CHAPTER VI

OPERATIONAL ANALYSIS-I

Introduction
Making the Loan Application
Appraisal and Sanction
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INTRODUCTION

GSFC has adopted functional organisation set-up. The whole organisation is divided, on the basis of its key functions, into three main departments -- (a) Appraisal Department; (b) Finance Department and (c) Operations Department. Various activities -- like issue and collection of application forms, appraisal of the applications, sanction of loans, disbursement of money and its recovery are spread over these three departments. Appraisal department is concerned with the procedure of appraisal and sanction of loans. The finance department takes care of legal documentations, disbursements and accounting aspects. The third department is looking after the follow-up work and recovery of loans. Different aspects related to these three departments have been analysed in this chapter.

MAKING THE LOAN APPLICATION

(i) Application Form:

For obtaining loan from the corporation, an application in the prescribed form is required to be made. These forms are available, free of cost, from the Business Development Cell at the Head Office - Ahmedabad, Regional Offices and the District Industries Centres (DICs). The corporation has devised different
types of application forms for the different loan sizes: (a) upto Rs. 25,000; (b) above Rs. 25,000 but upto Rs. 5 lakhs; (c) above Rs. 5 lakhs but upto Rs. 30 lakhs; and (d) above Rs. 30 lakhs. Special application forms have also been designed for loans under special schemes like loan to doctors, Equipment Finance, New Entrepreneurs Scheme (NES), loans for expansion/modernisation etc.\(^1\) All the application forms are in English language except one for a loan upto Rs. 25,000, which is in Gujarati.\(^2\)

(ii) Submission:

The corporation has made the following arrangements for the submission of the application forms.

(a) The duly filled-in application forms for a loan less than Rs. 1 lakh can be submitted to the Regional office of the corporation or to the DIC of the concerned district at which the proposed/existing unit is located.

(b) For loans ranging between Rs. 1 lakh to Rs. 3 lakhs, the application forms are to be submitted to the concerned DIC, except for schemes stated in (c).

\(^1\) For detail account see, GSFC : A Dialogue with the Entrepreneur, 1984, pp. 21-29.

\(^2\) Since Jan. 1988, the forms for loans upto Rs. 7.50 lakhs have been prepared in Gujarati.
(c) The application forms for Loans to be availed under the doctors scheme, chemical industry, equipment finance, and NES are to be submitted at H.O.

(d) Rest of the application forms are to be submitted at H.O. only.

Application forms for loans upto Rs. 25,000 are to be furnished in quadruplicate. Forms for loans exceeding Rs. 25,000 but upto Rs. 30 lakhs are to be submitted in duplicate, while the forms for loans exceeding Rs. 30 lakhs are required to be submitted in triplicate.

(iii) Scrutiny Fee:

The corporation charges a non-refundable scrutiny fee of Rs. 100 per first loan application of Rs. 1 lakh or part thereof; for each additional loan application the fees levied is Rs. 50 per lakh or part thereof. No scrutiny fee is charged for loan applications upto Rs. 25,000. SC/ST entrepreneurs and loan under NES are also exempted from scrutiny fees, for the loan amount upto Rs. 5 lakhs.

A study of the various application forms bring out the following facts:

1: The application form for loans upto Rs. 25,000 is in Gujarati with two parts; Part A and Part B. Part - A pertains to the information relating to
the background of the applicant. Part - B, which is to be filled in while meeting the appraisal officer, covers information like expected sale, income, working capital requirements etc. The form also contains two annexures: one regarding details of machinery and the other regarding financial position of self/sister/associate concerns. A check-list regarding documents to be supplied along with the application is also provided. The list covers 18 different documents, the details of which are given in Annexure: VI.1.

The corporation is charged with the over-cautious approach for a small loan size of Rs. 25,000 requiring several documents. In this respect, it can be argued that any organisation has to be careful while lending the funds irrespective of size of loan. The corporation, however, can request the different Government agencies for simplification of procedures. At present, the applicant has to approach various Government offices for collection of different documents/certificates. The procedure again, varies from office to office. Further it becomes the most challenging job when the level of education, income etc. of the loanee is low. The corporation should make the procedure simplified so that documentation requirements does not serve as a demotivating factor in the beginning.
The application forms for loans above Rs. 25,000 but upto Rs. 30 lakhs are more or less same, with some minor differences. The information to be supplied is covered under nine different heads:

(1) General information about the unit,
(ii) Brief history of the unit if applicable,
(iii) Details about the management,
(iv) Cost of Project,
(v) Means of financing,
(vi) Technical aspects of project,
(vii) Raw material and allied requirements,
(viii) Market and selling arrangement, and
(ix) Cost of production and profitability.

This is followed by a check list of documents (See Annexure : VI.1) and declaration cum undertaking.

The application form for financial assistance exceeding Rs. 30 lakhs, is in the form of a questionnaire. It is quite exhaustive. The rationale of that has been specified in the form itself. It reads, "As GSFC now finances upto Rs. 60 lakhs, it has becomes necessary for it to carry out in-depth examination of the project appraisal. An in-depth systematic analysis
involving latest appraisal techniques, calls for a whole lot of data from the entrepreneur.\textsuperscript{3}

The required information and documents are same as that of the other forms, but the minute details are covered under thirteen different proformas like -- projected cash flow statement, and projected cost of production for eight years; production and sale of each product, and margin money forecast for the next four years; details regarding factory, machinery, directors, sources of funds, etc.

The corporation claims that the necessary guidance is provided at the Business Development Cell at Head Office and at DIC for filling-up the forms. Looking to the quantum of details to be furnished in the form it is hardly possible to do it without the help of an expert like -- Chartered Accountant, or Project Consultant or some other professional, even though the corporation provides the necessary information in a booklet entitled 'A Dialogue with the Entrepreneur.' Looking to the procedure and formalities laid down for the application, it is felt that the corporation should provide for effective counselling and guidance to the applicants/entrepreneurs. My field work has also brought out a striking point that not only the procedure be simplified but due weightage may be given to the regional language and necessary literature may be prepared and supplied in Gujarati.

