UNIT 7 FINANCING THE NEW/SMALL ENTERPRISES

Objectives

After going through this unit you should be able to

- develop a framework for assessing your financing requirement
- describe the institutions which provide financial assistance to SSE
- explain in detail the various types of loans that may be availed from these institutions as well as the attendant requirement
- elaborate upon the defined role of the various financing institutions in respect of SSEs.

Structure

7.1 Introduction

7.2 Financial Planning-Assessing the Financing Requirements

7.3 Providing Bank Finance-The Indian Perspective

7.4 Financial Institutions which Provide Assistance to Small Enterprises

7.5 Types of Loans

7.6 Institutions and their Role

7.7 Self-employment Scheme for Educated Unemployed Youth

7.8 Summary

7.9 Self-assessment Questions

7.10 Further Readings

7.1 INTRODUCTION

Finance is one of the essential requirements of any enterprise. Small entrepreneurs, before setting up their organisation, need to be very clear about the extent and value of their financing requirements as well as the possible alternative sources from which these finances may be availed of while they would need to put in capital of their own. The Government of India as part of its policy of promotion of the small scale sector has set up a number of institutions to meet the financing requirements of this sector. Let us in this unit try to understand the type of financing needs that entrepreneurs may have and the institutional provisions to meet these requirements.

7.2 FINANCIAL PLANNING - ASSESSING THE FINANCING REQUIREMENTS

Financial Planning is appraisal of the financial aspects likely to happen in the future for which decision on course of action has to be taken now. Financial planning deals with futurity of present decisions in terms of goal setting. It helps developing strategies to achieve them by chalking out strategies, operational programme and assures smooth work. Goal-setting may be in terms of profits, sales, market share, acquisition of assets etc. Such goals are set after considering various functional areas like production", marketing, personnel, inventory, etc.

The goals that are set could be short-term and long-term. For example, determining capital structure of the firm shall be a long-term goal. The second step shall involve forecasting or determining the most probable course of events. A financial forecast includes estimation of the following:

1. Capital requirements
2. Working Capital requirements
3. Capital structure (debt-equity ratio)
4. Credit Policy
5. Contingencies

Financial planning is concerned with the general business policies as also trends. in business and their impact on the financial position as well as condition of the enterprise.

Short-term and long-term finance

Either when one sets up the enterprise or when one. is operating the business the upper most concern of an entrepreneur is to arrange financial resources to take care of all the operational requirements. Such financial resources could be short-term or long-term. These resources could also come from internal or external sources. The sources of short-term finance could be:

1. Bank borrowing for working capital ~
2. Sundry creditors
3. Deposits/borrowing from friends, relatives and others
4. Deposit received from customers.

The sources of long-term finance include:

I) Owner's capital, that is, equity;
II) Deposits/Loans given by owners (partners/directors) to the firm;
III) Term loans from financial institutions;
IV) Hire purchase/leasing facility from National Small Industries Corporation or similar organisations.
V) Credit facilities from commercial banks.
VI) Machinery purchase under IDBI Bill Rediscounting' Scheme.
VII) Seed capital, margin money, subsidy, soft loans from Government/Financial Institutions etc.

The above are largely external sources for raising-finance except owner's capital and deposits/loans. Funds can be generated internally by the entrepreneur through personal loans on his assets like PF/LIC/building/investments etc. It could be through personal borrowings from friends and relatives. For a running enterprise, it could be through retention of profits or conversions of assets into funds. Sound financial management implies that an entrepreneur religiously ploughs back a good part of his earning into the business enterprise. This ensures growth and stability. Such a policy will pay rich dividends in future and ensure easy access to borrowing from external sources in times of distress or when the unit is specially poised for expansion.

To ensure sound health, it is essential that short-term funds are utilised for acquiring current assets. Current assets are items like raw materials, stock in process, finished goods,'trade debts, investments, advance to suppliers etc. That is, items which are of current nature and keep changing their shape. They can normally be converted into cash within one year. Similarly, long-term finance should be utilised for acquiring fixed assets and partly for financing current assets to meet margin on working capital.

