CHAPTER VI

CONCLUSIONS AND SUGGESTIONS
With policy changes towards liberalization, privatization and globalization, India is looking towards greater industrialization. Due to these economic changes, a need has emerged for the financial institutions to be selective in choosing the prospective units for their financial assistance. A development bank is now required to give production-oriented credit based on technical feasibility, economic viability and financial soundness of the project with collateral security taking a back seat. In this direction project appraisal for industrial projects has assumed a distinctive importance. It is undertaken to protect the interests of investors in funding the project, ensuring the best quality of the asset and adequate long run profitability.

With a view to develop a conceptual framework and identify the need for the study, the literature on project appraisal was studied. It has been observed that there is a trend towards developing sophisticated methodology for appraising a project in terms of technical, managerial, commercial, economical and financial aspects. On the basis of the review of literature, it was concluded that the institutions as catalysts for development must be interested in projects bearing the following characteristics:

i. They are financially viable i.e. their returns commensurate with the required investment and a financing pattern be determined within established norms.

ii. They are economically desirable in the socio-economic context.

iii. They are technically feasible and the production process is acceptable.

iv. Their marketing strategy is in consonance with the prevailing and expected environment.

v. Adequate managerial resources are available during all stages of the project.

The J&K state being one of the least industrially developed states of India, the central and state governments have made considerable efforts to promote the growth and efficiency of industries in the state. Among various measures undertaken for the development of industries, two state-level development banks have been established for
accelerating the industrial growth in the state. The J&K State Financial Corporation (J&K SFC) was established in the year 1959 with the aim of boosting economic development in the state by providing adequate financial assistance for setting up of units in medium, small and tiny scale industrial sector. The J&K State Industrial Development Corporation Ltd. (J&K SIDCO) was incorporated under the Companies Act in the year 1969 with the objective to plan organized and sustained industrial growth, develop infrastructure and create a healthy industrial climate in the state. The financing of the medium and large-scale industries was also subsequently brought within the ambit of its activities. Both the institutions are entitled for refinance of term loan sanctioned in favour of the units from IDBI/ SIDBI.

The J&K SFC has assisted 9002 industrial units (3374 during 1990-2000) in the state from inception to March 31, 2000. The total assistance sanctioned and disbursed amounts to Rs.35283.28 lakhs and Rs.31886.91 lakhs respectively. The districts with higher level of industrialization claimed a high share in the cumulative assistance of the development bank. Two districts (Srinagar and Jammu) got a major share of assistance out of the sanctions and disbursements to industrial sector during the period 1990-2000. It was also observed that the financial assistance to industrial sector reduced during this period as compared to the transport sector due to disturbed conditions in the state. The J&K SIDCO has developed seven industrial estates with necessary infrastructural facilities in the state and has been entrusted with implementation of various schemes sponsored by the central government which includes growth centres, export promotion parks and a software technology park. The corporation has so far assisted 97 units (27 during 1990-2000) and the assistance sanctioned and disbursed amounts to Rs.8480 lakhs and Rs.4914 lakhs respectively. The major share of assistance had gone in favour of the units engaged in food products, textiles, electronic equipment, hotels, basic metals and metal products.

The recovery position of the units assisted by these development banks of J&K state has not been satisfactory. Out of the units assisted by J&K SFC, 1390 units have completely defaulted against both principal as well as interest. J&K SIDCO has failed to effect recoveries of dues in respect of 86 units. The performance of this recovery position has a serious implication for these institutions to grow and to cater to the needs of new entrepreneurs coming to the scene of industrialization. Apart from the disturbed conditions
in the state, which invariably had a nefarious effect on the performance of these institutions, the other reasons perceived are; faulty project planning, unsound financial viability, bereft of technical competence and lack of managerial cadres have not received proper attention while carrying out the appraisal for long-term viability of the units. This study was undertaken to examine the project appraisal practices in these development banks.

The information was collected from a variety of sources, which include the annual reports, brochures and the project files of these development banks. Fourteen projects recommended for assistance by the development banks during the period 1990-2000 were selected for an in-depth and critical study. In order to build the information base for the appraisal practices followed by these development banks, the data was collected from the appraisal reports, project reports, application forms, the available documents and files pertaining to these projects. To supplement the data with certain unwritten facts, personal interviews were sought with the officers and officials connected with the project appraisal, the promoters approaching for financial assistance and other agencies/persons connected with the industrial development of the state.

