ABSTRACT

INDUSTRIAL FINANCE AND PERFORMANCE OF THE INDIAN INDUSTRIES

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ABSTRACT

It is an undeniable fact that finance is one of the powerful variables, which affects the process and the extent of industrialization in the country. The government programme of rapid industrialization is likely to be bogged down if finance is inadequate. During the pre-independence period, the impediments to industrial development in India were partly financial as well as partly those related to deficiency in the industrial leadership. As a result of this deficiency in the industrial sector almost ninety percent of the industrial development in India depend entirely upon the managing agency system. But owing to dominant nature and monopolistic tendencies of managing agents, bottlenecks in infrastructural facilities and absence of the proper industrial policy and systematic planning and programme, India inherits a weak, uneven and imbalanced industrial structural base at the time of Independence.

Immediately after independence, industrial finance in India may be termed as efforts of an independent nation to reshape its financial resources to channelize them in the direction of fulfilling objectives of balanced industrial growth in the country with a sense of social commitment. Initially, it was a sharp reaction to the British finance system in India of the pre-independence time with all its vices and vicious motives. In the light of new visions and dreams to be fulfilled and new responsibilities to be shouldered, India needed to evolve its own vision and insight into industrial development and plan its financial policy to suit them. So it sought to reshape its autonomous industrial policy and plans-strategies and determined its priorities and objectives accordingly. As a result, the industrial structure in India has undergone a marked change due to varying pattern of priorities and objectives under the Five Year Plans and the corresponding industrial policy resolutions. It has as well changed structure of the industrial finance in the passage of time. This is what this research proposes to study in details. This forms the core of the proposed study.
The field of research was by and large confined to so far describing and analyzing the role of the managing agency as a dominant agency for providing finance in the industrial sector, the role of Commercial Bank in providing term finance to industry and urgent need to evolve a network of specialized institutions to cater to the financial needs of industry, etc. in accordance with the scenario detailed above. It has now become more broad-based and diversified. Various kinds of research have been undertaken on the industrial finance by researchers. Since they help us to evolve an overview of the development in the industrial finance in India.

During the pre-independence period, though finance was well-recognized element in the development of the corporate activity, literature related to the nature and scope and problems of industrial finance received least attention. Hence, literature on industrial finance of the pre-independence era was confined chiefly to the Managing Agency System & its role, and studies of commercial banking activity of industrial finance. It was more less a descriptive literature of textbook rather it highlighted the structural gaps in Indian Capital market that was related to the non-existence of the organized investment Banks, underwrites and new issue houses.

The Industrial Commission (1916-18) and the Banking Enquiry Committee (1931) escorted a new dimension when they highlighted lack of industrial finance dis-propelled rapid industrial growth and advocated for setting up financial Institutions in India. Number of studies has been carried out on this line exploring its various facets. In this respect the studies conducted by P.P. Pillai (1923-24), John Matthai (1924-25), V.K.R.V. Rao (1930-31), and N.G. Das (1934) focused their views on setting up special banks to finance industries and to create special machinery for underwriting and company promotion business. It would serve as an important means to resolve problems of industrial finance in India.

During the thirties, the studies conducted by Vera Anstey, Buchanan, Grant (1937), N. Das (1936) and others pose a general and
descriptive character. Problems of industrial finance are discussed within the institutional framework that prevailed then in India. It was pioneering works of P.S. Lokanathan (1935), S.K. Basu (1939) and Samant & Mulky (1937) that laid the real foundation for further research. They points out certain characteristic defects of the managing agency system stooped finance, that tended to render adverse effects on the industries. They also suggests to establish banks to meet the financial requirements of industrial concerns. Hence, these studies represent the core of research on industrial finance during the pre-independence period to generate a shift in industrial finance in India after its independence.

Some studies attempted to examine the problems of measuring the total factor productivity of Indian manufacturing industries over a period of time by using single and double deflation method.

