THE CHANGING FOCUS OF INDUSTRIAL FINANCE

S. S. MEHTA

1981

Published by

THE A. D. SHROFF MEMORIAL TRUST
235 Dr. D. N. ROAD,
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(ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation, and the lectures to be delivered by persons eminent in these fields.

(iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.

(iv) Instituting a prize to be known as The A. D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce, Bombay.

(v) Doing all such acts, matters and things as are incidental or conducive to the attainment of the above aims or objects or any one or more of them; and

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INTRODUCTION

The A. D. Shroff Memorial Trust arranges every year a public lecture to be delivered by distinguished speakers—by turn, on Banking, Insurance and Industrial Finance.

In this series, the lecture on Industrial Finance was delivered by Mr. Siddharth S. Mehta in February 1981. It unravels lucidly the intricacies of this complex subject. Mr. Mehta who holds the position of the Chairman and Managing Director of one of India's premier financial institutions, namely, The Industrial Credit and Investment Corporation of India Ltd., brings to bear on the subject the knowledge and experience of a lifetime in the handling of industrial finance.

Mr. Mehta has discussed the qualitative and directional changes in the role which finance has been made to play in economic development; and he has outlined the most fruitful ways of mobilising and channelling financial resources to meet the pressing needs and priorities of industry. It is only through such a perceptive analysis of the emergent role of industrial finance, that we are made aware of the power inherent in this instrument for the common good.

The Board of Trustees has pleasure in publishing the text of this highly educative lecture for the benefit of the authorities and the public.

N. A. Palkhivala
Chairman
Board of Trustees

Bombay,
May 26, 1981

A. D. SHROFF

(1899 - 1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid the following tributes to A. D. Shroff;

> "In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in large part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

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THE CHANGING FOCUS OF INDUSTRIAL FINANCE

by

SIDDHARTH S. MEHTA

I consider it an honour and privilege to have been invited to deliver the A. D. Shroff Memorial Lecture. The late Shri Shroff stood for an economic philosophy, at the focus of which was individual enterprise. One of his main pursuits was to strengthen institutional frame-work for channelising, in an efficient manner, the flow of funds to the private sector industry. The Industrial Credit and Investment Corporation of India Limited (ICICI), which was established in 1955, **inter alia,** to perform this role, owes a special debt of gratitude to him. He was a member of the Steering Committee which was instrumental in the establishment of ICICI. He also played a leading role in arranging capital for ICICI. In the capacity of one of the founding Directors, the late Shri Shroff guided ICICI in the initial years of its working. I welcome this opportunity of paying tribute to the memory of one who was keenly interested in the problems of development.

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* The author is the Chairman and Managing Director of the Industrial Credit and Investment Corporation of India Limited. He was Technical Adviser, Tariff Commission, Government of India, for 10 years before joining the ICICI as its Technical Adviser in 1959. Subsequently he was its Dy. General Manager, General Manager and Managing Director, before taking over as its Chief Executive in 1976. His field of special interest includes economic and industrial development, national planning, management of enterprises, modern technology and development of banking. The lecture was delivered by Shri Mehta in Bombay on 11th February 1981.

I intend to discuss, from a broad perspective, issues relevant to the subject of the changing focus of industrial finance with specific reference to the issue of overall accountability which assumes increasing importance as the economic environment becomes more and more complex.

The attainment of Independence in 1947, and more significantly, the adoption of national economic planning in 1951, brought about a major transformation of the financial system. With a push towards larger economic activity following national planning, the demand for funds increased rapidly and indications were that it would rise continuously. Besides meeting the requirements of a rising quantum of funds, an institutional framework had to be built up to cater to the varied needs of different categories of users. This called for the establishment of specialised institutions.

Term Financing Institutions

The Industrial Finance Corporation of India (IFCI) was set up in 1948. This was followed by the establishment of State Finance Corporations in different States in the early 1950s. In 1955, ICICI was set up. The Unit Trust of India (UTI) and the Industrial Development Bank of India (IDBI) were established in 1963 and 1964, respectively. The Life Insurance Corporation of India (LIC), which was set up in 1956 by nationalisation of privately owned life insurance companies, also belongs to the community of industrial finance institutions in so far as it provides assistance to industrial units. With the nationalisation of privately owned general insurance companies and the formation of the General Insurance Corporation (GIC) and its subsidiaries in 1972, these joined the ranks of all-India term financing institutions.

