CHAPTER IV
NON-PROPRIETORSHIP FUNDS

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* * *
(A) DEBENTURES

(1) Debentures as a Source of Finance

'Debenture' includes a debenture stock, a bond and any other security of a company whether constituting a charge on assets or not. A debenture is a document which either creates or acknowledges debt. Ordinarily, a debenture constitutes a charge on the undertaking of the company or some part of its property. Under the Law, it is not necessary that the debentures should create a charge. Debenture interest is payable whether or not the company earns profits. The Report of the Sachar Committee on Companies and MRTP Acts contains a suggestion in respect of the definition of the term 'debenture'. According to the Committee, the present definition allows companies to issue unsecured debentures.

Issue of unsecured debentures is another form in which long term borrowings may be made without the debenture holders getting any security for the money invested by them. The Committee feels that the provision of issue of convertible bonds - bonds convertible into shares of the company on agreed conditions - without constituting a charge on the assets only be retained. It is suggested therefore, that clause (12) of section 2 of the Companies Act, 1956, should be redrafted thus:

"'Debenture' includes debenture stock, bonds and any other securities of a company which constitute, except in the case of convertible debenture bonds, a charge on the
assets of the company*. If this suggestion is accepted and incorporated in the Act, all debentures must be secured, except for convertible debentures.

A brief reference may be made here to the principles of debt financing:

(i) **Business cycle and debt financing**: Past experience has shown that the more vulnerable a company's business is to the business cycle, the greater the need for restraint or caution in the use of debt in financing. Since industrial concerns operate under competitive conditions, the demand for most industrial or manufactured products is unstable. Most companies will find it advantageous to strengthen their financial position during the prosperity phase of the business cycle by reducing cost and building cash reserves so paving the way for expansion. Conversely, during depression some of the most successful companies have resorted to borrowing to finance expansion so that their capacity to produce has been enlarged by the time it is needed to meet the prosperity demands.

(ii) **Long term industry-trends and debt financing**: An industry will reflect in its operations its own life cycle namely, promotion, development and expansion, maturity and decline. A concern in the development and expansion stage can resort most safely to bond financing but, in maturity stage, debt should be
reduced in preparation for the eventual decline in earning power when heavy fixed charges may spell bankruptcy. Where an industry faces a declining trend in sales, debt reduction should be the primary objective of management.

(iii) **Earnings coverage and debt financing**: The primary evidence of the ability of a company to employ debt finance wisely is the number of times the earnings cover the debt interest charges. The higher the coverage of fixed charges over a period of time, the greater the ability of a company to employ borrowing as a means of raising funds.

(iv) **Amortization and debt financing**: Too often corporate managements assume that the earning power of the business is assured and hence new debts can be incurred safely. But experience shows that it is wiser to provide for partial, if not complete, debt retirement through the use of the method of sinking fund.

(v) **Conventional rules and debt financing**:

(a) The annual PAT should be at least three times the fixed interest charges of debentures.

(b) The record of earnings of the company should show stability and growth.

(c) The total funded debt of the company should not exceed the net working capital, so that fixed charges can be met despite the lack of earnings in one or two years.
(d) If the debenture issue requires a mortgage, the issue should not exceed 50% of the net replacement value of the property.

There are several reasons for the use of debentures in the financial structure of companies:

(i) The growth rate in a company's sales and assets may be so rigid that it cannot be supported entirely from retained earnings. To acquire additional assets, management must go outside the company to finance, and debenture financing is often preferable to short term debt or equity or preference share financing.

(ii) An increase in debt may bring a desirable increase in return on equity. So long as the financial leverage works favourably, a company can use debt financing to increase returns to shareholders. Larger fixed charges mean greater risk, but so long as the expected return rises faster than the risk premium applied by investors, the value of equity shares should increase.

(iii) Reduced fears of depression and long term periods of easy money have made managements less fearful of downturns in economic activity. The expansionary bias in terms of monetary and fiscal policies have been interpreted by them to mean that sales revenues will be high enough to meet interest expenses and that the leverage will be favourable.
(iv) Interest expenditure on debentures is tax-deductible. That means, if everything else is equal, the financial manager chooses to use debentures and not equity or preference as a source of finance.

(v) The general decline between 1956 to 1975 sharply increased the cost of equity financing, and investors often refused to buy new shares of financially weak or low profit making companies. Thus, considerations both of economy and of necessity have driven new firms into debenture financing.

(vi) Inflation has encouraged companies to use more of long term debt, since repayment later is likely to be made in cheaper rupees. The real burden of interest on debentures can be estimated from nominal cost, as per the following formula:

\[ ir = \text{pn} (1 - t) - \text{p} \]

where, \( ir \) = Real interest rate,
\( \text{pn} \) = Quoted annual interest rate,
\( t \) = Tax bracket of the company, and
\( \text{p} \) = Annual percentage increase in the price level.

Suppose, the rate of interest quoted is 8% p.a.; corporate tax rate applicable is 50%, and rate of annual increase in prices is 3%. Then, the Real Rate of interest will be:

\[ ir = 0.08 (1-0.5) - 0.03 \]
\[ = 0.01 \]
\[ = 1\% \]
(vii) Debentures often present an easier underwriting job as institutional investors have a longer absorption capacity for debentures than shares. Insurance companies, investment trusts etc. also prefer to invest in debentures.

The following limitations of debentures as a source of finance should, however, be borne in mind:

(i) Conservation in management can restrict the willingness to incur long term debt. Some managers see all debts as risky and prefer to have as little of them as possible.

(ii) Inflation cuts in two ways: (a) It may encourage companies to go in for debt. (b) Lenders expecting inflation will adjust their interest rate demands upward to compensate for the expected rate of increase in the price level. If they overestimate the inflation rate, their interest requirements may prove to be exorbitant. In that case, many borrowers might not think of using debentures.

(iii) Debenture holders might make some other demands that are financially burdensome or that restrict management's freedom. They may insist that working capital must be maintained at a certain level or they may ask for voting rights on certain management decisions.
(iv) Credit stringencies resulting from a tight money market or a change in creditors' attitudes may oblige a company to restrict long term borrowings. A company with excessive DER cannot borrow long term funds at any price.

(v) The periodic payment of interest and repayment of principal amount have to be made to debenture holders regardless of the company's earnings and financial position. Failure to meet those payments constitutes default of the contract. Thus, while measuring the risk, one has to take into account the total burden of debt represented by interest and sinking fund payments.

(2) The Role of Debentures in Financing Cotton Textile Mills of Ahmedabad

The study of the Balance Sheets of all the fifty cotton textile units of Ahmedabad for the period of ten years from 1966 to 1975, leads me to the following observations:

(i) There were 21 debenture issues outstanding throughout the period. Of these, only two were convertible debentures in that the debenture holders had an option to convert an agreed amount into the equity shares of the respective companies.

(ii) The contractual rates of interest payable on debenture ranged between 4% and 11%. More than half of
the issues carried interest rates between 7% and 8%. Only 3 issues carried an interest of 10% or more.

Debenture is a constituent of secured loans and secured loans are a component of non-proprietorship funds and therefore, a brief discussion on the role of secured loans as a whole is necessary.

**Non-proprietorship funds and cotton textile mills of Ahmedabad:** As mentioned earlier, the average share of non-proprietorship funds in the total funds had increased by 1.13% only, from 69.40% during 1966-70 to 70.20% during 1971-75. However, the overall contribution of these funds - consisting about 70% of total funds - seemed to have been significant during the period of this study. The non-proprietorship funds are made up of three sources: (1) Secured loans, (2) Unsecured loans, and (3) Trade credit & provisions. In this section an attempt is made to study the following aspects:

(i) The contribution of secured loans to total funds.
(ii) The contribution of secured loans to non-proprietorship funds.
(iii) Share of debentures in total funds.
(iv) Share of debentures in non-proprietorship funds.
(v) Share of debentures as a constituent of secured loans.
The secured loans consist of funds raised through the issue of debentures, borrowings from banks and financial institutions and funds acquired under DPG Scheme. A study of Table V and Table XIX regarding the contribution of secured loans to total funds revealed the following:

(i) The average share of secured loans in the total funds had declined marginally by 2.56% from 31.20% during 1966-70 to 30.40% during 1971-75. This was accompanied by an insignificant change in the variability factor from 31.33% during 1966-70 to 32.34% during 1971-75. This means that the financial policies adopted by textile units were uniform, though the level of uniformity had declined during the latter period.

(ii) Exceptional cases were:

(a) In the case of unit Nos. 6, 14, 15, 19, and 29, the share of secured loans was above the overall average during both the periods, but had declined during the latter period.

(b) In the case of unit Nos. 3 and 24, their individual share was above the average during both the periods, and it had increased further during the latter.

(c) In the case of units No. 4, 11, 20, and 37, the contribution of secured loans was below the average during both the periods, but it had increased during the latter period, whereas in the case of unit No. 13, the share was not only below the overall average but had
declined during the latter period.

The contribution of secured loans to non-proprietorship funds is brought out by Table VI and Table XIX. The findings are:

(i) The share of secured loans in non-proprietorship funds had declined by 8.37%, from 45.40% during 1966-70 to 41.60% during the latter period. This was accompanied by a minor change in the variability factor. 'Secured loans' was found to be the single largest source of non-proprietorship funds during both the periods. The change in the variability factor from 27.11% to 24.78% indicated that not only were the financial policies uniform, but also had the level of uniformity increased during the latter period.

(ii) The following were the exceptional cases:

(a) In the case of unit Nos. 3, 6, 7, 14, 15, 17, 31, and 40, the share was above the overall average during both the periods of study. In the case of unit No. 3, the share had increased, whereas in the case of the remaining units, it had declined in the latter period.

(b) The share was below the overall average during both the periods in case of unit Nos. 4, 20, 30, and 43. In the latter period, it had
increased in the case of unit Nos. 4, 20, and 48, whereas in the case of unit No. 30, it had declined further.

The main findings based on Table VII and Table XIX regarding the share of debentures in total funds are:

(i) The average share of funds from debentures in the total funds had increased marginally from 2.04% during 1966-70 to 2.16% during 1971-75. There was a significant change in the variability factor. The significant change in the variability factor indicated that the financial policies in relation to debenture finance were very dissimilar and the level of dissimilarity had increased further during the latter period. The share of debenture money in total funds was very meagre throughout the period of this study. In fact, only 6 units had raised money by issuing debentures.

(ii) Exceptions to be noted are:
In the case of unit Nos. 1, 7, 36, and 43, the contribution of debentures to total funds was above the overall average during both the periods. In the case of unit Nos. 1, and 43, the share had declined, whereas in the case of unit Nos. 7, and 36, the share had increased during the latter period.
A reference to Table No. VIII and Table No. XIX regarding the share of debentures in non-proprietorship funds indicated the following:

(i) The share had increased only marginally from 3.30% during 1966-70 to 3.50% during 1971-75. This was accompanied by a moderate change in the variability factor during the latter period. The level of variation was pretty high during both the periods. This means that financial procedures and policies as adopted by the textile units under study were fairly non-uniform. This level of non-uniformity had increased during the latter period of study. The number of units which did not use debentures as a source of finance declined for 45 to 44 during the latter period. As many as 44 units did not use this source of finance during both the periods. It may be concluded that debentures were not a popular means of finance throughout the period of this study.

(ii) The noteworthy exceptions were: In the case of unit Nos. 1, 7, 36, and 43 as mentioned above, the share was quite above the overall average during both the periods, but it had increased in the case of unit Nos. 7, and 36 and had declined in the case of unit Nos. 1, and 43, during the latter period.
A reference to Table IX and Table XIX regarding the share of debentures in secured loans makes the following clear:

(i) Debentures were a very small contributory source of finance even as a component of secured loans. In fact, their contribution to secured loans had declined from 7.00% during 1966-70 to 6.80% during 1971-75. This was accompanied by a moderate decline in variability factor. In regard to financial policies adopted by the textile units under study as to how much portion of secured loans need be raised through debentures, it may be concluded that the said policies were not uniform during both the periods and the level of non-uniformity was more pronounced during the latter period.

(ii) A study of unit Nos. 1, 7, 36, and 43, shows that debentures had played a better role as a component of secured loans than the overall average during both the periods. During the latter period, the share of debentures had declined very greatly in the case of unit No. 43.

In cases where the share of debentures had declined during the latter period, two factors seemed to have operated at the same time: (1) Some mills had redeemed a part of debenture money during the latter period. (2) There was an increase in the total non-proprietorship funds
during the latter period such that the share of debenture had declined.

Exceptionally enough, in the case of the unit No. 43, the share of debentures in total funds, non-proprietorship funds, as well as, total secured loans, was far above the overall average during both the periods. A stable record of profitability and adoption of schemes of expansion, were the determinant factors. However, during the latter period, it did not issue any new debentures and the share of debentures declined. It seemed that the management turned its attention to the newly opened up source of finance namely, the secured loans from financial institutions. The share of institutional loans in its total funds had increased from 5.70% during the former period to 17.60% during the latter. Looking to the credit-worthiness of the concern, the financial institutions must have granted assistance without any hesitation. Throughout the period of this study, the unit earned a net profit of 20.37% of net worth and had a stable record of dividend payment. This must have encouraged investors to purchase its debentures. This was one of the reasons for the higher than overall average share of debentures in total funds, secured loans and non-proprietorship funds.

In the case of unit No. 36, the share of debentures had increased from 3.56% of total funds during the former period to 9.69% of total funds during the latter.
The management had relied less on bank finance during the latter period. As such, the share of secured bank loans had declined from 29.03% of total funds during 1966-70 to 16.44% during 1971-75. Again, it had not tapped the institutional source of finance during both the periods.

The debentureholders of this unit had confidence in the profit earning and interest paying capacity of the concern. It had raised Rs. 9 lacs by issuing debentures during 1966-70, which had increased to Rs. 45 lacs during 1971-75. A good record of profitability was reflected in its earnings at the rate of 14.86% of net worth through out the period of this study.

A study made by C.H. Patwardhan* relating to the patterns of financing as adopted by 1001 large and medium companies working in India revealed that the share of debentures in total funds of these companies was 13.26% during 1965-66 to 1969-70 and it was 10.68% during 1970-71 to 1973-74. This indicated that the role of debentures had diminished during the latter period.

RBI data** for 1965-75 pertaining to the amount of capital raised through prospectus by issuing debentures indicate that an amount of Rs. 31.84 crores was collected through debentures during 1966-70 by the non-government corporate sector of India. It had declined to Rs. 5.92

crores during 1971-75. This means that the role of debentures as a source of finance had greatly diminished during the latter period.

The indices* regarding market prices of deben-
ture securities are presented in Table IV. 1.

Table IV. 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Cotton Industry (Base:1961-62=100)</th>
<th>All-India (Base:1961-62=100)</th>
<th>Year</th>
<th>Cotton Industry (Base:1970-71=100)</th>
<th>All-India (Base:1970-71=100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>97.8</td>
<td>90.9</td>
<td>1971</td>
<td>98.5</td>
<td>99.1</td>
</tr>
<tr>
<td>1967</td>
<td>90.3</td>
<td>88.6</td>
<td>1972</td>
<td>97.3</td>
<td>98.4</td>
</tr>
<tr>
<td>1968</td>
<td>86.6</td>
<td>85.7</td>
<td>1973</td>
<td>97.3</td>
<td>97.4</td>
</tr>
<tr>
<td>1969</td>
<td>85.5</td>
<td>87.1</td>
<td>1974</td>
<td>69.1</td>
<td>96.2</td>
</tr>
<tr>
<td>1970</td>
<td>85.5</td>
<td>88.1</td>
<td>1975</td>
<td>91.3</td>
<td>92.1</td>
</tr>
</tbody>
</table>

The debenture security prices showed a declining trend with an index of 97.8 in 1966 and 85.5 in 1970 for cotton textile industry. The declining trend was observed with an index of 98.5 in 1971 to 91.3 in 1975. Similar was the trend for debenture securities of All-India All-Industries, with an index of 90.9 in 1966 and 88.1 in 1970, together with an index of 99.1 in 1971 and 92.1 in 1975.

* RBI : Reports of Currency and Finance; 1965 to 1975.
It is unfortunate that the debenture security prices for Ahmedabad cotton textile mills are not available.

As regards the underwriting experience with regard to debentures, Table IV. 2 presents the RBI figures.

Table IV. 2

<table>
<thead>
<tr>
<th>Year</th>
<th>Net amount offered to public (Rs. crores)</th>
<th>Net amount underwritten (Rs. crores)</th>
<th>Amount devolved on underwriters as % of the amount underwritten</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>4.28</td>
<td>4.28</td>
<td>51.40</td>
</tr>
<tr>
<td>1972</td>
<td>18.00</td>
<td>18.00</td>
<td>10.40</td>
</tr>
<tr>
<td>1973</td>
<td>1.20</td>
<td>0.20</td>
<td>4.30</td>
</tr>
<tr>
<td>1974</td>
<td>5.00</td>
<td>5.00</td>
<td>44.30</td>
</tr>
<tr>
<td>1975</td>
<td>0.20</td>
<td>0.20</td>
<td>100.00</td>
</tr>
</tbody>
</table>

On the basis of the above, the following observations can be made:

(i) Throughout the period of 1971-75, the issues of debentures were underwritten to the full. The public response to the issue of debenture was grossly poor. No investor was ready to invest directly in the debentures of any company.

(ii) The amount devolved on underwriters shows frequent variations during 1971-75. There was not a single year when the underwriters had not to take up debentures themselves. This means that they themselves had to pay for a portion of debenture money ranging from 4.30% of the amount underwritten during 1973 to 100.00% of the amount underwritten during 1975.
A comparison between the role of debenture in financing (i) in the cotton textile mills of Ahmedabad and (ii) in the cotton textile industry and All-India All-Industries indicated that in the former, it was very small throughout the period of this study. Their share in total funds was hardly 2.04% during 1966-70 and it had increased very marginally to 2.16% during 1971-75. As compared to this, in All-India All-Industries, debentures seemed to have played a fairly good role as a source of finance. As per the study of finances of 1001 public limited companies made by C. H. Patwardhan, the funds raised by debenture issues were equal to 13.26% of total funds raised by such companies during 1966-70, though, their contribution had declined to 10.68% of total funds during 1971-74.

The basic reason for not raising a large amount of money through debenture issue seemed to be the very poor public response. The costs of issue including underwriting commission were fairly high. Moreover, in the absence of any organised stock exchange activities in regard to the purchase and sale of debentures, the debenture holders were not in a position to take advantage of liquidity or capital appreciation. There were downward fluctuations in the All-India indices for all the industries as also for the textile industry, as discussed earlier. There was hardly any trading in debentures on Ahmedabad Stock Exchange.
The financial policy of relying (to the extent of 25% to 30%) on banks and financial institutions for borrowings adopted by the managements of the cotton mills of Ahmedabad seemed to be another factor accounting for a very small role of debentures as a source of finance. Again, most of the debenture issues of these mills had carried an interest rate ranging from 7% to 8%. These rates were relatively unattractive in view of the fact that since 1973, even the bank rate had been raised to 9%, and the deposit rates in the mills were still higher.