When arranging funds one must consider :

a) Cost of borrowing
b) Time required for obtaining such finance
c) Period for which funds required
d) Repayment capacity keeping future profit generation pattern in view
e) Conditions stipulated by lenders of money.

The cardinal principal would be to have mix of funds which works out to be the cheapest; is available most easily and attaches minimum outside interference .in the day-to-day working. For S & T entrepreneurs special loan schemes have been formulated by financial institutions/banks including soft loan and equity support. Since these are granted on most liberal terms, efforts should be made to make use of them to the maximum.

From a practical point of view, at times, desired cooperation- and helpful attitudes are missing when dealing with banks/financial institutions. A real entrepreneur will not accept defeat and give up the project under such circumstances. Try another bank or another branch of the same bank after some time when the previous manager changes. Such a strategy has been found to be very helpful in carrying out the project successfully. When dealing with bankers it is important to bear in mind that tall talk does not carry one very far. Bankers are moved into favourable decisions only based upon concrete plans and past performance. These are best presented through a Balance Sheet and Profit and Loss statement.

Activity 1

How would you use your financial plan to assess your financing requirements. Discuss with respect to both your short-term and long-term financing needs.

…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………

7.3 PROVIDING ANN FINANCE---THE INDIAN PERSPECTIVE

Credit is an essential input for any industrial enterprise. Small enterprises, almost, everywhere in the world, face a serious problem of non-availability of adequate credit facilities both in respect of working capital and medium and long-term funds. The capital base of these enterprises is weak mainly because they are not in a position to offer appropriate collateral security. As such they have to rely on their own savings as also of their friends and relatives besides drawing on the facility provided by the local money lenders whose terms and conditions for offering this assistance are far from the normal terms and conditions followed by the commercial banks and financial institutions. Majority of the enterprises in this sector continue to be either proprietory or partnership concerns with little or no reputation of being `Safe Credit Risk' in the organised financial market. They have, therefore, no easy access to the organised capital market. As stated earlier, initial source of funding their enterprises is mostly comprised their own savings and borrowing from relatives and friends. Prior to the nationalisation of major Indian Commercial banks, role played by the banks and other financial institutions was only meager. The principal difficulty experienced by the scheduled banks and the State Bank of India in entertaining loan applications of small units for accommodation was that the latter's own capital and consequently the security which they can offer was not considered appropriate and adequate. Information about the quality and marketability of the products manufactured by the small enterprises was not available. It was also pointed out that the big banks, which could lend their funds with the necessary safety and less cost of management to large enterprises, were not inclined to entertain applications of small scale units because of the risk of slow moving accounts, petty defaults and greater office work in follow ups. The" commercial banks used to refrain from advancing even medium term loans to small enterprises for purchase of machinery and equipment let alone the long-term loans for acquiring their own premises.

It was felt that "hank lending" to small scale units could be enlarged if there was some agency to share and in sure losses. A new scheme known as "Credit Guarantee Scheme" to guarantee advances to small scale industries was launched by the Reserve Bank of India. This certainly encouraged particularly the State Bank of India to enhance its lendings to the small scale enterprises.

The all India Small Scale Industries Board, an advisory body chaired by the Union Minister for Industrial Development,-in its periodical meetings has been drawing the attention of the Government of India to the dismal situation of credit facilities as available to the small enterprises and urging upon the Government to devise suitable policy to solve this problem particularly because the growth and development of small industries is very much conducive to creating employment opportunities for larger number of people both in the urban and rural areas. Government of India, no doubt, has been keen to do the needful in this regard but the first step in this direction was taken by the State Bank of India, when it launched 'a pilot scheme in nine districts of the country to advance loans to small scale units. Encouraged by its success, scheme was later extended to all over the country. Other banks also started giving assistance to small enterprises. After nationalisation of the major Indian commercial banks as also recognition of small scale enterprises as one of the priority sectors of material economy, performance of the banking sectors in this regard has been progressively improving.