Between them, these all-India financial institutions (IDBI, ICICI, IFCI, LIC, GIC and UTI) provide term finance to industries both in the form of loan and equity. The rising scale of their operations is evident from the fact that their annual sanctions during 1970-71 to 1979-80 have increased at a compound rate of 25 per cent. Between 1966-67 and 1969-70, the comparable growth rate was 6 per cent. In the case of IFCI and ICICI, their combined annual sanctions have increased to over Rs. 350 crores in 1979-80, a manifold rise from their annual sanctions in the late 1950s of around Rs. 4-5 crores. By any standard, the growth rate in operations of term financing institutions is impressive, even after allowing for inflation.

Qualitatively, the expansion in the role of the all-India term-financing institutions is even more impressive. They cater to a variety of financing needs of industrial users. With the exception of short-term finance, they provide more or less a complete package of financial services. This includes term loans in Rupees and foreign currency, investment in shares and debenutures, underwriting of equity shares and assistance in the issue of a variety of debentures, export financing and deferred payments facilities. Starting from a simple form, many of these schemes have acquired nuances as the needs of borrowers became varied and complex and the industrial financing system, within the country and outside, became more sophisticated. In their operations, financial institutions have brought about a close co-ordination in financing through consortium-financing and co-financing with banks and international finance institutions. These features of industrial financing have helped financial institutions to extend the scope and quality of service to cater to the needs of industrial clients more effectively and efficiently.

Simultaneously, steps have been taken by the community of financial institutions to develop the business potential of State level agencies. For balanced regional growth and locational dispersal of industrial units, the strengthening of promotional-cum-developmental institutional infrastructure at the State level and below is of utmost importance. State finance corporations are, therefore, encouraged to finance small and medium-sized projects. In the case of large projects, they resort to consortium-financing with the all-India term financing institutions.

During the 1970s, most of the States set up Industrial Development Corporations to co-promote projects with private parties, in what is commonly known as the joint sector. The all-India term financing institutions have financed a large number of such joint sector projects. Besides, with a view to identifying local industrial potential and promoting small projects, Industrial Technical Consultancy Organisations (ITCOs) have been set up in a number of States. The TCOs are the result of co-operation between all-India term financing institutions, State level agencies and commercial banks. In building up the institutional framework, progress has been perhaps much greater than what was envisaged in the 1950s.

Growth of Commercial Banks

The changing expectations of society from the financial system have had a far more dramatic impact on the growth of commercial banks. In the 1950s, one of the important objectives of reorganisation of the banking system was channelising finance to agriculture. The State Bank of India was set up in 1955 with a stipulation that it would open branches in rural and semi-urban areas. The late 1950s and the 1960s witnessed a period of consoli-

dation of the banking system through mergers and amalgamations. Social control of bank advances and protection of small depositors were some of the other concerns of the banking system in the 1960s. By the end of the 1960s, rural development, improved regional distribution of credit, increase in the share of 'priority' sectors in bank credit, augmenting the flow of assistance to small enterprises, artisans etc. emerged as the more important objectives of banking. Nationalisation of major commercial banks was a step taken to attain all these objectives. Extension of the branch network of commercial banks was considered to be the most important step in the direction of penetration of credit into hitherto underbanked sectors and regions as well as for resource mobilisation from rural and semi-urban areas.

A major breakthrough has been made in the sphere of branch expansion, especially in the unbanked centres, after nationalisation. At the end of June 1969, there were 8,262 bank branches, of which 5,154 were in rural and semi-urban areas. At the end of June 1980, the number of branches increased to 32,419, of which 23,179 were in rural and semi-urban areas. Along with branch expansion, the pace of resource mobilisation has substantially increased. The outstanding deposits of scheduled commercial banks have shot up from Rs. 4,646 crores at the end of June 1969, to Rs. 33,283 crores at the end of June 1980. Agricultural lending operations of commercial banks have also risen. The setting up of Regional Rural Banks is the latest institutional effort at improving the flow of funds to agriculture.

The change in the borrower-mix of commercial banks has not been smooth transition. It has created personnel, management and profitability problems. Not all the banks were geared to cope

with the transformation of their objectives and functions. The existing staff of banks, more attuned to urban milieu, could not transform themselves easily to the promotional role, which was expected of them. Many staff members did not take kindly to posting in rural and semi-urban areas. Their salary structure imposed a disproportionately large burden on profitability of branches, which would have been unremunerative, even otherwise, in terms of the volume of business in the initial years.