Two suggestions can be made to increase the popularity of debenture as a form of investment: (i) Issue of convertible debentures or bonds (ii) Issue of Right debentures.

(i) **Convertible debentures**:

Convertible debentures are debentures that are exchangeable for equity shares at the option of the holders, under specified terms and conditions. The Reserve Bank of India itself has stated that the use of preference shares as a source of finance should be discouraged as a common policy in future issues and attempts should be made to see that convertible debentures are used on a large scale by companies to raise long term funds.
Convertible debentures are an American innovation to attract investors to invest in comparatively non-attractive securities. A convertible debenture is a security having dual identity: fixed income security and potential value as equity. The conditions regarding the period during which the option can be exercised and the number of shares in which it will be convertible are fixed in advance. Conversion value will be the number of shares in which a debenture is convertible. For instance, if one debenture of Rs. 1000 is to be exchangeable for 20 equity shares with a market price of Rs. 60/- each, the conversion value of the debenture will be Rs. 1200/-. A convertible debenture will usually sell at a market price higher than its straight value because of the convertibility feature.

A convertible debenture as a source of raising money would be suitable in the following situations:

(a) When investors are to be attracted in difficult times.
(b) When a company has already reached its borrowing limit.
(c) When a small company wants to raise money but cannot go to the share market or offer mortgage on assets.
(d) When a company is passing through financial difficulties.
The Sachar Committee has suggested that these debentures should be allowed to be issued as unsecured, i.e., without any need to mortgage assets of a concern. A convertible bond is an indirect way of issuing equity shares. The bondholder receives the interest for a certain period of time and may convert his bond into share holdings after the company starts making reasonable return on its investment. Convertible bonds have the following distinct advantages:

(i) The management can raise equity share capital indirectly without diluting the stock, till such time that the funds raised start giving a return on investment.

(ii) They offer a definite return to the bondholder who may otherwise not be willing to put his money in companies which are highly capital intensive and have long gestation periods.

(iii) The conversion price is normally set at a figure higher than the market price prevailing at the time of the issue of the security in the hope that the market price of the share will progressively grow. Hence, the company normally realises a higher price from conversion of convertible bonds than from the issue of right shares.

(iv) Till the bonds are converted, the cost of financing is low. Firstly, the bonds usually carry a lower
rate of interest than the dividend normally payable on shares. Secondly, the interest paid on bonds is a charge against taxable profits and hence, there is a considerable tax advantage.

(v) Bonds can also be sold when the share market is weak and the investors are wary of putting their money in new issues. Also, such bonds can raise considerable amounts of money. These two advantages are not there in the case of right shares which must be issued only when the market price of the share rules high and, in which, even at that time the amounts raised are considerably lower.

(vi) Convertible bonds are normally unsecured and, therefore, they do not affect adversely the capacity of the company to provide security against its other debts.

(vii) Financial institutions would support these bonds much more willingly than a right issue.

A serious disadvantage of convertible bonds is that it involves an element of speculation. We have already seen that the subscription price is set higher than the market price prevalent at the time of the issue of the bond in the hope that the market price of shares will grow in due course. If the expectation does not materialise, the bondholder may not like to convert the bond into shares. In such an event, he continues receiving a low rate of interest on his investment for a long period. Similarly, the company issuing the bonds also
loses if the bondholders do not exercise their option. On the other hand, if the market price of the shares at the time of conversion rules much higher than the conversion price, the company loses the opportunity of realising a higher price for its fresh capital. Hence, it is crucial that the conversion price should be determined after a scientific study of the future prospects and the future trends of market prices.

(ii) **Issue of Rights debentures**

Debentures may be issued on 'rights basis' to the existing shareholders. In September, 1978, the Government of India announced guidelines for the issue of debentures on rights basis to shareholders. The main features are:

(a) The guidelines are applicable only to those issues, which are right issues to their shareholders and the object of which is to augment the long term resources of the company for working capital requirements and to reduce the dependence on fixed deposits from public, shareholders and other short term borrowings.

(b) The maximum limit for the issue is: 20% of gross current assets, loans and advances minus the long term funds presently available for financing working capital, or 20% of paid-up capital, and free reserves, whichever is less, to be rounded off to the nearest multiple of Rs. 25 lacs.
(c) The DBR including the proposed debentures issue should not exceed 1 : 1.

(d) The rate of interest will be 10.5% for debentures issued up to 7 years, and 11% for debentures issued for 8 to 12 years. However, in order to make the debentures more attractive to the prospective investors, it is open to a company to offer suitable incentives like issue of debentures at a discount or payment of additional ½% rate of interest.

(e) The redemption must be made as prescribed, i.e.,
   (i) for debentures issued up to 7 years - 33 1/3% uniformly in the 5th, 6th and 7th year. (ii) for debentures with maturity between 8 and 12 years - 20% uniformly in the 8th, 9th, 10th, 11th, and 12th year.

(f) The debentures shall be listed on a stock exchange.

(g) The company should be a listed one and its equity shares must have been quoted at or above par in six months prior to the date of application for the issue of debentures.

(h) The company shall start allotment only after a minimum subscription of 75% of total issues is secured.

(i) So long as the debentures are outstanding, the directors of the company shall certify in their Annual Report that the funds raised through debentures have been utilised for the purposes
A very important point must be noted here. The above guidelines prescribe that the DER of the company issuing such debentures should not exceed 1:1 after the proposed issue, whereas the norm of DER accepted as normal (as per the study group as DER norms headed B. K. Madan) is 2:1. It is necessary that even for the issue of rights debentures, the norm of 2:1 is accepted; for otherwise, the scheme will not be useful in many cases. Thus, the average DER of the cotton textile mills of Ahmedabad during 1966 to 1975, had been equal to 0.98 : 1.00. Therefore, if the limit of 1:1 in terms of DER is rigidly exercised as per the guidelines, these mills will hardly be able to take advantage of the rights issue of debentures, even if so desired.

Another suggestion is to make the rights issue of debenture with conversion rights. Though a market for convertible debentures has not been established in our country, they are relatively more popular than non-convertible debentures. For instance, Camphor and Allied Industries Limited had issued 10% 5,000 convertible bonds of Rs. 1000 each aggregating to Rs. 50 lacs during 1975. The issue was over-subscribed despite the fact that capital market was very much depressed then on account of restrictions on payment of dividends.
The issue of 'Rights' debentures by large companies for meeting their long-term working capital requirements seem to be out of favour of financial institutions, since they have been pleading for a hike in the interest rate from 11 to a minimum of 13 per cent on them. While the monetary authorities are stated to be not in favour of a hike in the interest rate on such debentures, the Union finance ministry seems to be favourably disposed to the financial institutions' request. Several pending proposals with the controller of capital issues in this regard are expected to be finalised soon with the revised interest rates.

The hike in the interest rate on rights debentures assumes importance in the context of the levering up of the entire interest rates structure. Apart from the hike in the coupon rates on the Central and State Government loans and guaranteed bonds of semi-government bodies in the past one year, bank lending has become costlier following the imposition of seven percent interest earnings tax on banks. Other financial institutions are also likely to raise their interest rates following a similar tax on their interest earnings proposed in the latest Union budget.

Shareholders have not been attracted by these debentures. The subscribers have been the financial institutions and charitable and other trusts, where, these have been declared as 'public securities' by the respective State Governments. Moreover, after their issue, a
majority of them were being quoted at a discount. Financial institutions find that they have been saddled with these debentures with comparatively low return and without any liquidity.
During the last twenty-five years, the industrial structure of our country has undergone a great change. Way back Pandit Madan Mohan Malaviya had said that if a large industrial structure was to be developed in the country, the provision of extensive banking facilities was an essential pre-requisite. The prognostication has come true in terms of both the traditional banking facilities and the specialised financial agencies catering to the varied financial requirements of the industries in our country.

Although, normally, commercial banks cater to short term requirements, they provide term finance in several ways. They make advances against shares and debentures of industrial concerns. They advance loans on hypothecation of stocks, and against the mortgage of fixed assets. Term financing is a special business. It is mainly availed of by borrowers for the establishment of new industrial units, acquisition of fixed assets, expansion in plant capacity or modernisation and renovation of an existing unit. Term finance is required for periods longer than those of ordinary commercial finance and may not conform to the traditional concept of liquidity. Sometimes it is attendant with greater risks than those involved in commercial finance because of the longer period for which
it is required, the bigger amount involved and the limited marketability of security offered, viz., the fixed assets. On the other hand, in a term loan, there is a provision for regular repayments, a better financial discipline - both on the banker's and the borrower's part - and a more systematic long term planning of credit than in commercial advances. Sometimes a project financed on term basis gets the benefit of advice by foreign and local technical experts. The main source of regular repayment of instalments in term loans is the continued profitability of the concern.

The circumstances conditioning loan applications can never be uniform. The approach, the procedure, terms and conditions, even the decision whether the loan is to be granted or not, will depend upon various factors affecting the conditions of the industry concerned and the earning potential of the borrowing unit in particular. The final decisions will depend on the judgement of the lending bankers, for which the appraisal and analysis of these factors will be only the starting point.

When a bank makes a term loan, the provisions made in the loan agreement - known as protective tenets - are:

(i) General provisions used in most loan agreements, which are variable to fit particular situations.
(ii) Routine provisions used in most arrangements.
(iii) Special provisions that are used according to the situation.
(i) **General Provisions** are:

(a) The working capital requirement is probably the most commonly used and most comprehensive provision in the loan agreement. In a particular borrower's case, the bank may require a minimum working capital to be maintained throughout the duration of the loan. The minimum amount of working capital is set on the basis of the amount of present working capital and projected working capital, allowing for seasonal fluctuations.

(b) Cash dividend payment and repurchase of stock restrictions are another set of restrictions. The purpose is to limit cash going outside the business, thus preventing the loss of liquidity of the company. Most often such payments are limited to a certain percentage of profits.

(c) Capital expenditure may be limited to a fixed amount in rupees per year. This provision should not, however, be restrictive as to prevent the adequate maintenance and improvement of facilities and the limit should usually be equal to the amount of annual depreciation.

(ii) **Routine provisions** usually include invariable decisions found in most loan agreements. Ordinarily, the borrower is required to furnish the bank with certain financial statements, not to sell a substantial portion
of its assets, and to pay when due, all taxes and other liabilities except those contested in good faith. A provision forbidding the pledging or mortgaging of any of the borrowers' assets is always included in a loan agreement. Usually there is a restriction on contingent liabilities also.

(iii) Special provisions in the loan-agreement are used in order to achieve a desired total protection of the loan. It may contain a definite understanding regarding the use of loan proceeds so that there will be no diversion of funds to purposes other than those contemplated when the loan was negotiated. A limitation on investments may be imposed to safeguard liquidity by preventing certain non-liquid investments.

A bank may insist on life insurance of the executives of the borrower-unit, proceeds of policy may be payable to the bank. Aggregate salaries and bonuses of these executives may be limited to certain amount. It may also contain a management clause by which certain key executives must remain actively employed in the borrower company during the time the loan is not fully repaid.

The key to obtaining a term loan is the earning power of a company. The lender, in determining the likelihood of repayment, looks to a firm's future earnings rather than to the pledged property or to its current financial strength.
A term loan involves direct relationship between the borrower and the lender. There is a formal loan agreement stipulated in terms of repayment to which both parties agree. (As against this, in the case of issue of shares or debentures, there is hardly any personal or direct contact between the parties.)

A term loan involves repayment in periodic instalments beginning not more than one year after the loan is taken. This signifies the lender's insistence that the borrower makes adequate provision for regular repayment from the very beginning. Term loans usually command higher interest rates than what short term loans do.

A Study Group was appointed by the Reserve Bank of India, under the Chairmanship of P. L. Tnadon, in the year 1973, to look into the total pattern of bank financing and to determine the norms for current assets and DER. A synoptical review of the thinking and recommendations of the Study Group is made in the following few paragraphs as these make a significant contribution in the field.

Bank funds represent a scarce national resource and should, therefore, be used carefully. Financial discipline must be exercised by the borrowers and the banks should finance not merely on the basis of security but on the basis of a scientific appraisal of what constitutes the optimum working capital requirements of the borrower. Bank credit is essentially intended to finance working capital requirements only. For their long-term
requirements, etc., the borrowers must tap other sources. Even in the case of working capital, a portion of the contribution must come from the long-term funds. Thus, the Study Group envisaged the role of the banks primarily as institutions providing short-term and working capital requirements of the various sectors of the economy.

It defined working capital as the excess of current assets over current liabilities without taking into account the bank borrowings. It recommended that the working capital should be determined on the basis of the production plan submitted by the borrower. For this purpose, the actual levels of inventories or book debts should not be taken into account. On the other hand, the levels of inventories and receivable should be projected on the basis of the norms laid down by the Study Group. The idea behind this recommendation is that the banks should not finance excessive build up of inventories and receivables.

The Study Group has prescribed norms for inventories and receivables for fifteen key industries, taking into account the nature of the industry, the nature of the markets and the process of manufacture, etc. The norms for raw-materials are prescribed as consumption in terms of months, stock in process in terms of months of cost of production, finished goods in terms of months of cost of sales and receivables in terms of months of sales. While the norms prescribed represent the maximum levels, the Study Group has recognised that they can never be absolute
or rigid, specially in the context of the dynamic nature of the Indian economy.

It has suggested three different stages for working out the working capital requirements. At the first stage, the current assets may be worked out as per the norms and the current liabilities (excluding bank borrowings) should be deducted therefrom; 25% of this gap should be financed by the borrowers out of their long-term funds. Thus, the maximum permissible bank borrowings would be only 75% of the working capital requirements. Where the bankers had already sanctioned advances higher than the amounts as calculated above, the excess should be converted into a term loan to be phased out gradually. At the second stage though, the working capital will be determined as earlier, the borrower, will have to provide a minimum of 25% of the total current assets out of his own funds. In the third stage, the Study Group makes a distinction between core current assets and other current assets and suggests that the borrower should finance the entire core current assets plus a minimum of 25% of the other current assets. It further suggests that a borrower must gradually move from the first stage to the third stage, thereby reducing his reliance on the banker for financing working capital requirements. Initially, all industrial borrowers, having an aggregate limit of more than Rs. 10 lakhs from the banks, should be covered by these norms. Later, the scheme of financing may be extended to the small borrowers also.
The Group also reviewed the manner in which bank finance is extended to the borrower. It found that the present system of lending does not provide for any control by the banker over the levels of advances. Therefore, it recommended that the total credit limit of a borrower should be bifurcated into two components - firstly, the minimum level of borrowing, which the borrower expects to use throughout the year (a sort of a permanent loan); and, secondly, a demand cash credit which would take care of the fluctuating requirements. To motivate the borrower to take a higher level of fixed component and a smaller limit of cash credit, a slightly higher rate of interest should be charged on the demand cash credit.

The Study Group has also recommended that the banks should ask their customers to submit periodical reports. The most important of these reports is to be the quarterly budget report. The banks should examine the quarterly fund flows and all other data with special reference to any material variances. In addition to the quarterly data, the borrowers should also be required submit a half-yearly proforma balance sheet and profit and loss account within two months of the end of the half year.

In my view, the recommendations of the Tandon Study Group mark a radical departure from the present financing practice of banks. The report highlights the need for financial discipline, credit planning and a
proper distinction between long term resources and short-term finance. What the Group says makes very sound financial sense. One may even say that, if the recommendations are pursued vigorously, the total pattern of financial management in industry and in banks will change.

The revolutionary changes proposed are bound to create certain initial operational problems. The Report, initially, was not received enthusiastically by the industrial circles and the commercial borrowers. It was felt that it went too far. Many industrialists expressed the view that, if implemented, it would result in substantial shortage of funds for industrial units. Some Chambers of Commerce also attacked, what they called, the rigid approach in fixing norms on the ground that they would be obsolete in a situation which was rapidly changing.

The Reserve Bank of India constituted a Committee for the speedy and smooth implementation of the recommendations of the Tandon Study Group. The Committee has rightly been advised that, initially the banks should be asked to give a reasonable time to the borrower to adjust himself to the requirements of the new pattern of financing. Regarding the possible rigidity of the norms, the Reserve Bank has undertaken to revise them periodically. It can thus be seen that the implementation of the recommendations of the Tandon Committee Report is being done with a fair degree of flexibility.
The Role of Banks in Financing Cotton Textile Units of Ahmedabad

The banks were found to sanction assistance to the fifty cotton textile units of Ahmedabad under study in the following manner:

(i) Secured loans
   (a) On the hypothecation of inventory, stores, book debts, etc.
   (b) On the mortgage of fixed assets.
   (c) Against Railway Receipts (R.R.), Bills Receivables (B.R.), and Pledge of shares or debentures.

(ii) Unsecured loans mostly on personal guarantee given by directors.

The analysis of secured loans reveals that 68.78% of all financial assistance provided by the banks in the form of secured loans during 1966-70 was made on the basis of hypothecation. The share of such loans had increased to 84.46% of all secured loans during 1971-75. The loans granted on the basis of charge on fixed assets had declined from 20.50% during 1966-70 to 7.78% of all secured loans during 1971-75, whereas the share of loans against R. R., B. R., and Pledge of shares and debentures had declined from 11.08% during 1966-70 to 7.76% of total secured loans during 1971-75. This means that hypothecation was the single largest basis on which loans had been provided by banks.
The main findings based on Table VII, Table VIII and Table IX along with Table XIX are:

The share of bank secured borrowings in total funds had declined marginally from 28.60% during 1966-70 to 25.00% during 1971-75. This was accompanied by an equally marginal change in the variability factor from 38.15% to 37.52% during the latter period. This means that financial policies and practices in connection with financing from banks or the basis of security were more or less uniform during both the periods and the level of uniformity had increased further during the latter.

Not a single textile unit had a share of bank borrowings which may be called an exceptionally below the overall average share. In the case of unit Nos. 1 and 42, the share had increased, whereas in the case of unit Nos. 7 and 36, the share had declined in the latter period.

The share of secured borrowings from banks in non-proprietorship funds had declined from 41.80% during 1966-70 to 34.20% during 1971-75. This was accompanied by a similar change in the variability factor from 32.97% to 29.74% during the latter period. However, secured loans from banks were the single largest component of non-proprietorship funds for these mills during both the periods of this study. The change in variability factor indicates that financial policies adopted in this respect were fairly uniform and the level of uniformity had increased during the latter period. The share of secured loans
from banks in non-proprietorship funds was below the overall average in the case of unit No. 43, and had declined from 13.94% to 5.10% during the latter period. In the case of unit Nos. 6, 12, 14, 15, 17, 28, 29, and 42, the individual share was above the overall average during both periods. It had increased marginally only in the case of unit No. 3, during the latter period. In the case of the remaining units, this share had declined during the latter period.

The share of secured bank loans in total secured loans had declined marginally from 87.20% to 82.40% during the latter period. This was accompanied by a significant change in the variability factor from 15.44% to 20.57% during the latter period. This means that the financial policies and practices of the textile mills of Ahmedabad in this respect were more or less uniform. However, the level of uniformity had declined a little during the latter period. It was in the case of unit Nos. 7, 36, and 43, that the share of secured bank loans was above the overall average during both the periods and had declined during the latter period. In the case of unit No. 1, the individual average share was above the overall average during both the periods, and it had increased during the latter period.

