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## INSTITUTIONAL FINANCING OF SMALL SCALE INDUSTRIES

—A CASE FOR A CHANGE IN OUTLOOK AND PROCEDURES\*

Small scale industries are essentially the backbone of Indian economy. In the planning process they have rightly, been assigned the role of a priority sector. Since the small scale industrial units need comparatively less capital per employed person, they occupy a special place in the growth of the economy in terms of the output as well as employment potential. In spite of certain limitations vis-a-vis availability of scarce raw materials and supply of capital, small scale industries have amply maintained the pace of development in recent years. For instance, the number of units registered with the state directorates of industries which was 121,619 at the end of 1966, increased to 190727 at the end of 1970. The increase in registered factories has been at the rate of 17000 per year during the period 1966-70. Their number is estimated to have crossed 250,000 units at the end of 1973. In addition, there are a large number of unorganized units (about 350,000) spread over different parts of the country. The total employment provided by small scale industries of all types was about 5.8 million in 1965-66. This figure is estimated to have crossed 6.3 million at the end of 1970 and 6.8 million at the end of 1973. The estimated value of gross output of small scale sector was nearly Rs. 36,700 million in 1969-70. The average rate of growth has been around 11% in recent-years compared with 8% before 1965-66. Evidently, this sector of our economy has been making spectacular contribution to the nations industrial production and employment.

A small scale industrial unit requires funds for establishment, expansion, modernisation and for the day-to-day operations. These financial requirements can be classified into fixed and working capital needs. All of these needs cannot be met out of resources possessed by the owners. Of course, funds are only one of the

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inputs that this sector needs; but perhaps this is most vital input, without which no proposal for the setting up and smooth and successful operating of an industrial unit of any size, can be embarked upon. Evidently, the resort to borrowing of funds in varying degrees both for fixed capital, as well as, working capital needs is inevitable.

The purpose of this paper is therefore three-fold. Firstly, to examine the performance of the institutional sources of funds in general and State Financial Corporations and Banks in particular; Secondly, to highlight the short-comings in their outlook and procedures and finally, to suggest corrective measures.

#### PERFORMANCE OF FINANCIAL INSTITUTIONS

In this section the magnitude of financial assistance provided to small industrial units by the following institutions has been examined :

- (a) State Financial Corporations,
- (b) Commercial Banks and
- (c) Other institutions.

#### *State Financial Corporations*

The total financial requirements of the small scale sector for fixed assets alone during the fourth five year plan period, was estimated at Rs. 560 million. A sizeable portion of this was expected to be provided by the term lending financial institutions including SFCS. Table I exhibits the financial assistance granted by these term lending institutions to this sector.

**TABLE I**  
FINANCIAL ASSISTANCE SANCTIONED AND DISBURSED BY TERM-LENDING INSTITUTIONS TO PROJECTS IN SMALL SCALE INDUSTRIAL SECTOR

	<i>(Rs. in crores)</i>			
	<i>Sanctioned</i>	<i>Disbursed</i>	<i>Sanctioned</i>	<i>Disbursed</i>
	1972 - 73		1973 - 74	
IDBI	22.4	15.8	33.3	18.8
ICICI	0.2	0.1	1.0	0.2
IRCI	0.4	0.3	0.8	0.4
SFCS	56.6	29.8	64.8	35.5
SIDCS	0.2	0.1	0.8	0.9
<b>TOTAL</b>	<b>79.8</b>	<b>46.1</b>	<b>100.7</b>	<b>55.8</b>

Source : Reserve Bank of India,  
Report on Currency & Finance

It is obvious from the above that the State Financial Corporations have by far been the most important source of finance for long-term funds to small scale industries. The Industrial Development Bank of India normally, though not legally prohibited, does not directly provide financial accommodation to small industries. It grants financial assistance through indirect method i.e. through the process of refinancing. Table II gives a more detailed study of financial assistance provided by the SFCS to the small scale units.

**TABLE II**  
FINANCIAL ASSISTANCE SANCTIONED AND DISBURSED BY THE SFCS TO  
SMALL SCALE UNITS

	<i>No. of loans</i>	<i>(in Rs. million)</i>	
		<i>Sanctioned</i>	<i>Disbursed</i>
1962	1505	117.8	64.4
1963	1873	144.1	70.5
1964	2236	176.3	121.9
1965	2667	201.8	151.2
1966	3149	230.7	179.9
1967	3784	286.1	216.5
1968	4606	372.4	279.3
1969	5609	473.0	353.4
1970	7876	731.0	461.4
1971	n a	1151.0	781.3
1972	n a	1717.0	1079.3
1973	22136	2365.0	1719.4

Sources; compiled from : (a) Government of India, Small Scale Industries Development Commissioner, Small Scale Industries Department, New Delhi 1971,

(b) Reserve Bank of India Bulletins,

(c) Annual Reports of State Finance Corporations.