Despite a sizeable increase in resource mobilisation by commercial banks, claims on their resources have outpaced the inflow. The new demands on banks' resources have created problems especially for industrial borrowers. The demand for credit from industrial users, especially the organised trade and industry, is sought to be curtailed in several ways. In addition to control over allocation to industry, credit regulations have sought to control the flow of credit to individual large borrowers, who are required to justify their requirements; lending to them is being screened through a specially designed processing machinery. The control of credit on a borrower-basis, which affected mainly corporate borrowers, has often resulted in hardships and distortions.

Having described the background of the institutional framework, I would like to look ahead at the emerging situation.

Emerging Situation

Notwithstanding a pervasive net-work of institutions and sizeable mobilisation of resources, the emerging situation would seem to indicate growing pressures on resources. The first flush of domestic resource mobilisation through rapid branch

expansion would seem to be over. The scope for raising the domestic saving ratio, which is already high in relation to **per capita** income, is rather limited.

Thus while resource mobilisation, on an incremental basis, might decelerate, indications are that the need for resources would rise rapidly. All the sectors, physical and social infrastructure, industry and agriculture, would need additional resources. The foreign exchange reserves situation, which could have possibly absorbed a part of the resources requirements, is changing rapidly. With rising oil prices and consequent balance of payments deficits, foreign exchange reserves have started depleting. At least in the medium term, prospects for improvement in the situation are dim. The prospects for any increase in 'official development assistance' are also far from bright. There is rethinking in industrialised countries with regard to development aid; and in any case several of these countries are likely to remain too preoccupied with their own problems of inflation and unemployment to come to the rescue of developing countries.

The external environment is likely to add to the problems, with the prospects of rising crude oil prices, shrinking development aid (in real terms) and growing protectionism. Nevertheless, there is no need to take a pessimistic view. Many of the abovementioned problems are likely to affect other countries, perhaps with greater intensity in several cases. Our position may not be so bad relatively. We need to treat these adversities as a challenge and turn the situation to our advantage by taking concerted steps for acquiring greater self-reliance. This would need strengthening the production base through additional investment, which in turn would necessitate more resources. It is of equal im-

portance that resources, whatever may be the sectors to which they are deployed, are used with utmost efficiency. Dovetailing the task of additional resource mobilisation with a marked improvement in efficiency in utilisation is the principal economic challenge before us today.

All these would call for structural and conceptual changes in different areas of policy and the mode of implementation. Evolving an appropriate strategy for tackling the various emerging problems has become difficult because any solution would require striking an acceptable balance between economic considerations and others, that is, social, political, regional and sectoral. Expectations of society from those who are engaged in developmental activity, whether in the public or the private sectors, have increased over time. A new and growing dimension of social accountability has been added in judging industrial activity. What started as a voluntary social objective has, over the years, become an obligation. For instance, pollution control, workers' welfare, compliance with certain priorities, were in the nature of voluntary objectives of industry until a few years ago. Likewise, industry is now required to accept some of the socio-economic objectives of government's policy such as location of investment in backward areas, supply of essential commodities at low prices etc. as its own social responsibility.

Though the problem is not easy to solve, social objectives of industry has to be intertwined with its primary responsibility, namely, sustained efforts for improving efficiency in production. It cannot be overlooked that the corporate sector owes responsibility to shareholders, workers, lenders and consumers. It is against this changing focus and several new and complex elements of the

emerging situation that we need to look afresh at the role of government, financial institutions and industry in the process of development.

Role of Government

Government, with large resources at its disposal, can play an important role in areas, such as physical and social infrastructure. Adequacy of infrastructure is a precondition for all development, more so, for the development of backward areas.

Inadequate investment in infrastructure is a structural problem. Its solution would take some time. Fiscal debility of relatively backward States, a problem common to other federations, is one of the root causes. States relatively weak, both in terms of financial resources and administrative capabilities, have particularly lagged behind in the matter of infrastructural facilities. Often, the onus of making good the deficiency in infrastructural inputs has fallen on projects. This has resulted in delays in implementation and cost escalation and as a consequence some projects have become unviable. Some of them have turned sick when problems persisted for a long time. Concerted steps by central and state governments for improving the physical and social infrastructure in backward areas offer the only long-term solution to this problem. Pushing industrial investment in backward areas without first creating adequate infrastructural facilities would be inevitably at the cost of economic efficiency. Unless these minimum conditions are met, it would be difficult for any development activity, irrespective of whether it is in the sphere of agriculture, organised industry or small-scale industries, to flourish. In no small measure, deficiency in physical and social infrastructure has resulted in a decline in the productivity of capital.

