CHAPTER 8

8 Interventions and Suggestions

8.1 In Conclusion

A credit rating is a useful tool not only for the investor, but also for the entities looking for investors. An investment grade rating can put a security, company or country on the global radar, attracting foreign money and boosting a nation's economy. Indeed, for emerging market economies, the credit rating is key to showing their worthiness of money from foreign investors. And because the credit rating acts to facilitate investments, many countries and companies will strive to maintain and improve their ratings, hence ensuring a stable political environment and a more transparent one. They can best serve markets when they operate independently, adopt and enforce internal guidelines to avoid conflicts of interest and protect confidential information received from issuers.

Credit rating agencies cannot afford to commit too many mistakes as it is the investors who pay the price for their mistakes. Credit rating agencies should be made accountable for any faulty rating by penalizing them or even de-recognizing them, if needed.

Historically, it is evident that the North East region has been secluded from rest of the country, both culturally and geographically. This is the origin of all the problems currently existing in the region. In terms of credit assessment, the reason for low credit ratings of the borrower can largely be attributed to lack of entrepreneurial drive, lack of infrastructure, lack of proper connectivity to the
main land India, inadequate links with South East Asia, politically sensitive atmosphere, surrounded by international borders, which have resulted in poor financial viability of the region resulting in low credit penetration. A point, though, has to be made very clear, that a Bank/Financial Institution, can always support the development of the region by providing credit to increase Return on Equity of the entrepreneurs, but the first responsibility lies with the government as effective policies and efficient implementation of these policies can only result in improved credit quality of the borrowers and hence increased credit penetration. However, given below are a few suggestions to improve the development and consequently the credit quality of the region.

8.2 Wish list of Federation of Industries of North Eastern Region (FINER)

Over the years there have been situations where the premise and the goalposts that stirred any investors to make investments, have been subject to sudden changes and the rightful benefits that they had hoped for as per the policy, was denied by subsequent changes / retrospective amendments to the policy.

As per FINER, currently there is a sense of despondency in the investors and the confidence needs to be reversed by long term comprehensive policy announcement.

FINER has appealed to the government as under:

I. Extension of Policy beyond March 2017

II. North East Economic Zone:
a. To work on the concept of “North East Economic Zone” whereby without interfering the political and geographical set up of the North Eastern states, all North East states need to come under one economic zone by doing away with internal fiscal barriers and ensuring free flow of goods and services within the region.

III. **Power Generation Plant has been excluded from the benefits of subsidy:**

   a. NEIIPP, 2007 restricts investment subsidy on a power plant up to the capacity of 10 MW only. Similarly, subsidy on a captive power plant i.e. which is used in a unit for its electricity requirement during production of an eligible item is disallowed.

IV. **Economic and Infrastructure imbalance**

   a. At the time of independence, per capital income of the North East Region was above the National average but due to the partition, the economy of the region has been badly affected and the region continues to suffer for no fault of its own.

V. **Addressing the need for quality officials:**

   a. Posting of best officers of central government departments and agencies to the region. It is perceived in many cases that North East is made a dumping ground, or as a punishment posting zone, or posting for some officers who are ceremonially promoted at their fag end of careers.

VI. **Connectivity in the region should be given top priority.**

   a. Improvements to be brought in
i. Airways
ii. Highways
iii. Waterways
iv. Railways

VII. **Management of the Brahmaputra river and its basin**

   a. Flood Control, Irrigation and water management needs focused attention

   b. Consequently, better and improved agriculture will have the capacity to build the rural economy in the NER.

VIII. **IT Industry** could become the backbone of the NER, with so many English speaking students available in the NER and also its salubrious climate will be suitable for Information technology.

IX. **Skill Development** of the graduates should be given the required attention.

X. **Power** can be built in abundance. Not only can the NER become self-sufficient but also provide power to the country

XI. **Banking**

   a. There are several areas within banking where project and proposals, systems are benchmarked against all India norms, which, practically may be different for the North East. Hence appraisal benchmarks must be different.

   b. Financial Inclusion must get top priority to reach the remotest corner of states like Arunachal with the help of communication backbone

XII. **Tourism**
a. Tourism and Hotels should be accorded the status of an industry.

XIII. FDI in the North East

a. Special incentives could be considered for investing in the NER

XIV. Food processing Industry

a. The food processing Industry could be the sunrise Industry in the North East region, provided the potential is channelized and the industry given adequate support

XV. Taxation Policy: The Policy per se should be reviewed and status quo to be maintained.

FINER have been representing to the Govt., through its elected representatives, for consideration of benefits enumerated above.