It will be seen from the above table that the quantum of financial assistance provided to small scale industries by SFCS was very little till 1969. Since then it gained momentum. That is why the SFCS have become the major purveyor of term loans to these industries in recent years. It is estimated that of the total assistance provided by the SFCS, 20 to 55% had gone to the small scale industries, the remaining having been claimed by the medium scale industries. However, these institutions have not come forward in a big way so far, to assist the small scale sector. They have belied

the expectation placed on them because of their relatively poor performance in this field. However, it is heartening to note that the SFCS now provide foreign currency loans for import of equipments and/or technical know-how from abroad to small and medium sized industrial units. The SFCS had received 376 proposals involving total loan of Rs. 26.2 crores by the end of June, 1974. Of these, 178 applications involving assistance of Rs. 11.3 crores for refinancing domestic cost and import of foreign equipments had been disposed of by the SFCS.

#### *Commercial Banks*

The Commercial Banks had been rather reluctant in the past to provide credit facilities to small-scale industries. However, after the nationalization of 14 major commercial bank their credit facilities both short and medium-term have been considerably stepped up. It will be observed from Table III that the State Bank of India along with other nationalised banks have steadily increased the flow of funds to the small sector.

Judged by the amount of loan and the number of units assisted, the State Bank of India and its subsidiaries and the nationalised banks are by far the leading agencies providing short-term loans to the small scale industries. The number of assisted units by commercial banks rose from 81725 in 1970 to 200563 upto October, 1973, giving a rise of 146%. In terms of amount of loan the increase is of the tune of Rs. 459.5 crores i. e. an increase of 114%. It is estimated that 14.4% of the total bank credit was provided to this priority sector in 1973 as against 8.7% in 1969. The foregoing analysis shows a gradual increase in bank credit to the industries. However, they have not provided the desired amount of credit to the small industries so far. The Commercial Banks still play a safe game. Of course, a little change in their outlook has been noticed very recently.

#### *Objections to Attitudes and Procedures*

The study group of the Banking Commission on non-financial intermediaries (1971) had expressed confidence in the capacity of existing financial institutions in meeting the financial requirements of the small scale industries. Despite the very wide publicity given to their entrepreneurship schemes with liberal terms of credit, these

institutions suffer from the following objections in relation to their attitudes and procedures.

In the first place banks and other financial institutions have been practising the policy of playing safe. They have, readily been giving financial assistance to the already established sector of the small scale industries, which have good credit worthiness and have good assets to offer as security for the loans desired and maintain accounts and inventory records properly. Consequently, they pay very little attention to small units who cannot offer good security e.g. land, even if they have a good project.

Many banks still consider service of small loans as an expensive proposition and force the small units to have a resort to expensive non-institutional sources.

Moreover there are large scale procedural delays in processing applications which cause a lot of embarrassment and hardship to the applicants for the financial assistance. Often the terms for the accommodation provided are very strict and seek a lot of detailed information, much of which is not really essential to the granting of the loan.

In spite, of the enormous stress on liberalized finance to small scale sector, the financial institutions while evaluating loan proposals apply the same yardstick for the established units and the new units intended to be set up by the credit needy educated unemployed which is essentially a very discouraging factor.

#### *Suggestions for improvement in attitudes and procedures*

At the outset it may be pointed out that considerable improvement is necessary both in regard to the quantum of assistance, as well as, methods and procedures practiced by these financial institutions on the lines indicated below :

Credit sanctioning by banks and other financial institutions should essentially be need based, which implies that there has to be softening of their attitude in granting assistance to small borrowers. However, it does not mean that they should sacrifice the normal backing tenants. What is intended here is that there should definitely be a proper appraisal of the loan proposals, but lending to this priority sector should not be restricted to the well established classes

of borrowers or to the extent justified by the security offered. It is not enough that only credit worthy men and men with means should get finance; what is important is that finance should go to make people credit worthy. In other words, there is the need for the introduction of flexibility in regard to procedures and practices concerning provision of finance to small scale units especially if a loan proposal relates to a viable and productive economic activity. The loan should be sanctioned against future capacity to repay loans.