On the basis of analytical study into the techniques of project appraisal through perusal of appraisal reports and discussions with appraisal officers of development banks under study, it was found that there is no fixed or standardized approach to project appraisal for industrial units. Numerous and diverse elements enter into the process and it is difficult to have a cut and dried formula for adjudging straightway a project as 'acceptable' or 'unacceptable'. While broadly the same set of factors are taken into consideration in the scrutiny of individual applications, the weightage given to the several factors varies from case to case. The important factors assessed among these are the type of organization and activity of the proposed unit; the nature of product and market potentiality; the size; the quality of management; the soundness of financial position; the amount of the term loan required and repayment schedule.

In this study it has been found that the development banks rely mostly on the information submitted by the promoters in their loan applications. Though certain techniques are applied but most of the issues have not attracted the attention of the
appraisal officers. In the following paragraphs, the conclusions emerged from the study are presented. Based on findings, suitable measures wherever necessary have been suggested for proper appraisal practices in the development banks.

6.1 PROCEDURES

When potential project promoters approach a development bank, they are provided with the application form and are explained the procedure to be followed for expeditious processing and approval of their application for financial assistance. The main items to be furnished by the promoter in the loan application form include promoter's history, proposed capacity, production processing, technical arrangements, management, plant and machinery, raw materials, utilities and disposal of effluents. The cost of project, means of finance, marketing and selling arrangements, profitability and cash flows accruing from the project, government's consent and time schedule are also required to be submitted for undertaking an effective appraisal. Before a detailed appraisal is carried out, the appraisal officer(s) prepares a first memo to be presented to senior executives. In this process the objective is to decide as to whether the project, in general, is worthy for financial assistance. After clearance from the senior executives, the critical factors in the project are identified and put to close scrutiny in consultation with the promoters. In this process, the technology, the markets, the managerial resources and the financial aspects are assessed for ascertaining the viability of the project.

Most of the applications received during the period 1990-2000 were processed in more than three months. The time taken for appraisal in addition to the time lag between sanction and disbursement is found as one of the factors responsible for project inefficiencies. The protracted time lag causes the financial projections to go haywire. By the time the project is sanctioned and the loan disbursed, the capital cost of the project must have gone up substantially and put the promoter in a financial crunch. Market considerations also change which necessitates a re-look at the assumptions. Therefore, the effort of the development bank should be to reduce the time lag in-between these processes.

It was also observed that a promoter submits an incomplete application and supplements it by additional data from time to time. Since, development banks do not
consider an incomplete application, the promoter should better retain his application till it is complete and all the relevant data is available. Delay on the part of the promoter to furnish relevant particulars leads to delay in appraisal process.

There is a need for re-designing of application forms. The number of documents required for obtaining assistance should not be unduly large. None of the entries to be filled up in the process should be unnecessary. None of the steps involved in the procedures should be redundant and avoidable. Hence reframing of application forms from time to time is necessary to ward off all the defects and deficiencies experienced over time. This will reduce the time taken for project appraisal and speed up the sanction process.

6.2 TECHNICAL APPRAISAL

The technical appraisal of development banks looks into various factors and includes product range, technical services, phased utilization of installed capacity, technical services, availability of raw materials, location with availability of infrastructure, the plant and machinery and civil works proposed for the activity. However, some other important factors not taken seriously into consideration are machinery suppliers with their background, implementation schedule set forth by PERT/CPM/bar chart, technical strength and its suitability to competitive products. In ascertaining the technical feasibility of the projects, the development banks rely on the information submitted by the promoters in their loan applications. The independent analysis is not carried out to satisfy about suitability of plant and machinery, construction works, implementation schedule etc. In eight out of the fourteen projects studied in the present research study it was observed that the quotations from different suppliers were not assessed towards the evaluation of the items of plant and machinery on the basis of quality, efficiency and performance. In only one project, the civil works proposed by the machinery supplier have been rescheduled in terms of plinth area and the cost of construction. It has also been observed that mostly one appraisal officer (irrespective of not having technical competence) looks into all aspects of the appraisal process including technical appraisal.

