ROLE OF FINANCIAL INSTITUTIONS IN ECONOMIC DEVELOPMENT

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"Free Enterprise was born with man and shall survive as long as man survives."

— A. D. Shroff
1899-1965
Founder-President
Forum of Free Enterprise

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by

N.N. Pai*

The financial institutions together constitute a fulcrum on which the process of economic growth rests heavily, though by no means exclusively. The role played by financial institutions in fulfilling felt needs in quantitative terms as well as in catalysing a developmental surge has been amply demonstrated by even the commercial banking system in our country — especially in the years following nationalisation and re-orientation of their objectives and policies.

In the logistics of growth mechanism, finance is a crucial element. Rational distribution of resources is as important as their effective mobilisation. Thus, in the absence of well designed institutional apparatus, large chunks of the available resources might be infructuously utilised through mis-direction. The essence of sound economic development implies proper deployment of the available scarce resources through appropriate distribution mechanism so as to create conditions in the economy for further creation and mobilisation of additional resources at subsequent stages.

There was a crying need in India for the establishment of specialised term financial institutions for quickening development of both agriculture and industry. In the sphere of industry, although India has had a fairly long tradition in industrial production, the process of industrialisation was undermined both by structural imbalances and discontinuities. And, except in the cases of certain traditional items like cotton textiles, jute and tea, newer lines of production were to a large extent impelled by short-lived exogenous

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* The author is an eminent banker. This text is based on the Murarji J. Vaidya Memorial Lecture delivered by him as the Chairman of the Industrial Development Bank of India on 18th January 1983.

factors, the two World Wars in particular. In the result, the industrial base of the economy, despite immense growth potential, remained too narrow besides being confined to a few geographical locations. Therefore, what was needed for sustained and well-diversified industrial growth was a powerful in-built prime-mover and the supporting institutional framework to make it work effectively and speedily in terms of set objectives and priorities in conformity with national aspirations.

A number of important and new institutions, including the financial institutions, came into existence in the wake of the Five Year Plans, the launching of which marked a sharp break with the past and the erstwhile stagnating tendencies in the Indian economy. Unprecedented levels of direct Government investments in agriculture, industry, education and infrastructure opened up new investment opportunities on a wide front and on an increasing scale. This called for efforts in other areas to convert the emerging opportunities and catalyse the growth impulses into productive enterprises. For realising these objectives, there was a special role to be played by financial institutions in so far as the financial input of the right magnitudes, right types, and at accessible sources was the missing link around which the human and material resources could be harnessed to generate increasing volumes of real outputs and services.

Further, with the implementation of diverse plan programmes, over time and space in the country, many obstacles to growth have been overcome and bottlenecks reduced. In consequence, we have now reached a stage where, each year, the financial institutions of the country find themselves faced with new challenges. In the nature of things, they are called upon increasingly to find fresh solutions to new problems — problems of resources, development of relatively backward areas and adaptation of their policies in the light of experience gained.

Institutional structure

An outstanding feature of the network of term financial institutions in the field of industrial finance in India is their multiplicity and diversity of operations.

The distinction of being the first development bank of the country goes to Industrial Finance Corporation of India (IFCI) which was designed to be an all-India institution from the beginning.

There was also a pressing need to establish the State Financial Corporations (SFCs) since we needed such institutions catering to the term loan needs of medium and small industrial entrepreneurs. The SFCs which were established in the 1950s rely on Industrial Development Bank of India (IDBI) for bulk of their resources. The Industrial Credit and Investment Corporation of India Ltd. (ICICI) was established with the blessing of the World Bank which was keen in participating in the industrial development of the country by providing long-term funds in the form of foreign currency loans needed for meeting the capital goods import requirement of industry. Though ICICI was established essentially as a private sector institution, its current shareholding pattern, the status enjoyed by it in raising resources through government guaranteed bonds and the guidelines it is expected to follow in deploying its assistance put it in the category of public sector financial institutions.

