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CHAPTER - VIII

FINANCES OF ENGINEERING UNITS.

Introduction :

In order to transform underdeveloped economy into economically developed one, the significance of " Capital" can-not be neglected. It is an important input besides ----- entrepreneurship and technology. Without capital , unemployment and backwardness persist in developing countries. In these -- economies small scale units are justified on the ground, that they are labour intensive, and in overpopulated countries, they will absorb the surplus population and thus open job ----- opportunities. Even then, without minimum amount of capital, small scale sector will not absorb population. Availability of cheap finance is one of the important constraints on the growth of small scale units. In earlier chapter, we have seen the -- significance of " Entrepreneur. " Without entre-preneurs' -- capital will not result in capital formation and without capital, entrepreneurs can-not transform the resources in terms of --- physical stock or financial stock. The significance of capital

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has been realized by Nurkse who says, "We have to admit -
that capital is necessary but not a sufficient condition -
of progress."¹¹¹ Moses Abramovitz,¹¹² Robert Solow,¹¹³ E.O.
Domar¹¹⁴ or Simon Kuznets¹¹⁵ support the same view, and - -
emphasize the role of other factors also.

But thinkers like Hanson¹¹⁶ say deficiency of -
capital is a common obstacle, Lewis also agrees with the -
view that capital holds the key to the understanding and - -
solution of several other problems relating to development.
Mrs. Joan Robinson says. "Where enterprise leads finance -
follows." But unless he creates some utilities, entrepreneurs
can-not become credit worthy or attract capital and moreover

Ref :111 : Ragnar Nurkse, Problems of capital formation
in underdeveloped countries, P. 1.

:112 : M. Abramovitz, "Resources and output trends in
the United States since 1970". American Economic
Review, Proceedings, May 1956 P.P. 5-23.

:113 : Robert Solow, "Technical change and Aggregate
Production Function," Review of Economic and
Statistics, August 1957, P.P. 312-320.

:114 : E.O. Domar, "On the measurement of Technological
change." Economic Journal, Dec. 1961 P.P. 709-729.

:115 : Simon Kuznets, (ed), Income and wealth of United
States "Trends and structure, Income and wealth
services.

:116 : 1952, National Bureau of Economic Research,
New York P. 82-83.

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many a times where entrepreneurship is lacking, capital must come ahead. In earlier times as we have seen the technique of the products were quite simple. Now a revolutionary change is taking place in the sphere of technique, technology, machine, management, and marketing. All these are capital-deep things. The need of capital can-not be under rated.

A Changed concept of capital :

Even if financial assistance is made available, without human capital, real prosperity or income does not - arise " When poor countries enter upon the process of - - - developing a modern agriculture or industry with some notable exceptions, they invest too little in human capital relative to what they invest in non-human capital, skills and - - - knowledge useful in their economic endeavour are neglected as they concentrate on new plants and equipments. Thus an - - imbalance arises and as a consequence they fail, often by a wide margin, to attain their optimum rate of growth."¹¹⁷

This is applicable to the quality of - - - - - entrepreneurs and managers, which is indispensable to manage and organize the modern engineering sector. Equally important

Ref: 117 : T.Schultz, "Investment in Human capital in Poor countries." in foreign trade and Human capital" p.p. 14-15.

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is the type of machinery (i.e. capital) which is available to the manufacturers. In India capital per person employed in iron and steel is 5.7%, In U.S.A. it is 32.1%. Machines used here, are obsolescent and old types. Storage facilities are not available. These are due to shortage of capital and high rate of interest. The survey revealed that engineering units suffer on account of shortage of capital and they do not have sufficient storage facilities. As far as quality of - - - - manufacturers is concerned, the survey revealed that the - - percentage of skilled workers in oil engg. units is more than the unskilled. If the workers are unskilled there is waste of capital due to wrong handling of tools, wrong maintenance of materials, and capital-output ratio also rises. In Kolhapur engineering units, however the capital- output ratio was 1.84 for manufacturers, 0.68 for assembler, 0.57 for machine shop, 3.40 for foundries etc.¹¹⁸

Difficulties of small units :

In developed countries, the entrepreneurs are -
real, in the sense of the terms, they may demand new financial

Ref: 118 : "Recession in diesel oil engine industry
in Kolhapur" Nagaiyya SIFT Publication
Hyderabad.