3. GSFC : Preface to the form.
APPRAISAL AND SANCTION

Project appraisal calls for an evaluation of the worthiness of the project from various angles. This is necessary in order to seek safety of investment and profitability of the corporation so that it can meet the growing needs of industrial development in the state. The usual guidelines framed by the corporation for business lending and the efficiency of the management of the unit can not be relied in totality as some extrenuous factors may affect the working of the unit. The evaluation of term loan proposal, therefore, is a very complex exercise. Appraisal of project loan proposal should involve the examination of the proposal from different angles viz. economic viability, technical feasibility, financial soundness, managerial competence, commercial and marketing feasibility etc. The appraisal and sanction of the loan process of the corporation has been divided into four different groups as : (a) Mini Loan, (b) Tiny Loan, (c) Small Loan, and (d) General Loan.

(a) Mini Loan :

Loan upto Rs. 25,000 is known as Mini Loan. The DICs, of the concerned areas, are authorised to receive the application and prepare the appraisal note. The corporation has constituted a Mini Loan Committee (MLC), a sanctioning authority which meets at the DIC of the
respective districts. The committee consists of the following four members:

1. Regional Manager (RM), GSFC
2. General Manager (GM), DIC
3. Manager (Credit), DIC

If the application is sanctioned, the RM intimates to the applicant. The total number of meetings held for the years 1981-82, 82-83, 83-84, 84-85, and 85-86 were 76, 75, 77, 54 and 41 respectively. Considering the total number of DICs being 17 in Gujarat, the average number of meetings held at each DIC comes to approximately 4 a year. It can also be seen that the number of meetings is declining. This may be due to the fact that an amount of Rs. 25,000 is too small in the inflationary economic trend.

(b) Tiny Loan:

The loan of above Rs. 25,000 and up to Rs. 1 lakh is known as Tiny Loan. Here, too, DIC receives the application, prepares the appraisal note and forwards to the concerned regional office of the corporation, which checks them and asks for clarifications if any. The note may be returned also for necessary major changes.

In the later part of 1981-82, the corporation formed a Tiny Loan Committee (TNC), for appraisal and
sanctioning of such loan applications. The committee is consisting of two members viz.

(1) One, Regional Manager and
(2) Any one, from among the following:
   (a) GM (Finance)
   (b) GM (Appraisal)
   (c) Joint General Manager (JGM) (operation)
   (d) Deputy General Manager (DGM) (Appraisal)
   (e) Secretary (Board).

The committee meets at the concerned regional office. The committee interviews the applicants, and makes the decision. The number of TNC meetings held during the year 1981-82, 82-83, 83-84, 84-85 and 85-86 were 5, 39, 31, 35 and 32 respectively, with an average of 28 in a year, indicating more than two meetings a month. Further, considering five regional offices, it can be stated that on an average there were about 6 meetings per year or one meeting every two months in each region.

(c) Small Loan:

Loans falling within a range of Rs 1 lakh and Rs. 5 lakhs are known as small loans. The procedure, for appraisal and sanction of this category of loans is divided into two parts:

(i) Loans between Rs. 1 lakh and Rs. 3 lakhs, and
(ii) Loans above Rs. 3 lakhs but upto Rs. 5 lakhs.
(i) Loans between Rs. 1 lakh and Rs. 3 lakhs :-

Applications for loan falling in this range are appraised by the DIC, except for chemical plastic and electronics industries and special scheme loans like - NES, for Doctors, Equipment finance, Modernisation etc. are appraised by the Small Loan Division (SLD) at H.Q.

The appraisal reports prepared by the DIC are forwarded to SLD at H.O., where they are scrutinised by the Manager (Small Loan). In case of any query, either the report is sent back to DIC for modifications/explanations or the DIC official is called for discussions and then if required, is sent back for modifications. On satisfaction, the report is sent to Small Loan Committee (SLC) for final decision.

(ii) Loans above Rs. 3 lakhs and upto Rs. 5 lakhs :-

All loan applications covered in this range are received and appraised by the SLD, in addition to the exceptional loan applications upto Rs. 3 lakhs as stated in (i) above. The SLD prepares the appraisal report to put it before the SLC for final decision.

The SIC consists of the following five officials of the corporation:

(a) GM (Finance)
(b) GM (Appraisal)
(c) JGM (Operations)
(d) DGM (SID), and
(e) Secretary (Board)

The committee is scheduled to meet every Wednesday. It interviews the applicants and assesses the worthiness of the project. The number of meetings held during the year 1982-83, 83-84, 84-85, 85-86, 86-87 and 87-88 were 29, 35, 34, 35, 35 and 34 respectively. Looking to the number of meetings held, it can be said that the committee meets on an average three times a month.

(d) General Loans:

All the loan applications for amount exceeding Rs. 5 lakhs are described as general loans. The modus operandi of appraisal and sanction, are further divided into two parts: (i) between Rs. 5 lakhs and Rs. 30 lakhs and (ii) above Rs. 30 lakhs.

(i) Loans between Rs. 5 lakhs and Rs. 30 lakhs:

All the applications received by the GM (Appraisal) are assigned to the different competent appraisal teams created for evaluating proposals of different industries. There are nine appraisal teams comprising of financial and technical officers working under the GM. The team initially prepares the query letter for the missing information, if any for consideration of Management Screening Committee (MSC). The Secretary (Board) prepares the agenda for MSC meetings and fixes the
date for calling the applicant. The MSC, consisting of the following members, meets once a week:

(a) Managing Director
(b) GM (Finance)
(c) GM (Appraisal)
(d) JGM (Legal)
(e) JGM (Business Development)
(f) Co-ordinator (MSC) i.e. Secretary (Board)
(g) the concerned appraisal team.

The MSC interviews the applicants. If found suitable, scrutiny fee is accepted, otherwise, application is returned. On acceptance, the query letter prepared by the appraisal team is given to the applicant. After getting the explanations of the queries, the General Manager (Appraisal) puts the report before the Executive Committee for final sanction.

(ii) Loans above Rs. 30 lakhs:–

All the applications are received by the General Manager (Appraisal) who assigns them to the competent appraisal team. The team collects missing information and prepares appraisal report and submits the same to the General Manager for approval. The report is then sent to the MD for his perusal and if approved then will be placed before the Board for the final decision.
The appraisal function is the core of effective operations of the Corporation. It directly affects the survival of the Corporation. Considering the alarming problem of recovery, this issue requires special attention. On the basis of discussions held with the GSFC officials, DIC officials, IDBI officers and the observations made by the researcher, the following conclusions have been made.

