CHAPTER VI

CONCLUSION & SUGGESTIONS
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CRITICAL APPRAISAL CONCLUSION AND SUGGESTIONS

Considering the financial needs of small and medium scale industries, particularly in the context of emphasis laid on their development in the five year plans, the contribution of State Financial Corporations is not very significant. They have not yet been in a position to extend financial assistance on any appreciable scale. Further, a large number of applications are being rejected by these Corporations. These rejections necessitate serious thinking on the part of all those interested in the rapid expansion of medium and small scale industries. Though the Corporation may be justified in rejecting applications on certain valid grounds but their work does not cease with the refusal. They should devise means for making applicants credit-worthy. It is further alleged that undue delays occur in sanctioning loans to industrial units. These delays are often attributed to red tape which, however, is not the whole truth. The Corporations cannot afford to take decision in haste and repent in leisure. The management
of the Corporations is under an obligation to exercise extraordinary vigilance in regard to the credit-worthiness of the applicants and sound proof of title to property offered as security. In many cases, the applicants have not submitted satisfactory accounts and estimates of outlay and expansion schemes with corroborative proof.

It is asserted that the Corporations have provided accommodation to comparatively big industrial concerns on a rather disproportionate scale which is not fully consistent with their fundamental function. Cotton Textile, engineering, electric supply, oil crushing and similar industries as also tea and rubber plantations engaged in factory operations stand out as major recipients of loans. But the Corporations may not be censured exclusively for this state of affairs since the State Governments prefer to meet financial requirements of small industries directly under the State Aid to Industries Acts.

The Corporations have to face certain limitations and difficulties which are, more or less, of the same nature for all these Corporations.

The assessment of financial position of the borrowing enterprises entails a big headache since detailed
analysis of their non-standardised and non-audited accounts has to be taken into consideration for a period of at least four or five years. Most of the small business units do not follow the accepted principles and practices of accountancy. In partnership and proprietary concerns, the partners or proprietors do not keep their personal accounts separate from their business accounts.

The Corporations are reluctant to deal with the industrial units having doubtful expansion programmes, for such concerns do not provide adequate information regarding their installed capacity, actual output and estimated increase in production consequent on expansion. During World War II and the post-war period, there was a mushroom growth of small units without any co-ordination with large scale industries. Their problem of credit and finance is only a part of the vast complex in which the problems of production, quality control, finance and marketing etc. are vitally inter-related.

Many proprietary and partnership firms find it difficult to offer adequate security for their loans because of the defects in title to ownership and difficulties of evaluating the fixed assets. The limited experience of the Corporations has shown that many applicants do not have any resources to fulfil the conditions
of the grant of loans.

There is dominance of personal factor in small business units since their successful functioning is dependent mostly on the efficiency of one or a few persons. In case of personnel changes, continuity of efficient management can hardly be assured. Thus, the small enterprise is as uncertain as life and the continuity and capacity of the owners. This factor naturally enhances the difficulties of the Corporations engaged in the financing of small industries.

The industrial units in need of financial assistance from the Corporations do not realise the intricacies and delicacies entailed in mortgage and banking. In other words, they fail to appreciate the limitations under which the Corporations have to operate, and also the procedures and formalities which have to be gone through before the loans can be sanctioned.

The increasing emphasis on the development of certain cottage industries by the Central and State Governments is also one of the factors contributing to the limited scope for assistance from the Financial Corporations to small-scale industries. For instance, the Government
have placed restrictions on the working of small-scale oil mills in order to give fillip to oil extraction by the village ghanis. In the case of small rice mills, restrictions have been imposed on the issue of new licences for illustration of small hullers, and also in the matter of pounding of paddy by small mills so that hand pounding may be encouraged.

There is a difficulty of getting technical personnel of the right type to examine the soundness of the proposed schemes of the borrowing units. Though it may not be difficult for the Corporations located in Bombay and Calcutta to procure the services of experts, but such facilities are usually not available for other Corporations and the availability of these services means additional expenditure for such Corporations.