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institutions and the financial institutions come up. In under-developed economies, institutions have to be set up to supply finance and work as entrepreneurs and guide and thus create conditions in which would be entrepreneurs demand financial assistance from these institutions.

This creates supply leading demand responses. -

" i.e. The creation of financial institutions and supply of their financial assets, liabilities and related financial services in advance of demand for them, especially the demand of entrepreneurs in the modern growth industry sectors. - - Supply-leading has two functions 1) to transfer resources from traditional sectors to modern sectors and 2) to promote and stimulate an entrepreneurial response in these modern - - - sectors. Financial intermediation which transfers resources from traditional sectors by collecting wealth and saving from those sectors in exchange for its deposits and other - - - financial liabilities or by credit creation and forced - - savings is akin to the schumpeterian concept of innovational financing.¹¹⁹ This is important in countries where - - - - -

Ref : 119 : Leading issues in Economic development."-Meir

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entrepreneurship is a constraint on development. According -
 to Rondo cameron,¹²⁰ the top managment of financial institutions
 may serve as entrepreneurs in industrial enterprises. They -
 assist in the establishment of firms not only by underwriting
 a substantial portion of capital but more by assuming - - -
 entrepreneurial institutive. Small units need, not only - -
 finance but a package of other services comprising managerial
 and technical advice, marketing assistance and the like. All
 such facilities have been provided by the governmental - -
 institutions in the industrial area and the firms of small -
 units do not have to run from pillar to post. Before dealing
 in detail with all the sources of finance, the nature of the
 difficulties faced by small industries will be studied.

The nature of demand for finance coming from -
small units.

1) The demand from small units is for small -
 amounts as compared to large units, so innumerable accounts
 have to be opened which it is not possible for the banks to
 maintain. The requirements are " too small " to be financed

 Ref :120: Leading issues in Economic development.- Meir

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from these institutions. So " Macmillan Gap " exists. 2) The saving community comes to know of various securities, shares, they invest in these securities so funds have been dried up for small units, 3) The capital base of small units is small, so they can-not raise loans and they are susceptible to - - - failures. The firms which start with limited initial capital and when they expand capital falls short. It is difficult to raise equity capital, because it involves sharing of - - - management and control, small firms do not like this. 4) They have to borrow from outside at exorbitant rate.

Besides these difficulties, the small units fail during uncertain and recessionary period. The reasons are incomplete survey, poor planning, mismanagement, lack of - knowledge and energy on the part of the manager, inadequate - records. (5) Small units can-not raise funds in security - markets as they are mostly proprietors and partnerships. - Many a times they do not get their bills for the goods sold, they need working capital and trade credit (6) The banks deal in depositors' money, and when proper accounts are not - - - maintained collateral security is not given or competence - and credit worthiness is not found, the banks are reluctant to advance loans. The constraints of " banking principles "

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are rarely overthrown by banks, though new devices have been found out.

New devices :

These difficulties have been realized by - - -
 Radcliffe committee in England and Shroff committee in India.
 The method of " instalment Credit " and " term lending -
 institutions " has its origin in Radcliffe committees' -
 recommendations. Shroff committee suggested that banks can
 help industrial finance by purchasing securities floated by
 the financial institutions. In India there are many financial
 institutions sponsored by central Government and state - -
 Governments, and assisted, controlled formerly by Reserve -
 Bank of India and now by Industrial Development Bank of India.
 We will discuss the role played by state level financial -
 institutions in supplying finances to engineering units in
 Kolhapur. In recent times, Maharashtra State Finance - - -
 Corporation has been given a significant role in assisting
 small scale industrial sector. Hence a detailed discussion
 of its role in assisting engineering sector in Kolhapur will
 be made. Before this the type of finances needed by the units
 will be mentioned.

Types of finances :

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a new plant, for replacement or modernisation, for expansion or diversification. They need fixed capital, working capital, trade credit and promotional expenses. Accordingly they need long term Medium term and short-term finances.

Fixed Capital :

It includes assets that are intended to be used over again for a long period of time land and improvements, buildings, machinery, equipment and tools. The amount of funds necessary to acquire the needed fixed assets can be estimated from purchase price of business sites, building construction costs and equipment and installation costs.