It is true that future capacity is more difficult to assess than the present capacity and to lend money on the bases of the former involves greater risk. But this kind of a progressive and non-conventional outlook is much needed if the process of industrialisation is to proceed on the desired lines. The financial institutions must encourage credit needy small men especially technocrats interested in setting up import substitution or export based industrial units to approach them for financial help and grant the same at concessional rates of interest. If a small industry is highly export oriented in certain fields and is capable of being entirely designed to suit foreign importer's needs, they should readily finance such industries. In such a case there would be no repayment problem.

Banks and other financial institutions should appoint specialists for guidance on preparation of project report, taxation, accounting, and finance and marketing etc., so as to assist the fresh graduates particularly technocrats in the successful setting up and operating of the business. In fact, the key to the financing of small scale industries is to link technical assistance to financial assistance, both at the stage of application for credit as well as that of use of funds. This kind of a supervised credit will go a long way in helping the small entrepreneurs. Hence they should perform the functions of a mini-multi service agency suggested by the Thakkar Committee and provide real help to small scale units.

In the applications for the grant of loans, only essential information of a simple nature relating to the applicant and his credit needs should be required. Obviously, the banks and other financial institutions should not insist on the applicant's furnishing such information in writing which he is likely to be reluctant to part with. This information should be extracted by a bank official by questioning the applicant and examining his books of account and other

relevant papers. This sort of a change in the attitude will go a long way in increasing the quantum of financial assistance to this sector and encourage the growth of small scale industries.

In order to reduce the delays in the processing of applications and to conduct a proper appraisal of the loan applications, the banks must employ trained technical persons. Small Industries Service Institutes must train such persons. This will go a long way in overcoming the embarrassment suffered by the intending borrowers. Pending employment of such technical persons, credit needs of a small entrepreneur may be examined by making a technical evaluation of his project by an industrial extension centre.

It is essential to strengthen the equity capital base of small enterprise by a system of temporary equity participation by the financial institutions and commercial banks. As recommended by the Administrative Reforms Commission (ARC), a separate apex financial institution with a paid up capital of Rs. 25 crores may be set up. This apex institution should meet short and medium term credit requirements of small enterprises besides providing credit guarantee facilities to other financial institutions. This institution can also operate under agency agreement with the existing state financial institutions, commercial banks and cooperative banks.

Till such an apex institution as described above is set up the state financial corporations should provide long term loans on liberal terms and conditions and also provide equity capital to small enterprises. It needs to be stated that the amended State Financial Corporations Act, authorises the corporation, (a) to raise special class of share capital to be contributed by the state government and the Reserve Bank of India which would not carry minimum dividends clause, and (b) to take part in the equity capital of the industrial concerns. This special capital should be utilised for developmental activities--as contribution to equity capital, grant of soft loan, etc. to the small scale sector.

In order to overcome the financial difficulties of small enterprises it is desirable to devise some other forms of collective self financing e.g. cooperative credit or mutual indemnity financing. These forms of financing small enterprise have not been sufficiently practised in developing countries like India.

In short, a radical change is called for in regard to procedures and attitudes of financial institutions especially towards granting assistance to unemployed persons. They cannot offer adequate security for the loan, and do not enjoy good backing of owned funds and have no proper accounting and inventory records for the perusal of the former. These institutions must soften their attitudes and change their procedures in considering applications for financial needs from this group of persons. What is really needed is liberalization of the minds of those who run these institutions to understand and solve the problems peculiar to small scale sector and men of small means or no means. Then alone they will serve as harbingers of social and economic changes.



**TABLE III**  
**ADVANCES OF COMMERCIAL BANKS TO SMALL SCALE SECTOR**  
 (Rs. in crores)

	December 70		December 71		December 72		December 73	
	No. of Units	Balance Outstanding	No. of Units	Balance Outstanding	No. of Units	Balance Outstanding	No. of Units	Balance Outstanding
1. SBI & its subsidiaries	36935	152.2	48731	197.0	63231	254.8	89547	317.0
2. 14 Nationalized Banks	37072	198.7	46223	243.9	69133	315.3	100658	449.8
3. Other scheduled banks	7718	42.9	8581	52.6	9846	74.9	10358	91.7
<b>TOTAL</b>	<b>81725</b>	<b>393.8</b>	<b>103535</b>	<b>493.5</b>	<b>142210</b>	<b>645.0</b>	<b>200563</b>	<b>858.5</b>

Sources : (a) Reserve Bank of India Report on Currency & Finance.

(b) Reserve Bank of India, Bulletins.