Government of India having recognised the importance of small scale industries in the overall industrial development as also overall economic development of the country, has been engaged in formulating suitable policies and active programmes from time to time with a view to assisting small scale units in meeting their credit requirements. Since the second. Five Year Plan (1956-61) several institutions have been created to provide financial assistance to small scale units on terms and conditions which are relatively more liberal than those applicable to large scale industrial enterprises. There are, at present, various institutions/agencies which are engaged in the implementation of several schemes for the promotion and development of villages and small scale industries in the country. Financial institutions rendering assistance to the small scale enterprises are given in the following section.

Activity 2

A) Talk to some small entrepreneurs who have availed of bank credit. Discuss with them to find out:

   a) What were the procedures followed to avail the credit?
   b) What were the problems faced by them in getting the credit?

B) Talk to the Bankers of these entrepreneurs to gather information on problem that the bankers face with respect to financing in this sector.

……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………

7.4 FINANCIAL INSTITUTIONS WHICH PROVIDE ASSISTANCE-TO SMALL ENTERPRISES.

Financial Institutions rendering promotional assistance and credit facilities assistances to small scale industrial units/enterprises.

a) Reserve Bank of India: lays down the policies of lending supervision and follow up of advances to small scale industrial units Which is recognised as priority sector.

b) All India Lending Institutions

1. Industrial Development Bank of India (IDBI) -Small Industries Development Bank of India (SIDBI)--Various Schemes of the IDBI/SIDBI:

   i) Refinance Schemes for industrial loans

   ii) Special schemes for assistance to artisans and village and cottage industries, scheduled tribes/scheduled caste entrepreneurs, physically handicapped entrepreneurs, small scale industrial units

   iii) Refinance scheme for rehabilitation of small enterprises

   iv) Refinance scheme for modernisation of small industries

   v) Seed capital scheme

vi) Financing the New/Small

vii) Assistance through National Small Industries Corporation

viii) Scheme to assist women entrepreneurs etc.

2. Industrial Finance Corporation of India (IFCI)
3. Industrial Credit and Investment Corporation of India (ICICI)
4. Industrial Reconstruction Bank of India (IRBI)
5. Export Import Bank of India (EXIM Bank)
6. National Bank for Agriculture & Rural Development (NABARD)
7. National Cooperative Development Corporation (NCDC)

c) **Other Financial Institutions**

i) Commercial Banks

ii) State Financial Corporations (SFCs)

iii) Export Credit Guarantee Corporation (ECGC)

iv) Deposit Insurance and Credit Guarantee Corporation (DICGQC)

v) Regional Rural Bank and Cooperative Banks

d) **Others**

i) National Small Industries Corporation

ii) State Small Industries Corporation

Activity 3

Contact any one of the institutions described above, find out its financing service in, relation to the small enterprises. Do you feel that there is still some gap between the financing needs of enterprises and the provision made by these institutions.

……………………………………………………………………………………………
……………………………………………………………………………………………
……………………………………………………………………………………………

7.5 TYPES OF LOANS

A small scale unit as any other industrial unit requires loans for short-term and medium and long-term. Short-term finance or working capital finance is required for day-to-day operations of the enterprise and it is generally provided in the form of cash credit, overdraft facility and bills purchase and discount facility.' Short-term credit is also required for stocking raw materials, parts components, sub-assemblies required for producing /assembly of the end product. Medium and long-term credit (also known as terra finance) is required for acquiring fixed assets including land,. building, machinery and equipment both at the time of starting an enterprise as also its expansion of productive capacity by replacing or adding to the existing equipment.

To be specific the term "finance" .sanctioned in the form of "term loan" is required fo+r :

i) Land and site development

ii) Building and civil works

iii) Plant and machinery

iv) Installation expenses, and

v) Miscellaneous fixed assets which comprise vehicles, furniture and fixtures, office equipment, workshop and laboratory equipment, miscellaneous tools including erection tools, equipment for distribution of water & power supply and treatment of water, fire fighting equipment, affluent treatment and disposal plant etc.

Another element of the miscellaneous fixed cost, particularly, in respect of units to be located in backward areas is the expenditure on infrastructure facilities like water supply, power connection, roads, transportation including railway sidings in large projects.