Working Capital :

Funds necessary to cover the cost of operating the enterprise are termed as working capital. The amount of funds necessary for this purpose is based on a number of calculations.

a) Cost of inventory which includes the estimated stock of raw materials, purchased parts, supplies, goods in process and finished goods.

b) Wage and salary bill, including direct labour and indirect labour, sales and technical, clerical,

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supervisory and managerial staff.

c) Overhead costs (Other than wages and salaries) including maintenance cost and other service activities, fuel and other utilities, property taxes, insurance and so forth. - - -

d) Funds to cover sales activities, advertising -shipping services, credit extended to customers and the like.

In general, funds for working capital should be sufficient to meet current liabilities and the peak requirements of seasonal variations and enable the firms to take advantage of immediate opportunities in purchases that present themselves from time to time. Working capital in a going concern in " revolving fund". It consists of cash receipts from sales covering the cost of current operations. The shorter the time cycle of production and the more rapid the turnover in the sale of goods, the smaller the need of working capital. - - -

It is said, it requires eight to nine hours to turn out an oil engine out of raw-material, scrap.

The time cycle of production is short, but because the goods were not sold, the firms could not recover the funds or repay loans, still they want funds for working - - -

capital.

Trade Credits :

Trade credits are required to meet the expenses in between the sale of finished goods and receipt of the bills

Promotional expenses :

In addition to covering the fixed capital and working capital needs, the calculation should also include the funds necessary to cover the promotional costs to be incurred prior to actual operations and possible losses before the business becomes a paying operation. Promotional expenses include initial fees, taxes and engineering and development costs.

Finances are needed to meet all these requirements. There are many sources of finance to small scale industries. The sources are 1) Financial institutions. 2) Government 3) commercial banks 4) Co-operative societies Banks 5) money lenders, individuals etc.

The lending institutions generally consider the technical feasibility (2) economic viability 3) managerial

competence found in the production unit.

1) Technical feasibility considers the following points:-

- 1) The type of product, their capacity shifts
- 2) Raw material availability, knowledge about production process
- 3) present site and space
- 4) list of machinery required in present and its future requirements to availability of water, electricity and fuel.
- 6) Skilled and unskilled workers.
- 7) locational advantage.

2) Economic Viability considers :

- 1) Estimates about site, factory shade, machinery expenses of installing the plant.
- 2) Finances needed for fixed assets and the need to fulfill the difference
- 3) Primary and preproduction expenses
- 4) Demand estimates
- 5) Competition
- 6) Past experience and future programme.
- 7) Cost should be checked volume of expected sales.

3) Managerial competence -

The entrepreneur must possess managerial competence, initiative proper decision taking capacity and must maintain accounts. In its absence the projects fail -
Thus they consider -

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- 1) Personal quality, integrity, ability of the manager -
- 2) Earning capacity, liquidity and working capital ratio.
- 3) State of inventories, these inventories must be made up of marketable goods.¹²¹
- 4) Effects of recession
- 5) Management type.

The loan proposals¹²² are scrutinized before loans are sanctioned." Lending money to inexperienced small business people, without supervision is often equivalent to pouring it down the drain. What these people need is first supervision and advice, and only secondarily capital . . . special - - financial institutions ought, therefore to regard their main duty as being to have a staff of experienced business - - - administrators who can give advice to small business people, who ask for it, when money is lent its use should be - - - supervised carefully, the officers of the institutions - - should have power to enforce changes in managerial practice, as a prior condition of the loan and to check unprofitable

Ref : 121 : P.G.Hastings - "Term loans in "Small Business financing, small marketer's aids, No. 122 (Washington, Small business Administration. 1957)

: 122 : Proposals have to furnish the information in the forms (See- Appendix II)

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practices at least untill the loan has been repaid." ^{123.}

Against this background we will study the - -
sources of finance available to small scale units; and their
respective contributions to these ~~units~~' financial - - -
requirements.

I) State-aid to industries act -

It gives long and medium terms loans to small -
scale units for then to twenty years. Since 1955, loans under
this are granted on the security of fixed assets or - - -
moveable assets including raw materials, goods-in-process -
and stock-in-trade. Loans are given for fixed or working -
capital. This act was operated by the State Department of
Industries; now on behalf of the state Government; it is -
operated through Banks Z.P. and Maharashtra State Finance
Corporation e.g. Loans over Rs.10,000/- and upto Rs.one lakh
are given through the Maharashtra State Finance Corporation.
Loans over Rs.3,000/- and upto Rs.10,000 are given through
the Bank of Maharashtra and Sangli Bank Ltd. Loans upto -
Rs.3,000/- are given through Zilla Parishad.