Despite of all the above mentioned studies on industrial finance and productivity, one may define industrial finance as the activity concerned not only with the raising of funds but with administering these funds as well. Hence, any conclusion would sound illogical when there are aspects or areas still neglected and unexplored. They pertain to the research on industrial finance. Therefore, this study seeks to examine the efficacy of the five year plans and corresponding industrial policy resolution statements introduced by the government of India from time to time in the light of industrial development of the nation. It also assesses or analyzes the sources of finance and structural changes in the industrial finance sources with the passage of time and growth pattern of industrial development in India. In brief, the thrust of this study is to explain and analyze the relationship between industrial finance and industrial performance of the Indian industry.

The term “Finance” occupies the paramount position in the process of industrial development. The present study is concerned, therefore with the term lending financial institutions such as IFCI, IDBI, SIDBI, ICICI, IRBI, SFCs and SIDCs. Therefore other institutional & market sources of finance stay beyond its scopes. It may be noted that this study covers only the term lending (medium and long-term lending) with reference to financing of small, medium & large scale organized manufacturing industries at an aggregate level.

It may further be noted that this study is based exclusively on secondary data, which have been mainly published by IDBI and CSO. Most of the relevant data have been collected from various sources such as, 1. “Report on Development Banking in India” published by IDBI, and 2. “Annual Survey of Industries Summary Results for Factory Sector” published by CSO. It takes data also from the various issues of “Economic Survey".
The study also utilizes continuous time series data from 1979 to 1994 and also the cross section data of different years falling between 1979-80 and 1993-94. The years selected for comparative analysis are 1979-80, 1981-82, 1985-86, 1989-90, 1991-92 and 1993-94 for the simple reason that they mark the opening and closing year of the Fifth, Sixth and Seventh Five Year Plans for all practical purposes. The year of 1991-92 & 1993-94 (ASI data is available up to 1993-94) is selected, to observe the impact of new industrial policy of 1991 on the industrial growth and development.

The study seeks to probe into the area of growth pattern of industrial development through the various selected indicators or parameters. These indicators are number of factories, productive capital, total employees, total emoluments, net value added, profits, outstanding loans, value of output, total inputs and net capital formation. The study seeks to examine the performance of the various industries in terms of ratio analysis such as Labour Productivity (NVA/L), Capital Productivity (NVA/K), Capital Intensity (K/L), profitability, Debt Capital Ratio and Wages per worker. Accordingly, it tries to observe or examine the relationship at the aggregate level, between the industrial finance and performance of Indian industries (Performance of industries in terms of net value added over a period of time).

Further, to make inference more clear and plausible statistical tools like trend analysis, ratio analysis, Regression analysis, co-efficient of correlation and testing of hypothesis, etc. have been worked out for the period from 1979-80 to 1993-94.

The data that was employed for the analysis posed a practical problem related to linking of the data obtained from two prime sources, IDBI reports and ASI summary results for factory sector. Except these sources there is no other source available from where data on industrial finance may be derived. Hence, the relationship between industrial finance and industrial performance may be established and evaluated for the time
span specified on the ground the framework that can be worked out on the basis of the data available.

The study is conducted in three parts and presented in the scheme of chapterisation as detailed below:

**Part I: INDUSTRIAL POLICY, PLAN AND DEVELOPMENT**

Chapter – I reviews the evolution of industrial development in India since 1951, the setting up of the planning commission by the Government of India. For the purpose of meaningful review the period since 1951 has been divided into four sub periods:

1. High growth period: 1951-1965
2. Low growth period: 1965-1981
4. Reform and Post Reform period: 1991 onwards

It examines the strategy of industrial evolution under various five year plans and the corresponding industrial policy resolutions.

Chapter – II evaluates the efficacy of industrial policy on industrial development with respect to strategy of industrial development of the nation. It further review (a) whether the policy succeeds in preventing concentration of corporate power in a few hands and (b) whether it reduces regional industrial disparities in pursuance of plan priorities.

**Part II INDUSTRIAL FINANCE: SOURCES AND STRUCTURAL COMPOSITION.**

Chapter III explores the sources of finance and their structural composition. Correspondingly it also analyses the changing structure of the industrial finance with special reference to Institutional Finance. The study considers for its purpose the structural changes of industrial finance in view of the changing global scenario of business during the pre and post independence period.