The short-term loans or working capital is required for the following

a) Purchase of raw materials, chemicals, components, parts, sub-assemblies.

b) Consumable utilities, power, water and fuel. '

c) Labour and managerial service facilities, wages, salaries, bonus, provision of provident funds etc.

d) Repairs and maintenance, light, rent and fax on factory assets, insurance of factory assets, miscellaneous factory expenses, contingency, distribution costs, financial expenditure including interest on loan, both for long and short-term, guarantee commissions, depreciation etc.

Working capital facilities as are available from the commercial banks may be classified as

i) Dock and key pledge of stocks

ii) Factory/mundy type hypothecation advances (pending statement of stocks held by the Unit to be intimated to the banks)

iii) Advance against stock in process

iv) Advance against bills (when finished goods are supplied on credit)

v) Clean advance (contingency needs)

vi) Packing credit to exporters for executing export orders.

It is advisable that the working capital is never allowed to be inadequate which calls for on the one hand saving the unit from trading and on the other arranging for necessary stocks and other requirements to be pledged as per arrangement with the bank. Otherwise, the inadequate working capital can result in the following:

i) Hampers the growth of the enterprise because it becomes difficult for the entrepreneur to undertake profitable projects on account of non-availability of working capital funds.

ii) It becomes difficult to implement operating plans and achieve the targetted profits.

iii) Operating inefficiencies creep in when it becomes difficult even to meet day-today commitments.

iv) Sometimes the paucity of the working capital renders the enterprise unable to avail of attractive credit.

v) Fixed assets cannot be put to optimum use which affect the rate of investment.

Working capital finance is sanctioned in the form of cash credit, overdraft facility and bills purchased coupled with discounting facility working capital is physically an investment in the current assets. In any industrial enterprise initially cash is converted into raw materials which is converted into work in process and into financial goods and back to cash. This process being continuous results into blocking of some of the amount in this cycle. The working capital or the level of investment in the operating cycle depends on

i) changes in the terms of production, sales, while other factors are, constant.

ii) change in the price of raw material, time required to produce these, changes in the manufacturing techniques, process of manufacture, policy etc.

Activity 4

Take a sample of 10 entrepreneurs from your nearest industrial estate and find out from them

a) What are the sources of their working capital finance?

b) How far are commercial banks adequately meeting their working capital needs?

c) Are all these entrepreneurs using any non-organised creditors.

....
....
....
....

7.6 FINANCIAL INSTITUTIONS AND THEIR ROLE

Long and medium term loans are available from various organisations including National Small Industrial Corporation, Commercial Banks, State Small Industries Corporation, State Financial Corporation,-etc. In addition, these Corporations have got the re-finance facilities available to them from the Industrial Development Bank of India which has recently started a separate subsidiary Institution to take care of the requirements of the small scale industrial sector. The latter is know as Small Industries Development Bank of India and it has started operating with its head office at Lucknow only during 1990. There are specialised agencies to provide long-term finance. The role of different organisations is given in the following paras:

Shall Industries Development Bank of India

Small Industries Development Bank of India (SIDBI) under its Charter, has been, inter alia, assigned the-task of being the main purveyor of term finance to the small scale sector in the country. Small scale industrial units, small road transport operators and artisans, village and cottage industrial units in the tiny sector are extended financial assistance mainly by way of refinance through State Financial Corporations. (SFCs.), State Industrial Development Corporations/State Industrial Investment Corporations (SIDCs/SHCs) and banks which have wide network of branches. This way, it has been possible to reach even the tiniest industrial unit in the farthest corner of the country.

Eligible Institutions.

The institutions at present eligible for availing of refinance facilities from SIDBI comprise 18 State Financial Corporations (SFCs), 26 State Industrial Development Corporations/State Industrial Investment Corporations, 76 Commercial Banks, 196 Regional Rural Banks (RRBs), 11 State Co-operative Banks and 542 Central and Urban Co-operative Banks.

Eligibility

Term loans extended by eligible institutions to small scale industrial projects irrespective of the location and form of organisation of the unit are eligible for refinance assistance. Similarly, assistance is also made available for modernisation and rehabilitation of small industries.

