CHAPTER IV

BANK FINANCE TO SMALL SCALE INDUSTRY

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1 INTRODUCTION

In the modern money oriented economy, finance is one of the basic foundations of small kinds of economic activities. It is the master key which provides access to all the sources for being employed in manufacturing and merchandising activities. Thus, finance is the cornerstone of a small scale industry. Finance is the oil for the wheels of the industrial machine. Constant and adequate finance ensures smooth operations and prevents breakdown of the industry. The sources that usually provide finance for small scale industries are described briefly.

The sources of finance for small scale industries may be either internal or external. The internal sources are money invested by the proprietor as his capital contribution and the profit retained in the business in the form of reserves. The external sources from which, usually, funds may be borrowed are

i. Friends and relatives
ii. Trade creditors
iii. Public deposits
iv. Money lenders and indigenous bankers

v. Specialised agencies such as National Small Industries Corporation, State Small Industries Development Corporation, State Financial Corporations, Industrial Development Bank of India (IDBI), State Industrial Development Bank of India (SIDBI).

vi. Commercial Banks including State Bank of India and

vii. Co-operative banks.

2 FINANCIAL ASSISTANCE TO SSI FROM STATE BANK OF INDIA

The Primary purpose for which the Imperial Bank was nationalised was to make the bank play a promotional role in the context of planned economic development of the country. Besides opening branches in the unbanked centres and financing of the co-operative movement, the state bank has been the most significant single source of institutional assistance to small scale industries in the country. The financing of small scale industries by SBI was started in the late sixties. Till then, this sector depended heavily on moneylenders and indigenous bankers.

2.1 SCHEMES OF FINANCIAL ASSISTANCE TO SSI

State Bank of India has now evolved various novel schemes to meet the varied credit needs of the small scale sector after a careful study of its problems. Actually, the rapid growth of this sector during the last decade is mainly due to valuable assistance received from SBI. Besides finance, the State Bank of India offers a wide range of package services or assistancc to SSI. Section 33 of the State Bank of India Act enables it to extend term finance to industries, both big and small. This is a new field because traditionally banks provide only working capital for industries. The bank grants medium term loans for acquisition of plant and machinery for a new project or for modernisation of existing plant and machinery. The bank also issues deferred payments guarantees for the import of plant & machinery.

2.2 TERM LOANS

Term loans are normally sanctioned for acquiring fixed assets like land, building, plant and machinery for setting up a new unit or for modernisation or renovation or expansion of an existing unit. Term loans can be granted to meet preliminary and pre-operative expenses. At times, term loans are granted for repayment of non-institutional borrowings. For purchase of machinery, payment is made direct to the suppliers against invoices. In the case of construction of factory premises, the bank will call for statements of expenditure incurred duly certified by approved architects or auditors. In the case of loans sanctioned for repayment of non-institutional borrowers, payments will be made by the bank, direct to the creditors, obtaining back from them the receipted promissory notes, hundies, etc. All assets acquired or created with the bank's finance should be charged to the bank. [19]

Term loans should be repaid in 3 to 7 years and may be extended up to 10 yeas in exceptional cases, depending on cash surplus generated, where

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[19] Chandrasekar, K., "Financing of Small Scale Industries by the State Bank of India Siruthozhil Branch, Salem" Unpublished M.Phil dissertation submitted to the University of Madras, Oct. 1993, p.112.

secondhand machinery is purchased with bank finance, repayment period should not exceed the residual life of the machinery.

Term loans are disbursed in one or more instalments, depending upon the requirements. These are not running accounts. Suitable moratorium or gestation period is also allowed taking into account the time that will be taken by the unit to go into full stream. The approach for the appraisal of term loans is project-oriented. The projects should be technically feasible and economically viable.

2.3 WORKING CAPITAL FINANCE

Under working capital finance, financial assistance is extended to cover all credit gaps for purchase of raw materials, carry over of semi-finished goods and finished goods and against receivables. All cash credit advances are deemed to be for working capital purposes. These advances are short term lending and are repayable on demand. As manufacture and the turnover of stocks is a continuous and on going process, a repayment programme is not stipulated. These advances are required to be reviewed once in six months and renewed once a year. Cash credits are accounts in which operations are allowed on a continuous basis. Operations are normally by means of cheques. The borrower is given a limit for drawings on the cash credit account upto which the borrower can freely make debits and credits. The limit is determined on the basis of various factors such as capacity of the borrower, the requirements, the borrower's own state in the business venture, other security aspects, etc. Cash credit accounts are conducted on the following lines.

2.4.1 CASH CREDIT (LOCK & KEY) BASIS [20]

This facility is made available against all goods, which are not immediately required by the borrower for processing or sale. They are kept under pledge to the bank. This facility may be granted against important or valuable or seasonal goods and those allotted against quota. This facility is not available for perishable goods or non-moving stocks and those, which may require frequent withdrawals. Stocks are to be held in godowns under the bank's lock and the key will be retained by the bank. The borrower has no access to the goods. The releases and deposits of goods are done by the bank's godown keeper on application and against payment on the strength of delivery orders issued by the chief manager or deputy manager. Godowns are distinctly numbered and the bank's name board is displayed at a conspicuous place.