In the case of unit No. 42, in the list, the share of bank borrowings in total funds was above the overall average during both the periods. It was 45.31% during
1966-70 and had declined to 29.41% during 1971-75, when the overall average figures were 28.60% and 25.00% respectively. It seems that the management had relied mainly on bank borrowings for working capital purposes as well as for medium term investment needs. However, during the latter period, in addition to using bank borrowings as a source of finance, it had relied on unsecured loans, in particular, deposits from public. In fact, the share of unsecured loans in total funds had increased during the latter period.

Also, the share of deposits from directors had increased considerably during the latter period. The share of unsecured loans in non-proprietorship funds had increased from 13.26% during the former period to 20.23% during the latter. The share of Reserves in total funds almost remained constant, i.e., 24.02% during 1966-70 and 24.31% during 1971-75. This means that when internal funds in the form of ploughed back profits did not come up, the management relied on bank finance. The expansion and modernisation plans undertaken by the unit seemed to justify more use of both: bank finance and internal funds. However, during the latter period the unit had accepted more of public deposits and relied less on bank finance.

In the case of unit No. 3, not only the share of bank borrowings in total funds was above the overall average during both the periods, but the same had increased during the latter. It had relied greatly on bank
finance. It had secured 43.47% of total funds during 1966-70 and 52.68% of total funds during 1971-75.

The following factors were responsible for this situation:

(i) The share of unsecured loans in non-proprietorship funds in the case of this unit had declined from 26.82% during 1966-70 to 12.36% during 1971-75. It had collected only 0.75% of total funds by way of deposits from public during the latter period as against 12.56% during the former. The public confidence could not be maintained after 1970 as the profitability started to decline, and unit had to be taken over by NTC, Gujarat.

(ii) The share of proprietorship funds in total funds had declined from 18.89% during the former period to 13.55% during the latter. Its reserves accounted for 8.76% of total funds during the former period and had declined to 3.32% of total funds during the latter. With a reduction in total proprietorship funds and the lack of public confidence with reference to deposits from public, the management of this unit had no other alternative but to rely more on bank finance. The Government policy of increasing bank assistance to sick units encouraged this trend.
In addition, the average ratio of dividend appropriation to PAT was about 75% during both the periods. It indicated that the management of this unit had not made proper provision for facing future probable crisis and had distributed a very large part of profit by way of dividend.

In the list of exceptional cases, where the units had relied much less on loans from banks, a mention may be made of unit No. 43. In this case, the share of bank secured loans was not only below the overall average during both the periods, but had declined from 6.94% during the former period to 3.13% during the latter.

The following factors seemed to have been responsible for this situation:

(i) It had adopted the policy of exploiting a new and developing source of finance namely secured loans from specialised institutions. The share of such loans had increased significantly from 3.70% during the former period to 17.60% of total funds during the latter.

(ii) The decline in the role of public deposits was probably another contributing factor. The share of public deposits in total funds had declined from 8.21% during the former period to 6.37% during the latter.
In the case of unit No. 4, although the share of bank secured loans in total funds was below the average during both the periods, it had increased during the latter period to 22.16% from 14.83% during the former.

The following factors were responsible for the situation:

(i) The share of proprietorship funds in total funds had declined from 42.27% during 1966-70 to 34.37% during 1971-75. This was mainly because of the fact that the share of free reserves in total funds had declined from 31.35% to 25.06% during the latter period. With a reduction in ploughing back of profits, the management had to rely on bank finance.

(ii) Its earning record had remained satisfactory. It earned a net profit of about 14.40% of net worth during the latter. With increased profits, and decline in free reserves, a large part of the profits must have been distributed by way of dividends.

(iii) The management of the unit did not seem to have tapped the institutional sources of finance at all during both the periods. It had relied mainly on bank finance.

(iv) The share of deposits from public and those from directors had declined during the latter period as compared to the former and therefore, the management must have resorted to bank finance only.
As to why this unit did not decide to ask for loans from financial institutions is a point which is difficult to explain rationally. It may be that it seemed to have obtained the necessary working capital and medium term finance from one source only, i.e., banks.

According to the study of RBI* the total borrowings of public limited companies had declined from 27.54% during 1966-70 to 16.13% of total external funds during 1971-75. The decline in the role of bank borrowings was significant, i.e., 16.86% during 1966-70 to 8.75% during 1971-75.

The contribution of long term borrowings to gross fixed assets formation had also declined from 12.80% to 3.60% during the above period.

The other study of RBI** on finances of Cotton textile industry shows that the contribution of total borrowings and bank borrowings both had declined. The share of total borrowings had declined from 35.50% during 1966-70 to 13.83% during 1971-75, whereas the share of bank borrowings had declined from 19.20% during 1966-70 to 9.43% during 1971-75.

* RBI: 'Financing of gross fixed assets in Medium and large scale public limited 1650 companies': 'RBI Bulletin'; October, 1977.
The declining trend was not a new feature. Even during 1966-70, the share of total borrowings in external sources of cotton textile industry had declined from 71.40% during 1961-66 to 61.40% and the share of bank borrowings had similarly declined from 46.60% to 33.20% during 1966-70, as is brought out by Sastry.*

The study of Kothare and Menon** reveals that total borrowings as a part of total funds had diminished very greatly in case of the entire cotton textile industry from 149.14% during 1966-70 to just 44.30% during 1971-75. The share of borrowings in other industries had also declined from 13.13% during 1966-70 to 9.70% during 1971-75. The cotton textile industry as compared to others, was very slow in polishing back profits and therefore, had to rely to a great extent on borrowings. Table IV.3 exhibits the relevant data brought out by the study** when compared with those of my study.

Table IV.3

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Cotton Textile Mills of Ahmedabad</th>
<th>Cotton Textile Industry</th>
<th>All-India All-Industries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank loans as a percentage of total funds</td>
<td>28.60</td>
<td>25.00</td>
<td>149.14</td>
</tr>
<tr>
<td>Bank loans as a percentage of total secured borrowings</td>
<td>37.20</td>
<td>32.40</td>
<td>54.03</td>
</tr>
<tr>
<td>Bank loans as a percentage of non-proprietorship funds</td>
<td>41.80</td>
<td>34.20</td>
<td>33.20</td>
</tr>
</tbody>
</table>

A comparison of the role of bank borrowings in the case of cotton textile mills of Ahmedabad, entire cotton textile industry and All-India All-Industries, based on the studies referred to earlier leads to the following findings:

1. The share of bank borrowing in total funds of the mills in Ahmedabad was higher than the All-India All-Industries average during both the periods. However, the decline in the role of bank borrowings during the latter period was more apparent in case of All-India All-Industries. It is worth noting that the cotton textile industry was totally
dependent upon the bank borrowings during 1966-70 mainly due to the average profitability rate being low and a very liberal dividend policy. This dependence on bank borrowings had declined to a great extent during the latter period. The dependence on bank borrowings had not been too great in the case of cotton textile mills of Ahmedabad, as was found in the entire cotton textile industry.

(ii) Bank loans were the single largest component of secured borrowings in the case of cotton textile mills of Ahmedabad. The entire cotton textile industry had depended on loans from financial institutions and other to a greater extent than the mills of Ahmedabad. Heavy reliance on bank borrowings was found only in the cotton textile industry and not in other industries. The reason might be that in the case of cotton textile industry, the amount of internal resources used for gross fixed assets formation had been very meagre during both the periods of study. The Reserves and Surplus amounted to Rs. 1.94 crores during 1966-70 on an average and Rs. 24.9 crores during 1971-75 on an average in the case of cotton textiles industry. In case of other industries they were Rs. 50.40 crores and Rs. 194.9 crores respectively. The rate of ploughing back of profits had been low throughout the period of this study in the case of the cotton textile industry and consequently, it had to depend heavily on bank borrowings.
(iii) Even as a part of non-proprietorship funds, bank borrowings were the single largest component in the case of cotton textile mills of Ahmedabad as well as the entire cotton textile industry.

A few remedies may be suggested to improve the availability of bank finance to the cotton textile mills of Ahmedabad and the cotton textile industry as a whole:

(i) Credit for working capital to textile units may be increased on the basis of their cash flow in each case.

(ii) The banks may reduce margins for advances and grant loans for working capital.

(iii) Additional bill discounting limits should be granted at concessional rates in addition to the existing credit limits in order to promote credit sales and prevent distress selling.

(iv) The term loans may be given with a first charge on the fixed assets which are unencumbered or partially encumbered.

(v) The Tandon Study Group norms may be made applicable to the textile industry after they have been suitably revised.

(vi) Cotton textile units may be classified into three categories for the grant of finance:
(a) The banks may revise cash credit limits in the case of viable units experiencing difficulties on account of increase in costs.

(b) Banks may provide necessary finance to purchase raw materials at the right time and in right quantity and to carry stock to prevent distress sales to those mills which are in a state of incipient sickness. By reducing margins, granting term loans against fixed assets and by fixing need-base cash credit limits, they can be assisted.

(c) There should be a moratorium for the payment of interest charges for a specified period in the case of sick mills which have incurred substantial cash losses.
There are many financial institutions in India which provide term loans to industries. Such institutions are essential to provide long-term capital needed by the highly capital intensive industrial units of the day. In developing countries like India, they acquire a greater significance since they have not only to provide long-term funds to the industry but also to provide adequate technical and managerial assistance through participation on the Board of Directors. Otherwise, there is a danger that the borrowers may not be able to cope with the problems involved in large-scale projects. The total flow of funds from the term financing institutions during the Fourth Plan period had aggregated to Rs.1,296 crores. Some of the more important financial institutions providing term loans to industries and their methods of financing are briefly discussed hereafter:

(a) Industrial Finance Corporation of India (IFCI): Set up in 1948, the Corporation provides financial assistance to large-scale industrial concerns whether they are limited companies or co-operative societies. In an effort to integrate its policies with the overall objectives of the Government, the Corporation gives priority to projects promoted by new entrepreneurs or those located in backward areas or those which are based on indigenous technology or those having prospects of
earning foreign exchange or those which provide inputs for increasing the agricultural production or fulfill the increased demand for essential consumer goods. The corporation transacts the following kinds of business:

(i) Guaranteeing loans raised by industrial concerns;
(ii) Underwriting the issue of shares, bonds, or debentures;
(iii) Granting loans or subscribing to debentures in rupee currency, repayable in not more than 25 years;
(iv) Granting loans in foreign currency; and,
(v) Guaranteeing deferred payments in respect of machinery imported from abroad.

The corporation can also convert its loans into shares. Normally, it grants rupee loans in excess of Rs. 30 lakhs. It has also secured lines of credit in foreign exchange.

The loans by IFCI are generally secured by a first legal mortgage on the fixed assets block of the borrowing concern. Raw-materials, stocks and book debts are not taken as security. Loans are given up to 50% of the total cost of the project but, in special cases, the IFCI may advance even more than 50 per cent of the total cost. In the case of co-operative societies, the IFCI may finance up to 65 per cent of the capital cost of the projects, provided the loans are guaranteed by the Government. Similarly, higher percentage of total cost can be given as loans if the project is in a backward area.
The loans are normally repayable by half-yearly instalments over a period of 7 to 10 years. The corporation generally allows a grace period up to three years after the initial disbursement of the loan. The rate of interest keeps on changing but normally remains lower than the rate of interest charged by the banks. The corporation also levies a commitment charge on the undrawn amount of the loan. The applicants for the loans have also to agree to certain conditions like non-declaration of dividend without the prior approval of IFCI specially, if the dividend exceeds a certain stipulated percentage. Similarly, stipulations may be made with regard to conversion of loans into equity shares, if the loan exceeds Rs. 25 lakhs, broadening the management base to the satisfaction of the IFCI and restrictions on the remuneration paid to the directors, etc.

(ii) **State Financial Corporations (SFCs)**: Since the IFCI meets the financial requirements of public limited companies and co-operative societies only if such requirements exceed Rs. 30 lakhs, State Financial Corporations have been established under the State Financial Corporations Act, 1951, to provide loans to small-scale and medium-sized industries. The structure and the mode of operation of SFCs are broadly similar to those of IFCI. They grant loans to corporate and non-corporate industrial units with a margin of about 50 per cent on the value of the security. Under the State Financial Corporations Act, 1951, the State Governments and the
Reserve Bank of India, through mutual consultations, shape the overall policy and functioning of these corporations.

The SFCs have two major distinctive features as compared to the IFCI. Firstly, such corporations do not limit their financing operations to only corporate industrial units. They finance public limited companies, private limited companies, partnership firms and proprietorship concerns. However, these corporations are not allowed to subscribe directly to the shares or stock of any company having a limited liability except for underwriting purposes.

The second major difference is that the SFCs entertain applications for loans only to the extent of Rs. 30 lakhs.

(iii) The Industrial Credit and Investment Corporation of India (ICICI): This corporation was established specifically for the purpose of assisting private sector industrial enterprises specially with regard to the following functions:

(a) Assistance in the creation, expansion and modernisation of such enterprises;

(b) Encouraging and promoting the participation of private capital—both internal and external—in such enterprises; and,

(c) Encouraging and promoting private ownership of industrial investments and expansions of investment markets by providing finance in the form of long-term or medium-term loans or equity or by sponsoring and underwriting new issues of shares and securities.
The ICICI guarantees financial assistance for the purchase of capital assets—both indigenous and imported. A limited company in the private sector is eligible for assistance from the ICICI in financing any industrial project. There are no firm limits on the size of the assistance. Normally, however, Rs. 5 Lakhs is the lower limit for a loan but the Corporation is prepared to advance even smaller amounts in appropriate cases.

One of the significant features of the working of the ICICI is that it does not regard itself as a mere provider of finance but rather as a co-partner in the business. It is prepared to lend its skills in investment appraisal, execution and control. It has also provided risk capital through direct participation in share capital and underwriting of capital issues.

The corporation has also assumed an important role as a supplier of foreign credit. It has established an investment centre to encourage and promote participation of private foreign capital.

(iv) The Industrial Development Bank of India (IDBI): To organise and integrate the structure of industrial financing in India, this bank was set up in 1964 as an apex institution to co-ordinate the activities of other financial institutions. Thus, its primary role is to serve as a reservoir from which the existing financial institutions can draw their resources. The bank enjoys
a measure of flexibility in its scope and operations. This is essential since its main aim is to establish new enterprises especially in the key areas. Apart from assistance to other financial institutions, the bank lends direct assistance to industrial concerns, either on its own or in combination with other financial institutions. It can finance all types of industrial concerns both in the private and the public sector. There are no restrictions regarding the maximum or minimum limits which this bank can sanction. Similarly, it can accept any type of security against its loans.

The bank has also created a special fund to provide assistance to industries which require heavy investment and which may not otherwise be able to obtain funds in the normal course. The loans from this fund are to be used for industries which are necessary in the interest of the industrial development of the country. It has also taken over all the functions of Refinance Corporation of India (RCI).

It can thus be seen that the role of IDBI is flexible, both as an apex body of the financial institutions and as the direct lending body to industrial enterprises.

(v) The Industrial Reconstruction Corporation of India (IRCI): The main concern of this corporation is to help the sick and closed units which are otherwise of vital importance to the national economy. Thus, units which show promise of viability but are otherwise sick can seek
assistance from this institution. It is not a mere lending body in the ordinary sense but a reconstruction agency engaged in the task of reviving and revitalising sick units.

The corporation assists the sick units in the form of soft loans and guarantees with substantial concession in regard to repayment and interest rates. All forms of business enterprises are eligible for assistance although, in the process of reconstruction, the IRCI normally suggests that the proprietorship or partnership concerns should be converted into limited companies.

(vi) Life Insurance Corporation of India (LIC): Although financing of industrial enterprises is not a primary function of the corporation, it provides loans to co-operative sugar factories, industrial estates, State Electricity Boards, etc. on a long-term basis.

(vii) The National Small Industries Corporation Limited (NSIC): This corporation undertakes the supply of machinery and equipment to small-scale industries on hire purchase basis and is empowered to guarantee loans made by banks to small scale units.

(viii) National Industrial Development Corporation and State Industrial Development Corporations (NSIC & SIDCs): The primary objective of these corporations is to develop industries which are necessary to fill the gaps in the industrial structure. Financing of industries is done only in so far as it is incidental to industrial development.
A bird's-eye-view of the financial assistance sanctioned by the financial institutions working in India can be had by a study of the Table IV.4 given below.

One can observe that the total financial assistance had doubled during 1971-75 as compared to 1966-70. The largest contribution was made by IDBI during both the periods.

It may be noted that over a period of the ten years from 1966 to 1975, the assistance to textile industry was only to the tune of 5.74% of the total assistance made available by all these agencies.

Table IV.4

<table>
<thead>
<tr>
<th>Name of the Financial Institution</th>
<th>Assistance Sanctioned (1966-70) (Rs. crores)*</th>
<th>Assistance Sanctioned (1971-75) (Rs. crores)*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. IDBI</td>
<td>40.00</td>
<td>108.68</td>
</tr>
<tr>
<td>2. LIC</td>
<td>31.02</td>
<td>042.58</td>
</tr>
<tr>
<td>3. SFCs</td>
<td>18.74</td>
<td>063.04</td>
</tr>
<tr>
<td>4. ICICI</td>
<td>20.34</td>
<td>041.06</td>
</tr>
<tr>
<td>5. IFCI</td>
<td>23.72</td>
<td>025.36</td>
</tr>
<tr>
<td>6. SIDCs</td>
<td>04.39</td>
<td>020.32</td>
</tr>
<tr>
<td>7. UTI</td>
<td>06.54</td>
<td>005.42</td>
</tr>
<tr>
<td>8. RCI</td>
<td>12.10</td>
<td>-</td>
</tr>
<tr>
<td>9. NIDC</td>
<td>00.47</td>
<td>000.02</td>
</tr>
<tr>
<td>10. IRCI</td>
<td>-</td>
<td>003.58</td>
</tr>
<tr>
<td>Total</td>
<td>157.31</td>
<td>310.56</td>
</tr>
</tbody>
</table>

* Source: Annual Reports from 1966 to 1975.
Table IV.5 provides the total figures of assistance provided by IDBI + ICICI + LIC + UTI + SFCs + SIDCs, during the two periods of this study, based on BT study.*

Table IV.5

<table>
<thead>
<tr>
<th></th>
<th>Assestance disbursed (Rs. crores)</th>
<th>Capital Issues (Rs. crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 1966-70</td>
<td>128.70</td>
<td>90.14</td>
</tr>
<tr>
<td>2. 1971-75</td>
<td>259.34</td>
<td>111.16</td>
</tr>
</tbody>
</table>

The above data indicate that the financial institutions had become increasingly a good source of finance. The assistance disbursed was higher than the total capital issues during both the periods. In addition, the assistance doubled during the latter period, whereas the increase in capital issues was about 23% only. The overall rate of growth in institutional assistance was very encouraging.