SIDBI provides refinance at concessional rates of interest in respect of loans to certain special category of borrowers. The present refinance interest rate structure is given below

ANNEXURE-2
Refinance Interest Rate Structure

(Percentages)

		I tier		*II tier*	
		Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance	Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance
(a)	Basic Lending Rate (including assistance under modernisation scheme)	14.0	10.5	15.0	11.5
(b)	For new units in backward areas	12.5	9.0	13.5	10.0
(c)	For units in non-backward areas—				
	(i) All loans upto Rs. 25 lakhs	13.5	10.0	14.5	11.0
	(ii) All loans exceeding Rs. 25 lakhs	14.0	10.5	15.0	11.5
(d)	Composite Loans to artisans, village/cottage & tiny units (upto Rs. 50,000 per unit)—				
	(i) backward areas	10.0	6.5	11.0	7.5
	(ii) non-backward areas	12.0	8.5	13.0	9.5
(e)	Industrial estates—				
	(i) backward areas	12.5	9.0	13.5	10.0
	(ii) non-backward areas	14.0	10.5	15.0	11.5

(Percentages)

	I tier		II tier	
	Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance	Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance
(f) Rates of interest under specific schemes/purposes irrespective of location of the unit—				
(i) Rehabilitation assistance	—	—	10.0*	9.0
(ii) Units set up by SC/ST entrepreneurs & physically handicapped persons (upto Rs. 50,000 per unit)	—	—	10.0	6.5
(iii) Manufacture or installation of renewable energy/energy saving systems	12.5	9.0	13.5	10.0
(iv) Quality Control facilities	—	—	13.5	11.0
(g) Road transport operators (upto six vehicles)	—	—	15.0	11.5
(h) Equipment Refinance Scheme	—	—	15.0	12.0
(i) Single Window Scheme Working capital loan—				
(i) All loans upto Rs. 2 lakhs	—	—	15.0	11.0
(ii) All loans exceeding Rs. 2 lakhs	—	—	16.5	12.5
(j) Scheme of assistance for women entrepreneurs/MUN Scheme	12.5	9.0	13.5	10.0
(k) Ex-Servicemen Scheme—				
(i) backward areas	12.5	9.0	13.5	10.0
(ii) non-backward areas	13.5	10.0	14.5	11.0
(iii) Transport operators	—	—	15.0	11.5
(iv) Hotels, hospitals & tourism related activity—				
(a) backward areas	12.5	9.0	13.5	10.0
(b) non-backward areas	14.0	10.5	15.0	11.5
(l) D.G. Sets (irrespective of location and size of loan)	—	—	15.0	11.5
(m) Equity assistance under NEF/MUN/SEMFEX Schemes		— 1% service charge —		
(n) Assistance for acquisition of electromedical and other equipment	—	—	15.0	11.5
(o) Assistance for purchase of mobile sales vans	—	—	15.0	11.5
(p) Assistance to marketing organisations	—	—	15.0	11.5

*Primary lending institutions may increase the rate upto 11.5% p.a. in cases where the higher rate is justified on the basis of anticipated profitability of the borrowers.

Procedure for availing loan/refinance

Intending borrowers need approach only to eligible -institutions for assistance. The refinance operations are fully decentralised and all offices of SIDBI process refinance proposals emanating from regions/States under their respective jurisdiction. The eligible institutions are required to first sanction assistance to industrial concerns and, after complying with certain procedures laid down, seek refinance sanctions and disbursals from SIDBI.

Some important schemes of the SIDBI are given below:

Composite Loan. Scheme

The scheme covers composite loans upto Rs. 50,000 sanctioned to artisans, village and cottage industries and small scale industries in the tiny sector by eligible institutions. Assistance is provided for equipment finance or working capital or both. As the loans can be covered under the Credit Guarantee Scheme of DICGC, eligible institutions have been advised not to insist on collateral security.

National Equity Fund Scheme

With the objective of providing equity type of support to small entrepreneurs tiny/small scale sector and for rehabilitation- of viable sick units in the SSI sector, the SIDBI provides equity fund scheme.

Eligibility

(a) Entrepreneurs setting up new projects in the tiny and small scale sector for manufacture, preservation or processing of goods and existing sick SSI units undertaking rehabilitation if they are found to be potentially viable by the financing institutions, are eligible for assistance.

