CHAPTER IV

LENDING OPERATIONS

OF

STATE FINANCIAL CORPORATIONS
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According to Section 34 of the SFCs Act, a SFC may invest its funds in the securities of the Central Government or of any State Government.

The investments of SFCs in Government securities was Rs. 460 lakhs towards the end of the Second Five Year Plan. By the end of the Third Plan, it decreased to Rs. 376 lakhs. During the year 1969-70, it stood at Rs. 230 crores. In the years 1970-71, 71-72, 72-73 and 73-74, it was Rs. 216 lakhs, Rs. 169 lakhs, Rs. 174 lakhs and Rs. 138 lakhs respectively. In April, 1974, it was Rs. 138 lakhs.

The following table shows the position of Government securities with SFCs during the last 15 years.
### Table showing Investments of SFCs in Govt. Securities from 1960-61 to April, 1974.

<table>
<thead>
<tr>
<th>Year</th>
<th>Investments of SFCs in Govt. Securities (Rupees in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61</td>
<td>460</td>
</tr>
<tr>
<td>65-66</td>
<td>376</td>
</tr>
<tr>
<td>69-70</td>
<td>230</td>
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<tr>
<td>70-71</td>
<td>216</td>
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<tr>
<td>71-72</td>
<td>169</td>
</tr>
<tr>
<td>72-73</td>
<td>174</td>
</tr>
<tr>
<td>73-74</td>
<td>138</td>
</tr>
<tr>
<td>April, 1974</td>
<td>138</td>
</tr>
</tbody>
</table>

In December, 1956, Central Government after consulting Reserve Bank, issued instructions to States about the investment of surplus funds by SFCs. It was felt desirable to maintain a working balance in short-term deposits with banks up to about a year's requirement of funds. It was stressed that investment in long-dated securities would be unsuitable and that it would be the best policy for SFCs to invest in short-dated Government...
CASH, INVESTMENTS, LOANS, UNDERWRITING AND OTHER ASSETS OF SFCs AS AT APRIL, 1974.
Securities of not more than 2 to 3 years' maturity, in consultation with Reserve Bank. The State Governments were requested that in case they saw no objection to this, they may instruct SFCs under Section 39 (1) of the Act in terms of Central Government's letter.

Some of the States permitted their SFCs to invest in medium-dated securities. The general rise in interest rates (on bank deposit, etc.) with its effects on yield pattern is bound to affect the gilt-edged market also; and it will be felt more in the long-dated sectors. Thus, to avoid capital depreciation and losses if some of these investments need to be liquidated to replenish cash resources, as far as possible SFCs should invest in short-dated securities.

Under Section 25 (1) (g) of the Act, a SFC may subscribe to the debentures of an industrial concern, repayable within 20 years from the date of subscription. Section 25 (1) (f) also permits a SFC to underwrite issue of stocks, shares, bonds and debentures of industrial concerns and to retain them, if this is necessary to fulfil underwriting obligations, up to 7 years. For retention after 7 years, prior permission of Reserve Bank is necessary.

In India, equity capital constitutes a very
substantial part of the total capital raised by industry; preference shares and debentures are much less important. The ability of SFCs to finance debenture issues becomes still more difficult because the smaller companies with which they generally deal are often unable to raise funds in the open market. Another important factor which discourages this operation is the absence as yet of a broad-based market for debentures. To serve the purpose of broadening the existing and potential investor-participation in industry, SFCs should finance equities and debentures; but they should be able to revolve their portfolio of securities so that newer enterprises can be assisted.

SFCs have an important role in financing long term capital through debentures and participation inequities. They must develop this business if they are to contribute their share towards developing a capital market. Again, equity, rather than loan is often the most appropriate form of financing a new enterprise or a rapidly expanding one, on which a fixed debt beyond a certain level might place an intolerable burden. Equity investments also enable the participating credit institution to share in the profitability of successful enterprises and thus adds to its income. SFCs Act may, therefore, be amended as to authorise SFCs to participate directly in the equity of corporate industrial units. They should also devote more effort to develop
debenture financing. SFCs would not be able to participate in equity to any significant extent as it is a risky undertaking. They should, first, build up adequate reserves for the purpose. Regular and immediate income generated by a loan portfolio would naturally have a greater appeal to them than the delayed and uncertain returns on equity investments. The following measures might be suggested to enable SFCs to develop equity financing business gradually.

(a) **Investments in or underwriting of debentures:**

In the initial stages, SFCs should take up this operation in participation with IFC/ICICI, which would enable them to take advantage of the expertise already acquired by these larger institutions, and to increase the volume of their turnover. Again the cost of processing the applications will be small. It will be shared by the participating institutions and will go to increase the revenues of SFCs, more than proportionately to the cost. They will also gain necessary experience, which will enable them later to take up this operation independently.
(b) **Equity financing:**

The Act will have to be amended for this purpose. Equity financing is most appropriate for new enterprises as it imposes no interest burden. But SFCs cannot be expected to finance new ventures because of the risk involved and should proceed cautiously. They may start by participating in equities of enterprises which have become seasoned and with which they have had satisfactory dealings as leaders for a fairly long period of time. If more capital is needed for expansion, the enterprise may prefer to have it in the form of equity - which gives it a broader base on which to borrow from other sources, and might require the support of the SFC in issuing it. If SFCs participate in the equity, they will be able to share in the profits of growing enterprises. After acquiring sufficient experience, SFCs could later consider undertaking equity financing in respect of new ventures to fulfil their role of development banks. It may also be desirable to fix a ceiling, say 30% of the capital and reserves, up to which each SFC may engage in this business in the initial stages.

(c) **Cash Balances:**

Under Section 33 (2) of the SFCs Act, the funds of SFCs shall be deposited in Reserve Bank or State Bank.
of India and its subsidiaries or, in consultation with Reserve Bank, in a scheduled bank, or a State Co-operative bank. It is essential as SFCs must maintain a certain optimum relationship between their liquid and profit-earning assets. They have to keep liquid a sum adequate to meet all possible disbursals of sanctioned advances from time to time. They have also to pay interest on their bonds and other borrowings at regular intervals.

It is necessary to find suitable employment for the balance of the funds in hand. Investments constitute the next most remunerative assets of the Corporations. If the demand for loans increases, they may liquidate some investments.

Cash in hand and Balances at Banks of the State Financial Corporations towards the end of the Second Five Year Plan was Rs. 456 lakhs. At the end of the Third Plan, it stood at Rs. 436 lakhs. In the year 1969-70, it amounted to Rs. 849 lakhs. In the years 1970-71, 71-72, 72-73 and 73-74, it was Rs. 626 lakhs, Rs. 906 lakhs, Rs. 1184 lakhs and Rs. 960 lakhs respectively. In April, 1974, it amounted to Rs. 921 lakhs.

The following table shows the position of Cash in Hand and Balances at Banks of SFCs since 1960-61.
Table showing Cash in Hand and Balances at Banks of SFCs from 1960-61 to April, 1974.

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash in Hand and Balances at Banks (in lakhs of rupees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61</td>
<td>456</td>
</tr>
<tr>
<td>65-66</td>
<td>436</td>
</tr>
<tr>
<td>69-70</td>
<td>849</td>
</tr>
<tr>
<td>70-71</td>
<td>626</td>
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<td>71-72</td>
<td>906</td>
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<tr>
<td>72-73</td>
<td>1184</td>
</tr>
<tr>
<td>73-74</td>
<td>960</td>
</tr>
<tr>
<td>April, 1974</td>
<td>921</td>
</tr>
</tbody>
</table>

Applications received, sanctioned and disbursed:

Total applications received by SFCs since their inception, amounted to Rs. 39882 lakhs in 1969-70. Their amounts increased to Rs. 48793 lakhs, Rs. 67442 lakhs, Rs. 80834 lakhs and Rs. 101321 lakhs during the years 1970-71, 72-72, 72-73 and 73-74 respectively.
Out of the total applications received, applications worth Rs. 20844 lakhs were sanctioned up to 1969-70. The amounts sanctioned up to 1970-71, 71-72, 72-73 and 73-74 totalled Rs. 26532 lakhs, Rs. 35889 lakhs, Rs. 44046 lakhs and Rs. 58897 lakhs respectively.

Out of the total sanctions, amounts worth Rs. 14645 lakhs were disbursed by the year 1969-70. Disbursement amounted to Rs. 17729 lakhs by the year 1970-71, to Rs. 23284 lakhs by 1971-72, to Rs. 27634 lakhs by 1972-73 and total disbursements amounted to Rs. 33779 lakhs by the year 1973-74.

The following table shows the applications received, amounts sanctioned and amounts disbursed during the last five years.

Table showing applications received, sanctioned and disbursed from 1969-70 to 1973-74.