Terms and conditions imposed by financial institutions:
It will be interesting to recapitulate here, by way of a typical illustration, the terms and conditions of one of the loan applications sanctioned to the Manish Organics India Limited, Ahmedabad, incorporated on 29th October, 1977, as they were referred to in its prospectus inviting general public to its first issue of equity shares thus:

Term loans: Gujarat Industrial Investment Corporation Limited (GIIC), Ahmedabad and Gujarat State Financial Corporation (GSFC), Ahmedabad have agreed to give financial assistance to the company of Rs. 35.50 lakhs and Rs. 30.00 lakhs respectively, in the manner and on the conditions laid down in their letter No. GIIC/PRJ/5020/13057 dated 22nd January, 1979. GIIC/PRJ/5020/M(App.)/576 dated 23rd April, 1979 and No. GSFC: Sec. Cell: Board/10833 dated 29th January, 1979 respectively. By a resolution passed at the First Annual General Meeting held on 12th December, 1978, the Company has, under section 293(1)(a) and other applicable provisions of the Act, authorised the Board of Directors to mortgage and/or charge all the movable and immovable assets of the company, present and future, and the whole of the undertaking of the company.

Re. GIIC loan: The main terms and conditions are given below:

(i) The term loan together with interest, commitment charges, liquidated damages and other costs, charges and expenses provided in the loan agreement entered and/or to be entered into with GIIC shall be secured by a first legal mortgage and/or hypothecation (at the sole discretion of GIIC) of all present and future assets, both movable and immovable, which include land, buildings, jigs, plants and machinery, spare parts, vehicles, furniture and fixture, electrical installations and fittings and other
movable assets, etc. of the company by way of first charge ranking pari passu with GSFC and a floating charge on all other current assets of the company subject to prior charge of the Banks financing for working capital facilities against such current assets.

(ii) The loan shall be for a period of eight years recoverable in 12 equal half yearly instalments. The repayment of loan shall start two years after disbursement of the first instalment by GIIC.

(iii) The sanction of financial assistance as aforesaid shall be further subject to refinance being available from IDBI and upon the terms and conditions that may be stipulated by IDBI while granting such refinance facility.

(iv) Interest:
(a) Interest shall be charged on the assistance by way of term loan at such rate not exceeding 1/2% p.a. over the bank rate with a minimum rate of interest being 9.5% (minimum but not less than the bank rate), the present effective rate of interest being 9.5%, as may be decided by GIIC from time to time with quarterly rests, provided IDBI refinance is available at the existing concessional rate of interest of 6%.
In case IDBI refinance is not available either wholly or in part, GIIC reserves its right whether to grant financial assistance or not. In the event of GIIC deciding to grant financial assistance in the absence of IDBI refinance and/or on the amount of financial assistance in excess of IDBI refinance, interest shall be charged at normal lending rates as may be applicable in backward/specified areas.

(c) Interim disbursement: Pending sanction/disbursement of IDBI refinance, in case GIIC decides to make interim disbursement, this will not be construed as the sanction of financial assistance in the absence of IDBI refinance and in the event of IDBI refinance application being rejected, the interim disbursement made by GIIC, if any, is liable to be recalled on demand at the discretion of GIIC. Interim disbursement shall carry rate of interest at 11.5% p.a.

(d) Liquidated damages: If interest and/or instalment of the principal amount/s is/are not paid on or before due date/s or on such extended date/s as may be decided by GIIC, liquidated damages @ 6% over normal lending rates of interest shall be charged and recovered on the amount in default till such time the default continues. The liquidated damages shall be payable forthwith on receipt of notice of demand from GIIC.
(v) Minimum overall margin of 50% shall be maintained in favour of GIIC during the currency of the loan.

(vi) Commitment charges at \( \frac{1}{2} \)% p.a. shall be levied on the amount of loan that may remain undrawn on expiry of six months from the date of sanction of the loan and the same shall be recovered on expiry of six months failing which sanction shall be liable to be cancelled. The sanction shall be valid and effective for a period of two years from the date of sanction on payment of commitment charges at the aforesaid rate.

(viii) Sarvashri Laxmikant Bhagubhai, Janmejay Bhagubhai and Narendraprasad C. Patel shall give stamped undertakings:

(a) to raise and invest in the proposed project the equity share capital of Rs. 50.00 lakhs, which shall be maintained during the currency of the loan. Of this, the promoters shall subscribe for equity shares for a minimum amount of Rs. 20.00 lakhs.

(b) that they shall procure for the company at the appropriate time, on terms acceptable to GIIC, funds to meet the shortfall, if any, in financing the cost of the project or for working capital.
(viii) The financial assistance is a part of overall financial assistance of Rs. 65.50 lakhs by way of term loan, out of which an amount of Rs. 30.00 lakhs is to be made available from GSFC. In the event of assistance as stated above not forthcoming from GSFC, sanction is liable to be cancelled and the amount, if any, disbursed thereunder, may be liable to be recalled on demand.

(ix) Before releasing disbursement of the loan exceeding 50%, the company shall produce consent letter from Gujarat State Water Pollution Board of having made satisfactory arrangement for safe disposal of effluent by the company. Any increase in the cost of the project on account of this will be borne entirely by the company.

(x) The promoters/directors shall besides subscribing to the equity share capital to the extent of Rs. 20.00 lakhs vide condition No. 7(a) above, raise unsecured loan of Rs. 4.50 lakhs bearing interest at the rate of 9.5% p.a. and maintain the same during the currency of the loan.

(xi) The sanction of financial assistance is subject to the company making satisfactory arrangement for underwriting the proposed issue and to raise the equity share capital as required by financial institutions. The first disbursement of the loan shall be made after the public issue is made. The
subsequent disbursement shall be made on matching
disbursement basis upto 75% of the loan, and balance
will be disbursable only on raising full share
capital.

(xii) The company shall raise a total equity share capital
of Rs. 50.00 lakhs and out of these, the subscribers
to the Memorandum and Articles of Association, the
Promoters, the Directors and their friends, Nominees
and Associates, etc., shall, before any part of the
share capital is offered to the public or other
parties, as may be stipulated by GIIC, fully sub­
scribe and pay for in cash Rs. 20.00 lakhs.

(xiii) The company shall assure that the consent of the
Controller of Capital Issues relating to the propo­
sed issue of share capital, where applicable, is
valid and effective when the shares are offered to
public for subscription and that all the conditions
stipulated therein are duly complied with.

(xiv) The company shall finalise its arrangements to the
satisfaction of GIIC for the technical know-how,
engineering services and machinery supplies required
for the project.

(xv) The company shall ensure that the Promoters/
Directors will not, without the prior approval in
writing of GIIC, assign, transfer, pledge, hypo­
theicate, or otherwise charge or dispose of in any
manner howsoever or whatsoever their shareholdings in company, present and future. For this purpose the company shall obtain and furnish to GIIC undertaking(s) from Sarvashri Laxmikant Bhagubhai, Janmejay Bhagubhai and Narendraprasad C. Patel in favour of GIIC in a form required by GIIC.

(xvi) The amount payable to Cellulose Products of India Limited (CPIL) by the company for the supply of detailed design and engineering and other assistance shall be as per the actual cost incurred by CPIL subject to the maximum of Rs. 2.50 lakhs and the reimbursement of this amount shall be subject to the satisfaction of GIIC.

(xvii) V/s. Dalal Consultants and Engineers Private Limited and the company shall enter into a supplemental know-how agreement providing for a suitable performance guarantee for the satisfactory performance of the Glyoxal plant. The first disbursement of the loan shall be made after such agreement is approved by GIIC and executed by the company.

(xviii) Other usual terms and conditions shall also be applicable.

Re. GSFC loan :

(i) A minimum margin of 46.50% will be maintained in favour of GSFC during the currency of the loan.
(ii) Rate of interest will be 9.5% p.a., if refinance is available from Industrial Development Bank of India @ 6% p.a., otherwise it will be 13% p.a. Higher rate of interest at 6% over the normal rate of interest will be charged on the amount of default.

(iii) The loan shall be repaid within 7½ years by 12 half yearly instalments to commence after 24 months from disbursement of first instalment of loan. The repayment schedule will conform to the loan disbursed from time to time.

(iv) Directors will agree:

(a) To raise capital of Rs. 50,00,000/-. Out of stipulated capital, 50% must be raised at the time of first disbursement, upto 75% on matching disbursement basis, and balance will be disbursed after raising full stipulated capital, which shall be maintained during the currency of the loan.

(b) Deposit of Rs. 4.5 lacs envisaged shall be raised as and when necessary and retained during the currency of the loan to successfully implement the project.

(c) To arrange for balance requirement either by raising capital or by adequate bank borrowing for Rs. 15,35,000/- for fulfilling project norms.
(d) To obtain a satisfactory Banker's Report before disbursement of loan.

(e) Not to draw any amount towards remuneration, interest on capital or on any account in any year till any sum due to GSFC by way of installment or interest fallen due in that year remains unpaid.

(f) To sign necessary documents for refinance to be obtained by GSFC from Industrial Development Bank of India against the aforesaid loan.

(g) To arrange to get total Central/State Subsidy of Rs. 20.00 lakhs from concerned District Industries Centre and any shortfall in this amount will be met by raising the capital.

(v) Commitment charges @ 1.5% p.a. on the amount of loan not drawn out of the loan sanctioned shall be paid from the date as advised by the Industrial Development Bank of India, if refinance is sanctioned.

In case, refinance is not sanctioned by Industrial Development Bank of India, commitment charge @ 1% p.a. on the amount of the loan undrawn out of loan sanctioned shall be paid from the expiry of six months from the date of sanction.

(vi) 1% service charge-cum-legal fees will be levied on the loan amount sanctioned and the same will be recovered at a rate not exceeding 4% from each
disbursement made. The loan disbursement from GSFC and GIIC will be simultaneous and proportionate to the loans sanctioned.

(vii) An undertaking be given on the lines of Industrial Development Bank of India proforma indicating that Directors will not transfer or dispose of their shareholdings in the unit without permission of GSFC.

(viii) The following Directors shall personally guarantee the loan:
1. Shri Laxmikant Bhagubhai
2. Shri Janmejay Bhagubhai
3. Shri Narendraprasad C. Patel

(ix) Terms and conditions of GIIC sanction will also apply to GSFC sanction unless contrary stated hereinabove.

Additional terms will be as per Annexure which forms a part of sanction letter No. GSFC Sec. Cell: Board/10833 dated 29th January, 1979.

Note: The company has requested GSFC to waive this condition, but no decision has been communicated by GSFC to the company, so far. In the matter. If the waiver of this condition is granted by GSFC, the same will be subject to approval by the next General Meeting of the company as per Section 61 of the Act.
'Convertibility clause': The inclusion of 'convertibility clause' by the All-India financial institutions has been in vogue since 1971, when the Guidelines were issued by the Government of India. The Industrial Licensing Policy Inquiry Committee has recommended and the Government of India has issued directives to financial institutions purporting:

(i) Insertion of a convertibility clause in respect of loans granted by financial institutions to assisted concerns.

(ii) Nomination of directors by financial institutions on the boards of assisted concerns.

The insertion of this clause will not be necessary if the aggregate assistance is less than Rs. 25 lacs. It may be inserted for assistance exceeding Rs. 25 lacs and less than Rs. 50 lacs, but it can be waived with the prior consultation with IDBI. It is compulsory for assistance exceeding Rs. 50 lacs. Even in this case, if a waiver is to be exercised, it can be done with the consultation of Ministry of Finance through IDBI.

It may be noted that very recently some modifications in the convertibility clause were announced by the Finance Minister, Mr. R. Venkataraman while presenting the budget proposals for 1980-81*. They were:

(i) The convertibility clause will be applicable to financial assistance exceeding Rs. 1 crore.

(ii) The financial institutions are to exercise the option in such a way that they do not acquire more than 40% of share capital of an existing concern.

(iii) The exemption from the operation of this clause is extended to assistance for modernisation in any industry and for rehabilitation of sick units.

The above modifications were announced following repeated representations by industry that the rigours of the convertibility clause were inhibiting investment.

The convertibility clause is a significant development. Its impact will depend upon the degree, the timing and the duration of convertibility clause. The capital structure would change on this account as after the operation of this clause, the debt would be reduced and owned funds would increase. This is likely to have its effect on the leverage factor. The tax-deductible amount of interest would be reduced on one hand and on the other, the burden of declaration of dividends will increase. At the same time, the equity base will improve without much of additional cost. With reduction in interest charges, profit before tax would increase and attract higher corporate taxes. Similarly, appropriations for equity dividends on a large equity base might require some transfers from retained earnings. In addition to this, the insertion of this clause would mean increase in equity capital which might dilute its value and the control of the management might be affected in an adverse manner. The option seems
to infringe suddenly on the rights and privileges of the borrower company, its promoters and shareholders.

The effect of the convertibility clause can be illustrated thus:

(i) Suppose the following data are given:

(a) Total cost of a project: Rs. 100 lacs,

(b) Loan from Institutions: Rs. 60 lacs for 10 years,

(c) Owned funds (Equity share capital): Rs. 40 lacs,

(d) Promoters' contribution Rs. 10 lacs equals 25% of capital,

(e) After conversion of 20% of loan into equity, the equity capital will expand to a total of Rs. 52 lacs, and

(f) Promoter's new contribution would be equal to about 19.2% and not 25% as earlier.
(ii) Effect on shareholders: The various effects over years are estimated in Table IV.6:

**Table IV.6**

<table>
<thead>
<tr>
<th>Rs. (Lacs)</th>
<th>No. of years from sanction</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3</td>
</tr>
<tr>
<td>a. Loan sanctioned</td>
<td>100</td>
</tr>
<tr>
<td>b. Amount converted at the end of 3 years</td>
<td>-</td>
</tr>
<tr>
<td>c. Outstanding loan</td>
<td></td>
</tr>
<tr>
<td>1. Beginning of the year</td>
<td>100</td>
</tr>
<tr>
<td>2. End of the year after annual repayment of Rs. 10 lacs.</td>
<td>90</td>
</tr>
<tr>
<td>d. Total assistance for the year</td>
<td>100</td>
</tr>
<tr>
<td>e. Interest at 10.25%</td>
<td>10.25</td>
</tr>
<tr>
<td>f. Dividend paid on conversion at 12%</td>
<td>-</td>
</tr>
<tr>
<td>g. Cost of dividend after tax at say, 55%</td>
<td>-</td>
</tr>
<tr>
<td>h. Total cost of assistance</td>
<td></td>
</tr>
<tr>
<td>1. Amount (No. 5*No. 7)</td>
<td>10.25</td>
</tr>
<tr>
<td>2. Rate (No. 8 * No. 4)</td>
<td>10.25</td>
</tr>
</tbody>
</table>
A reference to the Income Statements and the Balance Sheets of the fifty cotton textile mills of Ahmedabad under study, indicated that none of them seemed to have been granted an assistance exceeding Rs. 25 lacs on an average during 1971-75 and therefore, the analysis of the impact of the operation of this clause on their financial structures has not been made.

Audit of loan agreements with public financial institutions:

Increased debt-financing is being resorted to by more and more companies in financing their projects, because of its obvious advantages compared to equity-financing. The audit of loan agreements with public financial institutions is necessary for the following reasons:

(i) Certain foreign financial institutions (like the Export-Import Bank of America or the U. S. Agency for International Development) stipulate that an auditor's certificate stating that all the convenants comprised in the agreement have been complied with by the borrowers, shall be sent to them every year.

(ii) The Indian financial institutions also require certificates from the company's auditors in respect of the following:

(a) Statement giving detailed break-up of promotional and pre-operational expenses already incurred by its promoters (in the case of a new company) (2) up to the date of submitting
its loan application and (ii) subsequent thereto, irrespective of the fact whether such expenditure has been capitalised or not.

(b) Statement showing investment of its funds, if any, by way of share capital, loans, deposits or otherwise in any concern including its subsidiary and holding companies.

These are instances where a Chartered Accountant may specifically be requested to give a certificate.

(iii) It is imperative that the statutory auditor studies the loan agreements carefully and ensures that all the covenants comprised in the agreements have been complied with. The loan agreements usually stipulate that in the case of any breach of conditions, the entire balance outstanding becomes due and payable immediately. Hence, any major breaches of covenants stipulated in the agreement may impair the "true and fair" view of the financial statements.

(iv) The internal auditor of any company should keep in his files extracts of the main provisions in various loan agreements and keep close watch on the company's transactions to ensure that no breaches occur. This must, in fact, be a continuous exercise until all the loans are fully repaid.
Co-ordination between SFCs and Banks: One need not overemphasise the necessity of co-ordination between SFCs and commercial banks which extend working capital finance and also to some extent, term loans, to small and medium scale industrial units. Since the role of both SFCs and Banks is complementary, it is all the more essential that they should come closer and co-ordinate their activities. Co-ordination is necessary not only for avoiding duplication of efforts, to have a common approach in dealing with the problems of small and medium scale industrial units, to provide mutual assistance in the matter of recovery of loans or rehabilitation of sick units, but also from the point of view of the borrowers, as it will ensure quick and timely assistance. While the top management of SFCs and banks do appreciate the need for co-ordination, the idea has not percolated down the line.

In this context it is necessary to briefly summarise the recommendations made by The Working Group on co-ordination between SFCs and Banks, i.e., the Bhide Committee, appointed by IDBI in November 1976. They are:

(i) Both Banks and SFCs should have a time bound programme for taking decisions about the provisions of financial assistance, with the entire process being completed within a maximum period of 3 months from the date of receipt of the application. To achieve this end, the SFC and the bank, chosen by the party for provision of working capital, should have an arrangement for joint appraisal and if such a joint appraisal is not found to be immediately
feasible, simultaneous appraisal by both the institutions should be made. Accordingly, it will be necessary to have arrangements between the institutions for exchanging information about the parties and the likely stand of the institution vis-a-vis the proposal.

(ii) The party requiring term loan and working capital assistance may approach either the SFC or the bank and the institution concerned should supply the party with the required number of sets of the common application forms as also provide necessary assistance in filling the forms. The required number of application forms duly filled in should be submitted to the other institution simultaneously. In the case of new units approaching the SFC in the first instance without having a banker, the choice of the bank for provision of working capital finance should be left to the applicant.

(iii) Difference of opinion if any, among the two agencies about the adequacy of the margin money or working capital should be sorted out in a joint meeting of the concerned officials of both the institutions.

(iv) It should be the endeavour of the SFC granting term loan as also of the bank granting working capital assistance to ensure that the terms and conditions stipulated do not adversely affect the interest of
the other institutions. Whenever a SFC or a bank comes across such a stipulation, which, in its view, is contrary to its interest, it may take up the matter with the concerned bank or SFC.

(v) SFCs should generally consider favourably request for second charge in favour of banks whenever specific request for it is received from bank, subject to certain stipulations, explained in the report.

(vi) With a view to having unified control over the financial operations of the borrowing unit and subjecting it to the requisite discipline, it will be useful if, as a matter of procedure; the disbursement of term loans to a unit by a SFC is routed through the bank providing working capital accommodation. The SFC may, in such cases, communicate to the bank concerned the purpose for which the loan amount has been released to enable the bank to keep a check on the proper utilisation thereof. This, however, does not preclude the SFC continuing its own procedure for ensuring proper utilisation of the amount disbursed by it nor should it cast on the bank any additional responsibility in the regard.