8.3 Subsidies structure in the northeast

Under the NEIPP 2007, there are four Central subsidies available to Industries.

I. Transport subsidy

II. Central capital Investment Subsidy

III. Central Interest Subsidy

IV. Central Comprehensive Insurance Scheme, 2007

The different subsidies being given out to the industry need to be reviewed in totality and steps taken to ensure that assets are created and that the subsidy does not go up in consumption. It would be a good idea to entrust the work of examining the efficacy of these subsidies to an independent body like Deloitte, or PWC or similar such organization for carrying out a comprehensive study for a thorough revamp of the scheme. A comparison also would be welcome with
Uttarakhand and Himachal Pradesh where various tax holidays were extended by the state government for attracting big industrial houses.

8.3.1 Transport Subsidy

Transport Subsidy is one of them under this scheme, subsidy on the transport of raw material and finished goods to and from NE states and interstate movement within the NE region is made available. This is available for a period of five years and only once in a life time for any company. Reportedly, there has been many a case where this has been misused and it is felt that it is nobody’s case that it should continue any longer. Because of this, many an entrepreneur establishes new companies with a view to keep on claiming transport subsidy perpetually. They spread their butter too thin and end up with companies with a weak balance sheet and increasing financial risk.

8.3.2 Capital Subsidy

Capital subsidy is available to units without any cap on upper limit and is available with some minor exceptions for all industries. There are many issues in its interpretation and exceptions and should be comprehensively overhauled to ensure that appropriate industries get established in the NER which create economic value and generate employment.

8.3.3 Central Interest Subsidy

Under the Central Interest Subsidy scheme Interest Subsidy makes available a 3% subsidy on working capital loan for a maximum period of 10 years. The units also try and get a rebate from the Banks making the Banking Risk inappropriately priced. This could be considered to be made back ended
payable through the Bank and then the Banking Risk could be appropriately priced.

8.3.4 Suggestions for better subsidy management

The Govt should carry out a comprehensive review of the subsidy structure in the NER and then introduce such schemes which are conducive to creating economic value and generating employment. Also, the Govt. should focus on creating infrastructure and making available adequate power. Attention should be paid to bringing peace to the area by involving the various tribes in the NER by making available avenues for earning and establishing their identity as a part of the Indian State.


As per the vision 2020, by Ministry of Development of North Eastern Region, it was mentioned that

“Further, policy needs to shift its focus from providing incentives (such as easy credit facilities, tax holidays, export promotion parks and capital investment subsidies) to easing infrastructural and fundamental bottlenecks to production and marketing”

The above statement implies that, the government desires to create increased supplies in the region by forceful intervention, but the region has inadequate demand. Lack of adequate demand is due to the demographic factors of the region, but one should not forget that due to substantial amount of natural resources, the region can serve rest of the nation, provided adequate
connectivity is available with mainland India. With the South East Asian connectivity, the region's economic development can become multifold.

The undernoted steps could be taken by the Govt. to improve the business environment in the NE Region, which will go a long way in improving the financial risk of the companies and businesses and reducing financial risk.

I. Simultaneous development of several activities with mutual linkages and opening out to the neighbouring countries. Substantial demand exists in the South East Asian countries. North East region can easily fulfil these demands. Region wise strategies are required for the above purpose. Substantial lime stone deposits are located in the north-eastern belt of Arunachal Pradesh which can feed cement industry. But the cement factories are unlikely to come up automatically there as transport cost of the output to the markets in mainland India may be prohibitive. These can be sold in the neighbouring countries. However, developing hydro-power plants, for which the state has enormous potentials, will create a ready and large enough local market for a cement industry to thrive. Once power generation picks up, availability of cheap power will make the cement and other industrial units more cost effective cancelling out some of the disadvantages of high transport cost. Meanwhile growth of the lead sectors will impart experience and skill to the workers in handling modern industry oriented production activities. This can address the problem of absence of a ready industrial workforce within the state.
II. Efforts have to be made in improvement of infrastructure—development of roadways, railways, internet and Airways will provide necessary support function.