The purpose of setting up one more all-India financial institution viz., IDBI, in 1964 could be best described in the words of the then Union Finance Minister of India, Shri T.T. Krishnamachari who said, while introducing the IDBI bill in the Parliament that "where a long term view is necessary and a certain amount of risk has to be taken, the existing institutions tend, by reasons of their statutory obligations and traditions, to be conservative and cannot in any case be very helpful. We are envisaging the new Industrial Development Bank as a central co-ordinating agency, which ultimately will be concerned, directly or indirectly, with all problems or questions relating to the long and medium term financing of industry and will be in a position, if necessary, to adopt and enforce a system of priorities, in promoting future industrial growth".

The Unit Trust of India (UTI), established in 1964, aims at mobilising the savings of the community so as to channelise them in corporate shares and debentures in such a way that the funds thus invested remain safe and ensure regular and growing return to the unit holders.

Another type of State level institution, namely, the State Industrial Development Corporations (SIDCs) came up, mainly in the sixties to undertake various promotional activities for the growth of medium scale industrial units. The SIDCs are State-owned institutions and they have promoted a number of joint

sector and assisted sector projects and also set up some subsidiary industrial units. In 1976, the SIDCs, which were till then functioning essentially as promotional and developmental bodies, acting as agents of respective State Governments in operating incentive schemes designed for attracting industrial units, were also brought into the fold of term lending by making them eligible for refinance facilities of IDBI. Our primary objective in doing this was one of making use of their services in promoting balanced regional development and especially in the development of backward areas of the country. IDBI is also happy to rely on the SIDCs for promoting new and technician entrepreneurs by delegating to them the function of agents in the deployment of IDBI's Seed Capital assistance to new and qualified entrepreneurs. The commercial banks which have all along been eligible for refinance from IDBI came much more prominently within the fold of term lending institutions only during the last eight years when IDBI's refinance assistance to banks increased at an accelerated rate from Rs. 7.5 crores in 1973-74 to Rs. 276 crores in 1981-82.

In the background of the growing problems of sickness among industrial concerns, IDBI took initiative in setting up the Industrial Reconstruction Corporation of India Ltd. (IRCI) in 1971 for rehabilitation of industrial units which are closed down or are facing the risk of closure but deserve to be revived.

Consortium financing

The multiplicity of the institutions engaged in term lending to industry has, in fact, helped in building up of a well-organised and resilient financing system for serving the industrial sector more effectively. Over a period of time, IDBI, in collaboration with other all-India financial institutions, has tried to evolve a well-defined purpose-oriented pattern of industrial financing by evolving and encouraging a system of consortium financing. Regular meetings among the Heads and the Senior Executives of the all-India financial institutions are held to discuss in detail the policy issues and pattern of sharing assistance to particular projects. Sometimes, commercial banks' representatives are also called to participate in these meetings for financing large projects or for dealing with cases of problem units. All projects costing Rs. 5 crores and more are assisted under the system of lead institution and consortium-finance.

The difficulties that were faced by the entrepreneurs earlier

when the modalities of consortium financing were still being stream-lined have been considerably resolved by evolving common application form and the concept of lead institution whereby entrepreneurs are required to deal with only one institution, single appraisal system, common documentation through the scheme of power of attorney by the lead institution and introduction of participation certificate scheme for projects with capital cost upto Rs. 10 crores, etc. The institutions have also gone a step ahead by extending recently the concept of single disbursement window in some cases, whereby the lead institution will disburse assistance on behalf of all the institutions involved in consortium financing, and claim the amount from the latter at a subsequent stage. Consequent to the streamlining of consortium financing arrangements, almost all the earlier procedural difficulties faced by entrepreneurs have been resolved and, therefore, entrepreneurs' fears about dealing with multiplicity of institutions need no longer exist.

Significantly, this arrangement has enabled bringing in the three investment institutions viz., UTI, General Insurance Corpn. of India, (GIC) and Life Insurance Corporation of India (LIC) in the fold of consortium financing who invariably rely on the appraisal done by any one of the three all-India financial institutions viz., IDBI, IFCI and ICICI.