Some of State Financial Corporations are faced with the problem of finding additional resources since more and more industries, both old and new have begun to approach these Corporations. The investing class is steadily diminishing and, in the new set up of things, has also become shy. In view of this added responsibility the problem to make more funds available to these Corporations brooks no delay.
The constitution and the working of the State Financial Corporations have been subjected to various criticisms which are similar to those levied against the IFC with certain modifications. It is claimed that the State Financial Corporations Act provides for a "Straight Jacket pattern" for all Corporations established by the different State Governments without taking into consideration the requirements and conditions prevailing in the different States. This view does not seem to be correct as the Act is only an enabling legislation to bring uniformity in the constitution and working of the various Corporations. The Act provides only the basic framework while there may be variance in matters relating to procedure and working.

Some extenuating circumstances may be found in the fact that the State Financial Corporations Act does not permit any accommodation unless it is sufficiently secured by pledge, mortgage, hypothecation, or assignment of assets in the manner prescribed by regulations. As a purveyor of long-term credit, the Corporations have to satisfy themselves that the proposal placed before them is backed by adequate and readily marketable security of tangible assets that the management of the applicant industrial concern is efficient and prudent, that the
profit-earning capacity of the borrower is sufficient and that there are reasonable chances of loan being repaid within the stipulated period. Often considerable delay is experienced in getting applicants to deliver all the documents required to establish their title to the mortgage property, to submit plans and estimates for the buildings, audited accounts for three years immediately preceding the date of application, income-tax assessment orders etc. One of the peculiarities for the management of small industrial concerns specially of the non-corporate type is that they do not have their accounts audited by qualified accountants nor do they follow the accepted practice of accounting in industrial undertakings. In the absence of properly audited accounts it is difficult for lending institutions to assess the financial soundness of borrowing concerns or to calculate the net value of assets offered in security. In fact one of the purposes of the 1956 amending bill was to reduce the rigorous provisions of the law so that the loans could be given on slightly less onerous terms. Section 25 of the State Financial Corporations Act was amended so that industrial concerns engaged in small scale and cottage industries, not having sufficient tangible assets, might avail themselves of financial
accommodation from the State Financial Corporations.

The gap between the loan applied for and the amount granted will be narrowed, as the industrial concerns gain experience in the intricacies of mortgage banking. The applications rejected are either for grant of working capital or from industrial concerns which do not come within the purview of Corporations or are based on unsound schemes backed with insufficient security, insufficiency of earning capacity to repay instalments of principal and interest, unfavourable credit reports, bad management etc. It is necessary in this connection that regional advisory committee should be set up. These committees will help the Corporations to have a further knowledge of the industries.

With the growing emphasis on accelerating the pace of industrial growth, practically in the small and medium scale sectors which now encompass more modern and sophisticated industries and also having in view the need to achieve a wider geographical dispersal of industries it has become necessary for SFCs to play a greater role than hitherto. This calls for strengthening of their organisational and financial aspects. I would offer the following suggestions to obtain the desired results:
The Reserve Bank may take up with the Kerala State Government the question of extending the jurisdiction of the Kerala SFC to the Laccadive group of islands.

Six SFCs with working funds below Rs. 4 crores, should take urgent steps to increase their business expeditiously if they are to reach the minimum size for viability.

The SFCs may make arrangements to obtain up-to-date lists of functioning small industrial units in the non-corporate sector from the appropriate departments of the respective State Governments.

SFCs may arrange for periodical surveys and/or seminars at selected growth centres in every district and arrange for periodical contacts with all existing and potential entrepreneurs.

SFCs should be enabled to extend financial assistance to certain additional lines of activity besides those covered at present.

SFCs may not finance concerns engaged in film production, construction of cinema theatres, medical
units and service units like laundering and advertising.

In view of the magnitude of assistance to small scale industries, there is a case for larger co-ordination and participation between SFCs and commercial banks.

Where a bank's credit-deposit ratio is on the high side and it has also granted sizeable term loans to small and medium industries without entering into participation arrangements with SFCs, the Reserve Bank may consider the question of advising it to evolve suitable arrangements.

The SFCs may be authorised to issue guarantees in favour of scheduled banks and State Co-operative banks in respect of not only loans but also other types of credit facilities.

In order to assist small and medium industries for import of plant and machinery, the SFCs may be enabled to issue guarantee in favour of ICICI.

In cases where an engineer or a technically qualified person has just enough resources to meet the initial pre-construction expenses and margin for working capital, SFCs may grant loans with very low margins of 5% to 10% on the value of fixed assets and postpone the
collection of the interest accruing during two or three years i.e. till such time as the borrowing concerns are able to make satisfactory gross profit. The refinance scheme of IDBI could also be modified to suit instances of this nature.