(b) All industrial activities and service industries, except road transport, hotel, restaurant and hospitals/nursing homes, are eligible for assistance under the Scheme.

(c) The unit should be located in village/town having population upto 5 lakhs (15 lakhs in the case of hilly areas and North-Eastern Region). However, in the case of the rehabilitation proposals, the project could be located in towns/villages with population upto 15 lakhs.

(d) New projects which avail of any margin money or seed/special capital assistance under the schemes of Central or State Government, SFCs and other State-level institutions or banks (except Central/State Investment Subsidy) will not be eligible for assistance.

(e) The rehabilitation proposal should conform to the norms prescribed under the Rehabilitation Refinance Scheme of SIDBI for SSI sector.

(f) The unit should be registered with State Directorate of Industries/appropriate statutory authority.

(g) The unit should be eligible for assistance under the Refinance Scheme of SIDBI. Sanction of refinance in respect of term loan for the project by SIDBI is a prerequisite for extending equity type assistance under the Scheme.

(h) The total fund requirement of projects in the form of equity assistance under NEF, term loan and working capital will be provided by a single agency. Central/State subsidy may be retained for meeting working capital requirement.

Project Cost

Project cost (including margin money for working capital) should not exceed Rs. 5 lakhs in the case of new project. In the case of rehabilitation projects also, total outlay on rehabilitation should not exceed Rs. 5 lakhs per project.

Amount of Assistance

Amount required to meet the gap in equity as per prescribed debt-equity norm, after taking into account the promoters' contribution, subject to a maximum of 15% of project cost within a ceiling of Rs. 75,000 per-project.

Interest

Only service charges @ 1% p.a. is payable.

Security

No security including collaterals to be insisted upon for the soft loan.

Refinance Scheme for Working Capital Loan under Single Window to Tiny and SSI Units by SFCs/SIDCs

Eligible units

New tiny and small scale units whose cost of project (excluding working capital margin) does not exceed Rs. 10 lakhs and the total working capital requirement at the normal level of operations is upto Rs. 5 lakhs, provided the unit has been sanctioned tern loan for fixed assets and loan for working capital by the same institution.

Nature and amount of assistance

Working capital loan upto Rs. 5 lakhs and permissible term loan for fixed assets.

Commitment charge

Nil.

Security

First charge on fixed assets and hypothecation of current assets.

Debt-equity ratio

3:1 for the total venture outlay (i.e. cost of the project plus total working capital requirement) after taking into account the amount of investment subsidy/incentive available for the project.

Promaters-contribution

As may be required to arrive at the debt-equity ratio of 3:1.

Scheme for Women Entrepreneurs

The Scheme has been formulated with the twin objectives of (i) providing training and extension services support to women entrepreneurs and (ii) extending financial assistance on concessional terms to enable them to set up industrial units in the small scale sector.

Training and Extension Services

Programmes for training and extension services for women entrepreneurs are organised through designated/approved agencies.

Eligibility

All projects in SSI sector including cottage, village and tiny industries promoted and managed by women entrepreneurs are eligible for concessional assistance under the Scheme.

Security

As maybe stipulate¢ by the eligible institutions. However, no collateral security is to be insisted upon.

Scheme of Refinance Assistance for Quality Control Facilities by SSI Units

The Scheme has been drawn up to encourage SSI units to establish facilities for testing and quality control with a view to ensuring better market acceptability of their products. The assistance will be provided byway of term loan normally not exceeding Rs. 7.5 lakhs per project.

Refinance Scheme for Modernisation of Small Scale Industries

The primary objective of the Scheme is to encourage industrial units overcome the backlog of modernisation and to adopt improved and updated technology and methods of production and prevent mechanical and technological obsolescence. Modernisation may include replacement or renovation of plant and machinery or acquisition of balancing equipment for fuller and more effective utilisation of installed capacity. Assistance under the Scheme is need based and as such, there is no maximum or minimum limits.