State-level institutions and banks

Even in regard to financing small and medium scale industrial units, especially those catering to local markets, the multiplicity of institutions definitely helps in view of the fact that for a vast country like India we need institutions to be as close to the borrowers as possible. Among these institutions, of course, the commercial banks are best suited in financing small scale and tiny sector units in view of their vast branch network and also on account of the fact that commercial banks alone can provide both working capital and term loans. Small scale units find it convenient to deal with a single institution for relatively small amounts of finance they need.

As regards the medium scale units the consortium financing approach was strengthened especially since 1976 when SIDCs were also brought into the fold of IDBI's refinance. It has since become possible to finance all projects upto Rs. 2 crores as commercial banks, SFCs and SIDCs can jointly provide loans upto Rs. 1.4 crores by availing IDBI's refinance facility.

Having described the structure of financial institutions in the country, let me now briefly touch upon the role played by them in the industrial development of the country. The aggregate sanctions of assistance of all the term financial institutions operating both at the national and the State-level increased sharply during the last decade, from Rs. 254 crores in 1970-71 to Rs. 3,130 crores in 1981-82. Similarly, yearly disbursements also spurted from Rs. 159.9 crores to Rs. 2,093.6 crores during the period. Cumulative sanctions and disbursements of all the institutions upto end of March 1982 were Rs. 14,916.5 crores and Rs. 10,176.2 crores respectively. The total investment to be catalysed by the cumulative assistance of all the institutions is estimated at Rs. 25,500 crores and the additional employment opportunities around 32 lakhs.

On the basis of this impressive performance, the financial institutions have rightly given rise to high expectations as regards their further significant contributions. This is quite natural in as much as the financial institutions, handling as they do substantial resources, have to play their part effectively in order to subserve in the desired manner the development objectives and priorities embodied in our Five Year Plans. At the current juncture, the financial institutions have a major responsibility to help in fulfilling the targets of industrial programme in the Sixth Five Year Plan.

The Sixth Five Year Plan envisages the growth in the manufacturing sector at the rate of 7.6 per cent in terms of gross value of output and 6.5 per cent in terms of value added. The growth target laid down for the manufacturing sector might appear to be somewhat modest but in terms of investment required for realising these targets, a sizeable amount of resources will have to be made available to the manufacturing sector. As far as the private sector is concerned, the investment of Rs. 15,157 crores has been targetted in the corporate manufacturing sector alone. This accounts for nearly 20.3 per cent of the total private sector investment planned for the current plan period. As regards the sources of funds of the private sector, it has been estimated that about Rs. 8,870 crores would be available to it in the form of internally generated resources comprising Rs. 5,710 crores by way of retained profits and Rs. 3,160 crores by way of depreciation provisions. It may be noted that the investment needs of the corporate manufacturing sector at Rs. 15,157 crores are worked out with

reference to 1979-80 prices. During the last two and half years, the prices have gone up further by over 20 per cent. Price rise leads to increases in wages as the wages in the corporate sector are linked to cost of living index. These wage increases would have adverse impact on corporate profitability and consequently on levels of retained earnings. Secondly, increase in prices also implies larger resources requirements to fulfil given investment plan. Even if we assume relative price stability during the rest of the Sixth Plan period, the corporate sector would have to mobilise from external sources much more than a total Rs. 7,000 to 8,000 crores during the five year period. My own feeling is that, to be on the safer side, we should plan for much larger amount of external sources of funds for the private corporate sector than the ones assumed in the Sixth Plan document. Keeping in view these overall investment figures, the term lending institutions have a challenging task before them to devise ways to meet the requirements of the private corporate sector.

One of the major tasks of the financial institutions is thus mobilising savings of the community and deploying them to areas where they can be used productively. Within the family of financial institutions, it is only the commercial banks and the three investment institutions which have been mobilising resources directly from the community for financing industrial and other borrowers. Insofar as the development banks, namely, IDBI, IFCI, ICICI, SFCs and SIDCs are concerned, their major sources of funds are –

(a) Central and State Governments and Reserve Bank of India

(b) Market borrowings by way of bonds, and

(c) Internal generation of resources.