The inconclusive technical appraisal is a potential source of serious errors towards the unsuccessful operations of the unit. Apart from the problems in the operations of the unit, an inadequate technical appraisal also leads to misleading cost estimates. For an
effective technical appraisal of the project, the development banks should conduct the internally organized reviews. In this direction, the following measures are suggested to be undertaken:

i. Technical personnel available with the development bank should be assigned the responsibility of carrying out the technical appraisal of the projects.

ii. Independent analysis has got to be carried out with regard to the adequacy of plant and machinery, miscellaneous fixed assets and the type of construction proposed for the activity. Implementation schedule be worked out on the basis of sophisticated techniques like PERT/CPM and the time be counted from the day of first disbursement of the loan.

iii. Technical aspects of the project proposals be compared with the similar plants operating in the country/financed by the development bank.

iv. Technical personnel of the development banks should undertake few visits to proposed sites during the appraisal process for ascertaining the availability of infrastructure.

v. Discussions be conducted with the project personnel for ascertaining their technical background and competence.

6.3 MANAGEMENT APPRAISAL

The development banks under study do not lay the requisite emphasis on the appraisal of managerial resources of the promoter. It is admitted that managerial competence is a key factor to determine the success or failure of a firm. Therefore, it is important to recognize the inefficiency of management at the appraisal stage itself. The objective must be to ascertain whether the promoter exhibits resourcefulness, understanding of the project and commitment to culminate the project to its fruition.

The study revealed that the quantifiable aspects such as verifiable records of the promoters of his past performance, his qualifications, and the performance of the enterprise in which he is associated or his other activities are analyzed by the appraisal officers. However, the analysis is carried out where the promoters have willfully provided the information in the loan applications. The other important aspects concerning their
leadership qualities, depth of commitment in the projects, capacity to mobilize the requisite resources, qualities of integrity etc. are not studied seriously.

Trait analysis are not carried out nor reflected in the appraisal reports. Appraisal officers were found well versed with the knowledge and judging the most important qualities such as integrity, experience, track record, commitment, frankness, intelligence, leadership and technical skills. However, no such analysis was carried out in respect of the promoters of the projects under study. The records of these development banks show a number of such meetings conducted during the appraisal process but no effort has been made in exploring the managerial competence of these promoters. These characteristics especially in respect of new promoters are required to be assessed by the development banks for ascertaining the success of the unit in addition to safety of the loan. It is, therefore, recommended that these traits be listed and scores be obtained from different officers in order to built up a rational analysis and avoid subjectivity. Different weightage is also required to be given to the different disciplines of management like finance, marketing, personnel, technical etc. Though a proprietor / partner / promoter director is not expected to have an expertise in all areas but should have a basic insight, initiative and ability to make the project move smoothly. In this context, the awareness of the limitations of these promoters is also essential to be explored. Promoters lacking in the basic skills be required to undergo training administered under entrepreneurship development programmes organized by various agencies in the country.

In case of established promoters it is recommended to pay visits to the unit and try to judge the management on various aspects. The information can be collected by observations during the discussions with the representative(s) of the management and/or any staff of the firm. Past records and performance be evaluated by applying financial techniques. However, development banks may have to adopt a cautious approach based on past performance records on the ground that success in past operation need not necessarily be a guarantee of a similar success in a new undertaking.

All the development banks reserve the right to appoint a nominee on the Board of assisted companies. It is recommended that the nominee directors be appointed with great
care and be held accountable for the success of the project. If possible, one of the appraisal officers of the project be appointed as a nominee director.

The assessment of Board of Directors in the evaluation of management of the companies was restricted to the promoter directors in case of eight out of nine corporate projects studied. In these cases a condition stipulated for appointing suitable directors with sufficient qualifications and experiences before the first disbursement of the loan was not found adequate. These persons as an essential instrument for the company's success are required to be assessed at the appraisal stage.