Chapter – IV outlines a fresh look on sources of industrial finance in the context of recent structural changes in the area of venture capital technology finance and infrastructure finance. It also outlines financial
sectoral reforms implemented by the government of India in a phased manner since 1991.

Part III INDUSTRIAL FINANCE: PERFORMANCE EVALUATION

Chapter-V presents an inquiry into an overall growth pattern and performance of Indian industry in the light of policy resolutions and the plan priorities. The inquiry is conducted industrywise and statewise using various indicators and ratios.

Chapter-VI evaluates the same phenomenon of overall industrial growth pattern in the light of industrial finance as bottleneck. On the ground of the review, inquiries and evaluation under taken on the basis of the data-analysis, it further seeks to establish the relationship between the industrial finance and the industrial performance through various statistical techniques.

The first task that the government of free India performed was to set up its own planning commission in 1951. Being an agency to work out plan-strategies, priorities and objectives of industrial development in India, it formulated Industrial policy resolution since 1951 and revised it over the period in the light of changing scenario and demands arising out of them.

The first IPR was conceived in retrospect to the 1948 policy of mixed economy in which the government was supposed to undertake the responsibility of industrial plan and development and its regulation. The IPR of 1956 is a revised version of the IPR of 1948 with objective of rapid industrialization and socio-economic goals. It stressed on the development of basic capital, heavy and machine building industries. It as well stressed on diffusing monopoly and concentration of economic power in a few hands by setting up industrial estates in all regions of the country equally.

When the IPR of 1956 was rendered ineffective to prevent monopolistics practices, the new IPR of 1973 was reframed on the same line with minor revisions in the form of MRTP Act and FERA Act. It
stressed on proper utilization of industrial finance. The IPR of 1977 is a second minor revision on the IPR of 1956 to ensure growth of small-scale industrial sectors that would generate more employment opportunities and help to reduce regional disparities in industrial growth. Further, with the IPR of 1980, the base of industrial growth was widended in the light of technological upgradation and modernization. The policy adopted a more liberalized view by lifting partly the government control over industrial growth. It encouraged the private sector to flourish in different parts of the country. The NIP of 1991 marked a huge step by the Government of India to unshackle the industrial economy from all bureaucratic controls and to allow it to breathe freely to suit the emerging scene of globalization and liberalization.

Within the framework of industrial policy statements and control and liberalization measures, the priorities of industrial programmes under the five year plans were established. They were further put to requisite amendments form time to time. The first plan assigned priority to the full utilization of the excess installed capacity of the existing industries. The second and third plans emphasized on the establishment and development of basic capital, heavy and producers goods industries and machine building industries. During the fourth and fifth five year plan, to accelerate the spirit of industrial growth, with conditions of stability, self-reliance and reduced uncertainties, the policy of export promotion, import substitution and mass consumption goods were given importance. While the sixth and seventh plan intended to work with regard to the objectives of structural diversification, modernization, improved productivity and self-reliance in consonance with IPR of 1980. Whereas, the eighth and ninth plan sought to achieve a desired industrial development in different sectors, through the modifications in industrial, trade, fiscal policies and change in duties and taxes.

In view of the industrial policy resolutions and plans-strategies, the resulting growth pattern was reviewed. The review revealed efficacies in industrial growth pattern. The period of 1951-65 experienced high
industrial growth pattern. The period of 1965-80 registered a sharply reverse trend in the form of low industrial growth. It occurred due to the inefficiency of the government machinery to implement the industrial licensing policy, the procedural delay and restrictive controls measures imposed by the government of India. However, the period of 1981-90 witnessed a new structural composition of industrial sectors that emerged with diverse industries like basic chemicals, petrochemicals and their allied industries flourishing fast. In its light, the growth of basic capital and machine industries was adversely affected. Again, the post-reform period of 1991 did not exert expected impact on structural growth of Indian industry with the new industrial policy resolution. In this way, the overall scenario of industrial growth pattern in India shows a trend of inconsistent growth demeaning the priorities and objectives envisaged through Industrial policy resolutions and plans.