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Ref.:123 : W.A.Lewis' Le financement despetites et-moyennes
enterprises " quoted by Nau Nihal Singh in"
Scientific management of Small-Scale - - -
industries page -97)

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Commercial Banks - Generally commercial banks give loans for working capital on the security of readily realizable - - assets. They are reluctant to give loans because risk of - default is there, 2) repayment of loan is not at convenience of the bank; commercial banks contribution to small units is small. It is revealed from Calcutta and Bombay University - Surveys. In Calcutta Commercial bank's contribution was 13.9% and in Bombay it was 11.2%. In Kolhapur we find that out of - 17 oil engines surveyed, 5 oil engine units were indebted - upto 10 lakh rs, 2 units between 10 to 20 lakh of rupees, 2 units were in the range of 20 to 50 lakh of rupees and 2 - units in 50 to 75 lakh of rupees. Castings repair, jobwork, steel welder and other were in debted upto 10 lakh only. - They need mostly working capital. Out of 35 factories 16% wanted more than 50,000 rs. for promotional expenses, for plant and machinery; 9% were in this need, 6% wanted working - capital. Thus majority of the units needed capital for fixed capital, promotional and working Capital.

Agency wise loans - 13 Units got loans from Government. Out of this 4 units got upto 5000/-rs., 6 units got in the range of - - - - -

Ref. to Table No.26.

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5 to 15 thousand rupees, 4 units got in the range of 15 to 30 thousand, 2 units were in the range of 30 to 50 thousand and remaining two were in the range of 50 - 75 thousand. Four percent of units got loans from Co-operative institutions; Five percent of units got loans from moneylenders, Forty two percent of units got loans from financial institutions and banks. This shows that engineering units in Kolhapur do not depend on moneylenders. In Calcutta¹²⁴, the contribution of moneylenders to financial needs of small engineering units was 50.7%. In Bombay¹²⁵ it was 27.0%. The role of Urban Co-operatives in Kolhapur is insignificant; they have contributed 7.5% to the small units.

Ref.:124: A survey of 153 small engineering firms in 1953 by B.I.S. (Calcutta) revealed that moneylenders contributed 50.7%; commercial banks 18.9% and others 30.4% to total credit requirements.

:125: A survey of 32 engineering firms undertaken by the Department of Economics, University of Bombay in 1957 showed greater in significance of Commercial banks lending to small producers. e.g. Relatives contributed 12.5%; moneylenders 27.0% and commercial banks 11.2% to total credit requirements.

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Now the time has changed unlike the past, - - - -
 Government sponsored financial and promotional institutions
 have been entrusted to the development and promotion of small
~~and~~ scale units, whereby the developing regions will be - - -
 transformed from traditional to developed ones. Hence as - - -
 stated above small units rely on institutional finance - - -
 considerably. Thus we can say that in Kolhapur, Government,
 other financial institutions and banks supply considerably
 larger portion of capital to engineering units.

Financial Corporations -

"Finance corporations" have been set up to provide
 funds to public, private or mixed companies, co-operatives
 or other forms of business organizations for medium or long
 term requirements." Development corporations" have been - -
 organized to provide both loan and equity finance. They take
 initiative in the creation, direction or operations of - -
 individual enterprises. They characteristically supply part
 or all of the equity capital required for industrial - - -
 enterprises, rather than loan funds and frequently assume --
 responsibility for management and control."¹²⁶ There are various
 - - - - -

Ref.:126: ECAFE - Mobilization of Domestic -
 capital, 1953 p. 142.

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corporations which play financial and promotional role. The needs of finance, machinery, land, markets or foreign exchange etc. are fulfilled by these corporations.

Maharashtra State Finance Corporation -

The regional branch has been opened in 1970-1971. The Corporation gives loan for purchase of land, factory, - shade, machines. It gives loans out of its own funds, in joint participation with State Industrial corporation of Maharashtra or nationalized banks, Loans to small scale -- industry are given at 25%. MSFC gives loans for 1) new - - industry 2) modernization, replacement of machinery and for new production, 3) gives loans to educated unemployed, - - young technicians, technical assistance scheme. When - - - entrepreneur is a technician or an artisan and do not raise capital then MSFC supplies "Seed capital" or supplies loan at low rate of interest. It supplies 20% of the cost of project or 1 lakh of rupees whichever is less, the loans are given to that extent.