As the transferability of shares of a private limited company is restricted, it may not be prudent for an SFC to subscribe to its equity shares.

Where a private company has or is likely to have sufficient fixed assets to offer as security, loans alone may be provided either carrying no interest during the first two or three years and slightly higher than normal rate during the later years or a progressively increasing rate. Where the company has potentialities for growth but the promoters do not have sufficient funds for the initial capital, the SFC might subscribe to redeemable cumulative preference shares subject to certain safeguards.

SFCs may subscribe both to equity and preference capital of a public company subject to certain safeguards.

In order to undertake financial assistance to industrial units in the form of loans with no or low rates
of interest in the initial years, or participation in preference or equity shares, SFCs may be allowed to create a special class of capital bearing no minimum dividend obligation to be contributed entirely by the State Governments and the Reserve Bank/IDBI in agreed proportions.

It might be prudent for SFCs to restrict investments in shares in each year to the amount of special capital which the SFC might be able to raise and the total of outstanding portfolio of share investments to not more than 15% of its outstanding loans and advances. An overall ceiling on the extent of investment in shares and outstanding underwriting obligations may be set up at an amount equivalent to the amount of special capital plus 50% of the normal paid up capital and reserves of an SFC.

In their head offices, SFCs should build up an appropriate machinery for financial and technical appraisal of projects and for advising assisted units on their problems.

SFCs may devise means of supplementing the efforts of State Governments and the IDBI in order to
achieve a more balanced territorial distribution of SFCs' assistance and also to ensure a reasonable coverage of all the districts.

Each SFC, as far as possible, should aim at having at least one office in each region. The State Government or the Reserve Bank may subsidise the cost of branch expansion programmes of SFCs deserving support in this regard for an initial period of 3 years.

Industrial surveys which are to be jointly conducted by the Reserve Bank, IDBI, ICICI and IFCI in certain developing States might cover not only the establishment of large and medium industries but also small industries. In addition, arrangements should be made whereby, project reports should be prepared and furnished to prospective entrepreneurs.

The responsibility of formulating policy measures governing the growth of small industries should be fixed on the Industrial Finance Department of the Reserve Bank.

The contingent liability may be excluded from purview of the ceiling prescribed in Section 7 (5) of the SFCs Act.

A ratio of 5:3 may be observed as between
bonds issued by an SFC and the amount of refinance obtained by it from IDBI. This ratio may be relaxed to 5:4 in deserving cases for short periods.

There is no case at present for enhancing the existing ceiling limits on loans and advances to individual borrowers. However, the ceiling on assistance to private companies may be raised to Rs. 20 lakhs.

The assistance that may be provided by an SFC to a single concern in the form of deferred payments guarantees, underwriting agreements and capital participation, along with loans and loan guarantees may not exceed Rs. 30 lakhs in the case of a company or a cooperative society and Rs. 15 lakhs in the case of other types of concerns.

In order to ensure that the SFC confine their dealings to the small and medium scale units in the lower brackets, the Reserve Bank may prescribe a suitable ceiling on the size of an industrial concern eligible for financial assistance from an SFC.

IDBI may be specifically mentioned as a separate class of shareholder in the same way as the State Government and the Reserve Bank in sub-section (3) of section 4.
of the SFCs Act.

SFCs may increase their capital by making private issues to be subscribed to by the State Governments and the Reserve Bank or the IDBI carrying a minimum dividend liability of 3% or 3½%.

The State Governments may allow the SFCs to convert the subvention liability into special capital bearing no minimum dividend obligation.

The Statute may be amended to enable IDBI also to forgo the dividend on its shareholdings in SFCs for credit to the Special Reserve Funds of the SFCs. The existing ceiling of 10% of paid up capital on the total amount that may be credited to the Special Reserve Fund may be raised to 25% of paid up capital. The SFCs may be allowed to utilise the balances in the Fund towards expenses for developmental purposes approved by the Reserve Bank and the State Government.

The existing ceiling limit at 60% of the paid-up capital on borrowings under Section 7 (2) (b) of the SFCs Act from the Reserve Bank may be raised to 90% of the paid-up capital.
The Reserve Bank may extend accommodation under Section 7 (2) (b) against an agreement executed by each SFC instead of an ad hoc bond. The State Government's guarantee for such advances should be automatic under the statute as in the case of deposits accepted at present by SFCs.