Besides providing infrastructure, government plays an important role in direct industrial investment in heavy and basic industries, which are vital sectors for an industrial economy. Public sector enterprises have acquired a predominant position in many spheres of industry. They have come to stay and little useful purpose would be served at this stage by questioning their developmental role on first principles. However, their contribution towards development could be considerably enhanced if public sector enterprises were to earn a financial return commensurate with investment made in them. Public sector enterprises could generate substantial financial surpluses through changes in management directed towards autonomy and those which spur efficiency.

It is unfortunate that important issues have often been decided in the past largely on ideological considerations. This has impaired the operational efficiency of the industrial sector. In formulation of policies, attempts are often made to look at various issues ideologically and to over-emphasise the achievement of social objectives — or may I call them socio-political objectives — without paying adequate attention to the harmful economic consequences of such measures. In the process, economic considerations have often become victims. Short-run gains have been nullified by long-run economic deficiencies which such measures create due to regulatory bias, that has inevitably crept into their implementation. Planning is essential for ensuring overall balanced growth. However, in an attempt to serve too many conflicting objectives, the process of planning has been extended to become unduly comprehensive and detailed. It has narrowed the scope for institutional initiative, more so, for individual initiatives. This tendency needs to be curbed and the trend reversed. An environment needs to be created in which, consistent with the

mixed economy frame-work, government and private industries can play their due role.

Challenges before the country are too many to restrain any sector from making a positive contribution in tackling them. Available productive resources need to be harnessed for this task. Along with finance, complementary inputs — entrepreneurship, management, organisation, training and skills, to name a few — are required for bringing about a healthy growth of industries. Industrial and economic policies need to be reformulated to create an appropriate environment for these inputs to interact both in the public and the private sectors.

Fiscal and credit policies play an important role in ensuring the healthy functioning of industrial units. Hitherto, fiscal policy has been used, by and large, to mobilise revenue for government. The policy has subserved this objective rather well and the proportion of income mobilised by government through taxation in India, has sizeably increased over the years. Credit policy has been used as one of the major instruments for allocation of resources. This allocative system has created distortions in the system and quite often funds have flowed into sectors where they are not used most efficiently. By the same token, there are cases where lack of funds has impaired the viable operations and growth of economic activity in certain sectors.

In the recent past, several factors have contributed towards inflationary trends, including the cost structure of industries. A sustained increase in indirect taxes, which are levied by central and state governments, have added to this trend in cost structure. The consequent increase in prices of final products has slowed down the growth in demand. This has resulted in recurrence of weak

market conditions for a number of products. The worst affected industrial units are those which are set up at high capital costs and are exposed to the pressures of inflation, and to price and distribution controls.

Credit policy has been particularly harsh to industrial borrowers. New units are the worst affected. Working capital margins, anticipated at the time of appraisal of projects, get eroded because of inflation. The requirement of short-term funds also gets enhanced as a result of general inflation. Inadequate availability of funds due to credit controls often chokes credit required for sustaining production. The cumulative impact of these factors is underutilisation of capacity and blockage of funds in units, which become financially weak. The capacity of financial institutions for recycling funds for assisting productive activity also gets impaired. A reappraisal of the framework of economic policies is therefore needed, to avoid industrial sickness and respond more effectively to the emerging situaton, which is going to be increasingly difficult.

The fact that policy instruments, ostensibly designed to promote industrial growth have operated in practice with a regulatory bias has been often catalogued. But, problems related to viability in industry's working brought about by fragmentation of licensed capacity and the impact of increasing cost of new investments, for instance, are now recognised by government.

This has prompted government to take remedial measures, at least in some spheres. For instance, core industries such as cement and fertilisers are assured prices which allow for a reasonable return. Existing units in several industries are allowed to

expand thus permitting them to attain economically viable scales. These are steps in the right direction. However, there seems to be reluctance on the part of government to extend the scope of such measures to form a policy. Perhaps it is time to recognise that assurance of prices has directed investment in certain key industries and that this policy could be extended to cover more industries and that the assurance could be given for a significant period of time along with provision for timely adjustments.

Allocation of resources among different users is no doubt a difficult problem. Conflicts between social, economic and political objectives cannot be resolved easily and a balance has to be struck between these objectives. It is, however, questionable whether this should be attained through a detailed system of controls. Resort to regulatory measures tends to disregard the importance of economic considerations in the organisation of industrial activities with the result that the economic efficiency aspect is undermined. In spite of a widespread recognition of the need for a liberal approach, reservations, restrictions and similar negative measures unfortunately still form an important part of the strategy adopted.