(vii) Whenever possible, the SFC should synchronise its inspection of the assisted unit with the inspection of the unit by the bank's officials. In cases where joint inspection is not considered feasible,
the official of the SFC taking up the inspection might contact the branch manager of the bank and discuss with him the aspects relating to the working of the unit.

(viii) The SFC may while nominating representatives on the boards of the concerns assisted jointly with bank, also draw upon experienced and suitable personnel from banks in consultation with the bank concerned.

(ix) In the matter of recovery of dues the following procedure may be followed:

(a) The Bank, through whom all the operations of the borrowers are routed, could assist SFC in collection of its dues. The Bank will record the due dates for payment of interest and instalments in respect of each loanee concern. The SFC will obtain and lodge with the bank a letter authorising the bank to debit the borrower's account on due dates and credit the amounts involved to the SFC. The party will, however, be free to revoke the letter of authorisation but in such an eventuality, the bank shall inform the SFC concerned immediately about such revocation.

(b) As regards debiting the account of the party by the bank for the purpose of paying the dues to the SFC, banks may follow the same practice as they adopt when they grant term loans in addition to working capital facilities.
(c) The instalments due on account of term loans should normally be paid out of the surplus generated by the borrowing unit. In case instalments are due to both institutions, the available surplus should be shared by them on a pro-rata basis, in respect of term loans. Where no surplus is available even to meet current obligations including short-term loan from the bank, the bank concerned may, if the situation is considered to be temporary, cover the gap by advancing a temporary or short term loan, repayment of which may be effected from out of future surplus on a priority basis. If the loan is meant to cover cash losses or an imbalance between current assets and current liabilities, in case where the situation is not of a purely short term nature, the financing institutions should workout a nursing programme after a thorough investigation into the working of the unit, and provide additional term loans either singly or jointly and the bank should also provide the additional working capital required.

(d) If payment to one institution is in default, the other institution should use its influence for the recovery of the amounts to both the categories of lending institutions. In case the default is wilful or is so reported by the SFC, the bank should insist on the clearance
of the dues as a condition for grant of fresh facilities or renewal of the existing limits.

(e) Legal action as also action for invoking claim under the Credit Guarantee Scheme for small-scale industries should be taken by the financing institutions in consultation with each other.

(f) With a view to avoiding leakage of funds of a borrowing unit through accounts maintained with other banks without the knowledge of the financing banks and the SFC, the coordinating agencies may also stipulate a condition that the borrower enjoying financial assistance from them shall not open accounts with any other bank without their prior written approval.

(x) The above recommendations relating to co-ordination between SFCs and banks would apply equally to other state-level agencies such as SIDCS/SIICS/SSIDCS engaged in the promotion and financing of industrial units.
Table IV.7 presents the relevant data pertaining to assistance actually disbursed by financial institutions and agencies other than banks to the 53 cotton textile mills of Ahmedabad under study.

Table IV.7

<table>
<thead>
<tr>
<th>Financing Agency</th>
<th>1966-70 (a)</th>
<th>1966-70 (b)</th>
<th>1966-70 (c)</th>
<th>1971-75 (a)</th>
<th>1971-75 (b)</th>
<th>1971-75 (c)</th>
</tr>
</thead>
<tbody>
<tr>
<td>HTC</td>
<td>72.95</td>
<td>48.14</td>
<td>65.69</td>
<td>75.69</td>
<td>46.74</td>
<td>61.75</td>
</tr>
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<td>GSFC</td>
<td>21.35</td>
<td>21.35</td>
<td>100.00</td>
<td>21.99</td>
<td>21.99</td>
<td>100.00</td>
</tr>
<tr>
<td>GSTC</td>
<td>36.60</td>
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<td>36.91</td>
<td>28.31</td>
<td>25.08</td>
<td>88.63</td>
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<td>ICICI</td>
<td>395.52</td>
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<td>64.64</td>
<td>475.13</td>
<td>330.28</td>
<td>65.51</td>
</tr>
<tr>
<td>LIC and other</td>
<td>62.12</td>
<td>61.80</td>
<td>99.48</td>
<td>41.22</td>
<td>41.01</td>
<td>99.49</td>
</tr>
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<td>Insurance Agencies</td>
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</tr>
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<td>UTI</td>
<td></td>
<td></td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>GIIC</td>
<td>5.74</td>
<td>2.00</td>
<td>34.84</td>
<td>26.90</td>
<td>26.90</td>
<td>100.00</td>
</tr>
<tr>
<td>NHDC</td>
<td>28.70</td>
<td>28.70</td>
<td>100.00</td>
<td>10.24</td>
<td>10.24</td>
<td>100.00</td>
</tr>
<tr>
<td>TOTAL</td>
<td>612.98</td>
<td>424.70</td>
<td>69.28</td>
<td>694.48</td>
<td>502.25</td>
<td>72.32</td>
</tr>
</tbody>
</table>

(a) Average total loans disbursed during the period (Rs. lacs)
(b) Average secured loans disbursed during the period (Rs. lacs)
(c) %age of (b) to (a)
The following are my main findings:

(i) Eight financial agencies working in Gujarat State had provided assistance to the tune of Rs. 612.98 lacs during 1966-70 and Rs. 694.48 lacs during 1971-75. The assistance actually disbursed had increased by 13.30% during the latter period as compared to the former.

(ii) The proportion of secured loans to total loans disbursed had increased from 69.28% during 1966-70 to 72.32% during the latter period. This increase of 4.03% indicates that the proportion between total secured loans and total unsecured loans disbursed had not changed much during the latter period.

(iii) The ICICI was the most active agency in providing financial assistance to the cotton textile mills of Ahmedabad. It had provided assistance to the tune of 62.80% of total institutional assistance made during 1966-70 and the same had increased to 68.24% during 1971-75.

(iv) All loans provided by GSFC, and NIDC were fully secured during both the periods of this study. The UTI did not provide any secured loans to the cotton textile mills of Ahmedabad.
A reference to Table VII, Table VIII, Table IX and Table XIX indicated the following:

The share of secured loans from financing institutions in total funds had increased marginally from 3.30% during 1966-70 to 4.00% during 1971-75. However, this was accompanied by a very significant change in variability factor, i.e., from 63.27% to 117.93%. This means that the financial policies of the cotton mills under study were non-uniform and the level of uniformity had declined further during the latter period.

Exceptionally, in the case of unit Nos. 1, 3, 21, 33, 43, and 50, the share of institutional borrowings in total funds was above the overall average during both the periods of study. However, in the case of unit Nos. 1, and 24, the share had declined, whereas in the case of unit Nos. 8, 33, 43, and 50, it had increased further during the latter period.

On the other hand, the individual share was below the average during both the periods in the case of unit Nos. 3, 17, and 44, and it had declined during the latter period in the case of unit No. 17. In the case of unit Nos. 3, and 44, the share had increased in the latter period. In fact, these two units had borrowed from the financial institutions during the latter period only.
The share of institutional secured loans in non-proprietaryship funds had increased marginally from 4.30% during 1966-70 to 4.50% during 1971-75. This was accompanied by a significant change in the variability factor, i.e., from 89.30% to 125.71% during the latter period. This means that the financial policies of the cotton mills in regard to obtaining finance from these institutions were not only non-uniform, but they were getting less and less uniform during the latter period.

Exceptionally, the individual share of unit Nos. 1, 3, 24, 33, 43, 45, 47, and 50, was above the overall average during both the periods of study. The share of unit Nos. 1, 24, and 47, had declined and that for the remaining units had further increased during the latter period.

The share of institutional secured loans in total secured loans had increased marginally from 9.20% during 1966-70 to 10.00% during 1971-75. This change was accompanied by a significant change in the variability factor from 92.46% to 136.00% during the latter period. This means that the financial policies adopted by the managements were absolutely dissimilar on this issue, i.e., the use of financial institutions as a source of finance. This dissimilarity had increased further during the latter period.

Exceptionally, the individual share of unit Nos. 1, 24, and 47, was above the average during both the
periods. As against this, in the case of unit Nos. 8, 33, 43, and 50, the share was not only above the overall average during both the periods, but had increased further during the latter period.

The individual share of unit Nos. 17, 39, and 44, was below the average during both the periods and that of unit No. 44, had increased during the latter period, whereas the share of unit Nos. 17 and 39, had declined during the latter period.

In exceptional cases, the unit No. 3, having below the overall average share of institutional secured loans and No. 8, having above the overall average share may be mentioned. In the case of unit No. 3, the share was just 0.93% of total funds during 1971-75. In fact it had not tapped this source of finance during 1966-70. It seemed that the management of the unit had relied to a great extent on bank loans. Its reliance on banks as a source of finance had increased from 43.47% of total funds during the former period to 52.68% of total funds during the latter. It had not used the institutional source of finance, probably as a matter of policy.

In the case of unit No. 8, the share of institutional secured loans had increased significantly from 7.59% of total funds during the former period to 26.96% of total funds during the latter. This is a unit which is now
managed by NTC, Gujarat. As a part of the overall Government policy of assisting sick units, the financial institutions working in Gujarat had assisted this unit very liberally. In addition, it had obtained 14.86% of funds from banks as secured loans during the latter period as against 24.55% during the former period, as its credit worthiness must have declined. In most of the years of its working, the unit had incurred losses. It could not have secured any funds through debentures. The share of deposits from public had also declined during the latter period. It could get short term loans from banks equal to 3.59% of total funds during the latter period, as against 5.00% of total funds during the former period. The management of the unit had to resort to institutional borrowings which was encouraged by the Government as a matter of policy.

The study of RBI* indicates that borrowings from financial institutions and agencies had contributed an amount equal to 16.66% of total funds of large and medium public limited companies during 1966-70. They had, however, declined to 7.35% during 1971-75.

The other study of RBI,** shows that the share of institutional borrowings to total funds in the case of the entire cotton textile industry had declined from 16.30% during 1966-70 to 9.40% during 1971-75.


According to the study undertaken by the ET Research Bureau, the share of institutional borrowings in the case of large industrial projects in private corporate sector during 1973-74 was very small. They contributed nothing during the 1st Five Year Plan, 0.30% of total funds during the 2nd Plan, 1.00% of total funds during the 3rd Plan period, 4.30% during the Annual Plans and just 0.30% during the 4th Plan period. Table IV.8 presents the relevant data of the contribution made by the financial institutions during the two periods of this study.

Table IV.8

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Cotton Textile mills of Ahmedabad</th>
<th>Cotton Textile Industry</th>
<th>All-India Industries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of Institutional borrowings in total funds %</td>
<td>3.30</td>
<td>4.00</td>
<td>16.30</td>
</tr>
</tbody>
</table>

The following conclusions can be drawn on a comparative study of the results of various studies as above:

(1) It is only in the case of cotton textile mills of Ahmedabad that the share of institutional secured finance had increased during the latter period.
In the case of cotton textile industry as well as All-India All-Industries, the share of institutional borrowings had declined during the latter period.

(ii) The decline in borrowings of cotton textile industry was sharper than those in other industries.

(iii) The total assistance made available from financial institutions to the cotton textile mills of Ahmedabad, i.e., between 3% to 4% of total funds was very meagre.

It may be concluded that in the case of cotton textile mills of Ahmedabad the institutional borrowings had increased marginally, both as a percentage of total funds and of non-proprietorship funds during the latter period. The managements of the textile mills of Ahmedabad seemed to be meeting their current needs mainly through bank borrowings. Institutions like GSTC and GSFC can play an increasing role in the development of the textile mills of Ahmedabad.

In fact, only fifteen cotton textile units of the fifty units covered in this study had secured loans from financial institutions during 1966-70 and only eighteen units secured assistance from them during 1971-75. This means that this source seemed to have remained unexploited to a large extent. As is clear from the study of the Annual Reports of Financial Institutions like GSFC, ICICI and GIIC, delay in sanctioning loan applications, delay in disbursement of sanctioned loans and in some cases, imposition of special and burdensome conditions to be fulfilled by the borrowers seemed to have come in the way of the efficient use of this source of finance.
(D) FUNDS UNDER DPG SCHEME

(1) Nature of Credit Under DPG Scheme

Credit under DPG scheme is usually available to the buyers of capital goods from the suppliers so as to enable them to import costly capital equipments and to pay in instalments spread over 5 to 10 or even 20 years. Under DPG agreement, the suppliers, who cannot afford to tie up their funds for long periods, finance such transactions through arrangements with their local bankers by obtaining promissory notes signed by the buyer for each instalment and getting them discounted. The buyer is required to provide a guarantee from his bank, which issues it on the security of fixed assets purchased under deferred payment facility. Credit up to 90% of value of equipment purchased may be obtained under this agreement. The credit is relatively more expensive as suppliers adjust the price of equipment sold with the result that the actual interest charged, even if it is low, it cannot be taken as the true cost of credit unless the buyer has the opportunity of choosing the supplier on the basis of the lowest quotation.

The Report of the Sachar Committee on Companies and MRTP Acts, contains a suggestion that as credit under DPG scheme is gradually becoming an important element of borrowings, instead of including it under the common heading of 'borrowings', specific item should be provided for 'loans under deferred payment arrangements'. It has also been
suggested that even secured loans should be sub-divided between 'short term loans and Advances' and 'other loans and Advances'. These suggestions are made as a modification of the requirements of schedule VI of the Companies Act, 1956. If these suggestions are accepted for incorporation in the Balance Sheets of the companies, a financial analyst will find it easier to ascertain the amounts of different kinds of loans obtained by a particular company.

**IDBI Scheme**: The Bills Rediscounting Scheme was introduced in April 1965, in terms of the powers vested in the IDBI under section 9(1)(b) of its statute, which authorises it to accept, discount or rediscount bills of exchange and promissory notes of industrial concerns subject to such conditions as may be prescribed.

The objective of the Scheme is two-fold. The manufacturers of indigenous machinery/capital equipment can push up the sales of their products by offering to the prospective purchaser-users deferred payment facilities. The manufacturer gets the value of the machinery within a few days of the delivery of the machinery by discounting with his banker, the bills of exchange/promissory notes arising out of sales of the machinery. The purchaser-user of the machinery, on the other hand, is enabled to utilise the machinery acquired and repay its cost over a number of years. The Scheme thus facilitates the sales of machinery, thereby contributing to the industrial progress of the country.
The Scheme was initially restricted to the sale of machinery to a few manufacturing industries, but the facilities under it have since been extended to all manufacturing industries in the country. Since December, 1968, the Scheme has also been extended to cover purchaser-users in the public sector such as autonomous bodies like electricity undertakings, transport corporations and government companies. The Scheme is near-automatic in operation and has been of special assistance to small and medium sized industries in modernizing and expanding their equipment. A simple procedure has been prescribed for availment of credit under the Scheme; it does not envisage any detailed appraisal by the IDBI of the project for which the machinery may be required. The assistance under the Scheme does not attract conversion stipulation. Execution of any cumbersome documents is also not necessary for utilisation of the facilities under the Scheme. The terms of the Scheme have been deliberately kept flexible and these have been liberalised from time to time to meet the varying needs of industry.

The prospective purchaser-user of indigenous machinery approaches the manufacturer/seller and suggests to him that instead of cash down payment in full for the required machinery he would prefer to acquire it on deferred payment terms under the Bills Rediscounting Scheme of the IDBI. If the suggestion is accepted by the manufacturer/seller, the cost of machinery excluding the
advance payment is sub-divided into half-yearly/yearly instalments and a separate bill/promissory note is drawn/made for each instalment plus interest in respect of deferred payments. On delivery of the machinery, the bills/promissory notes are accepted/guaranteed by/or on behalf of the purchaser-user and delivered to the manufacturer/seller who gets them discounted with his own banker thus realising the cost of the machinery, the discount payable by him to his banker is included in the amounts of the bills by way of interest for the period of deferred payment. The manufacturer's/seller's banker in turn takes the discounted bills to the IDBI and gets them rediscounted, thus obtaining the amount paid to the manufacturer/seller. The discounting bank takes back the bills from the IDBI against payment three working days in advance of their due dates and obtains payment thereof from the acceptor/guarantor of the bills on due dates.

Since the seller's bank is primarily responsible for payment to the IDBI, with a view to safeguarding its own position, it normally requires that the bills/promissory notes be accepted/guaranteed on behalf of the purchaser by its banker or a SFC or the IFCI or the ICICI or an insurance company. The Scheme, however, vests in the seller's bank the discretion to ask for such acceptance/guarantee or to waive it altogether and rely on the acceptance of the purchaser himself.
Salient Features of the Scheme

(i) **Scope of the Scheme**: The facilities under the Scheme are available for sale of machinery to all manufacturing industries, including industries manufacturing automobiles and agricultural machinery and equipment, both in the public and private sectors. However, sales of machinery for vanaspati manufacturing, brewery/winery and malt manufacturing industries require prior approval of the IDBI. The facilities are intended to be utilised for the purchase of machinery required for industrial use only; when the machinery is not required for industrial use, prior clearance of IDBI should be obtained. The assistance under the Scheme is not available for purchases of machinery required for setting up new projects, except small-scale industrial units. Further, the purchaser-wise limit is subject to the seller having necessary discounting limit with their bankers under the Scheme in the normal course. The Scheme covers sales of indigenous machinery and capital goods on deferred payment basis not only to purchaser-users in the private sector but also to those in the public sector functioning as companies/autonomous corporations. Normally, the facilities under the Scheme are available only in respect of complete supply of machinery/capital equipment which might include a reasonable amount of accessories/spare parts thereof. If the delivery of machinery is to be made in several consignments spread over a longer period as in the case of turn-key projects.
and the manufacturer/seller requires finance in the interim period, he could raise temporary accommodation from his bank which could be adjusted once the supply is completed and bills relating thereto are discounted. However, if the manufacturer/seller intends to obtain finance under the Scheme, in respect of partial despatches of machinery, prior clearance of the IDBI should be obtained. In such cases IDBI financing would be for identifiable parts of machinery/equipment.

IDBI does not itself discount bills of exchange/promissory notes but rediscounts those discounted by any of the institutions approved by it for this purpose. The bills/promissory notes to be eligible for rediscounting by the IDBI must be drawn/made/accepted/endorsed by an industrial concern as defined in Section 2(c) of the IDBI Act, 1964, which is reproduced below.

"Industrial concern" means any concern engaged or to be engaged in,

(a) the manufacture, preservation or processing of goods;
(b) shipping;
(c) mining;
(d) the hotel industry;
(e) the transport of passengers or goods by road or by water or by air;
(f) the generation or distribution of electricity or any other form of power;
(g) the maintenance, repair, testing or servicing of machinery of any description or vehicles or vessels or motor boats or trailers or tractors;

(h) assembling, repairing or packing any article with the aid of machinery or power;

(i) fishing or providing shore facilities for fishing or maintenance thereof;

(j) providing special or technical knowledge or other services for the promotion of industrial growth; and/or

(k) the research and development of any process or product in relation to any of the matters aforesaid.