<table>
<thead>
<tr>
<th>Year</th>
<th>Applications received</th>
<th>Amounts sanctioned</th>
<th>Amounts disbursed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 1969-70</td>
<td>39882</td>
<td>20844</td>
<td>14645</td>
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<tr>
<td>70-71</td>
<td>48793</td>
<td>26532</td>
<td>17729</td>
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<tr>
<td>71-72</td>
<td>67442</td>
<td>35889</td>
<td>23284</td>
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<tr>
<td>72-73</td>
<td>80834</td>
<td>44046</td>
<td>27634</td>
</tr>
<tr>
<td>73-74</td>
<td>101321</td>
<td>58897</td>
<td>33779</td>
</tr>
</tbody>
</table>
The main reasons of the applications being rejected by the Corporations were as follows:

(1) Scheme not feasible – technically and financially; (2) inadequate creditworthiness of borrower; (3) past record not encouraging; (4) inadequate security; (5) unsatisfactory title to security; (6) difficult position of raw materials; (7) low priority for certain industries (viz. for rice, dal, khandsari sugar) due to excess capacity; (8) sizable amount already advanced to the industry; (9) against Corporation's policy; (10) uneconomic nature of the unit; (11) other reasons – adverse reports from Directors of Industries, litigation against party, party not showing interest, or trying to defraud the Corporation, etc. Most of applications were rejected due to reasons listed at (1), (2) and (4) above.

Some SFCs e.g. Madhya Pradesh and Rajasthan have, in extreme cases, sanctioned loan applications from small scale units in as little as 1-2 week. Generally, the minimum time taken to sanction application from small units averages about 1 - 2 months (e.g. Assam, Andhra Pradesh, Jammu & Kashmir, Kerala, Mysore, Uttar Pradesh). The maximum is stated to be 3 months for Orissa, 4½ months for Kerala and Madhya Pradesh and 9 months for Gujrat.
The principal reasons advanced by SFCs for delay in sanction, to both small and other units, are - submission of defective schemes, inadequate information and inadequate arrangements for purchase of machinery, inability to submit proper accounts, delay in submission of valuation and their technical reports, legal opinion and banker's reports etc. In certain SFCs, viz. Andhra Pradesh, Assam, Bihar, Jammu and Kashmir, Mysore, Orissa, Rajasthan, Uttar Pradesh and West Bengal, Sanctions are delayed as they are given only after valuation and legal clearance.

In one instance, Mysore SFC disbursed a loan to a small unit within only 2 days of the sanction. Orissa, Kerala, Gujarat and West Bengal have disbursed similar loans in periods of 7, 13, 18 and 21 days respectively. Generally, disbursement takes on an average, 1 - 4 months after sanction e.g. in Punjab, Assam, Andhra Pradesh, Jammu and Kashmir, and Uttar Pradesh. More time is usually taken for disbursement of loans to medium and large scale units. Though Mysore disbursed such a loan within only 16 days, Orissa within 20 days and Bihar within 26 days, generally it takes 1 - 3 months. In some cases, Uttar Pradesh and West Bengal SFCs have taken as much as 15 months to disburse a loan. According to Kerala SFC, the delay was longer where loans were sanctioned prior to the establishment of the
applicant's title to the property.

The major reasons which account for delay in disbursement after sanction are:

(1) the borrower's inability to produce clear and marketable title to properties offered as securities;
(2) his inability to fulfil conditions imposed by the Board of the SFC while according sanction;
(3) delay in investigation and legal complications in regard to title deeds and completion of legal formalities;
(4) time taken in drafting mortgage deeds;
(5) delay by borrowers in furnishing required documents;
and (6) delay in importing machinery, construction of buildings etc.

If sanctions are not promptly utilised by applicants, large amounts of SFC's funds are kept idle in banks, earning low rates of interest. This is necessarily reflected in their income. The source of this difficulty might be lack of knowledge and technical skill on the part of the entrepreneurs to go ahead with their projects. This is also supported by the fairly large number of "applications rejected", "applications withdrawn" and "loans sanctioned but not to be made available". Though separate size-wise data regarding rejected and withdrawn applications are not available, they would
perhaps be largely from small units.

Borrowers experience difficulty in securing adequate assistance from SFCs and find their procedures cumbersome. Most of the prospective clients of SFCs are men with limited resources. They cannot afford the technical services of industrial consultants for preparing their projects. To expect the applicants to fill up complicated forms and answer an elaborate questionnaire without assistance is to scare them away. There is often a tendency to reject straightaway loan applications which do not satisfy the various criteria for sanction. The correct approach would be to assist the entrepreneur to modify his project in such a manner as to make it acceptable from the point of view of the SFC. Thus, SFCs should foster projects, provide guidance and assistance, and steer the different schemes until they become self-sufficient. Again, the legal processes should be made as expeditious as possible and, in the meantime, SFCs might consider granting interim loans in suitable cases as is done by IFC. An essential function of a development bank is fostering new businesses. If SFCs have to fulfil their role, they would have to take more active part in offering technical assistance in the creation and management of new enterprises and reaching out to the entrepreneurial class.
II. **Application Form:**

The forms prescribed by the Corporations are broadly of four different varieties, (i) for corporate units, (ii) for units other than corporate, (iii) for small scale industrial units, and (iv) for obtaining information on certain key items before the applicant is to complete a proper application form.

The application form for small scale industries, as suggested by the Committee set up on the recommendations of the Hyderabad Seminar on Financing of Small Scale Industries, has been adopted almost fully by only two SFCs viz. of Orissa and Jammu & Kashmir. Punjab and Maharashtra SFCs have included in this form certain other items, information regarding which is to be collected only at the investigation stage according to the Committee. The form suggested by this Committee is simpler than the forms for corporate and other units, (i) and (ii) above. But it covers all the major items, viz., the constitution and history of the concern; main raw materials required and their sources of supply; annual production and sale; details regarding fixed and working capital; borrowings; purpose of loan; and security offered.

The preliminary form (item No. 4 above) has been
adopted only in Maharashtra for small scale industrial units. It covers the more important items of the form recommended by the Committee. Where the position of the applicant as disclosed by information supplied in this form appears prima facie satisfactory and acceptable, the applicant concerned is then asked to fill the more detailed final form.

In addition to the information which corporations obtain through their application forms and discussion with the applicants, most Corporations have prescribed pre-sanction inspection forms on the lines recommended by Reserve Bank in 1960. Only Punjab SFC has made certain subsequent changes in the form suggested by the Bank, by deleting a few items and introducing certain others. Maharashtra SFC has no specific form for this, but the Inspecting Officer is expected to report on the lines of instructions given to him.

The application forms which have been devised are sufficiently comprehensive. They compare favourably with the forms received from some foreign development banks. There may be a few items, however, with regard to which the practice of foreign banks may be of significance.

Pakistan Industrial Credit and Investment Corporation has
prescribed two different preliminary application forms - a few industrial units and for existing units requiring finance for extension, balancing and/or modernisation. The two forms are largely similar, but the latter includes additional items seeking information regarding capacity, cost of production, etc. of existing units. Applicants are also expected to give information regarding affiliations of the unit with other groups, if any; experience and background of those in charge of the commercial and technical management of the factory; export potential for and past three years' imports of products to be manufactured; and sales organisation.

III. Security:

Section 25 (2) of the Act requires all accommodation given by SFCs - either as guarantees of loans and deferred payments or granting of loans and advances or subscribing to debentures of an industrial concern, to be "sufficiently secured" by "a pledge, mortgage, hypothecation or assignment of Government or other securities, stock, shares or secured debentures, bullion, movable or immovable property or other tangible assets in the manner prescribed by Regulations" or requires them to be "guaranteed as to repayment of the principal and payment of interest by the
State Government, a scheduled bank or a State Co-operative bank."

In general, a registered mortgage of fixed assets, viz. land, buildings, plant and machinery, etc. is accepted as security. Non-industrial assets too are accepted, but as supplemental or additional. Usually the SFCs' General Regulations, apart from stipulating that no loans shall be granted or guaranteed unless sufficiently secured, or guaranteed as mentioned above, also prescribe: (a) that for accommodation given under sec. 25 (2), instruments evidencing the security shall be in the prescribed form; (b) that the margins to be retained in the valuation of assets offered as security shall be as considered reasonable by the Executive Committee or Board; (c) that the earning capacity and prospects of the concern, the efficiency of its management, etc. must be considered in determining the margin; and (d) that instruments evidencing security must stipulate that if the value of assets pledged etc. falls, the borrower may be required to furnish additional security as determined by the Executive Committee.

The General Regulations or the statute do not specifically provide for taking personal guarantee, but it is generally taken from directors, managing agents,
partners, etc. of loanee as a matter of business prudence. The Seventh SFCs' Conference recommended that SFCs might waive this condition for well-established concerns with good management and past performance. Some SFCs retain a charge on liquid assets e.g. stock-in-trade, book debts, stores, etc. At the Ninth SFCs' Conference, State Bank representatives stated that such a charge makes it difficult for banks to grant working capital loans, and long term loans should be secured with only fixed assets. It was explained at the Conference that SFCs did not normally take liquid assets as security, and in cases where they did so, they would have no objection to release them if borrowers so desired. It may be recommended that mortgage deeds obtained by SFCs may, as far as possible, provide that their charge over liquid assets would rank after the charge of commercial/co-operative banks providing working capital loans.