State Industrial Corporation of Maharashtra -

This corporation develops industries in - - - developing regions in Maharashtra, excluding the regions in

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Bombay, Thane Khopoli, SICOM helps small and medium scale - units in other regions. It gives 75% of capital cost of the project under capital participation scheme with 13 - - - - nationalized banks and MSFC. SICOM gives guidance pertaining to land, technology and investment. They identify the - - - projects.

Regional Development Corporations -

With a view to achieve regional development, four regional development corporations have been set up. - - Kolhapur region falls in the jurisdiction of Western Regional Development corporation. It supplies 10% of capital cost.

Besides these institutions small scale - - - - industries get the benefit of central subsidy, State capital subsidy, assistance from State trading corporation, Metal and Mineral trading Corporations, Marketing facilities are available through industrial departments, MSIDC. small industries get 15% more prices that are given to large units. Small units get machinery on hire purchase from MSSIDC.

Working of MSFC in Kolhapur -

With a view to achieve decentralized industrial structure, it was thought that there should be decentralisation

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in decision taking in respect of sanctions and disbursements of loans to small scale units in Kolhapur region. Kolhapur - region falls in the regions declared as developing regions by Maharashtra Government.^{126-A} In 1970-71 a regional office of MSFC was opened in Kolhapur. The objectives behind this - - decision were 1) To achieve decentralization of industries 2) assist small scale units 3) develop backward regions - 4) Control small units in bigger cities like Bombay and - care should be taken that concentration of wealth in few - hands does not result.

In Kolhapur region we find there are ups and - downs in application of loans sanctioned by MSFC.

<u>Year</u>	<u>Applications sanctioned.</u>
1969-70	394
1970-71	460
1971-72	178
1972-73	72
1973-74	148

Ref.: 126-A: Western Maharashtra consists of 13 districts.

They are Dhule, Jalgaon, Nasik, Ahmednagar, Pune, Sholapur, Kolhapur, Sangli and Satara.

Kolhapur region - Kolhapur, Satara, Sangli.

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1974-75	123
1975-76	246
1976-77	327

Out of these sanctions, engineering units have got more sanctions, but ups and downs are due to changes - in general economic situation. The recessionary conditions affected the industrial sector and the financial - - - - - omstotitopms can-not remain indifferent to the problem - - because they have to depend on the repaying capacity of the units that borrow money from banks and financial institutions. "The oil engine and its component industry located in and around Kolhapur continued to be in doldrum, which affected the psychology of other industrial units also in the region!"¹²⁷ MSFC appointed a study group.¹²⁸

The study group's findings were i) The oil engine and components industry in Kolhapur had grown beyond the - requirements of the economy and a possitive efforts in - - - - -

Ref.:127: Tenth annual report 1972 ISFC p.3-4.

:128 : MSFC set up a small working group jointly with the State Bank of India, MSSIDC and RBI to examine - the problems of the oil engine and components - industry in Kolhapur.

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direction of diversification should be made. It is recommended -
that financial institutions and banks should consider - - -
sympathetically the difficulties of the entrepreneurs in the
industry and assist them in preparation of projects for - -
diversification.

MSFC and other Institutions.-

Accordingly we find MSFC with its close liason
and methods of collaboration with other banks, institutions,
Govts and RBI has been able to assist small scale units -
considerably e.g. It has been found out that the MSSIDC -
(Maharashtra State Small Industries Development Corporation)
assists the entrepreneurs in identifying the areas of - -
diversification and assessing the potential markets for the
diversified markets and MSFC along with other banks give --
financial assistance for requisite capital outlay for - - -
diversification, even if the concerned units have overdues
with the financial units. Reserve Bank of India also agrees
to grant credit guarantee to recession affected units if their
diversification was technically feasible and economically -
viable.

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Working Capital -

MSFC tries to help small entrepreneur in - -
raising working capital e.g. under Joint Participation in
term loans, with the Bank of Maharashtra, the MSFC gives -
terms loans, which are shared as 3 : 1 between corporation
and Bank. MSFC sanctions loans along with SICOM.