2.4.2 CASH CREDIT (PLEDGE TYPE) BASIS

This type of facility is available to small scale industries against pledge of raw-materials and finished goods immediately required for production or sale and semi-finished goods. Under this facility, the physical possession of stocks will remain with the borrowers. Stock register should be maintained by the unit and the drawing power is regulated by the bank on the basis of the stocks statement submitted by the borrower. The raw materials are released for production and the finished goods are lifted for sale in the local market or

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20 Ibid., p.115.

dispatched to other centres as per the cash credit agreement. The value of stock should be remitted into account before removing the stocks from the godowns. The bank's name should be displayed and the bank's pad lock is used to show that the bank has interest thereon. The bank does not post its own watchman in the premises. [21]

2.4.3 CASH CREDIT (HYPOTHECATION)

Under this facility all transactions would be routed through only one account. So it has the advantages of less clerical labour, less expenditure and less inspection of irregularities. Credit limits up to Rs.2 lakhs can be granted under this facility. Assessment of the limit is arrived after taking care of all the requirements of the unit including bills facility and advance payments. Drawings in the accounts are permitted within the permissible limits. Stock statements are obtained for limits above Rs.5000/- at monthly intervals. All assets in whatever or wherever located are automatically covered under this facility. The bank's board should be displayed at the prominent place in the godown and the factory premises.

2.5 BILLS PURCHASING AND DISCOUNTING [22]

It is one of the forms of granting advances to the customer. In this form, advance is granted against bills of exchange drawn by the customer on his clients. Bills are either purchased or discounted by the bank. As a matter of

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[21] Ibid., p.116.
[22] Ibid., p.120.

practice, demand bills are purchased and usance bills are discounted by the bank. Bill drawn under a letter of credit is negotiated whereas bills not accompanied by letter of credit are purchased. Bank purchases or discounts the bills which represent genuine trade. Bills issued or accepted by the parties for accommodation of another parties are known as accommodation bills. These bills do not represent genuine trade transactions. Bills may either be clear or documentary. Generally bank grants regular limits to its customers on annual basis for purchases or discounting of bills. Depending upon the period of credit and nature of credit extended by the borrowers to their customers, the bank will fix limits. This form of advance is of self-liquidating nature on the due date. On presentment bills are paid by the drawee and the advance stands liquidated. Bill of exchange which is a negotiable instrument is endorsed and delivered to the bank which gives the bank enough rights and recourse. Moreover, possession of documents of title to goods that amount to pledge of goods which gives the right of private sale. If bills are not paid or accepted, the bank may recover the amount from the customer.

To enhance the liquidity of advance, refinance from SIDBI is available to the banker against bills in the form of rediscounting of bills. Bill financing is not so popular among small scale industrial units.

3. RATE OF INTEREST

For term loan account, the interest is calculated on the basis of daily products and applied at quarterly intervals. For working capital finance (cash credits) interest is charged on the running balances and not on the limit sanctioned. This interest is calculated on the basis of daily products and applied at quarterly intervals.

Table 1

RATE OF INTEREST

Margin Amount in Rs.	91-92	92-93	93-94	94-95	95-96
1 to 10,000	16%	16%	16%	15.5%	14.5%
10,000 to 25,000	16.5%	16.5%	16.5%	16%	16%
25,000 to 50,000	17%	17%	17%	16%	16%
50,000 to 2 lakhs	17.5%	17.5%	17%	16%	16%
Above 2 lakhs	20%	19%	17%	17%	17%

4 MARGINS

Margins are retained to ensure that the borrower has sufficient stake in the project which in turn ensures his adequate involvement, continued interest and financial success of the project. Margins take care of the fluctuations in the value of securities and the loss which may arise due to a forced sale. The margins also take care of the deterioration in quality of the securities, their shrinkage, etc., and also of interest and bank charges. Up to Rs.25000 of credit limit no margin is required. Over Rs.25000, the bank insists upon the small scale industrial units to meet the margin of 20 to 30 percent.

5. SECURITY

For limits up to and inclusive of Rs.25000, collateral security or third party guarantee is insisted. But for limit over Rs.25000, collateral security by way of immovable properties or third party guarantee may be asked for only in cases where primary security is inadequate or for other valid reasons and not as a matter of routine. All assets created out of bank finance are to be charged to the bank by way of pledge or hypothecation or mortgage.

6 NON-FUND BASED OPERATIONS

6.1 Bank Guarantee and

6.2 Letters of credit

6.1 BANK GUARANTEE

The bank guarantees are governed by the Indian Contract Act, 1872. It has been defined under section 126. "Guarantee is a contract to perform the promise or discharge the liability of a third party in case of his default". Bank's certification of the financial ability of its constituents to meet certain payment or dues are financial guarantees. Under performance guarantee, there is an absolute obligation on the bank to make the payment to affected party in the event of non-performance of contract.

As soon as a contract is signed, the contractor may receive some advance payments from the other party either in the form of money or by way of supply of raw materials, from time to time during pendency of the contract.

Such payments or supply of raw materials are covered by the advance payment guarantee issued by the bank on behalf of the contractors. Deferred payment guarantees are issued to enable the purchaser to acquire fixed assets like machineries, plant, equipments, etc., without immediate outflow of funds. The bank undertakes to make payment of instalments together with interest on their respective due dates in the event of importer's default to make payments.

6.2 LETTERS OF CREDIT

Uniform customs and practice for documentary credits, 1983 defined a documentary letter of credit as any arrangement whereby a bank acting at the request and in accordance with the instructions of a customer is to make payment to or to the order of a third party or is to pay, accept or negotiable bills of exchange drawn by the beneficiary or authorities such payments to be made or such drafts to be paid, accepted or negotiated by another bank against stipulated documents, provided that the terms and conditions of the credit are complied with. Letters of credit are normally opened for customers who enjoy credit facilities with the banks as part of the overall credit facilities. In the case of non-borrowers, full margin will be obtained to cover the liability. For every letter of credit to be established, the unit is required to submit cash flow statement to establish that sufficient funds will be made available to retire the bills when presented. Letters of credit can be opened for the import of goods from a place with in the country. [23]

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[23] Ibid, p.127.

7 CONCLUSION

The commercial banks extend all possible financial assistance to small scale industrial units.