The evaluation of management set-up of the units in terms of management committees, executives etc. have not attracted the attention of appraisal officers. The success of the units mostly depends on the operational decisions taken by the managers within the framework of the policies laid down by the Board of Directors. In the present competitive environment, the success of the unit and its ability to forge ahead of its competitors depends to a large extent on the relative strength of its management. Therefore, the technical, marketing, financial and managerial personnel to be associated with the project need to be checked in the following manner:

i. Whether the personnel have adequate education, experience, and knowledge of the project plans and their precise function therein.

ii. Detailed time schedule for their association and training.

iii. The remuneration pattern envisaged for rewarding and retaining personnel with the requisite skills, experience and background.

6.4 ECONOMIC APPRAISAL

The social cost benefit analysis is to be applied in every project. None of the cases examined in this study was so analyzed. There seems to be no instructions or training imparted to the appraisal officers for carrying out the economic analysis of the project. No such attempt was made to find out the economic rate of return, the domestic resource cost etc.

In a small sized project, the economic benefits are far outdo the financial costs; it may be quite justifiable not to carry out a detailed economic cost benefit analysis.
However, in view of the resource crunch in the country and the impact of globalization, it becomes necessary to study the project's competitiveness at international prices. The Domestic Resource Cost will help to arrive at 'make or buy' decision of the product. Sensitivity analysis also becomes necessary due to uncertainty with respect to various variables and for products whose prices are highly volatile in the international market.

6.5 COMMERCIAL APPRAISAL

In the absence of databank availability with these development banks, the information submitted by the promoters becomes the only option to be accepted by the appraisal officers. In eleven of the projects studied, the secondary data was used for demand forecasting and in the rest of the cases no such analysis was done. The independent analysis to arrive at the realistic commercial viability of the projects was not carried out.

In case of small and medium scale units, an independent analysis will be difficult because of cost effectiveness. However, accepting the need of such information, an appraisal officer should try to get this information through sources like the promoters themselves, competitors, trade/industry associations, publications etc. It is recommended that a separate cell be created at divisional offices of these development banks for collecting the performance position of various industries both at divisional and national level. It should also collect the demand supply position of the various products required in the economy. The project feasibility reports of identified projects by J&K SIDCO need to be updated at regular time intervals.

The arrangement for marketing the produce is studied in relation to the business contacts of the promoters. In case of entrepreneurs having no business contacts, no such marketing arrangements are assessed. The development banks need to examine the marketing organization as well as the arrangements carefully. Even after disbursements the key personnel need to be interviewed for knowledge, experience and capability.

While examining the operational plans of a company, the main attention of the development banks under study have been found focused on the possibility of achieving planned sales level. However, it does not seem to take into account the reaction of the competitors to the new entrants or the steps that the competitor might take to exploit
increased demand. Having long term bearing on the success of the project, this aspect has to be paid an adequate attention.

Inflation is not explicitly considered into the projections on the assumption that input and output prices would move in unison. Experience confirms that external factors such, as legislative changes, energy constraint etc. tend greatly to alter demand patterns otherwise considered satisfactory.

6.6 FINANCIAL APPRAISAL

Financial appraisal is to find out investments, return and servicing of debt and equity. The emphasis is on the possibility of a reasonably high level of earnings and overall stability rather than a rapid development of profitability of the project leading to capital appreciation. Based on the review of literature, the financial appraisal conducted by a development bank, by and large, is designed to seek answers to the following:

i. Whether the estimates of the cost of the project fully cover all items of expenditure and are realistic?

ii. Whether the sources of finance contemplated by the promoters of the project will be adequate?

iii. What is the likely impact of the project on the level of production, sales, net earnings, borrowings, costs etc.?

iv. At what level of operation the project may be expected to break-even and start yielding profits?

v. Whether the financial soundness justifies the repayment of loan and interest there on?

vi. Whether the project will be a successful venture and give reasonable and adequate return to the shareholders/owners.