(1) The appraisal of loan proposal covers only financial and technical appraisal. The legal appraisal is done at a later stage of disbursement. The 'man-appraisal' is not given adequate emphasis. The corporation seems satisfied only with verifying the educational background and past experience of the loanee. Again, such information is forming a part of the details, to be filled-in in the application form. The corporation should, in fact, make systematic efforts to assess this very vital aspect when various studies and reports have found it to be a key element in the success of the business unit. In a case study, conducted by State Bank of India regarding the sick units, it was identified that, "the managerial capabilities of entrepreneurs were extremely poor and it was emphasised that while assessing the project feasibility, the entrepreneurial capabilities should be examined." 4

Prof. Kuchhal also found the ignorance of this vital aspect. In his word, "We observed that there has been some laxity in assessing the actual potentialities of the promoters. In our opinion, appraisal of promoters is far more important than the other aspects of project appraisal done by the institution."5 A diagnostic analysis of industrial sickness to find out the immediate and remote causes, carried out by Dr. Dholakia concludes that, "In Gujarat, of the 106 big and small sick units, 51 units were sick because of incompetent and inefficient management."6

The above referred studies have one common conclusion in them that the promoters are the key element and the entire process of promotion, birth and growth of an industrial unit depends on their abilities. Hence, examination of managerial abilities of promoters needs serious consideration. The Thomas Committee Report has also recommended that, "SFCs ... need in many cases to make the memorandum more analytical and critical, especially in areas such as assessment of quality of management."7

(2) The legal appraisal is done at a later stage of disbursement. Hence, even though the project is approved, the applicant has to wait for money till the legal appraisal is carried out. This unnecessarily delays the payment. The corporation should simultaneously carry out this appraisal. This will save the corporation from developing a false image that it snatches away the hope on legal grounds.

(3) The success of an industrial unit depends upon its marketing efficiency. Hence, an intensive scanning and detailed analysis of the environment in which the proposed industrial unit has to function, should form the base for assessing the marketing opportunities available to the unit. If the outcome of this analysis is not favourable, there is no sense in offering loan to the unit. Unfortunately, the corporation relies heavily on the information provided in the application form and the personal views of the appraising officers, for judging the marketing potentiality of the proposed product. The corporation has not made adequate and systematic efforts to collect and compile statistical data for making assessment of demand potentiality of various products.

The IDBI in its inspection report of the corporation has provided sufficient evidence of this ignored aspect. The report reads, "In cases of group financing to saree screen printing units at Jetpur, Mangalore tiles
manufacturing units in Saurashtra and Khandsari units around Rajkot, lack of information on market potential has led to creation of excess capacity in the past affecting the working of assisted units. The corporation should devote more attention on this aspect and strengthen its market information cell for the purpose."

In order to keep the knowledge of the appraisal team officers updated, the corporation may, enrich the 'Economic News Digest' -- a fortnightly compiling news from different sources by the Business Planning Department. For the purpose, the department may create a separate cell under it, the primary duty of which shall be collection and dissemination of information on this vital issue. Of course, it will add some burden on the corporation. However, looking to the recovery problem, this will be worth doing activity.

(4) The system of joint appraisal by DIC and the corporation needs rethinking. In comparison to the amount of loan, there are delays and unnecessary movement of files from DIC to Regional Office and back for explanations etc. Again, the quality of appraisal made by the DIC is questionable since the people managing the show at DIC are like other government employees and may not be possessing required skills and knowledge for appraisal.

With respect to the sanctioning authority, the corporation, since its inception has relied on the committee system. Right from an amount of Rs. 25,000 to Rs. 60 lakhs - maximum permitted under the SFC Act - , all the sanctions are approved by the different committees like SIC, TLC, MLC, the Executive Committee, and finally the Board.

The system has both the merits and drawbacks. By adopting the committee system, rather than an individual enjoying sanctioning authority, the corporation has taken sufficient care to avoid possible malpractices in the sanctioning authority. Again due care has been taken that the committee members should be from the senior level executives only. The lowest level committee member is the Regional Manager in case of MNC. Further, plus point of the committee system is better co-ordination.

The drawbacks of the system are eyecatching. One, it leads to heavy concentration of authority at top level officials. As a result, they remain over busy in attending committee meetings and thus are not available in their offices for consultation to their subordinates. Secondly, "because committees are run by formal leaders whose rank is higher than that of the other members, the leader usually dominates." 9

In addition to this, members with a prior commitment to one point of view might defend it to the exclusion of others. In case of TLC, having two members only, it is likely that superior officer's view will prevail upon.

At the end, the greatest disadvantage is that the heavy reliance on the committee system under the functional organisation structure permeates lack of responsibility. The existing organisation structure has only one responsibility centre at the top level only. The best way of doing the thing under committee system would be to adopt a divisionalised structure in which each division shall be treated as separate responsibility centre and its performance should accordingly be evaluated. This requires total change in the corporation structure which has been discussed at length in second chapter.

LEGAL DOCUMENTATION AND DISBURSEMENT

It is necessary that the project for which assistance is sanctioned by the corporation are implemented expeditiously. "The trend of disbursement indicates not only the success of entrepreneur in implementing the project, but also the corporation's success in disbursing the loan to the loanee. Disbursement of the sanctioned loan, no doubt, is an
important barometer to judge the performance of the corporation." \(^{10}\) While addressing the 19th Annual Conference of SFCs, the then Finance Minister Shri H.M. Patel emphasised that, "delay in making available the credit sanctioned, distorts the cost structure of the project, throwing it out of gear." \(^{11}\) In these days of high inflation rate, the above statement carries more weight. The corporation disburses the sanctioned loan on appropriate instalments as per specifications. \(^{12}\) The procedure adopted by the corporation follows a sequence, mentioned hereunder:

1: The agenda papers of the meetings of the MLC, TLC, and SLC along with the sanction letter issued by the Secretary of the committee are sent to the Disbursement Section of the concerned regional office which has the authority for disbursement of loan up to Rs. 5 lakhs. For the amount of loan exceeding Rs. 5 lakhs, the agenda of the Executive Committee or the Board as the case may be and the sanction letter are sent to the Disbursement Section at H.O.

2: The disbursement file is opened in the name of the party at the respective office as mentioned in (1) above.