Bills Rediscounting Scheme

SIDBI's assistance to small sector also flow's through its scheme of rediscounting, of bills/ .promissory notes arising-out of sales of indigenous machinery to purchaser-users on deferred payment basis oh special concessional rates of discount/rediscount for purchaser users as well as seller-manufacturers in this sector. There is no minimum limit for transaction under the scheme. Banks are allowed a higher spread of 1.25% p.a. between their discounting rates so as to encourage them to cater more effectively to this sector. The facilities under the Scheme are available for purchase of machinery for expansion, diversification and modernisation. New SSI units can also avail of the facilities under the scheme for purchase of machinery. SIDBI has decided to waive the requirement of physical lodgement of bills with it,' arising out of sale or purchase of machinery by SSI units irrespective of the amount involved. An advance/down payment of 15% is usually insisted upon under the Scheme with a reduced norm of 10% applicable for commercial vehicles and. textile machinery. The discount/rediscount rates applicable for small scale sector are as under:

	Flat rates for Bills/Promissory notes of unexpired usance of 6 months and over	
	Rediscount (% p.a.)	*Discount (% p.a.)*
Normal*	10.25	11.50
SEBs/SRTCs	10.50	11.25
Winery/Brewery/Malt	12.50	13.50

*would be applicable to SRTOs also

National Equity Fund Scheme

With the objective of providing equity type of support to small entrepreneurs tiny/small scale sector and for rehabilitation of viable sick units in the SSI sector, the SIDBI provides equity fund scheme.

Activity 5

Contact the banker you contacted for Activity 2. How do they evaluate the role of SIDBI for the purposes of refinancing schemes?

…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………

National Small Industries Corporation

The National Small Industries Corporation (NSIC), a public undertaking was set up in 1955, mainly to meet the requirements of `term Loan' to the small scale units for purchase of imported and indigenous machinery and supply the same to the entrepreneurs on hire purchase basis. This scheme of the NSIC was most-popular in 1950s and 1960s because, as stated earlier, prior to the nationalisation of the major commercial banks, this was the only agency rendering the aforesaid service to the small scale units. Comrnercial banks and other financial institutions had neither the charter of function nor were prepared to consider the small scale entrepreneurs as safe risk for advancing money on long and medium term basis.

Entrepreneurs wishing to avail of this scheme have to pay earnest money varying from 15 to 30% of value of machinery. In addition a service charge varying from 2 to 5%, depending on the value of the machinery and the location 6f the unit has also to be paid to the hirer. The full hiring value of the machine alongwith interest on unpaid amount and service charges is payable in 13 half-yearly instalments--first instalment falling due after one year of the installation of the machinery. In case of furnaces, boilers, cold storage, plants, tyre retrading, canning, electroplating etc. the loan, has to be returned in 9 instalments.

Certain special categories of entrepreneurs, such as, technocrats, physically handicapped persons, defence personnel and those belonging to schedule castes/schedule tribes are charged concessional rate of earnest money, interest and service charges. The entrepreneur is free to made his choice which, of course, is subject to scrutiny about the essentiality of the machine, technical abilities to operate, its capacity and above all, the country of import because at times due to constraints of foreign exchange shortage, NSIC may not be in a position to arrange foreign exchange from the specific country from where the entrepreneur is interested to purchase the machinery.

Prescribed application forms are available from the NSIC and its regional office/branches at the State. These have to be submitted to the NSIC or its branches at the State/District level through the Dy. Director/Regional/R. Director of Industries or through the respective District Industry Centre. The application has to be accompanied by latest quotations from the manufacturers of the suppliers of machinery approved by the NSIC. The details about the machinery required for individual product lies under engineering and non-engineering category can be obtained from the Small Industries Services institutes or branches of the institute set up by small scale industries development organisation of the Government of India or through the district Industry Centres. NSIC also supplies machinery to existing profit making and financially viable small scale units (with permanent registration as an NSSI unit) on easy leasing term. Reputed small scale units or entrepreneurs of proven ability can also get machinery on lease basis from leasing companies on terms agreed to mutually by the parties concerned. Under this scheme, during 1980-81 to 1989-90 more than 1,10,000 small scale units purchased machinery worth 14,668,291acs of rupees through NSIC.