The negative approach creates confrontation and rigidities which, in turn, lead to economic inefficiency and imbalances. Co-ordination in growth of different sectors can alone form the basis of a compromise between conflicting objectives. For instance, while all possible steps need to be taken for promoting and encouraging viable growth of small-scale units, a constructive approach would be to strengthen lnikages between the organised and the decentralised sectors. An enduring basis for the natural growth of small-scale units would be such a mutual interdependency and

harmony. The economic criterion of viability in investment decision-making needs to be restored. Unfortunately, profit has come to acquire a derogatory status. Profitability as an index of efficiency in the use of resources and their allocation needs to be reinstated in all sectors of economy. This would require a total change in the perception of government's role in the economy. In this context, rethinking on certain basic issues is also called for with regard to the sources of non-institutional finance for the corporate sector and the role of financial institutions.

Financial Institutions

The nationalisation of commercial banks in 1969 institutionalised virtually all the sources of industrial finance. The financial system which has emerged is characterised by the concentration of resource-flow into a limited number of institutions and banks which work in a closed system under direct or indirect government ownership. In a financial system which has thus become rather closely controlled, users do not have recourse to any alternative mode of finance of any significance. Consequently, the growth of industrial units has become heavily dependent on public sector financial institutions. This has circumscribed initiative and motivation for innovations in raising finance. A system like this could have perhaps rendered good service to its customers if there were adequacy of resources and each institution were allowed to function in a generally autonomous manner under broadly defined guidelines without the need for centralised control. As a result of low corporate profitability the capital market has hardly been a significant source of finance for a large majority of companies, as the return on equity has been historically low. Despite a steady increase in the amount of capital expenditure incurred by the corporate

sector, the quantum of equity capital raised from the capital market has remained rather modest and virtually stationary over time. Even raising of these amounts was possible because of underwriting and other support provided by term financing institutions. In several cases, the issued capital devolved on underwriters.

The problem of overdependence on institutional funds has aggravated with an upward movement in the structure of interest rates. Public deposits now constitute the only large source of funds obtained directly by the corporate sector. Not only is the cost of such funds high, but they cannot support the expanding needs of a growing company. While several companies have followed prudent financial policies and generated sizeable internal resources, such accruals have proved inadequate in view of the rapid escalation in capital costs.

As things stand, institutions have not been able to do full justice to their primary responsibility, namely, efficient provision of industrial finance and resource mobilisation. Their operational efficiency depends upon several factors, not all of which are under their control. For instance, earning reasonable profits so that a sound base is maintained for expansion of their operations is important for financial institutions. They also have to distribute dividends, besides servicing debt; and yet they are not in a positon to respond in a timely way to structural changes in borrowing and lending rates. Establishing a healthy relationship with shareholders, lenders, employees, financial community, business and industry and the community at large is their principal objective. At the same time, they are required to discharge their social obligations. Financial institutions have to strike a balance between their primary responsibility of financial efficiency and these obligations.

Institutions play their part in fulfilling the social objectives of the national plan, encouraging dispersal of industry in less developed areas and extending the ownership of industry to a large number of entrepreneurs. While providing assistance, financial institutions also extend support by exercising their influence on borrowers, to the fulfilment of the broader objectives such as creation of gainful employment opportunities, maintaining ecological balance, upgradation of technology, export promotion, import substitution etc. Institutions have made a significant contribution in attaining these objectives. But the problem is of a large dimension. Development finance institutions would continue to play their part in attaining the manifold objectives of policy, but in this direction much is required to be done by central and state governments and other agencies to create conditions congenial to development.

For instance, with a view to encouraging location of industries in backward areas, term financing institutions are providing assistance to projects located in these areas on concessional terms. These measures, however, would result in viable units, only if, adequate infrastructure is available.

For encouraging new entrepreneurs, terms and conditions have been relaxed by institutions. However, it is often not realised that the promotion of new entrepreneurs would always be a gradual process. While it is true that the quality of entrepreneurship can be created through training, some of the attributes of an entrepreneur are the result of certain capabilities of a person. These need to be tested. Trying out entrepreneurial capabilities of a new entrepreneur straightaway on large projects has its inherent risks, especially as the environment in which such projects have to operate is complex. The problem becomes compounded when large projects promoted by new entreprene-

urs have to deal with several uncertainties in one or the other areas of operation, be it market, infrastructural inadequacy, finance or any other.