Increasing importance of Government's resource support

The reliance of development banks on Government funds was relatively small in their early years of activity. Even for IDBI the reliance on the funds of Government was only by way of relatively small amounts of loans it obtained in the early years. Until 1976 bulk of its funds were obtained through equity and long term loans extended by the Reserve Bank through its National Industrial Credit (Long Term Operations) Fund. After 1976 IDBI's ownership was transferred to Government and since then the resource support received by IDBI from Government has been

growing. During 1981-82 IDBI received an amount of Rs. 195 crores from Government of India both by way of loans and equity support.

But given the constraints placed on the overall budgetary resources of Central Government especially in view of the growing requirement of funds for financing both revenue and plan expenditures, it would not be feasible to plan for dependence on this source at a rate at which growth was registered during the last couple of years.

Another major source of funds for these institutions is amounts raised on the market by way of bonds. During the financial year 1981-82 all the financial institutions together raised bonds to the tune of about Rs. 805 crores as against Rs. 540 crores during 1980-81 and Rs. 254 crores in 1977-78. These bonds are subscribed mainly by commercial banks, GIC and LIC. The bond quota allocated to the institutions like IDBI forms essentially a part of the overall kitty of captive funds that institutions like commercial banks, LIC, GIC and provident funds have to invest on account of statutory obligations and Government guidelines. Allocation of larger share in these captive funds to bonds of institutions automatically results in reduced availability of funds for Government of India and other similar borrowers. With a considerable slackening in the rate of growth of deposits with banks, the support lent by banks to these Government guaranteed bonds is growing at a much slower rate. During the last decade or so the statutory liquidity ratio (SLR) of commercial banks has been stepped up substantially from 25% in 1969 to 35% in 1981. Given the fact that commercial banks have also been called upon to shoulder greater responsibility in providing finance to priority sectors by directing them to allocate 40% of their total advances to priority sectors by 1985, there are obvious limitations on the extent to which the SLR can be stepped up further. This, therefore, puts a limit on the availability of resources for institutional bonds from commercial banks.

The financial institutions have been putting in special efforts for generating much larger level of internally generated resources through intensified loans recovery drive for dues from old borrowers. During 1981-82, for instance, the financial institutions generated nearly 44.5% of the total fund requirements by way of internal cash generation as against 41.3% during 1980-81. However, in a period characterised by rapid growth in lending activities, as

during the last couple of years, the proportion of total funds that could be generated internally would tend to remain small.

Foreign borrowings

Our total outstanding external debt as at the end of March 1982 was of the order of Rs. 15,400 crores. Substantial proportion of this external debt being official development assistance is both on concessional terms and with long maturities. Consequently, the debt service ratio as indicated by debt service payments in relation to total export earnings and the invisible is relatively low at around 10%. Therefore, there is some scope for raising foreign commercial loans without exposing the country to undue high foreign exposure. The country, therefore, enjoys a high credit rating in the international finance market. So far we have been a reluctant borrower in international markets and our commercial borrowings abroad have been very low. Therefore, it should not be difficult for us to secure foreign loans on relatively favourable terms. The recent sharp decline in international interest rates has been a welcome development. Thus, there is considerable potential for raising foreign borrowings to supplement our domestic savings for investment. In line with this thinking we have recently raised loan of US $25 million. During 1981 and 1982 ICICI raised funds equivalent of about US $80 million on the market. The financial institutions hope to tap this source increasingly in the next one or two years to supplement their resources.

The growing resources constraint faced by the institutions has, therefore, highlighted the need for making some of the traditional borrowers to reduce their dependence on institutional funds. Obviously, the borrowers who should be asked to rely less on the institutional funds cannot be the new entrepreneurs, the less resourceful small and medium scale entrepreneurs and some of the very large projects for which the private sector promoters cannot raise very large resources from the market. For these categories of borrowers the institutions will have to pay special attention and nurture them so that, eventually, they are able to stand on their own feet and are in a position to tap the market for funds required for their expansion/diversification projects.