III. Efforts should be made to improve the literacy rate of the region along with quality of education so that availability of skilled labour can be made easy. Establishing manufacturing clusters can also improve the availability of the skilled labour.

IV. Vertically integrating the agricultural/horticulture practices can benefit the region e.g. establishing fruit processing industries etc. It should also be noted that the Vision 2020 document is focused on promoting the local agricultural practices in the region like, tea, bamboo, handicrafts etc. Agricultural activities provide lowest value addition and the population remains poor. Government has to take bold steps to establish industries which can actually lead to increase in real income of the population as per the current income levels.

It is often assumed that inducements in the nature of subsidies and incentives alone help industries overcome constraints that are otherwise a hindrance in their setting up. The jury is still out on whether offering unsustainable tax sops and fiscal incentives really promote industrial growth. Market failures and the lack of adequate infrastructure are probably bigger constraints to the vertical integration of industry. Without a proper industrialization strategy for the region and some inter-Governmental planning, the market cannot play its role in facilitating integration, which crucially depends on a well-developed transport
network, free mobility of goods and services across the State and security of life and property.

8.5 Suggestions for Improvements in the financial management of NER enterprises

It has been observed by CRISIL and other financial institutions that the units that will do well are those which are

I. prudent in finalising capital expenditure plans
II. careful in investing in industries which involve heavy capital investment or those industries which are capital intensive
III. have the capacity to infuse sizable quantum of equity when required and at the time of planning their investment plans.

8.5.1 Strategies for improving CRA

Some strategies suggested below can be considered to be adopted by such Enterprises for bringing about improvement in their credit rating.

I. The basis of Credit rating by external credit rating agencies needs to be understood by the Industry in the region. A large number of businesses had little exposure to External credit ratings and were content with the fact they enjoyed a very good credibility in the Market. Market credibility and raters credibility are different things needs to be understood, and this realization will gradually percolate.

II. Rating agencies do not condone delays in payment of interest or installments even if the delays are small or even if the reasons for delay are genuine. While businesses used to drive comfort from the fact that
their bank branches knowing them would not be uncomfortable, with the
delays, they find that they are unable to find similar comfort with the raters.

III. Preparation of projections has to be more methodical and professional. Failure to meet projections for whatsoever reasons involves negative rating points and this can be avoided by paying more importance to the projections.

IV. The working capital cycles in the North east has been historically high. A number of businesses have a seasonal skew on account of prolonged monsoons and its impact on floods and communications. The element of trust in business houses in the region means that there is higher credit that is given than compared to most industries in the country. Similarly the raw material holding levels have to be kept higher considering the remote location and transport disruptions. With better management of these the financial ratios of businesses in the North East can be better structured to get a better rating.

V. In addition to better financial management, the raters would over a period of time understand the market in the region. The Intricacies of subsidies would also be understood better than what is being now.

VI. Corporatization would definitely lead to better ratings, but whether people opt for it would depend on the impact on cash flows and the comparative disadvantage on cash flows. The raters have to appreciate this limitation.

VII. Since there are subsidy regulation constraints that lead to multiple firms and entities, there is a larger incidence to inter firm transactions and
transactions from related parties. Both of these lead to negative score in course of credit ratings. Efforts should be made to minimize the impact of these in the financial statements.

VIII. In trade sector, the volumes are large but profitability in the books is limited perhaps owing to taxation at Normal rates for trading entities. The culture of maximum disclosure of income in trading entities would help in financials which are better amiable to raters.

8.5.2 Further Suggestions

Steps that can be initiated by different companies to improve their Credit Rating are as under:

These are general in nature based upon the assessment carried out earlier. Depending upon the need, different initiatives with different intensity can be adopted by different companies.

I. Corporatization of the unit into a Ltd. Co. This will give comfort to the Bankers and improve their confidence levels.