Ordinarily SFCs grant loans upto 50% of the value of assets accepted as security. Some have relaxed this, especially for loans to small units: (a) Andhra Pradesh - margin has been reduced to 25% on new machinery and 40% on buildings owned by units in industrial estates; (b) Bihar and Punjab - 40% in respect of sound and feasible schemes; (c) Gujarat - relaxed upto 35%; (d) Maharashtra - 25% in
deserving cases; and (e) Madhya Pradesh and Mysore - 25% of the loan is eligible for guarantee under the Credit Guarantee Scheme. Madhya Pradesh has also brought down the margin for other loans from 50% to 40%.

As regards loans to small units out of Government funds under agency arrangements, the margin is generally 25% as provided in the Rules framed under the State Aid to Industries Acts in some States e.g., Maharashtra, Gujarat, Mysore and Rajasthan.

Chambers of Commerce and Associations have suggested some further relaxations in regard to security, viz: (i) In view of import restrictions, second-hand machinery should also be accepted as security. Of course, no data are available, it seems that SFCs do sometimes accept such machinery, particularly for small units. The point is valid. SFCs may examine it for further relaxations, (ii) Hypothecation of machinery spares and machinery stores along with the main plant should not be insisted upon, (iii) Personal guarantees should not be insisted upon, if adequate security is available. But SFCs do not universally insist upon such guarantees, and even banks take them. In cases of concerns with good past record, specially joint stock companies, this requirement may,
no doubt, be waived. Such guarantees are, of course, necessary for loans to proprietary and partnership concerns.

IV. Valuation of Assets:

Valuation of assets is also of great importance. Generally there are three methods of valuation, viz., (i) book value, (ii) current market value as estimated by experts, and (iii) replacement value less depreciation for the number of years the asset has been used. The practice of different SFCs especially for plant and machinery, is as follows: (a) Andhra Pradesh - book value, engineers’ valuation or market value, whichever is lower; (b) Assam - normally market value; (c) Bihar - original cost less depreciation, (d) Gujarat - for new machinery, cost of components and manufacturing cost of machinery; existing machines are valued at book value minus depreciation for number of years in use; (e) Jammu and Kashmir - market value less depreciation; (f) Kerala - final valuation on the basis of original or purchase price less depreciation; (g) Madhya Pradesh - for new machines, cost (including erection charges) as per books of accounts and for old ones, market value after taking into account the number of years used; (h) Madras - new: invoice value (including all charges for erection etc.); used: replacement
cost less depreciation; (i) Maharashtra - new machinery is valued on the basis of written down value in the audited balance sheets; in case of inadequate depreciation, it is worked out at the rate of 10% per annum; valuation of second-hand machinery is done on the basis of expert opinion; (j) Mysore - based on age, working conditions, etc., (k) Orissa - on the basis of cost as shown in suppliers' invoices less depreciation; (l) Punjab - depreciated or assessed value, whichever is less; (m) Rajasthan - old plant and machinery are valued after allowing depreciation at the Income Tax Department rates; for new machinery, cost price as per suppliers' invoice is taken; for non-standard or fabricated machinery, assessors' valuation is taken; (n) Uttar Pradesh - invoice value plus freight, duties, insurance, transport and erection charges in respect of new machinery; replacement value less depreciation in case of old, after taking into consideration condition of the machinery, maintenance and upkeep, etc.

Some of the SFCs' Conferences have discussed this question. The First Conference suggested that the adoption of "Book Value" might not be appropriate where a concern had written down the value of an asset to a nominal figure though its market value might be much higher. It might also be contended that "market value" at a particular time may
not afford a proper basis to adopt for term loans, repayable over many years. It was generally agreed that a combination of one or more of these bases of valuation was desirable to safeguard the interests of SFCs and also the borrowers. The matter came up again at the Third Conference. The Seventh Conference discussed if, for urban land and buildings, market value should be considered, and if the capital value of assets should also include items like installation charges, technical know-how fees and interest on borrowed funds during construction. It was decided not to lay down any rigid policy.

A question which often arises is whether the practice of taking fixed assets at depreciated book value does not unduly undervalue them in relation to what they may fetch in the unlikely event of a foreclosure of the loan, and the disposal of the assets as part of a going concern. Plant and machinery are generally depreciated annually (particularly by limited companies) at rates allowed by the Income Tax Department, which in most cases is about 10% or more. After some years, the book value of a machine may be very nominal though its market value may yet be appreciable if well maintained; if such assets are taken at the depreciated book value, the security offered may not be adequate for credit required by the borrower. It may, therefore, be
necessary to consider the market value of the security also in deserving cases.

In States like Assam, Mysore, Punjab, Madras and Uttar Pradesh, there is no difficulty regarding the clarity of title to land offered as security. In others, viz. Andhra Pradesh, Rajasthan and Jammu & Kashmir, difficulty arises in areas where agricultural lands can be alienated only with sanction from revenue authority. In Bihar, the difficulty is stated to be only for leasehold or mining lands; in the former case, borrowers must get the rights of sale and transfer assigned in their favour, and in the latter, to get Government's permission to mortgage mining lands to the SFC. In Madhya Pradesh and Gujarat, title deeds are not easily available in areas of old princely States and the diversion of land to non-agricultural uses is a lengthy legal process. In Orissa, difficulty arises for land situated in areas which have yet to be surveyed and settled. In some areas, interest in land cannot be transferred because of special local systems of land tenure. For agricultural land, the Land Reforms Act there may also prejudice the interests of SFCs. State Governments have taken up survey and settlement operations in areas where SFC experiences
difficulties and are examining how far the Land Reforms Act is prejudicial to the Corporation's interests. In Kerala, recent land legislation has upset most titles to land.

In order to remove difficulties in establishing clarity of title to land, it has been suggested by one SFC that suitable legislation may be enacted to declare a title valid if it is clear for 10 to 15 years. But fairly long periods of limitation are prescribed for enforcement of claims in respect of immovable property, hence this suggestion cannot be accepted. A mortgage created about twenty years earlier may still be subsisting, if it has been kept alive by the mortgagor. In case, a Government have some interest in the property, it has sixty years within which to enforce its right. This suggestion involves cutting down substantially the periods of limitation now allowed for enforcing rights and is, therefore, extremely unlikely to be accepted. Except in cases mentioned above, there does not appear to be much difficulty elsewhere about the clarity of title to land. In places, where it is not quite clear, State Governments may take suitable steps to remove the difficulties.

The Sixth SFCs' Conference requested Reserve Bank
to examine the difficulties of Bombay SFC in assisting units situated on rented premises or premises not assignable to it, due to the provisions of the tenancy law. The Bank advised as follows:—The General Regulations of SFCs require that, in granting accommodation reasonable margins are to be maintained, taking into account, the managerial competence, earning capacity and prospects of the concern, etc. If reasonable margins are maintained to the satisfaction of SFCs, loans given on the security of assets mortgaged by such concerns can be deemed to be "sufficiently secured" within the meaning of section 25 (2). Again, the machinery installed in the premises of the type under consideration could, if it is immovable property, be mortgaged to the Corporation by registered deed, thereby creating an effective security in its favour. It could not be said, therefore, that loans to such concerns granted on the above basis were insufficiently secured.

Advances to such concerns presented some difficulties. In case of default, the SFC would not be able to exercise all its rights under the SFCs Act, especially, to have possession of the premises. It was felt that these legal impediments need not come in the way if plant
and machinery offered as security belonged to the "movable" category, provided the earning capacity, management, etc. of the concerns were good. The Bank noted that there was no difficulty in accommodating such concerns and felt that the question of requesting the State Government to review the tenancy laws in this connection would arise only if there were requests from such concerns for advances which the SFC was unable to meet because of the above-mentioned considerations. The Maharashtra Government took note of these difficulties. To facilitate the making of advances to units on rented premises, in March, 1961, Government issued a notification permitting the transfer or assignment of any lease-hold premises (irrespective of the period of the lease) to the SFC or the State Government as part of or incidental to a mortgage of any lease-hold premises, including the factory thereat, by an industrial concern eligible for assistance under the SFCs Act or the State Aid to Industries Rules.

V. **Appraisal:**

Unlike short term working capital loans which require only short term forecasts, quick turnover and
easy liquidity, inherently greater risks are attached
to term loans which must be dealt with by special skills.
It is much more difficult to estimate a borrower's
creditworthiness 10 to 12 years ahead than over a short
period of 6 to 12 months. The factors relevant to credit-
worthiness are substantially different over the longer
period. The capacity and experience required in the
appraising personnel for assessing them are of a different
order.