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11. The Hindu, dated 4-6-1978 (Hyderabad Edition)
3: The sanction letter covering the detailed terms and conditions is then issued to the party along with the requirements to be fulfilled for being eligible for first disbursement. The party is required to convey to the corporation in writing within 15 days, his unconditional acceptance of terms and conditions, failing which the corporation has a right to cancel the loan. However, the corporation gives sufficient chance of hearing the party and the reminder letters are also issued. If there is no response to these reminders, then the sanctioned loan is cancelled.

4: On getting unconditional acceptance, the file goes to the insurance section, which collects from the party a blank cheque towards the premium for insuring assets. The actual amount of premium is worked out later by the insurance company.

5: Having done with it, the insurance section returns the file to the disbursement section, where it is checked and passed on to the RM or the GM (finance) as the case may be for Payment Order.

6: Once the Payment Order is passed, the file goes to the legal section for completing legal formalities. A list of documents/papers to be executed/furnished is shown in Appendix-I.
On completion of the above formalities the file goes to the Accounts Section of the Regional office or the H.O., as the case may be for effecting disbursement. The cheque is then issued to the party. Initially, 25% of the sanctioned amount is disbursed to the party without any inspection of the progress of the project. The file is then returned to the Disbursement Section.

After the initial disbursement, a verification inspection is carried out by the concerned Regional office through their recovery inspectors for all the cases. The verification inspection authorities are as follows:

(a) For loans upto Rs. 5 lakhs - Inspectors.
(b) For loans between Rs. 5 lakhs and Rs. 15 lakhs - Manager/Jt. Manager/Dy. Manager.
(c) For loans above Rs. 15 lakhs - Regional Manager.

Verification inspection includes physical inspection of the site, verification of books and accounts, vouchers etc. The concerned inspecting officer prepares a Verification Inspection Report (VIR) to be submitted at H.O. or regional office as the case may be.

The VIR is scrutinised by the Deputy Manager and then he forwards it to Regional Manager with his comments on further disbursement.
The VIR has to be approved at H.O. by the different authorities as follows:

(a) Jt. Manager and Manager (Dist.) for loans less than Rs. 10 lakhs.

(b) Jt. General Manager (Legal and Finance) for loans between Rs. 10 and 20 lakhs.

(c) General Manager (Finance) for loans above Rs. 20 lakhs.

For further disbursement, the parties are asked to submit quarterly reports on the progress of the unit in the prescribed form. On its verification the amount is released.

:10: After making 75% disbursement, the corporation conducts another verification inspection. All the conditions are to be fulfilled finally at this time. The loanee is required to produce the proof of having made adequate arrangements for the working capital requirements of the unit, at this stage. The final disbursement is made on the basis of the final verification report.

Based on the study of the documentation and disbursement procedure adopted by the corporation the following observations emanate:

(a) The total number of documents required to be supplied/executed is very high. It is a matter of serious thinking whether by creating large number of
documents, the GSFC loan will be more secured. After all, the basic purpose to have various documents is to safeguard the funds of the corporation. The question is, 'Can the corporation secure its funds by having more documents?' After all, recovery of funds is a corollary of the earning power of the unit. To illustrate the case further, the corporation requires from the party, a letter from the Bank to agree in principle to sanction working capital at the stage of first disbursement. What is the use of such a letter when there is no clear commitment of the bank to provide working capital loan?

(b) Various documents are to be collected from different departments of the Government. The applicant has to go from post to pillor to procure them. Again at every stage, one has to spend for different papers, stamps, fees and undergo different procedures for obtaining documents. This takes a lot of time. Government should come out with a simplified procedure.

(c) Another issue which needs attention is the problem of coordination among the different departments. For example, there is avoidable delay in passing the disbursement and writing the cheque by the Accounts Section. Another example is of the loanees not getting the following two informations from the
disbursement section.

(i) How much disbursement does he get against each asset?

(ii) What is the nature and amount of deductions or adjustments made against the amount of disbursement due to him and claimed by him. This is because no adequate care has been taken to coordinate activities of the appraisal, disbursement and the accounts departments.

(d) Movement of file from one section to another for effecting disbursement is presented in Chart VI.1. Which clearly shows the back and forth movement causing delays in disbursement. Some activities can be grouped and thus unnecessary workload can be reduced. For example, passing the payment order and issuing of a cheque can be clubbed together which will reduce the workload of both the disbursement section and accounts section and will improve upon the customer service.

(e) Another issue has also come to the notice while discussing the flow of the work with one of the officers of the corporation. He opined that the poor show in the disbursement is due to the lack of coordination between disbursement section and refinance section. Due to delay in getting refinance from IDBI, the disbursement is held up.
CHART: VI.1

MOVEMENT OF FILE FOR EFFECTING DISBURSEMENT

PARTY

Disbursement Section

Insurance Section

Appraisal Section

A/c 9
Legal
M/Disbursement 2

R.M. 5

CHART: VI.1

MOVEMENT OF FILE FOR EFFECTING DISBURSEMENT

PARTY

Disbursement Section

Insurance Section

Appraisal Section

A/c 9
Legal
M/Disbursement 2

R.M. 5
Main reasons for such a situation are:

(i) The refinance section does not start preparing the application as soon as loan is sanctioned.

(ii) Some gaps in preparing the refinance application requiring further explanations etc. causes delay in correspondence.

(f) While studying the different conditions to be fulfilled for disbursement, it was found that certain impractical conditions are stipulated. One such requirement is confidential report on the credit worthiness of the loanee while making final instalment. This is merely a wasteful exercise since it will not serve any purpose. If such a report is required than it should have been asked for at the time of first or second disbursement and not at the time of final disbursement. It indicates undue suspicion that the promoter may defraud the corporation.

In this connection, it has been remarked by Prof. Kuchhal that "They (the corporation) should realise that they are more than equal partners in the venture and hence in monitoring the activities of the promoters, they must necessarily assume the roles of a guide, philosopher and friend. Once the institution has appraised the project and the
promoter, and have found the same worth supporting, it is not right for them to be unduly suspicious and assume from the very beginning that the promoter is to defraud them."\(^{13}\) To overcome such a situation it is necessary to keep in mind that such a fault finding attitude cannot be altered by merely changing the rules, bye-laws, directives or instructions. The only thing worth implementing is that the corporation should take better stock of their roles, functions, duties and responsibilities.

\[(g)\] For the initial disbursement generally for 25\% of the sanctioned amount, no inspection is required. But for subsequent disbursements, the Disbursement Inspection is carried out by the Recovery Inspectors. The important weaknesses of the system are as under :

(i) How far the recovery inspectors can be considered competent to report on disbursement inspection?