While settling the annual market programme of SFCs the Reserve Bank may take into account the utilisation of alternate avenues of raising resources such as refinance.

The SFCs may be allowed to raise a part of their resources through issue of bonds of shorter maturity, say 7 years.

In order to enable SFCs to utilise the refinance facilities on a liberal scale, the IDBI may allow some relaxations and make some adjustments in its procedures subject to the SFCs complying with certain minimum requirements.

IDBI may sanction refinance normally upto three times and in special circumstances upto four times the paid-up capital and reserves of an SFC.
Any accommodation that the SFC may obtain from the State Governments should be after obtaining the prior approval of the Reserve Bank as regards the quantum and the terms and conditions.

It is not in the interest of SFCs to change the existing ceiling limit on deposits that may be accepted by an SFC.

SFCs may be compelled by statute to transfer 40% of their profits each year to a reserve fund, the amount so transferred being eligible for income-tax concession under Section 36 (1) (viii) of the Income-tax Act. The State Governments should make a matching concession by waiving at least 50% of the stamp duty and registration charges on the documents that may be executed in favour of the SFCs by borrowers in the small-scale industrial sector. The existing ceiling of Rs. 3 crores on paid up capital for eligibility for the maximum concession under Section 36 (1) (viii) of the Income-tax Act may be raised to Rs. 5 crores.

The bonds to be issued by the SFCs may be exempted from stamp duty through appropriate changes in the relevant statutes.
An SFC which has temporarily surplus funds, may lend to the call money market provided they do not at that time remain indebted to the Reserve Bank, or purchase participation certificates recently introduced by some commercial banks.

In the interests of orderly development of the business of the SFCs and for better co-ordination of the activities of IDBI and the SFCs, the Reserve Bank should have the power to issue directives to the SFCs.

A provision may be made for the IDBI's nominee on the Board of Directors of each SFC in place of the IFCI's nominee.

No elected director should continue to hold that post beyond a maximum period of eight years.

As in the case of commercial banks, an SFC should be precluded from granting loans and advances or any other accommodation to a concern in which any of its directors is having substantial interest.

A State Government may, while appointing the Chairman of the Board of Directors of the SFC, choose him from among prominent industrialists in the region
or retired civil servants with appropriate background and experience in industry or industrial finance. The appointment of the Managing Director should be for a minimum period of four years subject to the State Government, on the recommendation of the Board of Directors, having the power of removing him from the post at any time. The appointment should not also be made for an unduly long period. The Reserve Bank may, in consultation with the State Government, prepare a panel of suitable candidates for appointment as the Managing Director of each SFC and the State Government may make the appointment on the advice of the Reserve Bank. The Board of Directors of an SFC may take decisions on purely administrative matters relating to its staff Regulations without reference to the Reserve Bank or the State Government. The Chief Presidency Magistrate or the District Magistrate may be empowered to assist an SFC in taking over the management, or, as the case may be, in realising the property of the defaulting concern. The Comptroller and Auditor General may prepare a panel of auditors acceptable to the State Government. The other classes of shareholders may choose one of the auditors in the panel to avoid multiplicity of audits.
While making the annual appropriations to the National Industrial Credit (Long Term Operations) Fund, the Reserve Bank may take into account the likely demand that may arise from the various sectors - small-scale, large-scale and public - and earmark the amount specially intended for small industries. There appears to be no need for the Central Government to make any separate allocation of large funds to the State Governments for enabling the latter to extend financial assistance, except for small amounts, to industrial units under the State Aid to Industries Act. The SFCs should not extend accommodation solely on the guarantee of State Government. Such guarantee may be accepted only as additional or collateral security, where warranted. To avoid overlapping of functions, the Development Corporations may render financial assistance of any kind only to units which cannot be assisted by SFCs and a provision may be made for the appointment of Managing Director of the Development Corporation as a director of the SFC and vice versa. SFCs may also put up the lending rate on loans by 1/2%.

The progress indicated by these Corporations so far has been moderate and many of the problems facing the Corporations are still the elementary problems of lack
of resources and prohibitive restrictions. The working group on the SFCs made a comprehensive Report on the problems and difficulties of the Corporations and suggested several changes in the practices and existing legal provisions, as well as the attitude of the Corporations. The eleventh Conference of the representatives of the SFCs also considered the ways and means of increasing the resources of the Corporations and to implementing the recommendations of the working Group.