There is no restriction as to the constitution of the industrial concern drawing/making the bills/promissory notes; it may be a proprietorship concern, a partnership firm, a private or public limited company, a co-operative society or a statutory corporation.

(ii) Manufacturers/Sellers of machinery under the Scheme:

The seller on deferred payment basis under the Scheme may be:

(a) a manufacturer of indigenous capital equipment/machinery of any type including agricultural equipment and machinery.

or

(b) an authorised selling agent/distributor of a manufacturer provided he has paid in full to the manufacturer for the machinery before the execution
of the relative set of bills/promissory notes.

or

(c) a design engineering concern getting the machinery manufactured according to his own specifications and designs under his supervision and selling it under his own name and with his own guarantee provided the name of his concern has been approved by the IDBI in advance.

(iii) Buyers of machinery under the Scheme:

One can purchase capital equipment/machinery on deferred payment basis under the Scheme if he is:

(a) the purchaser-user of the equipment/machinery in the private sector;

(b) an autonomous (i.e., not departmental) enterprise under the auspices of a State or Central Government, e.g., electricity board, road transport corporation or manufacturing unit;

(c) a selling agent/distributor/dealer of agricultural machinery and equipment provided he would afford similar deferred payment facilities to the farmers in respect of his sales of agricultural machinery and equipment to them and will not charge them unduly high prices;

(d) a farming enterprise not doing farming itself but providing mechanised services to small farmers.
The facilities under the Scheme are also available to finance purchases of indigenous machinery meant for export against allotment of equity in foreign companies to Indian entrepreneurs.

(iv) **Period of deferred payment:**

The period of deferred payment for the sales of machinery to be covered under the Scheme counted from the date of despatch of machinery or from the date of execution of bills/promissory notes, whichever is earlier, should not be less than 6 months and normally not more than 5 years. The purchasers in sugar, jute, cotton textile, cement and engineering industries can avail of 7-year deferred payment facilities on an automatic basis. IDBI would consider requests for 7-year facilities, in other deserving cases also. However, IDBI's prior permission should be obtained for this purpose by submitting an application through the bank concerned. The application should clearly spell out the circumstances which necessitate a longer deferred payment period. The manufacturer/seller should normally discount bills/promissory notes with his bank within a period of 2 months from the date of despatch of the relative machinery. In case bills/promissory notes are lodged by the manufacturer/seller after 2 months, his bank will have to obtain prior clearance of the IDBI for discounting the bills/promissory notes. The normal deferred payment period has been restricted to 5 years under the Scheme as it is intended to be essentially a purveyor of medium term credit only.
(v) **Quantum of assistance:**

The minimum amount of a transaction covering a set of bills/promissory notes eligible for rediscounting has been fixed at Rs. 10,000. It is not necessary that this transaction should relate to the purchase of a single machine only; more than one machine can be covered under one transaction. It is also not necessary that the bills tendered to the IDBI must be for at least an amount of Rs. 10,000. If the purchaser himself finances a part of the minimum transaction permissible under the Scheme, the bills for the residual amount, which will be less than Rs. 10,000, will be rediscounted by the IDBI. There is no restriction in regard to the minimum amount in the case of transactions pertaining to sales of agricultural machinery and equipment or transactions pertaining to the manufacturers-sellers or purchaser-users of machinery in the small scale sector.

The maximum amount for rediscounting of bills/promissory notes pertaining to a single purchaser has been fixed at Rs. 1 crore (face value of bills) over a limit year which is reckoned from the 1st July to the 30th June of the following year. The availment of the maximum limit is calculated with reference to the dates of drawing/making of the bills/promissory notes and not the dates of their lodgement with the IDBI for rediscounting. The maximum amount available to a State Electricity Board during a limit year has been fixed at Rs. 2 crores.
The lower and upper limits of assistance under the Scheme have been so devised that the facilities under the Scheme may be conveniently taken advantage of by the small scale industrialists and the small agriculturists for meeting their entire requirement of purchases of indigenous machinery. The larger units can use the facilities for purchasing machinery required for their replacement, renovation, modernisation or moderate expansion programmes. The Scheme should, however, not be utilised for financing large projects which would normally call for a detailed appraisal by the lending institutions.

(vi) Cost of finance under the Scheme

Discount rates: The existing rates of rediscount/discount are subject to changes from time to time. They range normally between 9% to 10%. The manufacturer/seller should not charge the purchaser-user by way of interest for the deferred payment period an amount which is materially higher than the amount paid by the manufacturer/seller himself to his banker by way of discount. If on discounting of the bills, any excess amount is found to have been charged, the same should be refunded to the purchaser through the discounting bank. The IDBI reserves the right to refuse to rediscount the bills of such manufacturers/sellers who do not strictly comply with this requirement.

Acceptance/guarantee Commission: The normal charge for accepting bills by a bank on behalf of the purchaser or guaranteeing the payments due thereon is 1% per annum. This expense can be avoided if the seller's bank dispenses
with the acceptance/guarantee of another bank or insurance company, etc., and relies on the acceptance of the purchaser-user himself.

Stamp duty: The usance bills/promissory notes are subject to stamp duty. The present rates of stamp duty in respect of bills/promissory notes executed under the Scheme are detailed out in Table IV. 9.

Table IV.9

<table>
<thead>
<tr>
<th>Usance of bill/promissory note</th>
<th>Stamp duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Up to 9 months</td>
<td>Rs. 1.50 for every Rs. 1,000 or part thereof</td>
</tr>
<tr>
<td>(2) Beyond 9 months and upto 12 months</td>
<td>Rs. 2.00 for every Rs. 1,000 or part thereof</td>
</tr>
<tr>
<td>(3) Beyond 12 months</td>
<td>Rs. 4.00 for every Rs. 1,000 or part thereof</td>
</tr>
</tbody>
</table>

Some facts about the Scheme upto 30.6.1978 may be recapitulated here: (i) Bills for Rs. 781 crores covering sales of indigenous machinery had been rediscounted. (ii) 909 manufacturers of indigenous machinery located in 19 States/Union Territories had taken advantage of the Scheme to extend deferred payment facilities to their customers. (iii) 3394 purchaser-users of indigenous machinery located in States/Union Territories had benefited from the Scheme. (iv) 52 commercial banks had participated in extending the benefits of the Scheme.
(2) **Secured DPG Funds and Cotton Textile Mills of Ahmedabad**

In general, for operating under DPG Scheme, irrevocable guarantees of the bankers of a textile mills company were required. The bank guarantees were secured against hypothecation of all movable machines of the company and immovable properties, the fixed assets as and by way of equitable mortgage as collateral security. In some cases, a financial institution like GSFC had given a guarantee for a particular sum against the guarantee of a company, and its managing director and all the machinery purchased under DPG Scheme were then hypothecated in favour of GSFC. In some other cases, the machinery was purchased against usance bills jointly accepted by the company and its bankers. In one case, note was given in its Balance Sheet as follows (note No. 7A).

"Company has purchased machinery on DPG basis for which the bank has accepted usance bills jointly with the company. Another bank has given guarantee to the former bank and the company has given a counter guarantee to the other bank and has hypothecated its movable assets including plant and machinery as well as created an equitable mortgage of its present and future immovable properties as security".

The study of Table VII and Table XIX in regard to the share of secured DPG funds in the total funds indicated the following:

(i) The average share of funds under DPG Scheme in the
total funds of the fifty cotton textile mills of Ahmedabad had increased from 1.56% during 1966-70 to 2.76% during 1971-75. Although, as a whole, the share of DFG funds was very small during both the periods, it had increased by 77% during the latter. This means that the textile mills had made a greater use of the scheme during the latter period. This was accompanied by a marginal change in the variability factor from 85.26% during 1966-70 to 93.50% during 1971-75. The variability factor was high during both the periods and therefore, it may be concluded that the financial policies and practices of the cotton mills of Ahmedabad in respect of DFG funds had varied significantly from each other during both the periods. In addition, the level of non-uniformity had increased during the latter.

(ii) As many as 23 units had not used this source of finance at all during both the periods of study. One unit No. 33, had used only in former period and unit Nos. 16, 25, and 37 had used this source of finance only during the latter. The unit No. 33, is a sick mill taken over and being managed by NTC, Gujarat. This unit had not adopted any Scheme of modernisation or expansion during the latter period for which DFG funds would have been very useful. The remaining three units seemed to have adopted some moderate Schemes of expansion for which DFG Scheme was taken benefit of during the latter period.
(iii) In the case of unit Nos. 19, 21, 26, 31, and 43, the individual share was above the overall average during both periods. It had declined in the case of unit Nos. 19, 31, and 43, and had increased in other cases during the latter period.

(iv) The share of the unit Nos. 20, 24, 27, 29, 30, and 39, was found to be below the overall average, and had increased in the case of unit Nos. 20, 24, 27, and 39, whereas it had declined in the case of other units during the latter period.

The study of Table VIII and Table XIX regarding the share of secured DFG funds in non-proprietorship funds indicated the following:

(i) The share of secured DPG funds in non-proprietorship funds had increased from 2.10% during 1966-70 to 4.02% during 1971-75. Their contribution to non-proprietorship funds was very small during both the periods; however, the same had increased by 91.49% during the latter. This was accompanied by moderate change in the variability factor from 80.86% during the former period to 93.61% during the latter. It must be said that the variability factor was very high during both the periods, which means that the financial policies in regard to the use of DPG funds had varied very greatly amongst the textile mills under study. In addition, the lack of uniformity had increased during the latter period.
(ii) Exceptionally, the individual share of unit Nos. 6, 11, 14, 15, 31, and 43, was above the overall average during both the periods. These units had made larger use of DPG Schemes than others during both the periods. However, whereas in the case of unit Nos. 31, and 43, it had declined, it had further increased in case of the remaining units during the latter period. As against this, the individual share of the unit Nos. 24, 27, and 29, was below the overall average during both the periods. In the case of unit No. 29, the individual share had declined whereas, in the case of unit Nos. 24, and 27, it had increased during the latter period.

The share of secured DPG funds in the total secured loans is exhibited in Table IX and Table XIX. The main findings are:

(i) There was a significant increase in the share by 97.67% from 4.30% during 1966-70 to 8.50% during 1971-75. This was accompanied by a moderate change in the variability factor from 89.33% during 1966-70 to 100.52% during the latter period. Although the overall average share was only marginal during both the periods, the increase was tremendous during the latter period. The high degree of variability during both the periods shows that the textile units using this source of finance had
followed dissimilar policies and practices. The degree of non-uniformity had increased, marginally during the latter period.

(ii) The number of units getting the benefit of DPG Scheme had increased from 23 during 1966-70 to 25 during the latter.

(iii) The individual share of the unit Nos. 6, 11, 19, 21, 22, 26, 31, and 43, was above the overall average during both the periods. In the case of unit Nos. 31, and 43, it had declined and it had increased in the other cases during the latter period.

(iv) In the case of unit Nos. 24, 27, and 33, the individual share was below the overall average during both the periods. The share of unit No. 33, had declined further, whereas the share of the other two units had increased during the latter period.

In the case of unit Nos. 24, and 33, no expansion plans seemed to have been undertaken. These units were declared 'sick' during 1972-73 and were taken over by NTC, Gujarat. With no expansion plans on hand, no import or purchase of big capital equipments seemed to have been made by them and therefore, they had obtained smaller credit under DPG Scheme during the latter period. This was the factor responsible for their lower share of DPG funds in secured loans.
Among exceptions, the unit Nos. 21, and 29, are worth mentioning. In the case of unit No. 21, the share of secured DPG funds in total funds was above the overall average during both the periods and had increased further from just 2.59% during the former period to 8.94% during the latter. The earning capacity of this unit was reflected in the ratio of 17.51% of net profit to net worth during 1966-75. The share of reserves in total funds had also increased from 13.22% of total funds during 1966-70 to 15% during 1971-75. With a good earning capacity and a fair measure of ploughing back of profits, the unit seemed to have adopted a process of expansion. In order to quicken this process, it seemed that it had opted for DPG funds and purchased the required machinery and equipments. The management of the unit seemed to have adopted a policy of less reliance on loans from banks and financial institutions. The share of bank loans had declined from 31.09% to 24.90% of total funds, whereas the share of institutional loans had declined from 5.73% to 2.89% total funds, during the latter period.

In the case of unit No. 29, not only that the share of secured DPG funds was below the overall average during both the periods, but had declined from 0.96% during the former period to 0.75% of total funds during the latter period. It seemed that the management of this unit had adopted a deliberate policy of relying on banks for most of its financial requirements. It had obtained
42.87% of the total funds from banks during the former period and 31.63% of the total funds during the latter. The unit had added to its Gross block at the annual rate of 1.91% during 1966-70 which had increased to 6.97% during 1971-75. This means that although there was a significant increase in the gross block, most of it had been financed through bank loans as a matter of deliberate policy. It might be that the plant and machinery installed was available within the country itself, and the share of imported machinery was very small, so that the use of DPG funds on a large scale could not be justified. With the use of bank funds, the management could purchase on spot the required fixed assets and therefore, had not gone in for the use of DPG Scheme on a large scale.

There is only one study on share of DPG funds, Viz; of RBI. Table IV.10 exhibits the relevant data:

<table>
<thead>
<tr>
<th>Year</th>
<th>New companies</th>
<th>Existing companies</th>
<th>All companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
<td>C</td>
</tr>
<tr>
<td>1971</td>
<td>7569</td>
<td>40</td>
<td>90</td>
</tr>
<tr>
<td>1972</td>
<td>12608</td>
<td>308</td>
<td>3990</td>
</tr>
<tr>
<td>1973</td>
<td>85</td>
<td>7116</td>
<td>0.01</td>
</tr>
<tr>
<td>1974</td>
<td>11429</td>
<td>762</td>
<td>10611</td>
</tr>
<tr>
<td>1975</td>
<td>5199</td>
<td>450</td>
<td>4123</td>
</tr>
</tbody>
</table>

where, \( A = \text{DPG funds (Rs. lacs)} \),

\( B = \text{Total funds (Rs. lacs)} \), and

\( C = \text{%age of DPG funds to total funds} \).
As far as new companies were concerned, practically no advantage of the DPG Scheme had been taken. The DPG funds had contributed even less than 1% to the total funds. In the case of existing companies studied, the share of DPG funds in the total funds had declined from 26.89% during 1971 to 10.91% during 1975. Taking all the companies under study, DPG funds had amounted to roughly between 2% and 7% of the total funds. The share of DPG funds in total funds ranging between 1.56% during 1966-70 to 2.76% during 1971-75 in the case of cotton textile mills of Ahmedabad was certainly less as compared to that brought out by the RBI study.
II. UNSECURED LOANS

(A) PUBLIC DEPOSITS

(1) Nature of Public Deposits as a Source of Finance

Financing of companies by accepting public deposits has remained a controversial issue over the last many years. Large number of companies have tried to attract deposits from the public by advertising in leading newspapers and by offering high rates of interest. As a result, the ratio of short term financing by borrowing from banks and other organized financial institutions has declined.

The method of financing by accepting deposits from the public dates back to middle ages, when the sense of co-operation had developed among the public. Any person who unfortunately came across a calamity was helped by others by mutual contributions in kind. This traditional method later on underwent a lot of change. Wise persons or seniors thought of forming groups having a limited number of persons as members from among themselves. These persons used to contribute to a common fund at regular intervals and any person in need could get the aggregate of contributions and pay back in equal instalments. This method latter on shifted to monetary contributions and came to be known as chit funds, nidhies, prize chits etc. In the twentieth century some organized companies have come into the field, known as investment companies which
collect deposits from the public and advance money to the needy persons, i.e., for industrial or household sector. Industrial sector has also been very active in collecting deposits.

Deposits from public have been a prime source of finance to the cotton textile mills of Bombay and Ahmedabad, tea gardens of Bengal and Assam and in few other industries. This system was developed mainly because of the imperfect banking organisation prevailing in the country earlier. The practice of accepting deposits from public was continued in full swing upto the first quarter of the present century. According to the Central Banking Inquiry Committee, during the thirties, public deposits constituted as much as 39% of total finance in the cotton textile mills of Ahmedabad and about 11% of total funds in the Bombay Cotton Textile Mills.

Under section 58A of the Indian Companies Act, 1956, no company including a finance company but excluding banking companies shall invite or allow any other person to invite or cause to be invited any deposit unless an advertisement, including therein a statement showing the financial position of the company, has been issued by the company in the prescribed form and manner. Besides, the Companies (Acceptance of Deposits) Rules framed under Section 58A apply only to the non-banking non-financial companies. The advertisement referred to above has to be published in a leading English newspaper
and in one vernacular newspaper circulating in the State in which the registered office of the company is situated.

The other relevant provisions of the Rules briefly are:

(i) No company shall accept or renew any deposit which is repayable on demand or on notice or repayable after a period except where such deposit is repayable after the expiry of six months or more from the date of acceptance or renewal of such deposits,

(ii) Maximum deposits that can be accepted by a company under various categories have been specified, e.g., (a) 15% of the aggregate paid-up capital and free reserves of the company, taken against unsecured debentures or any deposit from shareholders or deposits guaranteed by the directors, etc., (b) 25% of the aggregate paid-up capital and free reserves for other deposits. A short-term deposit, repayable not earlier than 3 months, may also be accepted by companies up to 10% of the aggregate paid-up capital and free reserves.

This deposit, however, shall be computed in determining the 15% limit indicated in (a) above; (iii) a register of deposits, with prescribed particulars, shall be maintained; and (iv) a return of deposit shall have to be filed with the Registrar every year.

Besides this, Section 58A (6) levies penalties on the company for contravention of the above-mentioned rules. In the case of invitation for any deposit in contravation of the said rules, the minimum amount of fine is Rs. 5,000 and the maximum limit is Rs. 1 lakh. Further, every officer in default is punishable with imprisonment for a term extending up to 5 years and also with fine.
The system of public deposits has certain advantages. The system is simple and does not involve a high cost particularly for well-reputed companies. The interest on such deposits is comparatively low, at least in the beginning. Deposits are mostly unsecured and do not create a charge on the assets of the company. On the other hand, the system has some basic weaknesses. During difficult periods like depression, even a slight rumour about the financial position of a company sends people running in panic to withdraw their deposits. This happened to the cotton textile industry of Bombay and to some extent, of Ahmedabad, during the years of depression. The depositors had rushed forward to withdraw their deposits from all mills including even the sound ones. "As a result, some mills had to close down, while others had to borrow from their friends or indigenous bankers at high rates of interest."* The system, thus, proved to be a fair-weather friend.

From the point of view of proper development of investment market, the dependence on public deposits reduces the number of good industrial securities in the investment market. It is, therefore, undesirable for the development of a sound capital market. Due to better avenues of investment available to investors, the public is generally willing to make deposits with companies only at high rates of interest. This makes the system uneconomical from the point of view of the company desiring to

raise finance. Adding to the high rates of interest payment by the company inviting the deposits is the amount that it has to pay by way of commission to the brokers. Such commission is high in the case of smaller companies. Thus the system of raising finance through public deposits is uneconomical for regular kinds of business. In addition, it may be difficult for a concern to meet financial requirements of a large size from public deposits because these may not be attractive enough to the investors on account of lack of proper security, possibilities of speculation by the management and difficulty of ascertaining the other obligations of the company which may be incurred against the security of the company's assets.