(ii) Can they spare sufficient time for the inspection, when they are primarily assigned some recovery targets for which they are directly responsible?

(iii) When their reporting relationship and accountability is for recovery, how sincerely will they perform this unpleasant task?

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\[^{13}\] Kuchhal S.C., Problems in Promotion and Financing of New Projects, Search and Research, op.cit., p. 75.\]
The weakness in the system has been categorically confirmed in the study material prepared by one of the senior officers entitled as "operational aspects of post disbursement inspections." It is mentioned, "Disbursements are often held up on account of delays in carrying out disbursement inspections. It is observed that 70% of inspection take more than 35 to 40 days. There are various reasons for these delays like movement of matter from Head Office to Regional Office and Regional Office to concerned Field Office. The inspection reports which we usually receive do not give a clear picture in particular column. It is sometimes observed that the capital certified by C.A. (Chartered Accountant) is more than the capital shown in the inspection report. It is sometimes remarked in the inspection report that it is not possible to find out whether the machineries have been purchased as per the sanction letter or not, as the machineries were found in wooden crates."  

Taking stock of the above points, it can be suggested that the disbursement inspection be separated from recovery inspection. Those who are concerned with disbursement, should only take care of this portfolio since they are better known to handle the requirements. A separate cell within the disbursement section itself

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be created for the purpose. For staffing the cell, people from the existing inspection staff sitting at the field offices, be transferred to the new cell, since the new arrangement will reduce workload at field/branch office. They may be given intensive training for the purpose. Thus a specialised inspectorial staff for disbursement purpose can be created. The new cell should operate at the place where the disbursement takes place, that is, either at regional offices or at Head Office. They can work under direct supervision of the head of the disbursement section of the concerned office. The change can quicken the disbursement process as well as improve the quality of inspection.

FOLLOW-UP

Objectives of a financial institution are different from the conventional lender. The primary consideration for a lender is the fixed return on the amount lent, safety of his funds and its repayment in accordance with the terms agreed upon. The financial institutions though are undoubtedly interested in getting their amount back, they are equally interested that the projects they finance grow and thereby contribute in the economic and industrial development of the country. This objective can not be achieved merely by supplying finance; in fact, it encompasses the entire range of relationship in the nature of partners for the common endeavour between them.
The quality of operations of financial institutions are, therefore, determined by the quality of enterprise creation.

The aforesaid required role places the relations between the SFC and the loanee units on a different footing. This consideration makes the post-sanction activity an integral part of the operations of the corporation. Hence, the corporation has to evolve a system of follow-up which, while safeguarding its interests, also provide timely advice to the borrowers. The Development Banking Centre of the Management Development Institute (MDI), New Delhi, has framed the following objectives of the follow-up operations.15

(a) To ensure 'proper' utilisation of assistance sanctioned and disbursed. The word 'proper' has to be interpreted in terms of the project concept and its various parameters as accepted by the institution while sanctioning the assistance.

(b) To encourage the implementation of the project to avoid time and cost over runs.

(c) To anticipate problems and reorient operational policies in such a way so that the problems are contained to the maximum extent possible.

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15. GSFC, Workshop for Inspectorial Staff, op.cit., pp. 76-85.
(d) To help viable economic operations of the unit so that the loan is repaid within the originally stipulated, or slightly extended, time period.

(e) To undertake evaluation of the performance of the unit and its financial health so that probabilistic solutions to emerging problems are provided.

(f) To devise information system best suited to the needs of receiving constant and reliable feedback on various operational aspects of the assisted concern.

(g) To progressively make use of follow-up experiences to upgrade the quality of project appraisal. The educational value of follow-up activities is gaining wider acceptance. The follow-up feedback is important to project appraisal staff so that the appraisal does not degenerate into a purely academic exercise.

(h) To aim at positive involvement in the problems of industrial growth, revitalisation and organisational effectiveness of not only units assisted by the corporation but industry as a whole by virtue of specific follow-up experiences gained over a period of time.

(i) As a lot of valuable information regarding the performance of industrial section flows regularly into financial institutions, it is desirable that
this feedback is used to commission specific industry studies. These studies can throw valuable light on problems of capacity utilisation, raw material availability, production and marketing problems, and future prospects in one or more industries. Another version of these studies may be interfirm comparisons. A comparative study of performance of units within a given time frame and geographical area can provide valuable indicators regarding their weaknesses and strengths. Such studies can be of immense use both to the appraisal and the follow-up staff.

After studying the basic nature as well as the goal and the broad framework of activities covered by the follow-up operations, an attempt has been made to relate what is expected and what GSFC actually does, in order to evaluate this key area. The detailed analysis is as follows:

(1) On comparing the objectives of the follow-up section of a financial institution, with the actual position of GSFC, the prima facie conclusion is totally different and shocking. The corporation after a long journey of twenty three years (i.e. during 1962-83) placed the Follow-up Cell under the exclusive charge of Senior Manager which is providing sufficient indication of neglect of this
major activity for such a long duration. Earlier, there was no separate section for such a vital activity. From the year 1987-88, "as a step towards rationalisation, the Follow-up Division was merged with the Post Sanction Department."\textsuperscript{16}

and post of Deputy General Manager, was offered to the head of follow-up section, directly reporting to the Joint General Manager recovery.

(ii) At present, there are five main activities carried out by the section. They are:

(a) Follow-up Inspections,
(b) Progress Report Scrutiny,
(c) Nominating Directors in the board of assisted units,
(d) Carrying out specific studies, and
(e) Making recommendations on rescheduling and rehabilitation of the sick units their revival.

The working of each of the above activity is evaluated in the following paragraphs:

(a) The follow-up inspection is to be carried out by the Recovery Inspectors. On the basis of available data, the following table has been prepared.

TABLE : VI.1

Coverage of Follow-up Inspection.