Earlier while reviewing the evolution of the institutional framework, I have narrated the widening of the institutional infrastructure during the last three decades. In the building up of these institutions, initiatives have been taken by government and private agencies, either individually or jointly. Financial institutions at the all-India level have themselves taken initiatives in building up other institutions, either as separate agencies or, at times, as special cells in their own organisations.

While on the subject of financial institutions and their role in development, I would like to say a few words about the general issue of institution-building and their accountability. Given the many preoccupations and complexities of the functions of a government in modern times, it is obvious that it cannot be expected to cope with all the needs on its own. Therefore, the setting up of institutions to perform several tasks is not only a legitimate solution but also an efficient one.

In India, institutions have been in existence for many years in various spheres of development. They cover a diversity of activities including finance, industry, social and economic services, and research and development. Their organisational form varies and they include public sector corporations, civic corporations, boards concerned with energy and transportation etc. These institutions are instruments for implementing a large part of the development effort. When we consider the question of efficiency in one sphere of development, we have to consider the efficiency of several complementary institutions because with a multiplicity

of institutional agencies, developmental activity has become closely interdependent. That is why, if we have to face the changes envisaged in the coming years successfully, we would have to consider the role played by institutions in diverse activities related to development in an integrated manner, with due cognisance of the growing interdependency and complementarity.

It is indeed true that over the years, the institutional framework has become large and comprehensive but can we say that the overall performance of financial institutions is fully satisfactory? Are responsibilities and relationships by all those who are concerned with the attainment of developmental objectives well understood? Have the institutions succeeded in evolving well defined goals and strategy of implementation which would be assessed in terms of objective criteria, some of which can be reasonably well quantified and others which have to be assessed primarily in qualitative terms? Have we defined the system of accountability in each case in terms of the criteria of profitability, direct economic efficiency and social responsibilities? If institutions have to perform efficiently and also to meet several socio-economic objectives all the above matters need to be understood, defined in terms of operational criteria and a suitable strategy evolved for their implementation. This appears to be essential because having defined these matters, institutions need to play their legitimate role on their own. For ensuring their success they need to be allowed the freedom of management, with the least external interference or pressures — sectoral, bureaucratic or political.

Corporate Sector

Let me now turn to the corporate sector, which is the third collaborator in the process of development. Corporate industry plays an impor-

tant role directly and, by extending support to other productive sectors of the economy. The diversification of the industrial base with the addition of a large number of products has not only resulted in the saving of valuable foreign exchange but also contributed to a significant increase in agricultural productivity and augmented the supplies of essential commodities. Some corporate units, both in the public and the private sectors, have also performed commendably in the sphere of exports.

Several corporate units and voluntary agencies have made a useful contribution in training, extension work and local development. But the main thrust of their developmental impact would be felt, as it ought to be, in their primary activity, namely, efficient production. Many managements have shown commendable foresight and dexterity in maintaining a high degree of efficiency in production along with discharging social responsibility. Enlightened industrial managements have generated their own internal accountability mechanisms which have enabled them, if not always at least often, to anticipate the changing expectations of the community rather than adapt their operations after the changes occur. Such managements have earned the good-will of shareholders, workers, consumers and lenders.

There are, however, some corporate units whose performance has been rather unsatisfactory for varied reasons. To a certain extent, this is an outcome of the regulatory bias in policy measures, to which I had made a reference earlier. In some cases, management weaknesses were responsible for the poor performance. The complexities of the emerging situation call for fresh thinking with a view to removing both the regulatory bias and strengthening management capabilities. Professionalisation of management, the setting up of ap-

propriate organisational systems, strengthening the in-built objective accountability mechanisms, broad-basing of company Boards and induction of the required disciplines, are some of the steps which are bound to improve the operational efficiency of corporate units. However, unless corporate units have a reasonable degree of freedom in taking decisions in different operations, in accordance with economic efficiency, all these steps would be of limited value. In my view, one of the most basic issues on which urgent rethinking is required in this context is the role of profitability in guiding economic activity.

Profitability has come to be looked down upon. It is strange that it should be so, because everyone has expectations based on the efficient management of an enterprise — government through taxes, employees through improved standard of life, society through fulfilment of various developmental objectives and the economy through growth. The attitude emanates out of confused thinking based on outdated values. An important function of profits, apart from earning an adequate return on risk capital, is to generate internal resources for replacement, modernisation and new investment. Profits are the wherewithals for growth. Unfortunately, the functional role of profits in the process of growth is not fully appreciated.