(a) **Security:**

Many prospective borrowers and even loan officers
believe that if sufficient security is offered, the credit
institution ought to make the loan without question. It
may be emphasised that security does not improve the
credit although it reduces the risk. In most cases, the
need for security, rather reflects some weakness in the
credit. Security makes the lender a preferred creditor,
but does not necessarily make the loan a wise one. Basi-
cally, a long term lender wants to get his money back
from the normal operation of business, after it has served
the purpose for which it was borrowed, but he does not
want to have to take over the security and liquidate the
business. Again, unlike self-liquidating commercial loans against the security of commodities, stocks, shares, bills receivable, etc. term loans to industries are granted mainly against the security of fixed assets not intended for resale but to be used for production. Thus, the repayment of a loan should come not from the sale proceeds of the assets forming security but from the earnings of the concern. Further, fixed assets are difficult to dispose of even in good times. Their forced sale might fetch meagre value. Secondly, term loans are not repayable on demand but according to a schedule of repayment extending over a number of years and thus the ability of the lender to convert the assets into cash is restricted. Thirdly, the lender has less control over the security as it all along remains in the possession and use of the borrower, and the lender does not have the same freedom to deal with it as in the case of an effective pledge of movables. Thus, unlike short term commercial loans, in the case of a term loan the lender cannot remain satisfied with the secured nature of the advance and current prices of the items of security. He has closely to examine the feasibility of the project while sanctioning the loan and to watch the prosperity of the industry and concern himself with the activities of the
borrower throughout the currency of the loan. This does not mean that no security should be obtained. It is usual to obtain as security a mortgage of the physical assets of an enterprise while lending on term basis. Thus, the security requirements may be relaxed or waived in deserving cases having regard to other relevant factors.

More concern with earning prospects and less with security will open the way for SFCs to help deserving enterprises, specially new ones which may not be able to provide conventional security or guarantee but have an acceptable scheme and are managed by technically qualified and competent persons. Obtaining maximum security, reduces the range of flexibility of SFCs and causes a stress upon caution in loan policies, which impedes progress.

Unless the borrowing company has a very strong balance sheet - this is unlikely in the case of smaller industries with which SFCs mostly deal - the only valid test of ability to repay at the end of a long term is appraisal of long-range earning power. Over a period of years, only the continuation of satisfactory earnings will maintain the balance sheet position, and poor earnings can cut away assets rapidly. The ability to appraise future earning power is needed for sound evaluation of term loans.
It can also be fashioned into an effective competitive weapon. The lending agency which employs the earning appraisal method in processing term loans is not only in a position to offer such a loan more soundly but also more competitively.

The necessity for assessment of the financial soundness of the venture assumes greater importance in the case of small scale industries. Small scale units, generally, do not maintain proper accounts. Even if they maintain them, they are unwilling to disclose them. Often, the books are not kept up-to-date. The balance sheets and profit and loss accounts are in many cases out of date and, therefore, do not offer much guidance to the present condition of the business. Whatever the conditions, the importance of a study of past performance, present financial position, and future prospects cannot be ignored. The maintenance of proper and up-to-date accounts is important not only from the point of view of a lender but also of the borrower himself who should know his precise position to plan future programmes of production, expansion etc. Hence there should be a drive for mutual understanding and persuasive effort on the part of the lender which may mean offering a sort of guidance to the borrower to maintain his books in the acceptable form.
(b) Project Analysis:

It is necessary to have full knowledge regarding the scheme, in respect of which the loan is sought. It may either be to establish a new unit or for the expansion, modernisation, etc. of an existing one. The scheme generally indicates the various requirements of fixed and working capital and how the expenditure thereon is to be met, the various sources from which the funds are proposed to be raised, the components of raw materials and their supply position, the prospects of the industry and the economics of working, showing the expected profits and availability of cash for repayment of the loan. It requires careful planning and budgeting and as such it is necessary that the scheme should be drawn up by, or in consultation with, persons sufficiently experienced in this line. Smaller units do not often prepare such schemes but estimate their requirements in a haphazard manner. The result is that sooner or later snags become apparent, and either the project has to be scrapped halfway or, if completed, its working becomes uneconomic and unremunerative. An examination of the scheme in its technical, economic and financial aspects, must, invariably be made.
(c) **Debt-equity Ratio:**

Normally, the main source of financing fixed capital requirements of an industrial unit is equity capital and it is essential to require an entrepreneur to put up substantial matching funds. Ordinarily, a debt-equity ratio of 1:1 is considered satisfactory though in deserving cases some relaxation may be allowed. A unit's borrowings should not be disproportionately large as compared to its equity base, as the weight of such borrowings may be too heavy for a unit to bear and affect the ultimate recovery of the term loan out of future profits. Again, reasonable entrepreneurial stake is an essential requirement. A lender should not have too large an interest in the success of a business. Sufficient proprietary stake ensures a more cautious and purposeful handling of the affairs of the management. Further, adequate equity imparts greater flexibility to the operations of the units and improves their shock-absorbing capacity or provides a cushion against adverse circumstances which cannot be anticipated when granting the loan. Market demand for the goods manufactured by the unit might dry up or there might be delays in the recovery of sale proceeds.
(d) Loan supervision and follow up:

It is necessary to scrutinise the execution and operation of the project which is to be financed by the lending institution. The object of such supervision is to keep the institution informed of progress, and to provide opportunity for advice in anticipation of difficulties and for assistance if trouble ultimately arises. In the case of new enterprises, or during the initial period of the loan, reports should be called for more frequently than in the case of established enterprises with a satisfactory history of successful operation. Periodical inspections may be conducted more frequently in the case of risky or new enterprises or where difficulties have arisen.

(e) Enterprises in difficulty:

Sometimes some enterprises fall into difficulties. Sometimes it is sufficient to reschedule principal and interest payments. Sometimes the enterprise is persuaded to engage competent technicians who can diagnose and cure the trouble. It may also be necessary for the lending institution to dispose of the assets in order to save its investment. The decision to try to keep an
enterprise going on, of course, influenced by the salABILITY of the assets. Where the assets are difficult to dispose of it might be necessary to make efforts to rehabilitate the enterprise by putting in new management, working out a financial reorganisation, assisting in devising new marketing arrangements, etc. There will be less difficulty in the case of a standard enterprise which has failed, as purchasers are readily attracted to take advantage of trained labour and the possibility of acquiring assets at a considerable saving.

A SFC is expected to evaluate a credit risk by taking into account the management, and economic and financial risks. Each of these should be weighed in relation to the others and should be considered in connection with the size of the commitment, the length of time it is to run and the economic desirability of the transaction. There is no one easy road to the evaluation of credit risk as circumstances alter the approach in each case. In fact, a safe loan is that which is free from ultimate loss. A sound loan is a safe loan that can be repaid within its maturity terms without hardships or stress on the borrower. It is not enough for a loan to be safe; it must also be sound. A borrower must not only have adequate financial strength or adequate security, he
also have adequate repayment ability.

Appraisal by SFCs is of importance to keep down administrative expenses and, thus reducing losses, almost all SFCs have avoided recruiting the minimum technical personnel necessary for appraisal as well as follow-up and supervision during the currency of the loan. Each lending institution should have a minimum complement of one team consisting of trained and experienced persons from each of the three fields - engineering, industrial economics and accounting, at a fairly senior level.

SFCs have tended to concentrate their advances in the traditional sectors of industry, and to avoid the less known but newer types of activity. In order to tone up the industrial structure and to gradually pave the way for a greater diversification of exports, the unorthodox sectors of industrial activity are to be consciously encouraged by SFCs.

In the existing set up, SFCs tend to put excessive emphasis on the security aspect of the propositions placed before them rather than on their economic viability. They seem to associate the repayment of their loans with the sale of security; but assets offered as security are
often difficult to dispose of as they do not ordinarily have a ready and regular market.

Lastly, when applications are passed through the sieve of a proper appraisal procedure, units which have higher growth potential and profit earning capacity will be separated from the others and it will pay the Corporations to concentrate their resources on such propositions. These would repay the loans earlier than others and capital formation would generally be quickened.

It has been demanded that SFCs should relax their security requirements and criteria. Suitable suggestions in this direction might be freeing liquid assets from mortgage charge, adopting more realistic and borrower-oriented basis for valuation of securities, removal of difficulties to the title of land in certain areas and the like. As these recommendations are implemented, there should be considerable relief, and SFCs would be able to function more expeditiously.

SFCs should also soften the rigour of the tests they apply for assessing their borrowers. They should bear in mind that no lending operation can be undertaken without a certain element of risk. And as the sector to which they cater is relatively weak, they should, in their
financing decisions, place more emphasis on the prospective profitability of the project to be financed than on security. If they are convinced that the project is economically viable and the borrower satisfied the tests of technical competence and personal integrity, a less rigid attitude on their part will be called for. There will be, of course, certain limits beyond which it is not possible to proceed, since the borrower must have a minimum stake in his concern, and there will always tend to be an aura of uncertainty about the future of a concern, or the realisable value of its assets if the concern has to be wound up, which surrounds even a detailed appraisal report. One way of helping a deserving entrepreneur starting a new business would be to allow some relaxation in the margin requirements, which will enable him to have a larger margin for manoeuvre in the difficult early years of operation. This will also enable him to utilise some portion of the loan to meet his requirements of working capital, which a commercial bank may not be willing to provide until he has established himself in business.