It may be noted that the study group on non-banking companies appointed by Reserve Bank of India - known as Raj Committee - had suggested in its report submitted to the Government in October 1975, that:

(i) Acceptance of public deposits should not be banned. It should be regulated. However, the ultimate objective of regulation should be to discourage further growth of deposits and to roll them back gradually so that they would cease to be significant source of finance for industry and trade.

(ii) The minimum period for deposits should be 6 months, and its duration should not exceed 3 years.

(iii) No ceiling on rates of interest is needed.
(iv) The Indian Company Law should be amended to put into effect the ceiling on deposits, i.e., a company can accept deposits from directors, shareholders and others of an amount which does not exceed 15% of paid-up capital and free reserves of that company.

The main recommendations of the Sachar Committee in regard to protection to depositors are:

(i) Henceforth, companies will be required to disclose the details regarding outstanding deposits, in the application form to be filled in by the depositors. This should serve as a warning to the depositors.

(ii) Private companies have been debarred from accepting deposits by invitation made to the public. They will be allowed to accept deposits only from directors and shareholders including relatives of directors.

(iii) The company and its directors would in future be deemed to be in default, if 10% or more of the matured deposits remain unpaid for a period of six months inspite of the claims being made in this behalf. The company can seek relief only by obtaining orders from the court.

(iv) A depositor would be empowered to move the court without express authorisation of the Central Government for prosecution.

(v) The limit of deposits will now be calculated with reference to free reserves and not with reference to paid-up capital and free reserves as at present.
If the recommendation No. 5 above is accepted for necessary amendment to the Acceptance of Deposits Rules, 1975, the capacity of public companies to accept deposits will be considerably reduced. This will mean that the companies making losses or companies which have not transferred sizeable amounts of profits to reserves will find this source of finance as useful only to a limited extent. Of course, this will be of great help in regaining confidence of depositors and protecting their investments to a greater extent.

Let us examine the recommendations of the Sachar Committee in so far as they relate to the protection to be given to the depositors:

(i) At present the companies inviting and accepting deposits are under a statutory obligation to give advertisements in newspapers in which certain relevant information is required to be given in order that an intending depositor may have a fair idea of the company's financial position. Additionally, the companies are also under an obligation to file returns with the Registrar giving details about the amounts of deposits etc.

The Sachar Committee has recommended that, in addition to the information now to be given, companies should also indicate in the advertisements and in the directors' reports and the application for deposits, all the information pertaining to the amount of deposits repayable during the year
which though claimed have not been repaid and the aggregate amount remaining so unpaid. This indeed is a very wholesome suggestion as the unwary depositor would be alerted that his deposit is likely to meet with the same fate on the date it matures for payment.

(ii) At present the law does not provide for any penalty in case default is made by the company in repayment of deposit on maturity. The Committee recommends that if default in repayment continues for a period of six months, the company should be subjected to penalties unless in the meantime, on an application, the court gives relief to the company. Now, it is somewhat difficult to understand how penalties imposed on the defaulting companies can be realised when such a company is in no position even to repay the deposit. The protection, therefore, sought to be given does not go far enough, and if the errant companies are to be detered then the Committee ought to have recommended that the managing director or directors having substantial interest in the company should be personally responsible for repayments of overdue deposits.

(iii) The Committee has also very thoughtfully recommended a complete ban on acceptance of deposits by companies where there has been a failure to repay either the deposit or the interest, although such acceptance of deposit might otherwise be within the prescribed limits.
(iv) It has been suggested that a company should not accept deposits for paying off earlier deposits.

(v) It has also been noticed that most of the cases where the depositors have come to grief involve the intervention of a broker and the Committee observes that the responsibility for looking after the activities of these brokers should be assumed by the stock exchanges. It seems that this recommendation, if accepted, apart from being difficult to implement, will cast needless burden on the stock exchange authorities. No indication has been given by the Committee as to how any given stock exchange could control the activities of brokers who canvass for deposits. The only way to deal with this menace is for the Government to introduce some system as now prevails in the insurance business. The brokers should be licensed in order to qualify them to canvass for deposit from public and to entitle them to receive brokerage from the companies. It is also common knowledge that the depositors themselves claim 1/2 per cent or 1 per cent more by way of brokerage on their own deposits and this payment is made either to the depositor himself or to his benamidar. Several companies who accept deposits pay a little higher percentage by way of interest to its members and employees and in their case, in addition to normal rate of interest, brokerage is also paid.

No company should be permitted to pay brokerage
(vi) Another significant suggestion made by the Committee is that private companies should be totally prohibited from accepting deposits from the public, and this recommendation is based on the concept that a private company should confine its activities in a narrow field and whatever resource such private company may need must be found from its directors, shareholders and relatives. However, private trading companies having large turnover may find difficult to function, because with a small capital base they may not be able to borrow from bankers and other financial institutions, and if they are prohibited from accepting deposits from members of the public, a substantial source of finance may dry up.

By and large, the recommendations are worthy of implementation. It seems that recommendations on other topics may take time, but the immediate need to protect the depositors, and particularly those from the middle class, would dictate prompt measures by the legislature so as not to expose this class of investors to the hazards of losing their hard earned monies.

Both the Government and the organized sector are in the dark regarding the quantum of such deposits in the hands of companies. The companies have found it to be a
safe proposition as investors have no representation on board of directors, nor is the board answerable to them. Similarly, the inflow of funds can be used for some cash crop type of dealings or for over stocking inventories. The public at large is ill-equipped with the insufficient financial data presented by the companies. The Government, as such, has been a silent spectator not able to take the necessary steps. Let only those companies opt for deposits which have a dire need for finance based on 'The Statement of Sources and Uses of Funds'.

The 1975-76 union budget proposals seemed to aim at discouraging the reliance of corporate sector on public deposits since it was proposed to allow only 85% of interest on deposits for tax deduction. A provision was also made for deducting tax at 10% at source from income from interest, if the payment or credit thereof exceeded Rs. 1000/- in a financial year. The redirection of funds from deposits to equity, however, can be made only if equity is made attractive to investors.

The capacity of private sector companies to collect deposits from public is likely to be adversely affected by a recent Government announcement permitting companies working in the public sector to collect public deposits. Although it may be premature to make any specific judgement, it is of interest to know that these companies have, so far, not utilised this opportunity in an effective manner. The Central Government has, so far, permitted
ten such public sector concerns. For illustration, the Indian Oil Corporation, with a capacity to secure a maximum of Rs. 93.21 crores by way of deposits as per rules, has obtained less than Rs. 2 crores as deposits from public.

Such a position seems to be on account of the following factors:

(i) Lack of experience and/or expertise in connection with acceptance of deposits.

(ii) Lack of confidence of the general public regarding the profitable use of deposit money.

(iii) Absence of canvassers or brokers.

(iv) Absence of Professionals in the Boards of Directors of such companies.

(v) Management mainly by Government officials.

(vi) Absence of satisfactory earnings record.

The following suggestions may be made in regard to the acceptance of public deposits:

(i) All deposits should be canalised through a special account in a nationalised bank specially commissioned for the purpose. A constant flow of data from respective companies will be an automatic check and control.

(ii) The Companies (Acceptance of Deposits) Rules, 1975, should be amended so that the companies may have to
give more meaningful data in the advertisement. The proposed utilisation of deposits should be specifically described. A general remark that the proposed utilisation is for the operations of the company is quite vague.

(iii) Presently, there is a flat rate of allowing 85% of interest paid as an eligible deduction. The Income-tax rules should be amended to allow, say, 60% to non-selected companies and 100% to selected companies. The regularity in payment of interest and repayment on maturity may be the major factors in selecting such companies.

(2) Financing through Public Deposits in the Cotton Textile Mills of Ahmedabad

Before analysing the role of public deposits in the financial structure of these mills, it may be of interest to know the terms and conditions on which deposits were generally collected, until 1979.

(i) The prevailing rates were as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Rate of interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 year</td>
<td>9½% to 10½%</td>
</tr>
<tr>
<td>2 year</td>
<td>10% to 11%</td>
</tr>
<tr>
<td>3 year</td>
<td>11% to 11½%</td>
</tr>
</tbody>
</table>

(ii) The minimum amount of deposit acceptable was Rs. 1000/- or 2000/-. 
(iii) A deposit of an amount below Rs. 5,00,000/- (Rupees Five lacs) from a depositor who was a member of the company throughout the whole period of deposit was carrying h% extra interest per annum.

(iv) A deposit of Rs. 5,00,000/- (Rupees five lacs) or more from any depositor whether a member or not was carrying interest at the rate of 15 (Fifteen) per cent per annum.

(v) Charitable institutions, shareholders and employees of the company were paid ½% additional interest per annum.

(vi) Deposits were acceptable in multiples of Rs. 1000/-.

(vii) Interest was payable half-yearly and on maturity, for deposits upto Rs. 10,000/- and for deposits above Rs. 10,000/-, interest was paid quarterly. Payment of interest was subject to deduction of tax, wherever applicable.

All other terms and conditions were to be according to the rules as might be in force from time to time and as prescribed by the Central Government and/or Reserve Bank of India.

A reference to Table X and Table XIX regarding the share of public deposits in the total funds of the 50 cotton textile mills of Ahmedabad makes it clear that the average share had declined from 4.90% during 1966-70 to 4.80% of total funds during 1971-75. This marginal reduction in the share was accompanied by a decline in the
variability factor from 65.31% to 55.94% during the latter period. This means that public deposits played a very minor role in the financing these mills. The variability factor during both the periods was fairly high. Therefore, it may be concluded that the policies in regard to the acceptance of deposits adopted by these mills were not uniform during both the periods. It may be added that the level of non-uniformity had declined during the latter period.

Exceptions may be noted here. In the case of unit Nos. 5, and 30, the share of public deposits in total funds was above the overall average during both the periods, but the same had declined during the latter. As against this, the share in the case of unit Nos. 4, 8, 14, 21, 23, 34, 40, and 45, was below the overall average during both the periods. In the case of unit Nos. 4, 8, 14, 21, and 34, it had increased and in the case of the remaining units, it had further declined during the latter period.

The following factors appeared to be responsible for such a trend:

(i) Policy of managements to procure short term funds to a large extent from banks.

(ii) Loss of prestige of some unprofitable or loss making units.

(iii) Government regulations on acceptance of public deposits.
(iv) Loss of public confidence in the case of certain units experiencing difficulties in regard to regular payment of interest and/or repayment of deposits on maturity.

It is clear from Table XI and Table XIX that the share of deposits in non-proprietorship funds had declined marginally from 6.90% during 1966-70 to 6.30% during 1971-75. Even here, they seemed to have played a very minor role. This marginal increase was accompanied by a decline in the variability factor from 77.57% during the former period to 64.59% during the latter. A high variability factor during both the periods means that the financial policies followed with respect to deposits varied greatly. However, the level of variation had declined during the latter period and it seemed that the textile mills of Ahmedabad were following a little more uniform policies in this regard.

Exceptionally, in the case of unit Nos. 5, 11, 22, 26, 30, 39, and 43, the share was above the average during both the periods. It had increased during the latter period in the case of unit Nos. 11, and 26, and had declined in the remaining cases during the latter period. As against this, the share was below the average during both the periods in the case of unit Nos. 4, 8, 14, 21, 23, 27, 33, and 45. It had declined further in the case of unit Nos. 8, 23, 33, and 45, and had increased in the remaining cases during the latter period.
The study of Table XII and Table XIX indicated that the share of deposits in total unsecured loans had increased marginally from 33.60% to 36.80% during the latter period. The public deposits continued to be the major component of the total unsecured loans. This marginal increase in the share was accompanied by a marginal reduction in the variability factor from 72.17% to 64.10% during the latter period. It was pretty high during both the periods and therefore, it means that the cotton textile mills of Ahmedabad had followed fairly dissimilar policies in regard to deposits as a component of unsecured loans during both the periods. However, the reduction in the variability factor during the latter period means that the policies were getting less dissimilar during the latter period.

Exceptions worth noting were: In the case of unit Nos. 6, 16, 35, and 38, the share was fairly above the overall average during both the periods. It had increased further, only in the unit No. 35, and had declined in the case of other units during the latter period. As against this, the share was below the overall average during both the periods in the case of unit Nos. 4, 23, and 37. It had declined further in all these cases with the exception of the unit No. 4, where it had increased during the latter period.

The share of public deposits in the total funds of unit No. 30, was above the average during both the periods.
However, the same had declined from 13.36% during 1966-70 to 5.92% during the latter period. It seemed that the secured loans from banks, which accounted for 18% of total funds, were the main source of external finance during the former period. Its reserves had increased from 21.91% during the former period to 23.46% of total funds during the latter period, therefore, one cannot say that the unit could not collect deposits because of the decline in credit worthiness of the unit. It seemed that on account of restrictions on public deposits and as a deliberate policy of relying less on external sources of finance adopted by the management, the share of public deposits had declined. It may, however, be noted that deposits continued to be an important source of external finance for the unit during both the periods.

In the case of unit No. 40, the share of public deposits in total funds was below the overall average and had increased from 1.92% during the former period to 2.92% during the latter. In this case also, the management seemed to have adopted a policy of relying less on deposits from public. Looking to the increase in the share of reserves from 9.90% during the former period to 18.16% of total funds during the latter period, one cannot say that it could not obtain enough deposits. On the contrary, the reserves position showed that the management seemed to have opted for internal funds - ploughed back profits in particular - for schemes of expansion. This was also verified from the data on
loans from banks. The share of secured bank loans had declined from 38.75% during 1966-70 to 23.35% of total funds during 1971-75. Thus, as a part of deliberate policy to rely less on external finance, the management must have decided to rely less on public deposits.
(B) DIRECTORS' DEPOSITS

(1) Directors' Deposits as a Source of Finance

"In the early days of industrialisation, when neither enterprise nor capital was plentiful, the managing agents provided both, and India's well-established industries like cotton, jute, steel etc., owe their present position to the pioneering zeal and fostering care of several well-known managing agency houses".* The system had originated and developed along with the evolution of the corporate organization in India. At that time, the public was not ready to subscribe to risk capital and the investment institutions were absent. The banks were not coming forward to provide term loans to particularly new companies. In the absence of any backing of managing agents, it was not possible for companies to float any public issue of shares.

Of the 590 managing agents operating as on April 1, 1966, 293 represented partnership or proprietary concerns, which were managing 316 companies with the paid-up capital of about Rs. 77 crores. Private limited companies working as managing agents - 227 in number - with the paid-up capital of about Rs. 11 crores were managing 359 companies with the paid-up capital of nearly Rs. 263 crores. 70 managing agents in the form of public limited companies were managing 194 companies with the paid-up capital of about Rs. 147 crores. As on 31st March, 1969, 393 agents managed 594 companies with the paid-up capital of about Rs. 570 crores.

Because of ill-developed capital market in India, shyness of Indian capital and non-helpful attitude of banks, the managing agents had assumed an important role as financiers of industrial undertakings in India. They had a very sound financial position and could make the inflow of foreign capital possible because of their own credit worthiness. They provided not only initial capital for new projects but also met the financial requirements for expansion and modernisation. They directly subscribed to shares and debentures of companies, and induced friends and relatives to purchase the same. They also met partly the working capital requirements of these concerns. They accepted public deposits, guaranteed loans and advances, and caused inter-company investments fruitful. Because of their standing as a financial and managerial partner in the development of a concern the general public deposited large sums of money in such concerns by way of deposits.

The data regarding the actual financial contribution in terms of absolute amounts, made to the concerns under their management, by managing agents are, however, not available.

Reference to the Report of Managing Agency Enquiry Committee, the Annual Reports on Currency and Finance of RBI, and the RBI Bulletins up to date, were also not helpful in the collection of data on the contribution made by the Managing Agents in the financial
pattern of the fifty cotton textile mills of Ahmedabad. Had the data been available, it would have been very interesting to compare them with the present amounts of public deposits outstanding with these mills.

In Bombay and Ahmedabad, the managing agents had attracted enormous deposits from the public for financing the current expenditure of the cotton mills. Not only did they attract deposits in this manner but they also furnished the working funds themselves. During the thirties, they had loaned an amount of Rs. 5.32 crores to the Bombay textile mills and Rs. 2.6 crores to the Ahmedabad cotton textile mills which formed 21% and 24% of the total finance required by the mills, while the bank loans formed only 9% and 4% respectively for these mills.

However, the financial contribution of managing agents was not without its weaknesses. They misused funds of companies by advancing them to their friends and relatives, mortgaging assets of companies to help their friends, making advances in sister concerns for illegitimate purposes, advancing funds of sound concerns to unsound companies and by wasteful capital expenditure. They proved to be very costly as a source of finance. The Administration Report of the Income-tax Investigation Commission contains disclosures about the method followed by the managing agents, especially those engaged in the textile industry. "Costs of production had been inflated by making entries of purchases of raw materials never made."
Sales were partly suppressed and the production was understated. Materials never required were purchased. The wastage was inflated.*

The managing agents so dominated the financial policies and practices of companies under their management that such companies could rarely have independent policies. The easy availability of funds from the client concerns induced managing agents to enter into speculative deals in shares and the shareholders were allowed to grope in the dark about the financial position of the companies.

Even the function of management had its own limitations. The managing agents failed to make improvements in the administrative set-ups of purchase and sales organisation and production management. Some agents did not have - or appreciate - any technical knowledge. In addition to this, the managing agency rights were treated as marketable securities. Without looking to the interests of the shareholders managing agencies were transferred. They indulged in interlocking transactions of a highly doubtful character.

After due consideration of the recommendations of Managing Agency Inquiry Committee, the Government had announced on September 5, 1966, that in five industries, namely, cotton textiles, jute, cement, sugar and paper & pulp, it would not be permissible to appoint or

reappoint managing agents on or after April 2, 1967, and the agency system would come to an end latest on April 1, 1970.

After the end of the managing agency system, most of the companies switched over to management by board of directors or managing directors.

It is intended here in below to study the change in the role of deposits from directors as a source of finance for the fifty cotton textile mills of Ahmedabad, on the implicit assumption that it was the managing agency system which gave rise to deposits from directors. The analysis also intends to study all other factors which might be responsible for the change in the role of this source of unsecured funds.

(2) Directors' Deposits and Financing of Cotton Textile Mills of Ahmedabad

A reference to Table X and Table XIX regarding the share of directors' deposits in the total funds makes it clear that such deposits had played a negligible role in financing the 50 cotton textile units of Ahmedabad. In fact, their share in total funds had declined significantly from 3.60% during 1966-70 to 1.56% during 1971-75. A similar decline was noticed in the variability factor from 101.31% during the former period to 81.09% during the latter. An absolutely high degree of variability during both the periods indicated that the textile
mills of Ahmedabad had adopted absolutely dissimilar financial policies in this regard. However, the level of non-uniformity had declined to some extent during the latter period.