While neglect of profitability is generally widespread, it is particularly greater in the public sector. Such an attitude arises at times from the confusion in the role expected to be played by public sector in economc development. Popular expectation is that the public sector need not make any profit as the guiding principle of public sector production activity should be 'service'. Rising

popular expectations and changing concept of the 'social objectives' of industrial activity, especially in the organised sector, have often set the tone for government policies pertaining to the corporate sector with an undue weightage being given to short-term and politically expedient solutions.

These factors have especially affected the operations of private sector corporate units in core industries, in whose case various policy measures have impaired profitability. While there is a growing concern about the losses incurred by industrial units, especially public sector enterprises, it needs to be appreciated that revision in price tariffs and reduction in consumer subsidies offer only a partial and temporary solution. A lasting improvement in the functioning of industrial enterprises would require a change of approach and attitude. In the public sector, an improvement could come about if the role of entrepreneurship, managerial competence and organisational strength in the efficient running of industrial units is given due importance by government and steps are taken for these to play their due part. Profits in this context would assume their rightful role, namely, serving as an index of efficiency.

The obscure view of profitability has affected the design of fiscal policy. While on the one hand, a variety of fiscal incentives are provided for encouraging investment, on the other, tax rates continue to remain high. As a result, net profits, though at times inflated in nominal terms on account of inflation, are low in real terms. Besides, even the nominally large surpluses generated in the form of depreciation and retention, prove far short of the resources required for replacement and modernisation. Technological obsolescence and decline in productivity have followed as inevitable consequences.

In fact, with intense pressure on 'new' investment, replacement and modernisation are often relegated to a second order of investment priority.

Social Obligations and Primary Responsibilities of the Corporate Sector

Indeed no industrial activity, whether in the private or the public sector, can afford to remain aloof from the rest of the economy. It must make a contribution to resolving pressing problems of the economy. Industry has to be responsive to issues like productivity and efficiency in the use of resources, research and development, contribution to gainful employment generation through backward linkages, training of workers, skill formation and upgradation, exports and several other forms in which industry contributes to development. It must also take into account its obligations to society in terms of issues like creation of employment, control of pollution, welfare activities connected with employees and so on.

The primary responsibility of the corporate sector is towards shareholders, workers, lenders and consumers. A corporate unit has to produce efficiently, sell its products and make profits both for distribution to shareholders and for growth. Manpower development, R&D, cost control, productivity, quality control, diversification, proper distribution and marketing are some of the important aspects related to improved efficiency in discharge of primary responsibility of a corporate unit.

The benefits of efficiency would naturally be shared by consumers, workers, shareholders and government. Efficient operation of corporate units would also enable them to discharge their responsibility to lenders. Regular repayments by corpo-

rate units would enable a quicker rollover of scarce capital resources and their better recycling so as to sustain maximum productive effort. Larger output and more rapid growth in investment would generate additional employment opportunities in the natural course, besides generating revenues for government, directly and indirectly.

Government, corporate management, workers and financial institutions all have a role to play in ensuring efficiency in the utilisation of resources. But the primary onus rests on government and corporate management. Formulation of policies and their implementation by government determine the economic environment. The perception by management of its role, as evident from the formulation of its objectives and their attainment with due attention being paid to efficiency and social responsibility, is an equally important factor.

What we need is a rethinking on basic issues in the light of many difficulties emerging in the environment. The concept of accountability and the expectations about the role of industry need to be viewed afresh, free from any preconceived notions. Indeed there is no need for taking extreme positions. Neither is the advocacy for efficiency and adequate return a plea for traditional for conventional socialism. We have come a long way from considering private profitability as the sole motive for economic activity. A view that welfare expenditure constitutes a sacrifice of profitability has few subscribers.

Co-ordination of Developmental Responsibilities

To achieve expeditiously and in an efficient manner, the multiple goals of policy, co-ordination

of developmental responsibilities, based on trade-offs between ideological and economic considerations, is urgently needed. Government has many preoccupations of great importance. And yet, it has extended its direct role in several areas, possibly, in too many areas! Sometimes I feel that it has been drawn into activities because of circumstances. At times, it has also moved away from liberal attitudes towards those which consider tightening of controls as the panacea for many problems. Since regulations have followed extension of government's role, a certain degree of rigidity has crept into the system. Responses are often delayed whereas changes are rapid. Perhaps, an introspection by government and a conscious effort on its part to curtail extension of its direct role and withdrawal from certain areas, might improve the responsiveness of the system to the changing conditions. We have created a fairly comprehensive institutional infrastructure and industrial base to which reference has already been made. Their potential in terms of supporting developmental effort is vast. With a greater degree of delegation and autonomy, the scope for initiative and imaginative innovations could be greatly improved.