Our attempt towards minimising dependence of entrepreneurs on the institutional funds can, therefore, yield rich dividends if these are directed to established entrepreneurs who have a good reputation on the market and have built up high level of confidence

among the investors through their good track record for utilising resources effectively as also ensuring reasonably attractive returns on the investors' funds. The companies which can do this are obviously the well-established and well-managed companies especially those belonging to the large industrial houses as also FERA companies. The institutions are keen that these set of borrowers try to explore all the avenues of raising resources, including borrowings on international capital markets, and, only after they have exhausted all these avenues, they should approach the institutions as a last resort.

Development of capital market

For enabling the well-established companies to raise funds from the market, and even as a part of their long term strategy, the financial institutions are keen to lend their full support to the development of a vibrant and healthy capital market in the country. Until recently, the efforts of the institutions towards the development of a strong capital market were mainly in the nature of underwriting support. Institutions now feel that new and innovative types of support are needed for activising the capital market and enabling it to raise much higher levels of resources for the corporate sector.

The measures for activising capital market could be conveniently classified into two categories viz., (a) the policies for improving the overall profitability of the corporate sector and the incentives for investors in industrial securities comprising equities and debentures, and (b) the other set of necessary conditions which the private sector itself may have to create for improving the efficiency in the use of capital. Let me first deal with the second aspect of the problem viz., the steps that the industrial community may have to take to keep its own house in order so that the investors develop greater confidence to invest larger proportion of their savings in industrial securities. It is a common observation that, in any given industry, a number of companies manufacturing similar or identical products have different levels of profitability as reflected in their balance sheets. Quite often, we do not find satisfactory explanation as to why some companies should make much lower level of profits than others given the fact that they work, more or less, in the same environment as their more efficient counterparts. The corporate sector would not be in a position to attract household sector's savings unless it is in a position to keep

its own house in order. This calls for great deal of attitudinal changes in the management methods and practices, which not only make it possible to run enterprises more efficiently but also that shareholders' interest are fully kept in view.

Let me now come to some of the steps recently taken by Government of India and the financial institutions to revive the interest of general public for investment in corporate sector. The major policy changes announced by the Government in 1981-82 relate to revision in administered prices of two major commodities, viz., Cement and Steel. This has already produced very favourable results by way of increased production and improvement in climate for investment in these industries. The spurt in the activity of the capital market during 1981-82 also owes a great deal to this realistic pricing policy. The other important steps taken by the Government during the last year have been with regard to the incentive structure of the debentures. The non-convertible debentures now assure a relatively high rate at 15% and are redeemable on maturity at a premium of 5%. The convertible debentures have already established a very good market for themselves in the capital market as could be noted from large amount of resources raised through this source, i.e. Rs. 185 crores in 1981-82 as against Rs. 45 crores in 1980-81.

Secondary market for non-convertible debentures

The scheme recently introduced by the three investment institutions, viz., LIC, UTI and GIC for imparting liquidity to holdings of non-convertible debentures of investors with holdings upto Rs. 40,000 is one such important step in this direction In the light of the recommendation of the Report of the Committee on Secondary Market for Debentures, the three investment institutions have devised an ingenious repurchase scheme for holdings on non-convertible debentures. As per this scheme, companies can offer unlimited buy-back arrangements to all individual investors with non-convertible debenture holdings upto Rs. 40,000/- provided the debentures are held by them atleast for a period of one year. A stand-by arrangement of this type would help in creating investment demand for non-convertible debentures on a much larger scale than in the past. The companies repurchasing their own debentures from individual investors can reissue them to other buyers or offer them for sale to investment institutions. The very assurance available to the investors that

they can sell their debenture holdings after a period of one year without any capital loss would tend them to hold on to these debentures and sell them to the companies only when they really need liquid funds. It is hoped that this scheme would help in creating a strong primary market for non-convertible debentures and also thereby encourage dealings in such debentures on the market since any holder with holdings upto Rs. 40,000/- and after a period of one year can always sell them back to the issuing companies. With the development of a strong primary market as well as secondary market for non-convertible debentures, a number of companies would be able to raise sizeable funds through this instrument from the market.