Based on the above parameters, the financial appraisal carried out by the development banks was critically analyzed. The broad conclusions drawn from the analysis and the necessary recommendations for ascertaining the financial viability of the projects are presented hereunder:
6.6.1 Cost of Project

The development banks estimate the cost of project, after considering the appropriate items of expenditure. The items of the capital cost include land (cost or lease premium), site development, civil works, plant and machinery, miscellaneous fixed assets, preliminary and pre-operative expenses, contingencies and margin money for working capital. However, the norms for assessment of the cost towards land, site development, civil works, plant and machinery and miscellaneous fixed assets are not followed. Cost of land in case of one project and lease premium in case of three projects was not included in the capital cost of the projects studied. The cost of plant and machinery and miscellaneous fixed assets are not necessarily verified with the quotations of the suppliers. In three of the projects, quotations for plant and machinery were not submitted by the promoters nor desired for submission and examination by the development banks for arriving at an appropriate cost. Quotation from a single supplier, selected and submitted by the promoters, had been the basis for arriving at cost of plant and machinery for five projects. There has been almost no practice of verifying the cost of miscellaneous fixed assets as per the quotations of suppliers. In eleven of the projects studied, the development banks have not compared the estimates of civil works proposed by the machinery suppliers/promoters with the prevailing market rates nor an independent exercise was made for the required plinth area and the rates.

The estimation of the capital cost of project provides the basic information to decide its pattern of financing and viability. When cost of the project is not estimated reasonably, the preparation of financial projections (profitability estimates, cash flow estimates and balance sheet) will be a futile exercise because the amount of depreciation, interest and dividend will change with the change in the capital cost of the project. The promoters also have to tie up the resources according to the estimates of the cost of the project.

It is, therefore, suggested that the capital cost of project be reasonably ascertained which is not only in the interest of development banks but also in the interest of promoters of the unit. Cost of land be included in the capital cost irrespective of the fact that the land
belongs to the promoters/ purchased/ leased for the unit. Before arriving at a cost of plant and machinery and miscellaneous fixed assets, the price and quality of the items be verified on the basis of a minimum of three quotations from reputed suppliers. The quotations submitted by the promoters be cross-examined to avoid any malpractice by the promoters. An independent analysis towards the civil works cost need to be carried out by these development banks through technical persons available within the organization. Contingency provision be worked out after taking into consideration the implementation schedule of the unit. The provision be necessarily kept irrespective of whether the promoters have proposed it in the loan applications or not. The cost of project so arrived be compared with similar project, if any, financed by the development bank in the past.

6.6.2 Means of Finance

The promoters play a major role in deciding the sources of finance. However, the development banks while examining the proposed pattern of financing adhere to the admissible debt equity ratio in accordance with the financing norms of IDBI/SIDBI. Capital contribution by the promoters in respect of two out of fourteen projects studied was not assessed in accordance with the net worth of the promoters. Unsecured loans from friends and relatives have been proposed in absence of any documentary evidence by such persons. Some projects revealed no option to raise the funds if unsecured loans did not materialize fully in view of promoter’s worth and financing limit of the development bank. Though necessary conditions have been put in the appraisal reports, but it is quite justifiable to explore the adequate means of financing before recommending the project for term loan assistance. The appraisal officers should also independently ascertain the manner in which the project is adequately financed and assess the resources of the promoters for equity contribution.

6.6.3 Financial Projections

Financial projections are studied mostly in the light of what promoters have proposed. With the result the period of projections have also remained the same. Little changes have been observed while comparing the projections carried out by the development banks with the projections submitted by the promoters. Relying completely on the promoters is not justified at all. Sales is one thing that promoters have a tendency to
inflated. Mostly, the profit figures that are required to see the project approved are kept in mind and figures are worked backwards to arrive at the sales.

Financial projections had been a basis for arriving at a financial decision by these development banks. Projects showing profits and not facing any liquidity problems have been recommended for term loan assistance. However, in case of one project the loan has been recommended inspite of the cash flow projections showing a liquidity problem in six out of ten years.

The assumptions on the basis of which financial projections were worked out are not mentioned fully in the appraisal reports. Unless assumptions are explicitly stated, it becomes very difficult for the evaluator to check out the reliability of the data. A close scrutiny of the cost estimates of the projects under study showed wrong computations of the figures and without having followed the proper accounting practices. The charges of repairs and maintenance were not increased over the figures of previous year in most of the projects. The increase is needed because longer the life of fixed assets, higher will be the repairs and maintenance charges. Depreciation provision based on Straight Line Method for profitability estimates and Written Down Value basis for taxation proposes was not adhered to in few projects. No provision for dividend was proposed for four projects. The projections were required to be prepared for the years to cover at least the whole repayment period of term loan. In three projects, the period of financial projections do not cover the whole repayment period. Moreover, there has not been a continuous practice of working out balance sheet projections, which is desirable in analyzing the financial soundness of the units.