I am aware that the process of economic planning and national priorities, which are an integral part of it, would involve a certain degree of monitoring of the flow of resources. But the questions which we need to ask are: Have the regulations served the objectives for which they were designed? Have they been consistent with maximising efficiency in the use of scarce capital resources? What are the factors responsible for the inadequacies? Are these factors institutional, organisational, managerial or any other? Is comprehensive planning the best alternative of attaining economic objectives?

The need for re-examining such basic issues is now felt also by policy-makers. Shortcomings of policies such as industrial licensing and price and distribution controls are recognised. Industrial licensing, apart from failing to ensure the most efficient use of capital, it is now appreciated, has at times tended to commit resources for inefficient projects. Price and distribution controls have, it is realised, turned out to be counterproductive. But we need to move further in the direction of formulating policies with the accent on liberalisation which allows a greater role to individual and institutional initiative without undermining in any way, the basic objectives of policy.

Liberalisation in any area of policy, however, automatically places additional responsibility on the corporate sector. The larger the company, whether in the public or the private sector, the greater is its responsibility. Observing fair trade practices is a corporate responsibility. Companies operating in monopolistic and oligopolistic market conditions would have to ensure that no misuse is made of their position. The growth of ancillary industries and generation of employment opportunities, control of pollution, would all become a part of their social responsibility. The corporate sector would have to formulate its growth strategy taking into account its impact in these areas. Liberalisation would also imply increased competition in the domestic market in due course. This challenge would have to be met through quality control, cost-effectiveness, economical marketing and after-sales-services. These are, in a way, the natural areas of social responsibility, which a community expects industry to discharge.

On its part, government, besides making appropriate modifications in policy, would have to tackle the problem of infrastructure. Shortages of infrastructural inputs and the spectre of rising import bill on account of petroleum and its products, have attracted great attention because of the immediate problems which they have created. While some of these problems may be short-term, by and large, many of them are long-term issues. Various alternatives for rectifying long-term problems, such as inadequacy of infrastructural facilities need to be considered. An openness of approach and pooling of managerial and other capabilities of different sectors for resolving these issues and meeting the emerging situation are required.

For example, in the sphere of energy, the generation of power on a sharing basis by a few industrial users needs to be considered with all the seriousness it deserves. This measure may well improve capacity utilisation and general efficiency in industry. Like-wise, in certain core areas of production where capital costs are high, project promotion in partnership between established Indian companies, foreign companies and central government might prove to be an effective solution for stepping up investment. We have moved far away from classical ideas of private and public sectors. Whatever may be the sector, the important issue is to take advantage of organisational strength derived from modern and efficient management practices evolved from experience. These examples illustrate the scope for policy solutions, provided there is a will, in stepping up investment and production in the coming years.

Concluding Observations

While I have made an attempt to assess the situation and have expressed concern for the

future, I do not wish to convey an impression either of despondency or helplessness. A developing society has to face problems. The situation in the foreseeable future is, no doubt likely to be difficult for India, but we have to think of ways of overcoming difficulties. Several of the problems in the emerging situation are of a conceptual or structural nature. Their solution, therefore, would require consideration of all possible options, with an open mind even with regard to basic issues.

Resource constraint seems to be a major factor which could frustrate all efforts at stepping up investment and growth. We need to constantly review the position and, besides adopting a flexible approach in the matter of resource mobilisation, introduce innovations in this regard. But all efforts at resource mobilisation would be in vain, unless concerted steps are taken to enhance productivity of capital through improved efficiency in the utilisation of resources. In my view, a clearer definition of objectives and accountability criteria and the establishment of proper systems for assessing performance in terms of these objectives and criteria are all a part of the process of taking industrial activity closer to efficiency.

We also need to assess government policy and its implementation, which are the major determinants of growth, from the perspective of problems and challenges lying ahead. In a situation which would be characterised by uncertainties and complexities, quickness of response of the system would be essential to cope effectively with the problems. Fortunately, over the years, we have established an institutional infrastructure in finance and other related activities, which, in my view, is capable of

coping with the challenges ahead. What we need to do is to strengthen the management capabilities of these institutions, and create conditions for their autonomous functioning within a broad framework of national economic priorities — priorities which are based on economic criteria and not on ideological considerations. A co-ordinated approach with regard to the role of different agencies engaged in development and a balance between conflicting objectives would provide an environment for the pursuit of growth based on economic efficiency. Bringing about these changes should be the principal endeavour of all those who are engaged in the task of industrial development.