It is also to be noted that SFCs were specifically set up to finance small and medium-sized units which cannot turn elsewhere for the credit they require except at a very high cost. There is increased pressure on the
resources of the larger financing agencies like IFC and ICICI, as large borrowers now prefer to go to them rather than to the capital market which is in a bad shape. Commercial banks have no doubt taken some interest in terms lending lately, but their capacity is bound to remain limited so long as they do not have surplus funds after meeting the working capital needs of industry. Under the impact of accelerated development plans and the emergency, demands on term lending institutions are expected to grow rapidly in the near future. SFCs’ success in facing this challenge will depend on how promptly and adequately they meet the changing needs of a growing economy. If they fail, they will have lost an opportunity to contribute to industrial development and in the process grow into strong institutions. For meeting the credit needs of small scale units, many of which are not good risks, SFCs should make greater use of the Credit Guarantee Scheme for small industries. This scheme has been extended to the whole of the country and would help SFCs to minimise the risk of this business.

The main aim of SFCs should be to see that the units they assist become viable in due course. The capital resources of the country are too scarce to be wasted on inefficient units. SFCs should, therefore, equip them-
selves fully to undertake post-credit services and should insist that their clients adopt modern productivity techniques. Credit is an important but not the only element and a too exclusive emphasis on credit alone is likely to lead to the establishment of units which become a drag on the economy and create more problems than they solve. There is, therefore, a great need for an integrated approach to the development of small industries.

To some extent the rigid attitude displayed by SFCs as revealed by their past operations has been the direct result of the provision of section 25 (2) of the State Financial Corporations Act, which provides for loans, guarantees, etc. to be made against sufficient security or guarantee. This statutory provision has led SFCs to obtain maximum security irrespective of the prospective profitability of the applicant concerns or the competence of their management, thus reducing their range of flexibility and forcing them to exercise excessive caution which has impeded their progress. This statutory provision may be amended by substituting the existing section 25 (2) by the following:

"Section 25 (2) - In determining whether or not
accommodation shall be provided under clauses (1), (b) and (g) of sub-section (1), regard shall be had primarily to the prospects of the operations of the industrial concern and the accommodation shall be secured by tangible security or guarantee of the State Government, a scheduled bank, a State Co-operative bank or others to the extent which may be considered by the Board to afford a reasonable protection."

To relax the present statutory provision does not mean that SFCs would lend without adequately protecting their interests. It actually means that in deserving cases, the directors will have the necessary manoeuvrability to accommodate new projects and the new class of entrepreneurs struggling to find a place in the industrial map of the country. They may also accommodate small scale industries which are often unable to provide conventional security but have an acceptable scheme and are managed by competent persons. Development banking means taking risks. Where the statute ties the institution down, progress is bound to be slow. Similar provisions may be observed in the constitutions of the Industrial Development Bank of Canada and Commonwealth Development Bank of Australia. If this suggestion is accepted, the SFCs will grow into proper development banks.
**Lending Rates:**

In the beginning, the few SFCs, then functioning, charged interest on their loans at 6% to 6 1/2% per annum, net, with a loading of one-half of one percent for late payment. Some SFCs like those of Punjab and Assam had two different rates depending on the size of the loans — in 1954 and 1955, the net rates in Punjab were 6 1/2% for loans below Rs. 2 lakhs and 6% for larger loans. During 1956-58, Assam charged 7% net for loans below Rs. 1 lakh and 6% net for larger loans. Orissa introduced a similar differentiation, but in 1962, those below Rs. 2 lakhs paid 6% net and others 6 1/2% net. Punjab SFC linked the lending rate with the Bank Rate. From 1st May, 1957 to 6th February, 1958, the lending rate was 2 1/4% above the Bank Rate, subject to a minimum of 6 1/2%. On 16th May, 1957, the Bank Rate was raised from 3 1/2% to 4%. In February, 1958, the lending rate became 3% above the Bank Rate, subject to a minimum of 7%. After the Bank Rate was raised to 4 1/2%, the rate was fixed at 7 1/2% net. Uttar Pradesh SFC has such a link since 1962; 3% above Bank Rate, subject to a minimum of 7%.

A considerable measure of uniformity has now been reached. The usual rate for all SFCs is 8 to 9% net, with a loading of 1/2% for late payment.
The R.B.I. increased bank rate from 6% to 7% per annum with effect from 1st June, 1973 and the IDBI revised its refinance rates effective from 16th June, 1973. Consequently, the cost of borrowings for the Corporation from RBI and IDBI increased by 1% per annum. It, therefore, became necessary for the Corporations to revise its lending rates so as to retain a reasonable margin between the cost of borrowing funds and its lending rates.

SFCs were actually meant to provide funds which otherwise were not available. They were not to subsidise industry by financing them at lower than the economic rate. Even such margins as SFCs now have are likely to be further reduced. Their effective borrowings rate by means of bonds, including all expenses, is already above 5%. This rate will go further up if institutional investors who make up the bulk of the investors for these bonds are to be attracted.

Taking all these factors into consideration, the present lending rates require to be adjusted to allow the Corporations to have a margin of at least 2½%. It may be argued that industrial units may not be able to bear the higher rate. But the incidence of interest on the
cost of production is small and the rate of profit in a controlled economy is high. Industrialists are prepared to pay even 9% to 9 1/2% on preference shares and a slightly higher rate on their borrowings is not likely to affect them adversely.

Charges other than interest:

It is generally alleged by small borrowers that SFCs levy disproportionate charges for such items as application fees, valuation, legal examination of documents, etc. These charges may be grouped under the following heads:- (i) application, (ii) technical appraisal, (iii) valuation, (iv) legal scrutiny, (v) inspection, (vi) commitment, (vii) stamp duty, (viii) registration charges and others. Apart from stamp duty and registration charges, governed by State Government rules, there is the variety of bases that is adopted for them. This results in their different incidences. The following is a brief description of these charges: -

Application fees:

Eight SFCs make no charge. Two others charge only nominal amounts. The rest four SFCs and TIIC charge
on the basis of the amount applied for, but in very different ways. TIIC and Mysore levy consolidated fees for application, technical advisers, valuation and legal scrutiny.

**Technical advisers:**

In West Bengal, Kerala and Bihar, there is no schedule of charges; borrowers pay ad hoc amounts, if necessary. In Uttar Pradesh, they are charged travelling allowance for SFC and State Government employees at prescribed rates; for others, actual expenses incurred are recovered.

**Valuation:**

In addition to fees of technical advisers, Uttar Pradesh SFC recovers travelling allowance charges or actual expenses, as the case may be, for valuation. In West Bengal, Kerala and Bihar ad hoc amounts are charged, being usually 25 paise in Bihar. Elsewhere, there are varying schedules, depending upon the assessed value of property and its nature.

**Legal fees:**

Regular rates are laid down by only a few
Corporations.

**Inspection charges:**

Schedules have been prescribed only in Rajasthan and Punjab. Bihar has detailed rules for presanction inspection and periodical post-disbursement inspection. Elsewhere, either no charges are levied or travelling expenses are recovered.

**Commitment charges:**

The bases and rates of these charges vary from Corporation to Corporation.

**Stamp duty and Registration charges:**

Rates vary from one State to another.

**Other charges:**

The only other charge mentioned is the guarantee fee of 25 paise % under the Credit Guarantee Scheme.

The following schedule shows some of the charges
for small and large concerns:

### Schedule showing average charges by SFCs

<table>
<thead>
<tr>
<th>Charges</th>
<th>Small Concerns</th>
<th>Large Concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Application fee:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kerala</td>
<td>971</td>
<td>898</td>
</tr>
<tr>
<td>Madras</td>
<td>725</td>
<td>113</td>
</tr>
<tr>
<td>Mysore</td>
<td>1376</td>
<td>632</td>
</tr>
<tr>
<td><strong>Technical Advisers:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kerala</td>
<td>542</td>
<td>209</td>
</tr>
<tr>
<td><strong>Valuation:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assam</td>
<td>119</td>
<td>84</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>317</td>
<td>130</td>
</tr>
<tr>
<td>Madras</td>
<td>174</td>
<td>34</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>277</td>
<td>113</td>
</tr>
<tr>
<td>Punjab</td>
<td>282</td>
<td>58</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>122</td>
<td>67</td>
</tr>
<tr>
<td><strong>Legal Scrutiny:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bihar</td>
<td>282</td>
<td>30</td>
</tr>
<tr>
<td>Kerala</td>
<td>97</td>
<td>70</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>134</td>
<td>56</td>
</tr>
<tr>
<td>Madras</td>
<td>130</td>
<td>14</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>1257</td>
<td>382</td>
</tr>
<tr>
<td>Punjab</td>
<td>134</td>
<td>27</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>111</td>
<td>63</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>100</td>
<td>65</td>
</tr>
<tr>
<td>West Bengal</td>
<td>694</td>
<td>481</td>
</tr>
</tbody>
</table>
The outstanding feature of these charges is their uniformly heavier incidence on small borrowers. This is primarily due to the adoption of the slab system, with a minimum charge payable by all borrowers up to a specified amount applied for, with decreasing proportionate charges in the higher slabs. These figures, of course, do not exactly reflect the absolute magnitude of those charges, the relative incidence on small and large borrowers will show the same tendency even if all the relevant statistics are taken into consideration.