The government of India, at its outset, looked for a viable option to private money lending system that prevailed during the British rule. It sought to create its own industrial financial structure with first establishing IFCI in 1948, ICICI in 1955, IDBI in 1964, IRBI in 1971, SIDBI in 1990 at the national level. It as well set up a network of finance agencies and institutions like SFCs and SIDCs, owned by state governments in most regions of the country. In addition, the government establishes specialized financial institutions like the RCTC, the TDIC, the TFCI and the NEDFI etc. The prime objective of the industrial finance structure was to facilitate medium and long-term financial assistance to industries of all categories in all sectors and in all states or regions on equal parity in the light of balanced industrial growth.

The performance of finance through this structure was expected to achieve the twin goals; industrial growth and socio-economic development. It was expected to foster industrial growth through supporting projects of expansion, renovation, modernization and diversification of existing units. In view of modernization, it looked to encourage enhancement of technical know-how and technological
advancement. Further, in view of the fast changing scenario on international level with liberalization and globalization, it encouraged foreign investment in India by providing foreign currency loans and forex services. It also sought to enhance the market potentials of Indian products to elevate them to competition in international markets. However, in course of the development, some industrial units were unable to survive and cope with changing trends. Hence, the finance performance also looked to support such sick units and help them through rehabilitation programmes.

The performance of industrial finance also reiterated its commitment to society in terms of attaining socio-economic development to suit the socialistic thinking of the time. Using industrial development as agency, it was supposed to avail increasing employment opportunities to the people of India. It was expected to help the development of the infrastructure and advancement of telecommunication and information technology through industrial growth to elevate the living standard of the people of India. All these benefits were supposed to be distributed equally and justly among all states or regions of India. It would ensure balanced regional industrial growth to foster the objective of social justice, that the Government of India is supposed to ensure.

In view of the twin objectives, the Government of India sought to put all available sources of industrial finance to appropriate use. It well sought to explore new resources of finance to cope with fast increasing demand for industrial growth. To affect just distribution of finance sources in right direction, the government floated huge number of schemes with diverse motives. Some of them are Bills Rediscounting Scheme (1965); Risk-capital Foundation Scheme (1975); Soft Loan Scheme for modernization, Bridge Finance Scheme, Seed Capital Assistance Scheme (1976); Technical Development Fund Scheme (1977); Automatic Refinance Scheme (1978); Modified Soft Loan Schemes (1984); Textile Modernization Fund (1986); Small Industries Development Fund (1986); National Equity Fund, Single Window Scheme, Equipment Finance and
Refinance Scheme (1987) and many other schemes in the pre-reform period. In the post-reform period since 1991, the institutional finance schemes and several other organizations addressed more specifically to the demands of privatization, through venture capital fund for high-risk, high-return ventures in IT sector, Scheme of Direct Assistance for Development of Industrial Infrastructure and Forex Services and liberalization and globalization, through the SEBI, the EDII, the NSEIL, the SHCIL, the ISIL, the CARE, the INFUSE, the CRISIL and the NSDL. To foster balanced regional industrial development, the government also floated schemes to provide assistance, incentives and concessions in finance in form of low rate interest, lower margins, tax-exemptions and reduced service charges, etc.

The present research has been an attempt to review the performance of finance by financial institutions in India. The performance has been operated through various finance schemes announced and implemented by the government from time to time. Since the finance performance has the eventual realization in industrial performance, it accepted the data on industrial performance as the base to have comparative analysis in view of envisaged objectives. So the analysis was devised on selected parameters or indicators of industrial development, such as: number of factories, productive capital, total number of employees, total emoluments, net value added, profit, outstanding loans, value of output, total input and net capital formation. The industrial performance was analysed on the grounds of the following hypotheses.

1. There exists no one to one correspondence or functional relationship between capital intensity and net value added.

2. An increase in number of factories does not always mean an increase in all remaining selected development indicators of industries.