While evaluating the role played by financial institutions, therefore, in the industrial development of the country, their assistance in quantitative terms would not alone serve as an adequate yardstick. Credit should also be given to the institutions for all their efforts in helping the corporate sector in raising larger amounts of funds from the market. The institutional support to projects in the form of actual financial commitments would come down to the extent they help in strengthening the capital market. This way, the institutions would be able to catalyse much larger level of investments in the economy.

As a result of several measures introduced by Government and the financial institutions in minimising dependence of the corporate sector on institutional funds, a welcome change in the pattern of financing of projects has been emerging. This is clearly reflected in the pattern of financing of the corporate sector during IDBI's latest accounting year 1981-82. While IDBI's direct assistance during the three-year period 1978-79 to 1980-81 increased at an average rate of 37%, the growth in sanctions slackened to 10% in 1981-82. All the same, the total investment catalysed by IDBI assistance sanctioned in 1981-82 is estimated to be 43% higher than in the preceding year. This has been made possible mainly due to larger share of project costs being financed by promoters' own resources and funds from the capital market. An analysis of financing pattern of projects directly assisted by IDBI indicates that the share of finance to be provided by promoters themselves and to be raised from other sources, principally the capital market, increased from 50% in 1978-79 to 66.5% in 1981-82. As regards the pattern of financing of projects promoted by MRTP companies as well as those with cost above Rs. 10 crores

each, the share of project cost financed from promoters contribution and sources other than the financial institutions worked out to 48.8% in 1979-80, 47.8% in 1980-81 and 76.5% in 1981-82.

The growing reliance of the corporate sector on non-institutional sources is also clearly reflected in the spurt in activity of the capital market. The amount of fresh capital raised on the market during 1981-82 was significantly higher at Rs. 474 crores as compared with about Rs. 138 crores in 1980-81 and less than Rs. 100 crores per annum on an average during the preceding decade. During the current financial year it is anticipated that the market would be in a position to mobilise around Rs. 600 crores of fresh capital. With the recent measures taken by Government through suitable changes in incentive structure for debentures, realistic pricing policies for industrial products subject to pricing and distribution controls and the ingenuity of the corporate sector to devise attractive packages in respect of new issues, it is hoped that slackness that had developed recently in the capital market would prove to be a temporary phase. In my view the trend towards larger reliance by the well established companies on the capital market for the needed funds is of an enduring type and not a temporary phase.

Convertibility arrangements

Despite considerable streamlining done by the institutions in consultation with Government in regard to convertibility arrangements, certain mis-apprehensions continue to be voiced. Keeping in mind the difficulties faced by the entrepreneurs, Government of India modified the convertibility guidelines issued to the financial institutions in the latter half of 1980. No convertibility is now stipulated in respect of loans upto Rs. 1 crore. Even in the exercise of conversion it is ensured that after exercise of convertibility option, institutions would not be holding more than 40% of the share capital of any industrial concern. This has been specifically done with a view to removing any fear on the part of entrepreneurs about the so called back-door nationalisation, a misunderstanding which was being voiced by entrepreneurs for long. Let me reiterate that it is not an intention of the financial institutions to resort to any back-door nationalisation of units through the convertibility arrangements. It is also not the intention of the institutions to take over the units financed by them as the institutions are created mainly for stimulating industrial development of the country by

providing the required finance primarily for the units in the private sector. The institutions would find the job of running the assisted units too onerous to them unless they are obliged to do so for rehabilitation of units which have become sick due to mismanagement or lack of proper management. The convertibility guidelines permit institutions to acquire more than even 51% of the shareholdings of a unit in cases where they are forced to do so. For instance, if a unit defaults in its repayment of institutional loans without any sufficient and justifiable reason or if the unit is mismanaged, the institutions have a right to exercise their convertibility option and take over the management of such unit for putting it on better footing. This is in the overall public interest for protecting the interests of the institutions, the shareholders, revenue authorities, the employees and the creditors of such units.