Exceptionally, the share in the case of unit Nos. 9, and 44, was above the overall average during both the periods and had, however, declined during the latter. In the case of unit Nos. 2, 10, 13, 16, 19, 22, 23, 27, 29, 32, 41, 42, and 46, the share was below the overall average during both the periods. It had increased in the case of unit Nos. 2, 13, 22, 27, and 42, and had declined in the remaining units during the latter period.

A study of Table XI and Table XIX revealed that the share of deposits from directors in the non-proprietary funds had declined from 4.20% during 1966-70 to 1.84% during 1971-75. This means that their importance as a source of finance had declined during the latter period. As such, they did not play any major role in financing the activities of the cotton textile units of Ahmedabad. This change was accompanied by a significant decline in the variability factor from 118.12% during the former period to 99.78% during the latter. This means that financial policies in this regard were absolutely dissimilar. However, the non-uniformity had declined marginally during the latter period.
In the case of units Nos. 4, 9, 11, and 44, exceptionally, the individual share was above the overall average during both the periods, but had declined during the latter period. As against this, in the case of unit Nos. 13, 22, 27, and 42, the share was below the overall average during both the periods. However, the same had increased during the latter period. The individual share of deposits of unit Nos. 19, 29, 32, 41, and 46, was below the overall average during both the periods and had declined further during the latter.

The study of Table XII and Table XIX makes it clear that the share of directors' deposits in total unsecured loans had declined from 15.80% during the former period to 10.80% during the latter. This means that they had played a minor role even as a component of the unsecured loans. This was accompanied by a marginal decline in the variability factor from 110.95% to 101.67% during the latter period. The fifty cotton textile units of Ahmedabad had adopted absolutely non-uniform policies in this respect. However, the high level of non-uniformity had declined marginally during the latter period.

Exceptionally, the share of deposits in the case of unit Nos. 4, 9, 11, 14, 24, and 44, was above the overall average during both the periods. It had further increased in the case of unit No. 24, had declined in other cases during the latter period. As against this, the share of deposits was below the overall average in the case
of units No. 2, 13, 16, 19, 22, and 32, during both the periods. It had increased in the case of unit Nos. 19, and 22, and had declined in the remaining cases during the latter period.

The two cases of exceptions are worth considering.

In the case of unit No. 9, the deposits from directors had played a very major role during 1966-70, when they had contributed an amount equal to 22.15% of the total funds. However, it had declined to 5.86% of the total funds during 1971-75. The basic reason seemed to be the abolition of managing agency system. It seemed that such deposits were withdrawn by depositors after 1970. In fact, the role of public deposits as a source of short term finance had also declined. The short term sources like trade credit had provided 38.11% of total funds during 1971-75 as compared to 25.41% of total funds during 1966-1970. On the other hand, it was possible that the management might have decided to rely less on 'borrowings' during the latter period and that was why, the share of secured loans as well as unsecured loans in the total funds had declined during the latter period. Still, the share of directors' deposits in total funds was above the overall average during the latter period.

In the case of unit No. 10, the share of directors' deposits was below the overall average during both the periods and had declined further from 1.28% of total funds to 0.56% of total funds during the latter period.
Excepting for the fact that managing agency system had been abolished after 1970 and therefore, deposits might have been withdrawn, there seemed to be no rational factor responsible for this situation.

It may be concluded that deposits from directors were negligible, when compared with the total funds deployed by all the fifty cotton textile mills of Ahmedabad. This is true even in those cases where deposits have increased in absolute as well as percentage terms during the latter period of the study. In general, deposits from directors as a %age of total funds had declined in most cases during the latter period.
(C) SHORT TERM LOANS

(1) Nature of Short Term Loans

Commercial banks are typically the largest source of short term funds to business and industrial units. For small and medium sized companies, banks play a primary role in financing business growth, because such companies do not have easy access to the capital market. Short term unsecured bank loans are typically regarded as self-liquidating in that the assets purchased with the proceeds generate sufficient cash flows to pay particular loans in less than a year. At one time banks used to confine their lending almost exclusively to this type of loans. Short term self liquidating loan is an important source of business finance. It is particularly popular in financing seasonal build ups in inventories. It can be extended under a line of credit or under a revolving credit agreement.

Line of credit usually known as cash credit is an arrangement between a bank and its customer with respect to the maximum amount of unsecured credit the bank will permit the customer to owe at any one time. Usually credit lines are established for a one-year period and are subject to one year renewals. The audited report of the customer company is looked into by the bank. The amount of the loan is based on the bank's assessment of the credit worthiness and upon the credit needs of the
borrower. Depending upon changes in these conditions a line of credit may be adjusted at the renewal date or before, if conditions necessitate a change. The cash budget gives the best insight into the borrower's short-term credit needs. Despite many advantages to the borrower, a line of credit does not constitute a legal commitment on the part of the bank to extend credit. If the credit worthiness of the borrower should deteriorate over the year, the bank may not want to extend credit and would not be required to do so. Under most circumstances however, a bank feels bound to honour a line of credit.

A revolving credit may be arranged with a bank. It is a formal commitment by a bank to lend up to a certain amount of money to a company over a specified period of time. Many revolving credit arrangements are for three years, although it is possible for a company to obtain a shorter commitment. As revolving credit arrangements are for more than one year, they can be regarded as intermediate or medium term financing. This arrangement is particularly useful at times when a company is uncertain about its funds requirements. It has features both of a short term borrowing arrangement and a term loan, for the borrower can borrow a fixed amount for the entire duration of the commitment. Thus, the borrower has flexible access to funds over a period of uncertainty and can make more definite credit arrangements when the uncertainty is resolved. Such arrangements can be set up so that at the maturity of the commitment, borrowings then owing can be converted into a term loan at the option of the borrower.
While granting unsecured loans and short term loans up to a period of one year or so to the cotton mills, the banks had relied mostly on guarantees given by one or more directors of respective mills. A study of unsecured loans from banks and those from specialised financial institutions together can be made with reference to their share in the total funds, the non-proprietorship funds, and the total unsecured loans.

The study of Table X and Table XIX revealed that the share of unsecured and short term loans from banks and financial institutions in the total funds of all the fifty cotton textile mills of Ahmedabad had declined from 6.60% during 1966-70 to 4.80% during 1971-75. This was accompanied by a moderate decline in the variability factor from 83.94% during the former period to 78.54% during the latter. A high degree of variability during both the periods means that the textile mills under study had not followed uniform policies and practices with respect to institutional financing during both the periods and the degree of non-uniformity had declined marginally during the latter period.

Exceptionally, in the case of unit Nos. 1, 5, 20, 25, 47, and 48, the share was above the overall average during both the periods. It had increased in the case of unit No. 5, and had declined in the case of the remaining
units during the latter period. As against this, in the case of units Nos. 6, 13, 16, 24, 29, 38, and 46, the share was below the overall average during both the periods and had increased in the case of unit Nos. 6, 13, 16, and 29. It, however, had declined in the case of other units during the latter period.

Table XI and Table XIX showed that the share of institutional unsecured loans in the non-proprietorship funds had declined from 8.90% during 1966-70 to 6.20% during 1971-75. The variability factor also had declined from 84.11% during the former period to 77.03% during the latter. A high degree of variability factor means that the textile mills had not followed uniform policies with respect to the above during both the periods. However, the decline in the variability factor suggests that the degree of non-uniformity had declined during the latter period.

Exceptionally, the individual share in the case of unit Nos. 1, 4, 20, 37, 47, and 48, was above the overall average during both the periods, but had declined during the latter. As against this, in the case of unit Nos. 13, 16, 29, 33, and 38, the individual share was below the overall average during both the periods, and had declined further in the case of unit No. 38, and had increased in the case of other units during the latter period.
A reference to Table XII and Table XIX indicated that the share of short term loans in the total unsecured loans had declined from 45.40% during 1966-70 to 39.80% during 1971-75. This was accompanied by an increase in the variability factor from 55.70% during 1966-70 to 69.85% during 1971-75. This means that the textile mills had not followed uniform financial policies in this regard during both the periods and the degree of non-uniformity had increased further during the latter period.

Exceptionally, the individual share was above the overall average in the case of unit Nos. 8, 23, 31, and 37, during both the periods. It had declined in the case of unit Nos. 8, and 31, and had increased in the case of unit Nos. 23, and 37, during the latter period.

It seemed that unit No. 31, had not accepted any deposits from public or credit under DPG scheme during the former period, whereas in the case of unit No. 37, the management did not rely at all on deposits or credit under DPG scheme during the latter period. The unit No. 37, had obtained deposits from public only to the extent of an amount equal to just 0.20% of the total unsecured loans.

As against this, the share was below the overall average during both the periods in the case of unit Nos. 38, and 44. Whereas in the case of unit No. 38, the share had declined further, it had increased in the case of unit No. 44, during the latter period.
It seemed that the management of the unit No. 38, had relied heavily on public deposits. It had collected deposits from public to the extent of 81.47% of the total unsecured loans during the former period. However, public deposits as a part of total unsecured loans had declined to 55.66% during the latter period. This was the factor responsible for an increase in the reliance on institutional loans.

In the case of unit No. 38, the share of short term loans was far below the overall average during both the periods. In fact, the share had declined from 0.02% during 1966-70 to 0.01% of total funds during 1971-75. It seemed that the management had adopted a deliberate policy of relying less on non-proprietorship sources of finance during the latter period. The share of secured bank loans had declined from 43.67% to 31.08% of total funds during the latter period. The share of secured loans from financial institutions had also declined from 5.07% to 1.77% of total funds during the latter period. The average amount of profit after tax had almost doubled during the latter period as compared to the former. The share of reserves had increased from 27.56% during the former period to 29.40% of total funds during the latter period. This means that the management was successful in adopting a policy of moderate expansion through owned funds only. In fact, the share of proprietorship funds in total funds had increased marginally from 42.16% to 44.27% of total funds during the latter period.
In the case of unit No. 44, the management had not relied much on unsecured institutional loans during the former period and had relied on deposits from directors which were equal to 66.84% of total unsecured loans. However, during the latter period, its reliance on deposits from directors had declined to just 18.99% of unsecured loans and therefore, it had started relying on institutional loans during the latter period.

In the case of unit No. 5, the share of short term loans in the total funds was above the overall average during both the periods and the same had increased from 12.45% during 1966-70 to 15.16% during 1971-75. It seemed that the management of this unit had adopted a deliberate policy of relying mainly on bank finance at least for working capital needs during the former period. Even for medium term capital needs it had obtained secured loans from banks equal to about 27% of total funds during both the periods. Thus, it seemed to have relied on bank finance to the extent of nearly 40% of total funds. During the latter period, it had collected comparatively less amount through public deposits, i.e., 11.21% of total funds during 1966-70 and 7.82% of total funds during 1971-75, and therefore it must have increased its reliance on short term bank loans.
Unsecured loans from financial institutions:

The Table IV.11 relates to the unsecured assistance disbursed by the financial institutions and agencies other than banks to the fifty cotton textile mills of Ahmedabad.

Table IV.11

<table>
<thead>
<tr>
<th>Financing Agency</th>
<th>1966 to 1970</th>
<th>1971 to 1975</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a)</td>
<td>(b)</td>
</tr>
<tr>
<td>1. NTC</td>
<td>72.95</td>
<td>24.81</td>
</tr>
<tr>
<td>2. GSFC</td>
<td>21.35</td>
<td>-</td>
</tr>
<tr>
<td>3. GSTC</td>
<td>36.60</td>
<td>23.09</td>
</tr>
<tr>
<td>4. ICICI</td>
<td>385.52</td>
<td>136.32</td>
</tr>
<tr>
<td>5. LIC &amp; Others</td>
<td>62.12</td>
<td>0.32</td>
</tr>
<tr>
<td>6. UTI</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>7. GIIC</td>
<td>5.74</td>
<td>3.74</td>
</tr>
<tr>
<td>8. NIDC</td>
<td>28.70</td>
<td>-</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>612.98</strong></td>
<td><strong>188.28</strong></td>
</tr>
</tbody>
</table>

(a) Average total loans disbursed during the period (Rs. lacs)

(b) Average unsecured loans disbursed during the period. (Rs. lacs)

(c) Percentage of (b) to (a).
We can derive the following readings from the table:

(i) The proportion of unsecured loans to total loans provided by these eight agencies had declined from 30.72% during 1966-70 to 27.68% during 1971-75. The proportion between secured loans and unsecured loans had remained unchanged.

(ii) UTI had provided all financial assistance without any tangible security. G. I. I. C. had not provided any unsecured assistance during 1971-75; whereas NIDC and GSFC had not provided any unsecured loans during both the periods.

(iii) It was only in the case of NTC that the share of unsecured loan had increased during the latter period.

(iv) ICICI was the single agency to provide 72.35% of all unsecured assistance sanctioned by all the agencies during 1966-70 and the same had increased to 76.35% of total unsecured loans made available by all the eight agencies.

Only one study that by Patwardhan* gives all-India figures with reference to the role of short term loans. Table IV.12 gives the figures for comparing the role of unsecured and short term loans from lending institutions.

in financing the fifty cotton textile mills of Ahmedabad with that in All-India All-Industries.

Table IV.12

<table>
<thead>
<tr>
<th></th>
<th>Cotton Textile Mills of Ahmedabad</th>
<th>All-India All-Industries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1966-70</td>
<td>1971-75</td>
</tr>
<tr>
<td>Unsecured loans as %age of total funds</td>
<td>6.60*</td>
<td>4.80*</td>
</tr>
</tbody>
</table>

* Loans from banks and financial institutions combined.
** Only bank borrowings: 1966 to 70 and 1971 to 74.

Thus, the textile mills of Ahmedabad had relied much less on institutional borrowings during both the periods as compared to All-India All-Industries. In fact, the reliance of All-India All-Industries was nearly three times that in the case of cotton units of Ahmedabad. Again, the reliance on bank borrowings had declined during the latter period both in the case of cotton textile units of Ahmedabad as well as All-India All-Industries. Therefore, this was a general trend in financing found in all the industries working in India. However, it may be noted that the decline of 37.50% in the case of the former was far greater than that in the case of the latter being just 6.20% during the latter period.
The declining trend in reliance on banks and other financial institutions during the period of this study seemed to have been caused by the following factors:

(i) The financial institutions seemed to have relied more on security as far as the assistance to textile mills of Ahmedabad was concerned. In fact, the unsecured loans granted by them had declined from 30.72% of total loans during 1966-70 to 27.68% of total loans granted during 1971-75.

(ii) Banks also seemed to have been very cautious in regard to granting of unsecured loans to these units. They had increased loans on hypothecation from 68% during 1966-70 to 84% of total loans granted during 1971-75. This means that the cotton mills had failed to get large borrowings without any tangible security from banks.

It may be concluded that the textile mills of Ahmedabad had tried to meet their current needs through bank borrowings. The institutions like GSTC, GSFC, GIIC, NTC, etc., can certainly play an increasing role in the development of these mills.
(D) FUNDS UNDER DPG SCHEME

(1) Nature of Unsecured DPG Funds

The nature of Deferred Payment Guarantee Scheme was described in Chapter (IV). (Vide : Non-proprietorship funds: I(D) ). Generally, funds under the scheme are available only against the security of tangible assets. Exceptionally, they are available, when the guarantee is given by the directors of a company and it is accepted. Thus, when funds are available only on the basis of directors' guarantee, they are unsecured funds available under the scheme. These funds generally do not account for a large share in the total unsecured loans as they are available for the purchase of import of capital equipments. They are guaranteed by banks against the personal guarantee of a managing director. In such cases, the hypothecation of movable machinery of the company and immovable assets is not required.

The Sachar Committee on Companies Act and MRTP Act in its report has recommended that specific items should be provided for DPG Loans under 'secured loans' and 'unsecured loans' respectively in a distinct manner.

(2) Unsecured DPG Funds and Cotton Textile Mills of Ahmedabad

The study of Table X and Table XIX indicated that the share of unsecured DPG funds in the total funds had increased significantly from 1.29% during 1966-70 to 2.31% during 1971-75. Although the unsecured DPG funds had played
a very minor role in the financing of the cotton textile mills, their role had improved during the latter period. This was accompanied by a significant change in the variability factor from 83.10% during the former period to 107.88% during the latter. This means that these mills had adopted very non-uniform financial policies in regard to this source of finance and the degree of non-uniformity had increased further during the latter period.

Exceptionally in the case of unit Nos. 7 and 44, their share was above the average during both the periods and it had increased further during the latter period. As against this, the share of unit No. 5, was below the overall average during both the periods. However, the same had increased during the latter.

A reference to Table XI and Table XIX makes it clear that the share of unsecured PPS funds in non-proprietorship funds was very insignificant during both the periods. The same had increased significantly from 1.92% during the former period to 3.48% during the latter period. This was accompanied by a significant increase in the variability factor from 88.85% during the former period to 111.29% during the latter period. This means that these mills had not followed uniform financial policies in regard to this source of finance and the degree of non-uniformity had increased further during the latter period.

Exceptionally, in the case of unit Nos. 7, 28, and 44, the share was above the over-all average during both
the periods and the same had increased further during the latter period. As against this, the share of unit No. 5, was below the average during both the periods, but had increased during the latter.

A significant increase can be noticed in the share of unsecured DPG funds in total unsecured loans from 9.60% during the former period to 16.20% during the latter. The study of Table XII and Table XIX shows that this increase was accompanied by an equally significant increase in the variability factor from 86.43% during the former period to 105.93% during the latter. This means that during both the periods, the cotton textile mills of Ahmedabad had adopted very dissimilar policies in regard to this source of finance and the degree of non-uniformity had increased further during the latter period.

The share of unit Nos. 7, 12, 28, 42, and 44, was above the overall average during both the periods and had increased further during the latter period. As against this, the share of unit No. 5, was below the overall average during both the periods, but had increased during the latter.

In the case of unit No. 44, the share of unsecured DPS funds in total funds was above the overall average during both the periods and it had increased from 4.91% during the former period to 7.10% of total funds during the latter. It seemed to have adopted a moderate plan of
replacement. Its gross block had increased from Rs. 140.14 lacs as at the beginning of 1966 to Rs. 273.32 lacs at the end of 1970 and then further increased to Rs. 455.34 lacs at the end of 1975. The management of the unit had collected less during the latter period in the form of total secured loans. In fact, the share of secured loans had declined from 27.10% to 18.18% of total funds during the latter period. As against this, its reserves had increased and their share in total funds had also increased from 12.10% during the former period to 16.20% of total funds during the latter. A part of the growth in gross block was financed through DPG funds. Another reason for the increase in the share of DPG funds seemed to be that the management had relied less on institutional finance during the latter period. The share of bank loans had declined from 15.70% to 4.56% of total funds during the latter period.

**Trade Credit, Provisions and Inter-Corporate Investments and Loans**

These subjects are dealt with in detail separately in the Chapters V and VI that follow because of the following considerations:

Trade credit and receipts from other mills through inter-company investments and loans do constitute a part of non-proprietorship funds, but provisions—though from within—provide generally usable funds and cash-flows to the extent they are invested in earmarked funds. The inter-company investments and loans may cut across a unit’s non-proprietorship funds, too, through outward movements. Again, the latter have a special significance in terms of corporate power concentration.