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Units Inspected</th>
<th>Total no. of outstanding units</th>
<th>(2) as % of (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982-83</td>
<td>1924</td>
<td>11,153</td>
<td>17.25</td>
</tr>
<tr>
<td>1983-84</td>
<td>2039</td>
<td>12,343</td>
<td>16.50</td>
</tr>
<tr>
<td>1984-85</td>
<td>3646</td>
<td>12,094</td>
<td>30.15</td>
</tr>
<tr>
<td>1985-86</td>
<td>3688</td>
<td>12,491</td>
<td>29.50</td>
</tr>
<tr>
<td>1986-87</td>
<td>4834</td>
<td>13,137</td>
<td>36.80</td>
</tr>
</tbody>
</table>

Source: Annual Report of GSFC.

It is clear from the above table that follow-up inspection has been more than 36% of the total units. However, it should be noted that it has gradually increased from 17% to 36% over the four year duration. It shows that, out of the three units, on an average, only one unit has been visited once a year, indicating a poor follow-up efforts. Atleast, every unit should be covered for inspection once in a year. If the corporation can frame a programme to inspect every unit on a half yearly basis i.e. twice a year, it would be in the fitness of the requirements.

(b) The assisted unit has to submit periodic progress reports and annual statement of accounts. In this respect, it was found that -- the corporation is
not giving due emphasis to scrutinise the reports and to maintain proper records to study the health of the units. Infact, such a continuous evaluation will help the corporation to have an early alarms about the health of the unit. In this connection, the IDBI in its inspection report has also suggested that, "The corporation should introduce a proper system to obtain periodic progress reports and annual statements of accounts of all the assisted units, scrutinise them and take appropriate remedial actions wherever necessary."\(^17\)

\(c\) The third major activity as a part of follow-up measures is to nominate directors in assisted companies where loans exceed Rs. 20 lakhs. The scheme was introduced in August, 1975, by appointing 14 nominee directors. "At the end of year 1985, the corporation has 99 nominee directors providing their valuable services to 217 assisted companies."\(^18\)

The nominee directors are required to work as a bridge of communication between the company and the corporation. The guidelines issued by RBI, to the nominee directors appointed by SFCs are quite exhaustive, stating different roles expected of the directors, which include:

1) Take active interest in overall management policies without interference in day today working of the company.

ii) Try to prevent any mal-practices, abuses and diversion of funds of the companies.

iii) Promote productive efficiency and growth in the assisted companies within the framework of State policies.

iv) Encourage management to formulate systematic planning and monitoring system and also help evolve formulation of objective policies on purchase, pricing, sales, investment etc. to the extent possible.

v) Report to the financial institutions regularly on all important aspects of the company's performance.

The first four functions are related to assisting the unit. The last one is the key role, the director has to play in order to bridge the gap. However, this activity has been carried out sincerely is a matter of investigation by evaluating the frequency and quality of information they have supplied to the corporation. In this connection, IDBI, in its inspection report has remarked that, "The reports from nominee directors were received by the corporation only in few cases and the same were placed before the board for information." \(^{19}\) This shows that the reports are not submitted by many directors. Further they are simply presented before

\(^{19}\) IDBI, op.cit., p.30.
the board for information only. In fact, the corporation should ensure that all the nominee directors submit their reports on a regular basis and the adverse features/remarks be made by the concerned director in the report. Detailed guidelines be supplied to such directors about the requirements of the corporation, so that the corporation can take suitable prompt actions, if required, before it is too late.

(d) After creation of a separate cell for follow-up section, it undertook various studies. During the year 1982-83, a study on the working of selected units was carried out. Two studies, one, regarding the performance of units established by Non-Resident Indians (NRI) and the other, on performance of units at some leading industrial estates like Vatva, Nandesari and Umergaon, were conducted during the year 1983-84. The section also studied the performance of units located at Kandla Free Trade Zone during the year 1985-86. Looking to the number of studies undertaken by the section in comparison to the business of the corporation, it seems that it is negligible. The explanation offered for such a poor performance of the section in this direction was 'want of adequate staff'.

(e) The other activity of the section is to make recommendations on reschedulement and rehabilitation of the cases referred. In practice, it was found, that only rehabilitation cases are referred to while reschedulement decisions are taken by the PS Section of the recovery department at H.O.

(iii) The follow-up activity is the counterpart of the appraisal and hence a close association of both the functions would certainly make the operations free from various problems at a later stage. Unfortunately, it seems, that there is no link between these two functions. The follow-up section is not provided even a copy of the appraisal report, sanction letter or any information about disbursement, recovery or legal action. Thus it totally remains isolated from other sections. Not only this, the main activity of follow-up inspection is also done by recovery inspectors, with whom, the follow-up executives have no direct line (reporting) relationship thus totally dependent on borrowed hands.

All these observations clearly indicate that the corporation has not come out of a traditional approach of neglecting this developmental function. Perhaps this is the reason why, one of the officials of the follow-up section commented that the section is meant for punishment transfer as the section exists without
clear objective, doing some activities here and there and contributing negligible in comparison to what it ought to.

**RECOVERY**

Appraisal and sanctions are done within two to three months, disbursement takes two to three years, whereas the process of recovery continues over 8 to 12 years. Recovery of loans is the most significant activity because achieving the self-sufficiency for the financial requirements depends upon how much recovery of loans contribute in the total financial needs. Against such an ambitious expectation, the proportion of recovery of dues works out to be a meagre 17.71% of the total requirements of funds for the year 1986-87 for all SFCs. This is a sufficient indication that vigorous deliberations and action plans are taken-up in order to attain the self-sufficiency over a period of time.

At present, GSFC has fixed up four dates viz. 1st of April, July, October and January in a year for the repayment of principal sum, whereas the interest payment is to be made by the loanee in two instalments falling due on 1st of August and February.

The repayment period with the moratorium for the different schemes have been presented in Table VI.2.