3. A higher or increase in the share of net value added would not necessarily asserted by a higher or increased share of the productive capital, the total inputs and the value of output.

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4. Higher share of productive capital does not always lead to increase in number of factories as well as in the level of employment.

5. Higher net value added would not necessarily mean higher share of profit.

6. Higher value added and profit oriented industries may not necessarily have a lower share of outstanding loans.

7. Higher capital intensity does not mean higher capital productivity.

8. Higher capital per employee may not necessarily lead to higher labour productivity.

9. Higher capital productivity would not essentially lead to higher labour productivity.

10. Higher was the productivity of capital the higher would not mean the profitability of the industry and vice-versa.

11. Higher the capital per employee higher would not mean the debt capital ratio and vice-versa.

12. Higher profitability of the industries would not lead to lower debt capital ratio.

13. The higher wages per employee would not always lead to higher labour productivity.

The above hypotheses were reviewed for industrial performance in the contexts of industrial sectors in India and statewise or regionwise industrial development in India. The data that was employed for the analysis posed a practical problem related to linking of the data obtained from two prime sources, IDBI reports and ASI summary results of factory sector. The former details on industrial finance disbursed to industries while the latter details on the performance status based on the development indicators. But there is lacking of proper linking of two in terms of the benefitter and the performer. However, an attempt is made to conduct analysis that has revealed the following observations.
1. There is little support to contend that production function and the level of technology; innovation and inventions remain the same for all different manufacturing industries in India. On the contrary, we have a strong ground to view considerable variations in the levels of technological options available in the different manufacturing industries in India. This reveals that the strategy of industrial policies and priorities of planned programmes introduced by the Government of India could not maintain a balanced structure-based growth pattern of industrialization in India during the period of analysis.

2. The industrial assistance granted by financial institutions to industries does not always exert influence on their contribution in terms of net value added, productive capital and net capital formation in cases of all the types of industries in India.

3. The result of the analysis reflects that the relations in the groups of net value added and disbursals of finance and the productive capital and disbursals of finance are significant and positive. However, this positive relationship does not always exist in cases of all manufacturing industries in India. Actually, the relationship may give negative and significant results, provided the objectives of financing for balanced structure-based growth pattern of industrial development are realized through correct or proper implementation. To some extent, this negative relationship between them ought to be emerged in those industries where factors other than the industrial finance disbursed by the financial institutions for industrial development are more important.

Secondly, the relationship between industrial finance and the net capital formation is positive and significant too. However, in a restricted sense actually the relationship may give negative and significant results, provided the disposition of the industrial assistance once received depends upon the decisions of the entrepreneurs whether to invest it in the process of industrial development or to use it for some other purposes. As a result, the
industrial assistance disbursed by the financial institutions may or may not generate high volume of fixed capital formation in the different industries of India. Further, there is a positive and highly significant nexus between the disbursals of finance and the outstanding loans available to the industries irrespective of their nature. However, the reality shows that the relationship may give negative and significant results, if the financial institutions are guided by the market forces of commercial viability and profitability to ensure their safety and liquidity prior to providing industrial assistance to the industries. Thus, the real and the anticipated situations given above reflect that the selected financial institutions have failed to generate balanced growth pattern of industrial development in India.

4. Accordingly, at the state or region level, we find very little support to the credence that production function or the level of technology is equal for different states or regions of India. The results actually show the opposite picture that there is a considerable variation in the levels of technological options available. It reflects that the Governments industrial policy and its plans strategies have not generated adequate environment for balanced regional industrial development. They also remained incapable to counter inherent structural drawbacks that hampered industrial development in the backward states of India.

5. The share of industrial assistance disbursed by the financial institutions among different states and regions of India does not always grow with their respective share of net value added and productive capital during the period of analysis.