II. This will enable the Co. not only to bring more transparency and will enable it to raise equity from the market and reduce its financing costs( if eligible under SEBI guidelines)

III. Eliminate borrowings from friends and relatives which will also help in reducing costs.

IV. Leverage the balance sheet to increase top line, and also increase profitability by decreasing the period of credit on goods sold to sub dealers. Having a monopolistic position can help achieve this.
V. Optimization of stock holding period with a view to reducing financing costs and improving profitability.

VI. For effective working capital management companies need to have professional finance people who understand Banking and can maintain financial discipline.

VII. Use of LCs should be resorted to more and more with a view to reduce the holding period of imported raw material. Optimisation of financing vs. holding costs

VIII. Long term sources of funds should be tied up well in time to fund Long term uses.

IX. Never divert short term working capital for long term uses. Liquidity is essential for survival of a company.

X. Raising money short term from the market is expensive and shows the company's weakness and therefore should be avoided.

XI. Profitability and Return on Capital will improve once better working capital management is done.

XII. Promote subsidiaries with care and planning, not just to get the benefit of Govt subsidies. Investment in subsidiaries is taboo from a Banker's point of view and should be avoided unless there is economic value being created. This weakens the Parent and financial indiscipline creeps in and irritates the Banker. Funds get diverted unnecessarily. A subsidiary should be created only if arrangements for adequate funds are there. Diverting Bank Funds as Owned capital into another Company is a big Indiscipline and frowned upon by Bankers.
XIII. In the event of funds crunch, it is always better to sell off certain unproductive or un-remunerative assets to reduce the debt burden.

XIV. If the sister concerns are not strong enough then it might make sense to sell some of the businesses. This single factor will help improve profitability by significant number. Also, the unit can score high on group risk as per the CRA model.

XV. In units which are working capital intensive, they have to manage their working capital most efficiently. Better inventory/receivable management systems should be installed.viz. SAP for SME.

XVI. Hedging of raw material on commodity exchanges can be taken up as commodity prices can be volatile. This way the unit can reduce industry risk.

XVII. Hedging of Forex exposure is an excellent strategy for protection from Forex risks. Don’t get carried away by the natural hedge argument.

XVIII. Also putting up an appropriate succession plan can help earn the unit some scores to improve its CRA.

XIX. Diversification is must and increasing expenditure on R and D for better products will ensure continuance.

XX. Explore supplying products to customers other than Govt. departments which create liquidity strains and increase the financial costs of production. Over dependence on supplying only to the Govt is not a good strategy.

XXI. Make major dealers and sub dealers to arrange for their own finances and pay up earlier reducing interest costs.
XXII. Whenever required, declaration of dividends should be curbed and maximum profits to be ploughed back with a view to strengthening the TNW.

XXIII. A proper well laid down succession plan should be brought on board to ensure continuity.

XXIV. Regularly examine all costs and rationalize these wherever possible

XXV. Negotiate with suppliers for better deals and discounts

8.6 Suggestions for Bankers and Financial Institutions

I. One most important take away that the Banks and Financial Institutions can have is to never under price the financial risk. The risk should always be appropriately priced and business considerations of top line growth should be curbed to keep the environment sanitized.

II. Always look at the group picture in totality. Never take a decision on the standalone balance sheet of the company. Ask for a consolidated balance sheet of all the companies in the group on a common date and square off the cross subsidization within the group, interoperate sales and investments, to arrive at the correct picture.

III. Insist upon asking uncomfortable questions and seeking answers.

IV. Insist upon taking the services of a forensic auditor to track down siphoning off or tracking down of the Banks money.

V. Cast the real balance sheet by striking off the likely subsidies that may or may not come in an indefinite time frame.

VI. Revisit their model of assessing the Credit Risk of enterprises and find ways and means to make it more objective with a view to making it not
only more objective and fair and transparent to the companies but also should have the predictive capability of alerting the financial institutions in time. SBI have done this review and are in the process of amending their CRA models for the various types of customers that it has.

8.7 Suggestions for the academic world

I. In addition to the theoretical inputs being given to students of MBA Finance, the University must seek the contribution of practitioners of the financial management i.e. professional bankers of various levels as visiting faculty to get inputs on practical banking and risk management.

II. Various Universities and independent colleges should introduce programs like Master of Management with specialisation in Risk Management and also introduce a short duration certificate programme in Risk Management.