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TABLE VI.2

Details regarding Repayment and Moratorium Period

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>The Scheme</th>
<th>Repayment period</th>
<th>Moratorium period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>New unit under General Scheme</td>
<td>Upto 3 yrs.</td>
<td>Upto 2 yrs.</td>
</tr>
<tr>
<td>2.</td>
<td>Loans to SC/ST entrepreneurs upto Rs. 3 lakhs</td>
<td>Upto 12 yrs.</td>
<td>Upto 3 yrs.</td>
</tr>
<tr>
<td>3.</td>
<td>Loan under NES</td>
<td>Upto 9 yrs.</td>
<td>Upto 2 yrs.</td>
</tr>
<tr>
<td>4.</td>
<td>Mini loans</td>
<td>Upto 7 yrs.</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Seed/Special Capital Scheme</td>
<td></td>
<td>Upto 5 yrs.</td>
</tr>
<tr>
<td>6.</td>
<td>Equipment Finance Scheme</td>
<td>Upto 5 yrs.</td>
<td>Upto 1 yr.</td>
</tr>
<tr>
<td>7.</td>
<td>Modernisation Scheme</td>
<td>Upto 6 yrs.</td>
<td>Upto 1 yr.</td>
</tr>
<tr>
<td>8.</td>
<td>Doctor's Scheme</td>
<td>Upto 7 yrs.</td>
<td>Upto 1 yr.</td>
</tr>
</tbody>
</table>

Source: Data collected during field work from H.O.

The procedure adopted by the corporation for recovery is as under:

1: The recovery file is opened at (a) the district/field office, (b) the regional office and (c) the PS department at HO, on receipt of a copy of the sanction letter.

2: The Dy. Manager/Jt. Manager of the district/field office, allots the unit to the inspector, with the approval of the RM.

3: The recovery inspector starts visiting the unit as soon as the first instalment of interest becomes due, since there is no moratorium of interest except
for the NES which is two years. The inspector, on the basis of visit, prepares the Recovery Visit Report (RVR) in triplicate and submits to the head of district/field office. One copy of the report is retained by the head and the remaining two copies are sent to the Regional Manager who in turn keeps one copy with him and submits the other copy to the PS Deptt. (H.O.), with his comments. From PS Deptt. it goes to DGM (Recovery) and then to JGM (operations). There is one exception that RM is not required to submit the copy to H.O. in case of loan up to Rs. 1 lakh. The RVR is to be prepared in forms having two different colours. Red colour form is used for the units which are in default for more than two years, while the white colour form is used for the other units.

4: Monthly recovery meetings are held at the regional office for review. It is attended by the RM, the Manager (PS), JGM (operations) DGM (Recovery) and concerned inspector.

5: The Manager (PS) at H.O. studies the cases of default which are in default for two or more years. He suggests the actions to be taken and puts up a note to the DGM (Recovery) who issues a Hearing Notice (HN) to the party. The main idea of issuing HN is to discuss proposed actions for recovery.
Four alternatives are available to the corporation:

(a) Recalling the loan under Section-30 of the SFC Act.

(b) Sale of the Assets under Sec.-29 of the SFC Act.

(c) Collection of arrears as Land Revenue under the Gujarat Public Moneys (Recovery of Dues) Act, 1979 and

(d) Filling a civil Miscellaneous Application in the court.

:6: If the party responds to HN, the DGM (Recovery) negotiates with him and puts up the finalised terms for approval of JGM (operations) or the MD. If the party does not respond, the final notice for legal action is sent.

:7: If the party does not respond at all, the corporation advertises for sale of assets. Two types of advertisement may be given: (i) for floating enquiry wherein the interested parties can contact concerned officer of the corporation for the purchase of the assets, (2) specific for the purpose of sale of the assets with their value and asking for earnest money deposit. Valuation of assets are done by the appointed by the corporation the professional valuers. All the cases of disposal have to be approved by the Board.
Revenue is an issue which has attracted the attention of the entire corporation, since the liquidity of the corporation and ability to undertake further operations are dependent on its success. The procedure is analysed in the following paragraphs:

(i) There is high concentration of authority for decision making and multi levels of operations, which makes the recovery performance ineffective and diluted. The following chart explaining that the decision making is at the sixth, seventh or even at eighth stage of operations.

**CHART VI.2**

**Movement of RVR**

<table>
<thead>
<tr>
<th>Stage</th>
<th>Person</th>
<th>Duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Inspector</td>
<td>Prepares RVR</td>
</tr>
<tr>
<td>2.</td>
<td>Manager District/Field Office</td>
<td>Collects RVR from (1) and forwards to (3)</td>
</tr>
<tr>
<td>3.</td>
<td>Regional Manager</td>
<td>Collects RVR from (2) puts his remarks and submits to (4)</td>
</tr>
<tr>
<td>4.</td>
<td>Manager PS Deptt. at H.O.</td>
<td>Prepares a note and submits to (5)</td>
</tr>
<tr>
<td>5.</td>
<td>DGM (Recovery)</td>
<td>Issues HN and Negotiates with the party and submits the proposal to (6) for approval</td>
</tr>
<tr>
<td>6.</td>
<td>JGM (operations)</td>
<td>Approves actions other than Legal</td>
</tr>
<tr>
<td>7.</td>
<td>M.D.</td>
<td>Studies Legal action proposed and puts before Board</td>
</tr>
<tr>
<td>8.</td>
<td>Board</td>
<td>Finally decision for legal action is taken</td>
</tr>
</tbody>
</table>

Source: Based on field study.
Thus, the procedure consumes lot of time for approvals. Further, the regional offices though created for the purpose of decentralisation does not enjoy any authority. There does not seem any logic behind keeping the recovery job too much centralised. The corporation should incorporate some changes like the recovery cases upto Rs.5,00,000 or any other suitable amount shall be totally dealt with by the regional offices.

(ii) It is worth appreciating the fact that the top management of the Corporation seems to be aware of the need for recovery drive. The fact has been confessed and expressed in the right perspective by the then M.D. Mr. K.D. Buddha. He said, "It was a question of the survival of the corporation. We became aware of the inescapable need for improving our recoveries if we wanted to finance new enterprises. It was the permeation of this awareness into the corporation which set up thinking about improving our debt recovery performance."21

(iii) There is no proper system of demarking the defaulting units. The use of red colour RVR form for defaulting units for a period of two years or more is the only system adopted by the Corporation.

(iv) The overdue position would have been the result of the several factors. One of the factors, "would have been the end result of poor or incomplete project conception".\(^{22}\) The target fever in the minds of sanctioning authority makes the situation worst. In this connection, one of the officials made a remark that, "If you really want to get your loan proposal cleared smoothly, file your application in the month of January or February."\(^{23}\) This is a serious issue and the corporation should see that no such target oriented biases be developed.