6. The outcome of the analysis reflects that, the relation between net value added and disbursal of finance is highly significant and positive. However, this relationship between them might be negative and significant, if the objectives of financing to affect balanced regional growth pattern of industrialization in regions or states, developing as well as those industrially lagging behind, are realized through correct implementation.
Secondly, the positive relationship between the net capital formation and disbursals of finance implies that the balance growth pattern of industrialization is associated with a high rate of capital formation in different industries in all regions or states of India. However, the relationship between them ought to be negative and significant, if the financial institutions grant industrial assistance in different forms and for different purposes. They do not directly add to the volume of real capital formation, though they form a major sources of finance in the growth of industrial development. In line with it, the relationship between outstanding loans and disbursals of finance would have to be actually negative and significant, if the financial institutions pursued the market forces of commercial viability and profitability to ensure their safety and liquidity before providing industrial assistance to the industries of all regions of India. Thus, the real and the anticipated situations given above reveal that the selected financial institutions have failed to ensure balanced and adequate quantum of industrial assistance equally among all states or regions of India irrespective whether they are industrially affluent, industrially developing or industrially lagging ones. This analysis further leads to contend that industrial assistance disbursed by the selected financial institutions failed to generate a balanced regional industrial development in India.

Persistence of imbalanced structure based growth pattern of industrial development in different regions of India that is generated by the industrial assistance disbursed by financial institutions are consequence of the following factors:

1. The financial institutions provide industrial assistance to industries in different forms and for different purposes. But they have failed to evolve a system by which proper utilization of finance for the purpose may be monitored. The facts remains that the finance received by entrepreneurs was not always utilized for the purpose. It was diverted to some other purposes.
2. The modern industrial development is affected by multiplicity of internal and external factors that may be beyond the control of the management. All these factors are interrelated. Among these factors, availability of finance is a prime factor for the enhancement of industrial performance. The industrial assistance granted by financial institutions to industries does not always exert influence on their overall performance. Because the fact remains that the industrial finance is just one of the many factors to affect industrial performance.

3. Prior to decision of providing industrial assistance to the industries, the financial institutions are found to be guided by market forces of commercial viability and profitability to ensure their safety and liquidity rather than being based on planned goals of balanced structural base growth pattern of industrial development. Therefore, the result of such modes of financing activities of financial institutions moving on caution and safety concerns would allow more and more flow of finance to industries with high value added or high profitability or high status in terms of capital intensity. This in turn, it hampered the balanced industrial development.

4. A notable shortcoming on the part of the financial institutions is that, the assistance disbursed by the financial institutions has increased at a lower rate than their sanctions. This reveals that there is a wide gap in the assistance sanctioned and their disbursements by financial institutions. Hence, the widening gap between the two indicates that the financial institutions have failed to mobilize sufficient amount of financial resources to industries in time when the acute needs of finance arose. These delayed the industrial development. The fact remains that it is the procedure delays and innumerable formalities are responsible for slow pace of disbursements of assistance.

5. A part of the industrial assistance is increased due to the inflationary increase in the supply of money. These real and anticipated situations of inflationary pressure may generate low
volume of fixed capital formation in the different industries of India. This in turn, it led to slow down industrial development.

6. The concerns like safety and liquidity affect. The industrial finance to concentrate in few hands under the pretext of projects like expansion, diversification, etc. So it has failed to satisfy wide base of industrial entrepreneurs.

7. The profit earning motives of financial institutions have led to concentrate their operation on the direct market purchase of shares rather than providing underwriting facilities or providing initial capital. This has bottlenecked the prime objective of industrial growth in the wake of increasing commercial motives.

8. The financial institutions, too, prefer to lend to industries that are located in areas that are free of bottlenecks like inadequate infrastructure and the initiative of the state or the region. The considerations like high net value added and profitability have prevented them to divert finance to deprived states and regions. Therefore, the emerging picture of imbalanced regional industrial development is not unexpected phenomena.

9. The financial institutions are functioning under a severe resource constraint for the problem of low recovery of their advances. They did not yet devise a system to ensure recovery of advances during the period of analysis. Off late in 1993-94, it is known to have a system like it. But it is too late to ensure efficient motoring of industrial finance.