This is as regards the relative incidence on small and large borrowers for any one Corporation. The figures also indicate fairly substantial variations among the different Corporations. Attempts should be made to reduce these differences and bring the rates to a more comparable basis. Taking all the charges together, their average incidence on small and other borrowers are 2.5 and 2.0 percent respectively. In the case of the small borrowers, the incidence is more than these figures indicate as most loans to them are for much smaller periods than those to other borrowers.

Registration charges and stamp duty levied by the State Governments generally bear almost equally on
all borrowers except in West Bengal, Maharashtra, Bihar and Punjab where the incidence seems heavier on small loans.

In a note submitted to the Hyderabad Seminar, Shri B.N. Mehta, Legal Adviser, Reserve Bank of India, had suggested that as far as loans to small units were concerned, State Governments might, under Section 9 of the Indian Stamp Act, or any corresponding law in force, remit or reduce stamp duty payable on mortgage deeds; and they might be enabled to remit or reduce registration charges.

Later, directed by the Small Scale Industries Board, the matter was taken up by the Committee on Credit Facilities, which set up a Sub-committee to examine the pattern of stamp duty, registration fees and other charges levied on loans to small scale units, and make suitable recommendations. These recommendations, endorsed by the main Committee, were as follows:

The following documents should be supplied free of cost by the authorities concerned - (i) valuation certificate in respect of land and buildings, (ii) non-encumbrance and title to property certificates in respect
of land and buildings, (iii) drafts of mortgage deeds and surety bonds and/or guarantee bonds. It also suggested the maximum rates of stamp duty on (a) personal bonds, (b) surety or guarantee bonds, and (c) on mortgage deeds. For mortgage deeds, it had suggested complete exemption for loans up to Rs. 5,000. The sub-committee also suggested the exemption of personal bonds, surety bonds and/or guarantee bonds from registration fees and certain maximum registration fees on mortgage deeds. It had also suggested that other incidental charges for documents, copying charges, legal fees, etc. should not be levied at rates higher than the following:—

(a) on personal bonds, surety bonds and/or guarantee bonds — nil and (b) on mortgage deeds, at Rs. 10.15 P.

The Small Scale Industries Board considered these recommendations and decided that instead of the uniform and liberal scales of stamp duty, etc. suggested by the sub-committee, as the existing rates differed widely in the various States, it would be more desirable to recommend that for loans to small units, the States charge only 50% of their normal rates. It also endorsed the recommendation for the free supply of (a) valuation and non-encumbrance certificates in respect of land and
buildings and (b) draft of mortgage deeds and surety bonds and/or guarantee bonds. The working group on the Appraisal of Applications for Term Loans also recommended that pending an amendment of the statute, the States may consider allowing reduction in the stamp duty and registration charges on loan documents.

These recommendations were sent by Central Government to the States for implementation. The present position seems to be: Valuation Certificates in respect of land and buildings and draft mortgage deed are supplied free of cost in Assam, Delhi, Himachal Pradesh, Jammu & Kashmir, Orissa and Rajasthan. In Delhi, Himachal Pradesh, Orissa and Rajasthan, non-encumbrance certificates in respect of land and buildings and surety and guarantee bonds too are supplied gratis. In Himachal Pradesh, Jammu & Kashmir and Rajasthan, small units assisted under the State Aid to Industries Act pay no or reduced stamp duty and registration fees on loan documents. Efforts should be made by all State Governments to implement the recommendations of the Small Scale Industries Board at an early date.

**Loans and Advances:**

Loans and Advances form the most important item
of the total assets of SFCs. Some of the SFCs have made some loans to small scale industries under the State Aid to Industries Act out of funds provided by the State Governments. Ten SFCs disbursed Rs. 6.3 crores by way of such loans. The following statement shows the amount of the outstanding loans by SFCs during the last five years:

Table showing outstanding loans of the SFCs
(from 1969-70 to 1973-74)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>776</td>
<td>948</td>
<td>1136</td>
<td>1356</td>
<td>1582</td>
</tr>
<tr>
<td>Assam</td>
<td>429</td>
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<td>457</td>
<td>480</td>
<td>528</td>
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<tr>
<td>Bihar</td>
<td>336</td>
<td>406</td>
<td>502</td>
<td>667</td>
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<tr>
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<td>329</td>
<td>475</td>
<td>558</td>
<td>672</td>
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<tr>
<td>Gujarat</td>
<td>803</td>
<td>1213</td>
<td>1576</td>
<td>2058</td>
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<td>607</td>
<td>651</td>
<td>802</td>
<td>997</td>
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<td>28</td>
<td>78</td>
<td>127</td>
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<td>171</td>
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<td>Jammu &amp; Kashmir</td>
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<td>217</td>
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<td>251</td>
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</tr>
<tr>
<td>Kerala</td>
<td>489</td>
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<td>765</td>
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<td>1200</td>
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<td>Madhya Pradesh</td>
<td>625</td>
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<td>703</td>
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<tr>
<td>Mysore</td>
<td>660</td>
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<td>1088</td>
<td>1371</td>
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<td>Punjab</td>
<td>399</td>
<td>473</td>
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<tr>
<td>Rajasthan</td>
<td>457</td>
<td>513</td>
<td>616</td>
<td>747</td>
<td>929</td>
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<tr>
<td>TIIC</td>
<td>1410</td>
<td>1601</td>
<td>1914</td>
<td>1966</td>
<td>3140</td>
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<tr>
<td>Uttar Pradesh</td>
<td>502</td>
<td>677</td>
<td>1024</td>
<td>1411</td>
<td>1687</td>
</tr>
<tr>
<td>West Bengal</td>
<td>677</td>
<td>710</td>
<td>715</td>
<td>719</td>
<td>728</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>10481</strong></td>
<td><strong>12881</strong></td>
<td><strong>15689</strong></td>
<td><strong>18484</strong></td>
<td><strong>22792</strong></td>
</tr>
</tbody>
</table>

Amounts in lakhs of rupees.
DIAGRAM SHOWING OUTSTANDING LOANS OF SFCs FROM 1969-70 TO 1973-74
(AMOUNTS IN LAKHS OF RUPEES)
Advances to small units:

In advancing loans to small units, the Corporations have generally stuck to the more "traditional industries and to industries for which the process of production are relatively simple, and do not require detailed scrutiny of the proposals at a relatively advanced level of technical expertise, and for which machinery as well as raw materials are more readily available, often internally.

Advances to other units:

Loans in the group "Food Manufacturing Industries" account for 20% of the total for SFCs, and 16% of the total for all Corporations. The total amount of this group is well distributed among sugar, tea, cold storage and miscellaneous food preparations.

The next most important group, in this case very much more important than for small units, is textiles which have taken up 17% of the outstandings of SFCs. Percentage of total outstanding in respect of other units was as follows: - Manufacture of chemicals and chemical products 8%; Manufacture of machinery except
electrical machinery 9%; Manufacture of non-metallic mineral products 5%; Basic metal industries, of which iron and steel basic industries 6%; Manufacture of transport equipment 5%; Manufacture of paper and paper products 4%; Manufacture of metal products except machinery and transport equipment 3% and Manufacture of electrical machinery 4%.

Viewed against the background of even such limited measure of diversification of the industrial structure of India which has been attained since Independence, these Corporations have not contributed significantly to this achievement. They have shied away from the newly developing industries. The reason is that perhaps understandable inclination of their management to take up for assistance units in such industries for which the processes of production are relatively simple, and do not require very detailed scrutiny of the proposals at an advanced level of technical expertise. It may be the result of four other considerations:— (1) the lack of technically qualified persons on the staff of these Corporations to appraise proposals from the less well-known sectors of industrial activity, or of sufficiently effective arrangements for such appraisal by outside bodies;
(2) in most cases, applications from "non-traditional" sectors would be, ex definitione, from newly set up units, often yet to be engaged in manufacture - but it was not till 1955 that industrial units "to be engaged" in manufacture, etc. were eligible for assistance from SFCs; (3) as the financing of "non-traditional" industries sometimes entails more risks, SFCs with their meagre resources and dead weight of subvention liabilities may have preferred to concentrate on safer business instead of branching out into unknown fields; and (4) the absence of underwriting and of direct subscription to the equity of borrowing concerns - facilities which newly set-up units greatly value, and the provisions of which must have contributed significantly to the success of ICICI in directing much of its assistance into the newly developing sectors of industry which also seem to possess a high growth potential. But the success of ICICI is also due to a few other factors, viz. large scale operation, availability of foreign exchange, and of a large, long term, interest-free loan from Government - none of which applies to SFCs. The availability of foreign exchange often holds the key to starting industrial units in most of what was designated as the "non-traditional" sector of industry. The availability of the interest-free loan emboldened ICICI
into financing new units and taking up their shares which may give little or no returns in the first few years: the dividend paying capacity of ICICI itself was fully underwritten by the returns on interest-free loan.

Grant of loans for working capital:

The question of providing working capital loans was considered at the SFCs' Conferences of 1954 and 1955. It was held that while there should be no objection to granting such loans in appropriate cases, there should be no overlapping of functions between SFCs and commercial banks. SFCs normally provide working capital only in appropriate cases e.g. where it is not forthcoming from banks etc., the unit concerned is well-organised and counts in the economy of the State and its products command a ready market. The second SFCs' Conference of 1955 evolved a formula for such loans so that well-managed and financially sound concerns did not experience much difficulty in obtaining working capital from banks. There should be no competition with banks. It was laid down that where the loan from SFCs was primarily for block capital, the working capital constituent should not exceed 25% of the total amount applied for. Loans, primarily for working capital
could be given only if the concern failed to obtain it from banks.