(v) The process of disposal of assets of defaulted units is very slow. Beginning with advertising, inviting tenders, negotiations at two-three levels, and then final approval by the MD and the board takes about 6 months to one year. The corporation uses only the newspaper media for sale of assets. The corporation may think of other medias like -- holding conferences at different places, sending the circulars to different machinery suppliers, spare-parts dealers, industrial and project consultants etc.


\(^{23}\) Based on personal visit and discussion with the official.
(vi) One important thing which is solely found missing is the lack of special incentives to the recovery staff. Recovery -- being a thankless job -- requires some additional motivation. The corporation should devise a suitable incentive plan aligned with the recovery targets.

**ACCOUNTING SYSTEM**

Accounts department in any organisation serves the role of a nerve centre. The department is responsible for assuring the owners that the operations of the unit do meet the requirements of providing true and fair picture. The accounting system of the corporation can be grouped into two parts:

One  : Financial Accounting, consisting of maintaining cash book, preparing the final accounts etc.

Second : Loan Accounting, concerned with maintaining the accounts of loanees.

(1) **Financial Accounting**:

The accounting policy is based on the 'General Regulations' framed by the Corporation. The power to make such regulations is granted to the Board under Section-48 of the SFC Act. Accordingly, General Regulations 55 and 56 are prepared to guide the accounting policy, as stated below:
55. **Accounts** :-

The Board shall cause accounts to be kept of the assets and liabilities, and receipts and expenditures of the corporation.

56. **Annual Statement of Accounts** :-

The Board shall cause the books of the corporation to be balanced on the last day of the month of March in every year and the annual accounts shall be set out as follows :-

(a) a balance sheet in the form specified in Schedule A,

(b) a profit and loss account for the year in the form specified in Schedule B."

Thus in the absence of any specific mention of the system to be adopted, the corporation has a liberty to get its accounts prepared on any of the system either the mercantile or the cash based. The corporation followed the mercantile system upto the accounting year 1980-81. The system has several inherent limitations. It fails to show true state of affairs since the income is shown in the credit side of profit and loss account on an accrual basis, though the same may not have been received. "It is also likely that in a particular case the interest is not recovered for many years because...

24. GSFC, General Regulations, op.cit., p. 31.
of sickness of that unit. But owing to the existence of tangible security with the corporation, it is not written off as bad debt. The interest accrued on such unit would also be taken as income though actually it may not be realised."

Thus it incorporates window dressing in its statements and fails to provide true and fair view of the operations. A detailed study of the published accounts of the corporation for five year duration viz. 1974-75 to 1978-79 was carried out to compare the profit shown under the prevailing merchantile system and the actual should be profit on a cash system. The study found that, "if the financial performance is judged on cash basis, the corporation has been running at a loss as against the profits shown in the published accounts prepared on merchantile basis ... the amount of interest received in cash varies from 52 % to 69 % of gross income, as such, on accrued basis total amount of interest credited varies from 93 % to 96 % of gross income. This means profit is over-stated to this extent." 


27. Ibid.
The cash based accounting system has several merits. It reflects true and correct financial position. Correct profitability is reflected because only the interest amount collected is accounted. It automatically indicates the efficiency of the recovery function. The system is also most suitable to the corporation because no window dressing is necessary to show the rosy picture of the performance in order to maintain share price etc.

The Working Group on Reduction of arrears of SFCs recommended to adopt cash system of accounting in 1977. Assam SFC was the first to introduce the system from 1st April, 1979. The corporation continued the mercantile system upto the year 1980-81. It was only from 1st April, 1981, that the corporation shifted to cash basis of accounting.

(2) Loan Accounting:

At the time of releasing first disbursement, an account in the name of the party at H.O. is opened. The loanee receives the notices of the quartely instalment and half yearly interest prepared by the computer section. The loanee has to make payment within 15 days. When the amount is received, the department prepares three copies of the receipt. The original one is sent to the loanee. The second one, on which red mark is kept is sent to computer section and the
third one is retained by the department.

The performance of loan accounting system is not free from certain criticisms, like — ledgers are not up-to-date. Study of notes forming part of profit and loss account and balance sheet, was made. To illustrate the case, "The balance to the Credit or Debit in accounts for amount receivable or payable including loans and advances under different heads are not confirmed." This note has remained from 1975-76 to 1983-84. This means for a long duration of 9 years, balances under different heads were not confirmed. It is only from the year 1984-85 the note was deleted.

The main reason for such a weak accounting performance is due to high turnover of officials. The department was managed by deputationists from the State Government and thus no systematic consistent accounting system was developed. The corporation saw 11 officials during 1960-61 to 1980-81. Of the eleven, five had served only for one year. Thus, the corporation was compelled to leave the old practice of relying on deputationists. Deputy Manager (Accounts) was appointed during the year 1982-83 who holds the post even today.

Realising the magnitude of the problem, the corporation invited a consultancy firm of Bombay to study the matter and to suggest the system for improving the performance of loanees accounting, which submitted
its report in 1983-84. The major accounting problems identified were as follows:

1. The existing system does not give either to the corporation or to the loanee perfect information necessary for servicing and repayment of loans.

2. There are plenty of duplications, lot of unnecessary workload and waste of human energy.

3. There are divergences between the requirements and actual practices.

4. There is a complete lack of confidence on all sides in what the Accounts say. No one really believes that they represent a true and fair picture of the affairs of the corporation and of its loanees.

The last point when observed for a banking type of corporation is really shocking. The recommendations made by the study report were implemented partly.\textsuperscript{29} Infact, the department needs to be thoroughly overhauled and reorganised.

The recommendation made earlier shall be reiterated here also that the corporation should not keep all the accounts of loanees at H.O. All loan accounts covered under the mini loan and tiny loan be kept at regional offices, for which the RM is responsible for sanction and disbursement. In fact, the corporation should adopt divisionalised organisation structure in letter and spirit by offering sufficient autonomy to the divisions.

\textsuperscript{28} Credit Trust; Report on Innovations, Accounting and Information Management Systems for GSFC, 1983-84, (Unpublished) Chapter-II (Genesis and Gaps) pp. 8-27. 

\textsuperscript{29} GSFC : Annual Report, 1983-84, p.22.