Under its 'Development finance scheme' loans -
are given for Research and Development Diversification, - -
Educated unemployed, Technical assistance programme, young
technicians programme. Besides this soft loans from IDA -
(World bank) are disbursed through MSFC. It also gives - - -
refinance facility from IDBI. MSFC is linked to State Bank
of India, Reserve Bank of India, Industrial Development Bank
of India, MSSIDC, MIDC, Commercial banks, RDC State-aid-to
industries act." Through this it has established a necessary
' Organizational infrastructure " to help small units and -
thus engineering units in Kolhapur.

In 'Chapter on Technical aspects 'we supported
diversification of products from theoretical stand point. -
The financial institutions also gave all possible - - - - -

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encouragements to engineering units in their diversification efforts. Some could use the benefits but a large number - - especially small units of component manufacturers and - - - assemblers may not be able to take up any feasible project for diversification on account of existing composition of - plant and machinery with them which is quite obsolete; they must be rehabilitated. The plants and machinery lack - - - versatility.

Engineering units in Kolhapur depend largely - on these financial institutions, as is revealed from the -- findings.

MSFC sanctions term loans after the provision of working capital, land and machinery has been made by the party. In order to avoid multiple Financing and duplication in taking loans from MIDC for land; MSSIDC for raw material, MSFC supplies Common application form.

MSFC is an institution committed to the growth of small scale industry and backward areas. It is responsible to State Govt. and IDBI. The managing director is a key - - figure. He is nominated by IDBI on 1) Amendment to SFC and

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co-ordination with commercial banks. 2) He is one of the - - directors of SICOM Board. 3) MIDC Board. 4) He is a member of the Advisory Committee of NSIC, 5) and a member of State level Committee for sick industrial units. 6) He convenes the meeting of regional managers of the corporation in - - - Maharashtra. Thus he is well acquainted with the problems faced by small units pertaining to raw material, land, - - technical financial and foreign exchange needs and measures are taken to solve them.

Difficulties in procedural requirements -

Small entrepreneurs are generally perplexed - while going through all the procedural formalities; The - time spent on completing the forms is considerable. The - - party has to prepare a project for loan. In which details - - regarding 1) The purpose of loan 2) Trend in production, which the party intends to undertake 3) Details about organization, product. 4) Manufacturing process, location, - - production programme giving details of shifts, days, - - - - manufacturing capacity, installed and capacity utilization per year, 5) Raw materials 6) Cost of project i) land and -- building, plant and machinery, working capital pre-operative

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expenses. 7) Employment potential 8) Utilities like water, -
Electricity, fuel required 9) Financial Provisions - - - -
i) Promoters contribution, borrowings for fixed assets, - -
working capital or Seed capital and interest rates.

The projects is forwarded through technical, - -
legal and cost departments where it is scrutinized from - -
technical, economic, managerial and legal aspects and then
it may be sanctioned or refused. After sanctioning of the - -
loans; the disbursement is made within six months on the --
condition that the building has been constructed and - - -
production commenced. The party is bound to pay interest
and principal, from the time they receive the first - - -
instalments.

All these formalities are excessive and scrutiny
is time consuming and rigorous. The party is required to - -
furnish information about land, building, machinery, - - - -
electricity and secure license from State government, - - - -
Maharashtra State Electricity Board etc.

The procedural difficulties, defects and delays
should be avoided, at the same time reliable information -
must be furnished by the party to avoid future rejections of

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application. i) It is found that mortgage offered is - - -
 inadequate 2) Value of the assets is disproportionate to -
 the amount of loan and can-not be accepted without risk to the
 lending agency 3) More firms go out during recession - - -
 4) Accounts are not maintained nor audited according to - -
 principles. So in Kolhapur number of rejections is more than
 those found in Poona or Bombay*

In this Chapter we find that financial - - - -
 institutions viz. 1) Regional office of MSFC opened in 1970.
 2) Regional Development Corporation.
 3) S I C O M (1966-67)
 4) Small Industries Development Corporation
 (1954).
 5) Maharashtra Industrial Development -
 Corporation (1962).
 6) Small Industries Extension Centre etc.

established by the Government show greater sympathy - - -
 towards engineering units, advise them on all matters and help
 them in development efforts.

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 * Ref.: Various annual reports of MSFC.

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