Since then the situation has changed much. In the context of continuing pressure of demand for bank advances from all sectors, the assumption that working capital loans from SFCs would mean encroachment in the business of banks, has lost much significance. Also, as the supply of many raw materials has been uncertain from time to time, manufacturers have often to hold larger stocks to ensure fuller utilisation of capacity. At the same time, higher prices make it difficult to finance such inventories. So the provision of relatively longer term working capital is now more important, especially for newly set-up units. Accordingly, the Eighth SFCs' Conference laid down the following general principles, leaving it to the Corporations to adjust them where necessary:

I. **Considerations for the grant of working capital Loans:**

   The goods manufactured by the concern are of standard quality and have a ready market which is not temporary or transient for a new concern, initial working capital is required to hold the necessary minimum level of
raw materials, stores and finished goods. The unit belongs to a category of high priority or importance from the point of view of industrial development in the State. It is partly lying idle for lack of working capital. The loan is required to provide margin for accommodation from banks against raw materials and finished goods. The nature of industry is such that short term finance granted by banks is not suitable and the working capital is needed for a period of at least 2 to 3 years.

II. Conditions subject to which loans for working capital may be sanctioned:

The loans should be secured primarily against block assets, and should not be of the nature of cash credit arrangements. When the loan is required for working capital in combination with block capital, the portion of working capital should not ordinarily exceed 50% of the total amount of the loan. Loans primarily for working capital should not ordinarily be for periods exceeding 5 years. The loans should not be such as to encourage overtrading.

Generally there is a demand for working capital along with block capital loans. Most SFCs give as working
capital either 25% of the block capital or an amount equal to the estimated working capital requirements for two to three months.

In answer to the question whether it would be more convenient to obtain both equipment and working capital loans from SFCs, the opinion of Chambers of Commerce, Associations etc. is that it would be advantageous to do so. In case SFCs could not provide both equipment and working capital loans, it is suggested by some that they may guarantee loans obtained for working capital from banks. As a matter of fact, working capital should be obtained from commercial banks, and SFCs may provide the permanent or initial working capital which is included in the cost of the project.

Loans on an agency basis:

Under Section 25 (1) (d) of the Act, a SFC, may act as agent of the Central Government, State Government, IFC or any other financial institution notified in this behalf by the Central Government, in the transaction of any business with an industrial concern in respect of loans or advances granted, or debentures subscribed, by any one of them. The provision was introduced in 1956,
after the Second SFCs' Conference in 1955. It was then recognised that, following the policy announced by the Central Government, under the State Aid to Industries Act/Rules, substantial Government loans would be made available to small scale industrial units on liberal terms, such as low rate of interest and low margin on security, but that this was likely to impinge on the SFCs' field of operations. So a modus vivendi had to be evolved to protect SFCs' interests and also make a beginning of institutionalising the flow of such Government funds to small ventures. The Conference recommended amending the Act to authorise SFCs to function as agents of State Governments to scrutinise and sanction loan applications received by latter from small enterprises, to disburse such loans, and to collect and remit all amounts to Governments.

So far, SFCs Andhra Pradesh, Maharashtra, Uttar Pradesh, Punjab, Kerala, Rajasthan, Assam, Gujarat and Orissa have been appointed as agents of their respective State Governments for channelling block loans to small units under the State Aid to Industries Act/Rules, as the case may be. The Government of Madhya Pradesh had agreed to channel these loans through the SFC, but so far no action has been taken in this matter. West Bengal Corpo-
ration was also appointed as such, but the arrangement has not been implemented as the Accountant General, West Bengal, has been reported to have raised certain constitutional and statutory objections to it. The Government of Bihar have also agreed to appoint Bihar SFC as their agent. The Government of Madras have decided not to appoint TIIC as their agent.

Under the Government of India's liberalised scheme of financial assistance to small units, it is provided that SFCs would be entitled to a margin of not more than 2% of handling these loans on behalf of Government; this margin is to be borne equally by the Central and State Governments. States have been giving SFCs a 2% commission for handling these loans, the commission payable being calculated on the amount disbursed in any one year and not on the amount outstanding. Thus, a mere 2% on each loan in the first year alone is expected to cover the administrative costs of the SFC over the entire life of the loan. In Maharashtra, the SFC gets commission on the basis of the amount outstanding, subject to a maximum commission of Rs. 50,000 in any one year and also gets an annual subsidy of Rs. 10,000 for administrative expenses. It may be suggested that Commission should be paid to Corporations on the same basis as in Maharashtra. It is
also suggested that this agency Commission should be paid to SFCs promptly, as and when due.

At its 9th meeting, The Small Scale Industries Board had recommended that to progressively bring SFCs into the sphere of financing small scale industrial units, at least 10% of block loans given by the State Governments to such units should be routed through SFCs. This would also improve the latter's finances and partly help to reduce the subventions which the States are having to pay to meet the deficit in SFCs' net profits in relation to the guaranteed dividends.

While sanctioning loans to small units out of their own resources and on their own terms, SFCs generally follow a practice of not entertaining applications from such units up to certain limits e.g. Rs. 75,000 in the case of Maharashtra, Rs. 25,000 in the case of West Bengal and Rs. 10,000 in Kerala. This is to avoid overlapping as loans up to these limits are to be given by the State Departments of Industries. The Seventh SFCs' Conference also held that while it would not be economical for SFCs to handle loans below a certain amount (say Rs. 5,000 or Rs. 10,000 depending upon the requirements of individual States), duplication should be avoided, and all loans
within a specified range should be routed through SFCs. Since agency loans carry subsidised rates of interest, SFCs cannot disburse them within the specified limits out of their own funds. The higher rates of interest of these institutions would not attract small borrowers. Keeping these variations in mind, the Committee on Credit Facilities of the Small Scale Industries Board (SSIB), at its 6th meeting held in Calcutta, held that the procedures and agency arrangements should be standardised. It recommended that States might ordinarily grant loans up to Rs. 15,000 and SFCs should act as the agents of Government for higher amounts in all cases. Where, however, the States were already permitting SFCs to grant smaller loans, they might continue to do so.

The Development Commissioner, Small Scale Industries, stated in a note submitted for consideration of the Ninth SFCs' Conference, that the expectation that SFCs would be able to function effectively as credit institutions to small units has not been realised to any appreciable extent. Some States do not have adequate funds to meet the demand for such small loans. At the 20th meeting of the SSIB, it was recommended that, as in Maharashtra, States which did not have adequate funds should arrange
with their SFCs to advance loans out of the latter's funds on liberalised terms regarding interest, margin etc. against State Government's guarantee and subsidy. States have not yet taken any steps in this direction. SFCs may not, however, be very enthusiastic to undertake this business now as many of them are acutely short of funds to meet the demands of medium, and to some extent small-sized units.

In addition to acting as agents of State Governments under Sec. 25 (1) (d) of the Act, SFCs can also act as agents of financial institutions to be notified in this behalf by the Central Government. The Central Government notified ICICI as the financial institution for the purpose of this section. But so far such agency functions with other institutions have not developed. Since ICICI does not have branches in other parts of India, it could consider appointing SFCs as its agents for loans given to industrial concerns situated in distant parts of the country. In particular, SFCs could undertake periodical inspections of borrower concerns on its behalf.

LOANS AND ADVANCES BY STATE FINANCIAL CORPORATIONS IN PARTICIPATION WITH OTHER FINANCIAL INSTITUTIONS:

SFCs can also finance industrial concerns in
participation with other lenders. So far this has made very little progress for various reasons. Participation presupposes a measure of comparability among the participants in such matters as technical skill in appraisal. For a number of SFCs, this condition was not satisfied vis-a-vis institutions like IFC and ICICI.

The Seminar on Financing of Small Scale Industries in India suggested evolving agency arrangements between commercial banks on the one hand and SFCs on the other, or participation in the extension of loans between SFCs and commercial or co-operative banks etc. The object was to reduce the risks of term lending and to overcome 'borrower-resistance' by enabling them to approach only one institution for their short as well as long term requirements. The Scheme for Guarantee of advances granted to small scale industries also envisages participation arrangements between the banks inter se as well as between banks and other specified credit institutions. The question of SFCs financing industrial concerns jointly with other agencies was considered at the Sixth and Seventh SFCs' Conferences. It was thought that the appointment of banks as agents of SFCs would eventually pave the way for working out participation loan arrangements and that
there was no use forcing the pace of development, Maharashtra, Andhra Pradesh, Punjab, Uttar Pradesh, West Bengal, Rajasthan and Orissa have appointed the State Bank of India as their agent to disseminate information regarding their activities, forwarding to them loan applications received from various parties, furnishing credit information on prospective borrowers, disbursing loans etc. SFCs in Maharashtra, Andhra Pradesh and Madhya Pradesh have also appointed certain other scheduled banks as their agents for these purposes.