Institutions have come to hold shares in a number of industrial units. The shares held by the institutions are those which result from (a) underwriting of public issue of capital, a part of which devolves on them, (b) direct subscription whenever entrepreneurs so desire, (c) shares acquired through bonus issues or subscriptions to right issues and lastly (d) through conversion of term loans into equity. The investment institutions also acquire shares through their market operations.

The institutions normally dispose of their shareholdings in small lots so that their sales do not have a pronounced effect on the market sentiment or enable certain individuals to corner the shares. Sometimes the shareholding is sold to the promoters in order to strengthen the present management in cases where their dealings with the institutions have been satisfactory. The sale of shares to other entrepreneurs/business houses is considered only in cases where the institutions come to a conclusion that the unit is mismanaged and that a change in management is essential for running it efficiently and in the overall public interest. This is in the best socio-economic interest of the community at large. Therefore, there need not be any apprehension in the minds of the entrepreneurs that the institutions would do anything to upset the present management so long as the units are being managed reasonably well.

Development of backward areas

Balanced regional development with special emphasis on development of backward areas has been one of the principal pre-

occupations of the financial institutions. Of the cumulative assistance sanctioned by the all term financial institutions upto end of March 1982 nearly 41% or Rs. 5.553 crores was to units in backward areas. Assistance to specified backward districts is made available on concessional terms like lower interest rate, longer moratorium, easier repayment schedule and more favourable treatment in regard to promoters' contribution and debt-equity norms. Projects in some of the specified backward districts are also eligible for Central investment subsidy. Some of the State Governments have also introduced their own schemes of investment subsidy, sales tax loans/concessions, subsidy for consultancy services etc.

As frequently pointed out, bulk of institutional assistance to backward areas has largely been taken advantage of by the projects situated in proximity of already developed centres. This however, is not surprising as industries tend to conglomerate in areas where large markets and infrastructural facilities are already available locally or are in fairly close proximity.

The problem of industrial backwardness is deeper and, as such, calls for suitable strategies to bring about accelerated industrial development of the backward regions. Though the financial institutions do encourage flow of their assistance to industrially backward areas of the country, the actual flow of assistance is essentially determined by locational decision of entrepreneurs and licensing authorities. The locational decisions of entrepreneurs depend in turn on such important factors as easy availability of raw materials and skilled labour, closeness to markets and adequacy of basic infrastructural facilities. While institutions have taken a number of steps to promote higher level of entrepreneurial activity in industrially less developed regions, it needs to be recognised that flow of institutional assistance to the backward areas depends upon the number of worthwhile proposals coming up from these areas. In this context it should be noted that no viable proposal coming up from industrially backward areas has been declined assistance by the institutions. In fact they are anxious to step up significantly their involvement so as to make possible much faster development of the backward districts of the country, particularly the 87 'No-Industry Districts' (NIDs) which do not have any medium or large industry. The Government of India have already announced certain policy measures to encourage industrialisation of these districts according to which special preference is to be given to these districts in considering grant of industrial licences

and the units licensed for location in these districts will not be permitted to change the location. Besides, levy cement would be made available on priority basis for construction of industrial projects coming up in these areas. A special Cell has also been set up in the Ministry of Industry, Government of India, to monitor and co-ordinate the efforts being made for industrialisation of NIDs.

Recognising the priority to be accorded to the promotion of industry in the NIDs, IDBI has already initiated certain promotional measures covering, in the first stage, about 25 NIDs to be selected in consultation with the concerned State Governments. The promotional measures envisaged include surveys to assess the industrial potential of these 25 districts so as to identify industrial opportunities, preparation of feasibility and project reports, undertaking of market studies of specific products and identification of the training needs for potential entrepreneurs. Financial, technical and administrative assistance to specific projects would also be arranged, wherever necessary. The promotional task is being assigned to the chain of Technical Consultancy Organisations (TCOs) sponsored by IDBI and other financial institutions in different States. Thus, the TCOs will identify, on a priority basis, industrial potential in the small, medium and large sectors on the basis of available natural and human resources (including artisan skills) of the districts. The immediate improvements needed in the basic infrastructure facilities would also be identified. The NET OUTPUT of these surveys would be integrated with the overall industrial development plans of the districts concerned.