In view of the above limitations, the financial projections for the entire economic life of the projects under study were worked out. The projected figures with regard to profits, cash flows, depreciation provision, interest expenses etc. showed a variation as compared to the figures worked out by the development banks. Therefore, financial analysis carried out on the basis of these financial projections depicted a different picture (which is largely dismal) of the financial soundness of these projects.

It is, therefore, suggested that while working out the financial projections, the basis of various figures need to be ascertained and checked in order to satisfy that the profits
shown in the profitability estimates are realistic. An independent analysis to work out the sales price, cost of materials, labour etc. be carried out. It is recommended to work out projections including balance sheet projections for the entire life of the projects or at least till the financial assistance is repaid in full. Then only the long-term viability of the project can be ascertained which would facilitate the application of some sophisticated financial techniques like NPV and IRR. Moreover, financial projections be worked out under various pessimistic scenarios like increase in the cost of raw materials, fall in the price of output and reduction in the proposed capacity level. It is also recommended that the project appraisal carried out by the development banks should attach a statement of assumptions.

6.6.4 Financial Analysis

Financial soundness of the projects worked out by the development banks is restricted to profitability estimates, cash flow estimates, debt equity ratio and average debt service coverage ratio. Debt equity ratio is strictly followed as per the guidelines and financing norms of IDBI/SIDBI in view of refinancing from these institutions. Average DSCR is considered most vital in determining the financial soundness of a project. The ratio calculated by development banks has worked out to above 1.5 times in all the projects studied, which show a satisfactory position in terms of interest payments and repayment of term loan. Since the development bank draws up profitability and cash flow estimates for the proposed project in the light of what promoters have proposed, the DSCR is not an adequate indicator as it can be manipulated. It is possible to change DSCR by simply extending the repayment period. Therefore, other sophisticated financial techniques like NPV and IRR are better indicators.

In addition to debt equity ratio and DSCR, certain other ratios worked out for the projects were turnover investment ratio (nine projects), turnover per job (two projects) and net profit ratio (two projects). In respect of one project, few more profitability ratios were calculated. The ratios are calculated but the comments on behaviour of such ratios in the light of financial position of the project are missing. Moreover, these ratios are not compared to get a proper idea about the expected performance of the unit. It is to be noted that the ratio analysis is not an end in itself but a means to achieve the end result of analyzing the health of the project. Interpretation of ratios, their comparison and future
behaviour is very important to ascertain as to how the ratios are linked to the need and purpose of the assistance and their impact on the financial health of the unit.

The other financial techniques used in few cases were breakeven analysis (six projects), pay back period (four projects) and internal rate of return (two projects). However, internal rate of return was calculated but its comparison with the cut-off rate was missing. There is not a practice of working out a cut off rate (cost of capital) for the projects in these development banks. Net Present Value as an indicator for the financial soundness of the units has not attracted the attention of appraisal officers. The financial viability of the projects was also not tested on the basis of sensitivity analysis. The repayment schedule of term loans considered highly important by development banks has been drawn on the basis of surplus shown in financial projections. If financial projections go wrong and expected surplus is not available with the projects, the repayment of term loan is likely to face difficulties.

In the light of the above limitations observed in financial analysis, the detailed financial viability of the projects was carried out to analyze the financial implication of the project choice of these development banks. The objective was to answer a question; had the development banks carried out detailed financial analysis, would its projects be still recommended for term loan assistance? On the basis of realistic assumptions, the financial projections for the entire life of the project and financial analysis has been carried out under four sensitivity conditions viz; (i) normal conditions, (ii) 5 percent decrease in the selling price of the output, (iii) 5 percent increase in the cost of raw materials and consumables and (iv) 5 percent decrease in utilization capacity of the unit. The major conclusions drawn are as follows:

i. Under normal conditions, average DSCR and interest coverage ratio work out below normal in two projects and nine projects respectively. One project shows losses and cash deficit at an optimal production year. Net profit ratio and return on capital employed are not satisfactory in respect of four projects each. Break-even point is higher as compared to capacity utilization level of one project. Though the payback period is within the life span of the projects but the discounted cash flow techniques revealed a different picture. Nine out of the
fourteen projects show negative NPVs and much lower IRR as compared to their cost of capital. Therefore, with these financial parameters, nine projects are not worth financing under the normal realistic assumptions.