Participation arrangements may be worked out in conjunction with other institutions in the matter of extension and guarantee of loans and underwriting of issues of shares and debentures. The question of participation loans was gained importance in the context of some of the recent amendments to the SFCs Act, extending the sphere of co-ordination between various institutional agencies and SFCs, and other developments like commercial banks stepping into the area of formal term lending to industries, setting up of SIDCs in some States, etc. Under the recent amendments to their statute, SFCs can undertake a few items of business, some involving relatively large investments e.g. the financing of transport industry or industrial estates which might require outlays beyond the
statutory provisions of these institutions to accommodate.

With the impact of developmental expenditure, the cost of putting up a project is also rising, emphasising the need for participation loans to reduce risks. Again, in view of statutory and other limitations, any one institution such as a SFC may not be able to meet singly all the credit needs of an industrial concern. Apart from loan capital, the demand for equity capital too is likely to be large. While SFCs cannot as yet directly participate in equity shares, they can assist concerns by underwriting issues. Thus, SFCs must work in close co-operation with other experienced financial institutions. They are also likely to benefit much from their association with institutions like ICICI and IFC in the important matter of appraisal of loan applications. The extent and manner in which SFCs may collaborate with other agencies for granting loans is indicated below, as submitted to the Ninth SFCs' Conference.

(a) A medium-sized unit organized as a public limited company or co-operative society whose requirements exceed Rs. 20 lakhs, which is the statutory limit for advances to such a concern by SFCs, may be financed jointly with
IFC/ICICI. The SFC may continue to service the loan account, act as agent of IFC/ICICI to the extent of the additional loan (permissible under Section 25(1)(d) of the Act) and accept a pari passu charge on the security which may continue to be supervised by it. This will mutually benefit all the parties. If the industrial unit is a proprietary or partnership concern or a private limited company, for which the limit of advance by the SFC is ₹ 10 lakhs, such an arrangement can be made only with ICICI as IFC cannot finance such a concern.

(b) Where a concern requires assistance both in foreign currency and in rupees, former may be provided by IFC/ICICI depending upon the form of organisation of the concern; SFC may provide the rupee loan, both agencies having pari passu charge on the securities.

(c) Commercial banks and SFCs may jointly finance an industrial concern, against composite security for acquiring block assets as well as for working capital purposes, banks taking the earlier maturities - for which they can also obtain refinance from RCI - and SFCs the later ones.

However, the scope of participation in loans will
and should be somewhat limited. Financing institutions have their own independent methods of scrutiny and also their own separate entities to maintain. Collaboration among equals holds more promise than among such unequal partners as SFCs on the one hand and IFC/ICICI on the other; and they are likely to remain so for many years. It must be stressed that the main function of SFCs is to finance medium and small scale industrial units. This should absorb all their energies and resources. Excess emphasis on securing business in participation with other agencies will make them lean more towards financing larger borrowers, to the detriment of attention being given to medium and small units. Participation, of course, will have some benefits. In the first place, the cost of appraisal will be less as it will be shared by the participants. Secondly, it will gradually improve SFCs' ability to appraise loan applications through contact with the better organized financing institutions. Lastly, it will enable them to entertain applications with a foreign exchange component if exchange is provided by the participants. But SFCs would have greater manoeuvrability if the Government were to make periodical allotments of exchange to them, for financing the foreign exchange cost of projects falling within any defined body of priorities that Government may lay down.
Business other than that of loans and advances:

SFCs may also undertake a few other businesses in addition to their main function of granting loans. They may be guaranteeing of loans raised by industrial concerns; guaranteeing of deferred payments; subscribing to debentures of an industrial concern, repayable within 20 years from the date of subscription, and underwriting issues of stock, shares, bonds and debentures by industrial concerns.

These activities may be considered as follows:

(1) Guaranteeing of loans:

Under Sec. 25 (1) (a) of the Act, a SFC may guarantee:

(i) loans raised by industrial concerns which are repayable within a period not exceeding 20 years and are floated in the public market, and (ii) loans raised by industrial concerns from scheduled banks or state cooperative banks.

Provision (i) enables it to guarantee loans raised by an industrial concern in the public market. The word 'loans' would generally mean debentures floated
in the open market. The intention of the legislature was that SFCs may only guarantee loans raised in the market. No SFC has guaranteed such a loan so far.

Provision (2) was introduced for special types of joint lending by SFCs and other institutions e.g. where concerns find it difficult to get working capital funds from sources other than SFCs, like banks etc. which may consider the residuary security left for covering their advances to such concerns as being inadequate — in size or quality — to cover their risks after SFCs had obtained a charge on their other, major, assets for financing the acquisition of fixed assets. Tea gardens present such an example. Normally, commercial banks secure their short term advances to gardens with the fixed assets in addition to a hypothecation of the crop. If the garden obtains a term loan from a SFC, the bank would tend to be deprived of the fixed assets as a backing for its working capital loan when a guarantee may induce it to continue its finance without a charge on the fixed assets.

To ensure that a SFC does not enter into large commitments in the form of guarantees, or in underwriting shares, the Act has limited the aggregate of such contingent liabilities to twice its paid up capital and reserve
fund. It may be stretched to three times, with the prior approval of the State Government and in consultation with Reserve Bank. Again, the Act has placed an overall limit to the total amount outstanding in respect of any industrial concern in the form of assistance by way of loans, guarantees, etc. at Rs. 20 lakhs in the case of public limited companies and co-operative societies and Rs. 10 lakhs in other cases.

(2) Guaranteeing of deferred payments in respect of capital goods purchased in India:

In terms of Sec. 25 (1) (b) introduced in April, 1962, SFCs may guarantee payments due from any industrial concern for indigenous purchase of capital goods. IFC too has been authorised to extend such guarantees, in terms of Sec. 23 (1) (b) (ii) of the IFC Act. No such guarantees have been issued so far by either SFCs or IFC. These guarantees must also be "sufficiently secured". The guarantee of foreign deferred payments has been left over to IFC. Perhaps no guarantees for indigenous purchases have been issued so far due to the unwillingness of the machinery manufacturers or dealers to offer deferred payments terms beyond a very short period in view of the demand
conditions, as in a sellers' market for capital goods, prevailing in India at present. There does not, therefore, appear to be much scope for SFCs to develop this business in the circumstances obtaining at present. However, if they could extend the sphere of their activities to this field, they could increase their income without direct financial commitment.

(3) **Direct Subscription to Debentures:**

Sec. 25 (1) (g) of the Act permits SFCs to subscribe to the debentures of an industrial concern, repayable within 20 years from the date on which they are subscribed to. If such debentures carry on option for subsequent conversion into stock or shares of the concern. SFCs may exercise such option and acquire such stock or shares in accordance with, and subject to, the provisions of Section 81 of the Companies Act, 1956.

(4) **Underwriting:**

Underwriting is gaining importance as a means of protecting borrowing concerns from the vagaries of the investment market - of ensuring the possession of adequate funds at the time they are needed, and at a reasonable cost.
In the case of development banks, underwriting combines investment and marketing functions. ICICI tries to attract as much private interest in the issues as possible but does not agree to underwrite unless it is prepared and willing to keep in its portfolio, the full amount of the issue underwritten by it. To the extent private capital is attracted, it feels it has performed a useful function, even though it retains a large part of the issue. It sells shares out of its portfolio only gradually, and in small quantities, to avoid depressing their price, in the interests of the enterprise and other investors in it.

Under Sec. 25 (1) (c) of the Act, SFCs may underwrite the issues of stock, shares, bonds or debentures by industrial concerns. Under Sec. 25 (1) (f), a SFC may retain, as part of its assets any stock, shares, bonds or debentures which it may have to take in fulfilment of its underwriting liabilities, so that it disposes of them as early as practicable, but in no case beyond 7 years from the date of their acquisition, except with the prior permission of Reserve Bank.

The question of underwriting was considered at the Third, Fourth, Seventh, Eighth and Ninth SFCs' Conferences. The Third Conference, in 1956, set up a Committee of representatives of IFC and some SFCs to formulate certain
suggestions. The Committee was generally in favour of SFCs venturing into the field. It recommended that initially they should underwrite fixed interest-bearing industrial securities i.e. debentures and preference shares of redeemable type with rights for cumulative dividend, to minimise the risks of loss of income and probable depreciation in capital value. The Fourth Conference which considered the Report of the Committee felt that in view of the risks involved it was not yet desirable for them to enter the field. The Seventh Conference considered a suggestion to set up a consortium of financial institutions to support large public issues by industrial concerns, but it was not accepted. The question of underwriting came up again at the Eighth Conference in 1961 in the context of the programme of industrialisation envisaged under the Third Plan, during which period many new industries were scheduled to be developed in the private sector. This Conference agreed that some SFCs' might make a small beginning in under-writing issues provided they exercised caution and observed certain safeguards. The general considerations and precautions to be taken by SFCs as contained in the Reserve Bank's note, prepared on the suggestion of the Eighth Conference, were accepted by the Ninth Conference for serving as guide lines to SFCs.