In my view, co-ordinated joint effort by the institutions and the concerned Government agencies would be necessary to ensure simultaneous development of infrastructure and the industrial projects. Besides, the institutions may have to adopt a new and bold approach and offer additional incentives in the form of say lower promoters' contribution and interest rate, higher debt-equity ratio, longer repayment schedule etc. to attract industries, particularly medium and large scale projects in NIDs.

Industrial sickness

No discussion on industrial financing and growth is complete without reference to the growing menace of industrial sickness. There appears to be a fallacious assumption that finance would be the panacea for industrial sickness in the country. The nursing of

sick units is necessary in the interest of sustaining production and employment, but it is the sole responsibility of the Government and the financial institutions. There are also cases where management of sick units throw them in the laps of financial institutions and merrily start new and more profitable ventures. The promoters and managements of sick units believe that the institutions will not be allowed by the Government to close an industrial unit. Why then should they inject further funds or suffer any sacrifice?

Rehabilitation of sick units calls for a concerted and co-ordinated approach on the part of all concerned viz., the financial institutions, banks, State and Central Governments, other creditors and more particularly the promoters and labour who are directly concerned with the unit. There is a tendency to pass the burden of revival of the unit on to the financial institutions which have a large stake in the unit and consequently have to bear the heaviest burden in the form of reliefs and provision of further finance. The ultimate objective of reviving an otherwise viable unit is conveniently forgotten. On the other hand, an irretrievable unit is compelled to stretch its parasitic existence. The decision to nurse a sick unit should be taken purely on professional consideration of viability. While social considerations cannot be ignored, they cannot be the sole guiding factor and in any case the entire burden of social cost should not be passed on to the banks and financial institutions.

One of the main reasons for the industrial sickness particularly of the new projects is the inadequate management. According to a recent study by RBI, 52% of the sick units suffered on account of management deficiencies. The institutions are considering the following measures to tackle the serious problem of sickness:—

i) building up a cadre of experienced and qualified professionals in various disciplines, who will bridge the deficiencies in management of assisted units wherever necessary, though on a short term basis.

ii) setting up a Data Bank which would aid better appraisal of the entrepreneurs by having knowledge about their credit rating on the basis of their past track record. The Data Bank would also provide ready information about the suppliers of machinery and equipment, prices etc. and thereby help a realistic estimate of project cost to avoid overruns.

iii) streamlining and strengthening the institution of nominee directors to enable them to play more effective role in managing the performance of assisted units without, of course, interfering in day-to-day management.

With the acceleration of the pace of industrialisation in the country, the tasks that development banks have been called upon to perform are continually growing and with that the involvement of financial institutions is also increasing in many new areas. In view of the growing resources constraints faced by the institutions, their attention at the present juncture is being increasingly directed to help building up of a strong capital market and thereby attempting to bring about a change in the financing pattern of projects more in favour of promoters' own resources and mobilisation of savings from the capital market. These changes are in the right direction and, basically, they would promote a healthy financing pattern of the private corporate sector. The focus is, as it has always been, to help catalyse the maximum level of investments in the desired direction, at more appropriate locations and on the basis of a broad-based entrepreneurship in the country.

The views expressed in the booklet are not necessarily the views of the Forum of Free Enterprise.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

— **Eugene Black**

Have you joined the Forum?

The Forum of Free Enterprise is a non-political and non-partisan organisation, started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions, and other means as befit a democratic society.

Membership is open to all who agree with the Manifesto of the Forum. Annual membership fee is Rs. 30/- (entrance fee, Rs. 20/-) and Associate Membership fee, Rs. 12/- only (entrance fee, Rs. 8/-). Graduate course students can get our booklets and leaflets by becoming Student Associates on payment of Rs. 5/- only. (No entrance fee).

Write for further particulars (state whether Membership or Student Associateship) to the Secretary, Forum of Free Enterprise, 235, Dr. Dadabhai Naoroji Road, Post Box No. 48-A, Bombay-400 001.

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