ii. The projects selected were found sensitive to selling price of the output. With a 5 percent decrease in the selling price of their output, only two projects depict DSCR at a satisfactory level. However, only one project shows positive NPV and higher IRR. Though the break-even point as a percentage of installed capacity is normal in five projects, but the margin reduced considerably in four projects.

iii. The projects are also sensitive to the cost of raw materials and consumables. With a 5 percent increase in the cost, financial viability of most of the projects gets affected. Two projects have shown a satisfactory DSCR, positive NPV and a higher IRR.

iv. With a 5 percent decrease in the capacity utilization level; average DSCR, interest coverage ratio and net profit ratio are below satisfactory in two, nine and one project respectively. Break-even point in one project is higher than the capacity utilization level. Ten projects show negative NPV and a lower IRR.

In addition to the above, an attempt has made to ascertain the financial viability of these projects after the release of Capital Investment Subsidy. The incentive shows a favourable impact on the financial projections. While comparing the financial viability with the normal conditions, only two more projects turn out to be viable. The other seven projects continue to show negative NPV.

The above inferences revealed that the decision with regard to financial assistance by the development banks might have changed for some of the projects. The findings on the financial appraisal and other aspects support the hypothesis of the study. The analysis revealed that the development banks for determining the financial viability of a project do not use the adequate and appropriate financial techniques. The data provide sufficient evidence to the assumption that the project appraisal is not based on adequate data and also prescribed norms are not followed in evaluation of technical, managerial, economical and commercial aspects of a project.
With the objective of upgrading the viability of the projects during project appraisal process, certain tests have been conducted for upgrading the viability of the projects studied. One test has been conducted for a decrease in the cost of project on the basis of certain essential parameters foregone by the development banks in ascertaining the reasonable cost of various components of the project. Second test has been conducted for decrease in the cost of production as the development banks for ascertaining the cost of raw materials, consumables, utilities etc., carried out no independent analysis. The conclusions emerged obtained under these two optimistic tests are:

i. With a 10 percent decrease in the project cost, one project still continue to show unfavourable DSCR in addition to a cash deficit at optimal production level. Six projects show interest coverage ratio below normal. Break-even analysis and payback period depict an improvement. However, seven projects continued to show a negative NPV and lower IRR. With a 15 percent decrease in the capital cost of the project, one project continued to show a cash deficit, below satisfactory DSCR and interest coverage ratio. As per the discounted cash flow techniques, nine projects show a positive NPV.

ii. With a high sensitivity towards cost of raw materials and consumables, a decrease in the cost of production has shown a significant effect on the financial viability of these projects. Three optimistic scenario of 3 percent, 4 percent and 5 percent decrease in the cost of production has been tested. Little changes have been observed in case of one project, as cost of production was not significant for upgrading the viability in view of its low variable costs due to proposed service for cold storage facilities. The ratios, break-even analysis, payback period and ARR show an improved viability of the projects. However, NPV and IRR as a criterion, five projects and two projects continue to show a negative NPV and lower IRR with 3 percent and 4 percent decrease in the cost of production respectively. However, all the projects show a positive NPV and higher IRR with a 5 percent decrease in the cost of production.

The above inferences revealed that the projects forthcoming for financial assistance are highly sensitive towards the cost of production. With this scenario, the development
banks are suggested to critically analyze the data obtained from the promoters and make an independent analysis wherever required. The major focus should be to ascertain reasonably the cost of project and cost of production. For coping up with uncertainties, sensitivity analysis is suggested to be carried out for ascertaining the long-term viability of the projects. They should also identify the critical areas for upgrading the financial viability of the projects. Major focus in the financial analysis should be given to sophisticated techniques like NPV and IRR in addition to break-even analysis, debt equity ratio and debt service coverage ratio etc. It is desirable in view of the promotion of viable units in the state.

