBI norms. Instead of surprise visits, informed visits can be arranged for prompt units.

6.15 IMPROPER OPERATION OF THE ACCOUNT

Yet another obstacle which the bank has to encounter is with regard to improper operation of the accounts by the borrowers, especially in Cash Credit advances. Under the working capital finance, the borrower obtains advances for the operations of the unit but does not operate the account properly and the idle cash with the borrowers result in bad debts.
Some other borrowers withdraw the entire amount of the sanctioned limit which cannot be prevented by the bank. Further, there is no guarantee for the bank that the funds withdrawn are used for the purpose for which they are lent or otherwise.

The bank should strictly warn such borrowers against their improper operation of the account. If they continue the attitude, their credit limit may be curtailed.

6.16 SALE OF FIXED ASSETS

With the help of term loan facilities, borrowers acquire fixed assets like machineries and equipments. They are prompt in repaying the instalment dues regularly for the first five or six instalments and gain the confidence of the bank. After that, they sell the assets acquired through bank finance, without the knowledge of
the bank. This fraudulent activity cannot be traced out immediately, as the bank concentrates only on defaulters. Even when the legal action is taken against them, it is very difficult to locate the whereabouts of such borrowers.

At the time of sanctioning loans the documents of title to the fixed assets should be obtained by the bank. Such documents should not be released till the whole amount is repaid. For ensuring retention of movable assets like sewing machines, printing machines, cycles, etc frequent inspection should be conducted by appointing more Field Officers.

6.17 DISHONESTY OF THE BORROWERS

The most important reason for default is the unwillingness on the part of the borrowers to repay the loan. Any problem can be solved and they can be made to repay the loan, if they are willing. If they are not willing
due to lack of basic honesty and integrity, banks cannot recover loans from them.

Therefore, it should be the endeavour of the bank to choose the borrowers with integrity and sincerity, so that accounts may not go bad. So, selection of the borrower, coupled with credit management results in good recovery. Default could occur, sometimes, due to the circumstances beyond the control of the borrowers, say, power-cut, non-availability of raw materials, strike, bandh, etc. The bank should appreciate such genuine cases and recommend for suitable extension of time for repayment.