Following are some of the suggestions to make SFCs more serviceable to the country:

As regards the question of resources, more than Rs. 9 crores out of Corporations' total share capital have been provided by the Reserve Bank of India. With a view to improving the working of the SFCs and to make them function more effectively, it may be recommended that Corporations should raise their resources by way of share capital, deposits, bonds and provisions of funds by Government and the RBI. The tax exemption limit in respect of credits to the Special Reserve Account may be stepped up from 10% to 25% subject to the overall limit of paid up capital. Hence,
the Corporations must increase their resources by fixed deposits, issue of bonds and debentures, by writing off the outstanding subvention liabilities of the Corporations and by raising of the ceiling of accumulations in the Special Reserve Fund.

Many of the small industrial enterprises have got no idea about the existence of these Corporations. It is, however, difficult to say to what extent conferences have actually proved useful because apart from the inaugural address of the Reserve Bank of India, very little is known about the agenda, trend and discussions, conclusions reached and suggestions implemented. If the proceedings of such conferences are published and the progress made in implementing their recommendations from year to year is indicated, it would enable public discussions of the problems of State Financial Corporations to be conducted in a far more informed and, therefore, intelligent manner. In the absence of this vital information it is hard to maintain even continuity of discussions.

Great care should be exercised in formulating proper rules of procedure for these Corporations. The sound principle of mortgage banking should be watched
for them. Indiscriminate sanctioning of loans should be avoided otherwise these Corporations may become the aggregates of financially crippled enterprises. The lending policies may be adjusted in the light of experience gained regarding the financial position of the various industries operating in the respective regions. But cautions need not lead to interia on the part of the Corporation which are expected to act as philosopher, friend and guide for the small industries. The Corporation's duty does not cease with the provision of credit but it should continue to exercise and constantly watch over the progress of the customer-enterprises for enabling them to proceed on right lines. Hence, it may be concluded that the Corporations must follow the liberal policy in granting loans to the industrial units.

The Reserve Bank has got an important role to play in the establishment and functioning of the State Financial Corporations. The Bank has one nominee on the Boards of Directors of each of the State Financial Corporations. Apart from the statutory provision, which specifies that the Bank should be consulted before the Corporations issue any bonds or debentures for the purpose of increasing their working capital or frame regul-
lation under the SFCs Act. As a matter of fact the Corporations have voluntarily agreed to have inspections by the Reserve Bank and the State Governments, have welcomed such inspection. The Bank should adopt a policy to make the Corporations more serviceable to the country so that no single industry may be deprived of adequate finances.

The small-scale industries have played an important role in the development of the country since past. Though the Corporations provide the assistance to these industries but special care must be given in providing the loan to them.

More than eight Corporations have been acting as agents of respective State Governments for routing funds allocated under the liberalised scheme of assistance to small-scale industries. All the State Financial Corporations must follow this policy.

There should be full co-operation and co-ordination between State Financial Corporations and Industrial Credit and Investment Corporation of India so that they could jointly assist the industrial concerns in obtaining finances.
The attitude of the State Legislatures should be sympathetic and the discussions may be directed for effecting improvement in the working of the Corporations rather than lead to acrimonious debates.

Though the growth of the activities of the Corporations has been slow and halting because of the irksome adherence to their red-tape, yet they are rendering a valuable service to small and medium scale industries.

A depressing feature of the working of many of these Corporations has been their inability to meet their commitments of guaranteed dividends. Most of the Corporations need subvention from their States for honouring this obligation. The Corporations should strengthen the technical staff at their disposal in order to ensure expeditious and efficient handling of the applications. The procedure for granting loans also needs to be clarified to the applicants, so that the interval between the receipt of an application and the actual date of sanction may be reduced to the minimum.

In fact, the Corporations are a new experiment in our country. They are in an infant stage like our industries. Modern industry requires a huge amount of
capital which these baby Corporations are unable to provide. Keeping in view the progress made by these Corporations, it may be hoped that in the near future, they would be able to keep pace with the requirements of the industries.

It is hoped that the State Financial Corporations will do Yeoman's Service in the industrialisation of the country.