In this study the financial viability of the projects worked out through different techniques will serve as a guideline for the appraisal officers of the development banks while evaluating the projects on financial aspects. In the process of evaluating the project in terms of financial viability, the development banks should ensure that the projects meet the following minimum financial criteria:

i. The estimated cost of project is reasonable, complete and has a fair chance of materializing.

ii. The financial arrangements worked out are comprehensive without leaving any gap and ensure cash availability as and when needed.

iii. The estimates of earnings and operating costs are as realistic as circumstances permit.

iv. The repaying ability as judged for the project operations is demonstrable with a reasonable margin of safety.

6.7 GENERAL SUGGESTIONS

Based on certain general observations in the project appraisal process by these development banks, the following few suggestions are made for an effective and comprehensive project appraisal practices:

i. In the present practices, it seems that the appraisal of the project is carried out to justify the decision already made. Where financial assistance is recommended, mostly positive aspects of the proposed unit are highlighted and the negative ones
are hardly surfaced out. It is suggested that the project appraisal should be the starting point process for project financing and should also reflect any weak points observed in the project.

ii. The successful lending is termed as the one which is characterized by assured return of the principal alongwith interest thereon with a corresponding development of the unit availing lending facility and for evolving such a success/story, the human factor has a sheet anchor role to play. Thus, people dealing with the appraisal process need proper training to improve upon the quality of the appraisal process. Adequate exposure and experience at the credit desks at all levels is also necessary. It is recommended to provide quality training to these officers through various training institutions of the country to ensure a more knowledgeable, comprehensive and accurate appraisal.

iii. It is necessary to ensure that the proposed project complies with various statutory provisions. A comprehensive checklist, therefore, is felt desirable. Comments on various items of the checklist will itself enable the concerned officer to prepare a comprehensive appraisal note.

iv. It has been a practice to begin moratorium period from the date of first disbursement of the loan. However, the time lag is such that by the time the project is completed, it is time for the repayment to begin. This is virtually impossible for a unitholder to hoard and a unit sinks deeper and deeper into the morass of debt. The moratorium should instead be from the date of completion of the project.

v. Since various financial institutions (development banks, commercial banks etc.) criss cross in financing the industrial projects, a meaningful coordination between these institutions is needed. A coordinated environment will facilitate free and systematic flow of information in the appraisal process and thereafter as well.

vi. Discussions with concerned officers revealed that they are quite burdened by paperwork and get little time to engage in relatively more important issues of appraisal work. Therefore, it is suggested to provide computer facilities to the appraisal officers for undertaking detailed work of project appraisal with the help
of this hi-tech gadget. It is also recommended to delegate more authority at lower levels so that proposal processing is expedited.

vii. The development banks should realize that financing is a fine art and it is the development bank’s own confidence and judgment, which would stand in good stead particularly in financing industry. Thus, appraisal officers have to be extra vigilant and periodically inspect and monitor the working of industrial units financed by their institutions. This would help them understand the inherent weaknesses of the units and can build a rational judgment to correct them at the appraisal stage itself.

To sum up, the project appraisal practices followed by development banks of Jammu & Kashmir are not in full commensuration with the minimum required norms. Certain vital parameters in technical, managerial, economical, commercial and financial aspects are not assessed properly with the objective of assuring long-term successibility of the industrial projects. This phenomenal deficiency has large implications towards failure of the projects both operationally and financially. The situation in turn may have nefarious effect on development banks in the sense that both the principal as well as interest there-on get jeopardized and as a result the prospectus of development banks become grim. This state of affairs tends to become detrimental to the state economy in general and industrial development in particular. Therefore, it becomes imperative for the development banks to carry out appraisal process effectively with due scope to the recommendations put forth in the study.

The objectives of the present study have been realized to a great extent. The same is evident from the observations mentioned above. Further, they make clear the utility and significance of the present study. The study is also successful in highlighting the deficiencies in the project appraisal practices followed by development banks under study. The inferences drawn suggest the need for further research relating to a comparison of project appraisal practices followed by development banks of J&K state with other development banks operating in different states of the country and also with the All-India Development Banks. Further, the viability of the projects ascertained in the project appraisal can be compared with the actual operational results of the units for determining the efficacy of appraisal practices.