State Financial Corporations

State Financial Corporations (SFC) which exist almost in every State and Union Territory (U.T.) of the country constitute the most important single source of long-term credit to small scale industries. In view of the wide disparities in the levels of industrial development in different States and the vast size of the country in early 1960 it was felt that there was need to supplement the work of Industrial Finance Corporation of India (a Central Government institution set up for meeting the credit and capital investment needs of large scale corporate bodies) by setting up u8FC in each State and UT for granting term 'Finance' and equity capital to small scale and medium scale industries which are mostly either ownership or partnership concerns. Where there are no SFCs the Industrial Development Corporation operating in the States or UTs concerned perform the functions of the SFC also. The SFCs have their regional offices, branches and field level offices. The loans granted by these Corporations are payable in equal annual instalments spread over a period of l0 to l2 years the first instalment falling due for payment after one or two years of the disbursement of the loan. Generally speaking, advances are made up to 50 to 75% of the value of assets offered as security including those acquired out of the loans. Number of units covered in the scheme has been gradually interesting. During the period 1980-81, 1988-89, 2,30,839 units were covered under the scheme. The amount sanctioned to them was Rs. 5,664.52 crores and the actual disbursement was Rs. 3,858.92 6rores. However, the percentage share of the small scale units from this source continues to be nearly less than 40 per cent. It may be mentioned here that the loans obtained from this source is also used for purchase of land, construction of building besides purchase of machinery.

Although there is no statutory debt equity norm (to be followed by these Corporations and Commercial Banks) ,normally they follow 3: I debt-equity ratio while eva1uating the loan applications from small scale units. This means that the unit is eligible to raise three times of its own resources by way of term "Debt.". Another norm followed is the rate of promoters' contribution which is fixed in accordance with the cost of the project. The actual rate applicable would, however, depend upon the location of the project, the class of entrepreneur and the type of scheme under which the loan is sanctioned. In considering the actual amount of loan to be advanced by the SFCs, the latter have prescribed certain upper limits. The maximum amount of loan which can be sanctioned by NFC is Rs.60 lakhs in case of limited company or Corporations Societies while the relative limit in other cases including for proprietory and partnership concern iuBo.30lokbm.8FCxoperate various schemes for financial assistance to SSI units, most popular among these is composite loan under which no promoters contribution is necessary while the integrated loan scheme enables the unit to operate upto Rs. 1 lakh inclusive of working capital component. Besides, there are other schemes also operated by the SFCs and these are meant for special type of entrepreneurs, women entrepreneurs etc. The seed capital and -sp6cial capital scheme also in operation by the SFCs are intended for extension of equity types of assistance for new entrepreneurs.

The applications for loans to be submitted to SFCs are to be accompanied by a project report and other relevant information as may be prescribed by the SFCs .The applications are considered for sanction on the basis of the financial viability, technical feasibility and competence of the entrepreneur as assessed by the Corporation .The financial means the capacity of the product operate ' satisfactorily, generate cash surplus, service the loans and other liability and earn fair return on the capital invested. The technology feasibility of the project comprises the operational efficiency of the unit in terms of plant and machinery installed, spares used, raw material and other inputs, know-how / technology employed, capacity utilisation of the plant, scale of production, quality other product, cost of production vis-à-vis the norm prescribed for particular process. On receipt of information about sanction of loan, the entrepreneur has to take steps that may be prescribed by the corporation for completing the documentation requirements to facilitate drawal of loans/ instalments according to the requirements of the unit. These would comprise execution of loan agreement, irrevocable power of attorney, promotes, deed of undertaking, guarantees etc as may be required by the corporation.

State Level Small Scale Industries Corporation

States Small Scale Industries Corporations (SSICs) which exist AJT render a very useful assistance in meeting the long-term credit needs of the small scale units particularly for industrial premises either in the form of self-constructed buildings or "sheds in the industrial estates. In view of the varying cost of land and cost of construction of buildings.

Commercial Banks

Commercial banks in India comprise the State Bank of India and its subsidiaries, nationalised banks, foreign banks and other scheduled commercial banks, regional rural banks and non-scheduled commercial banks. The total number of branches of commercial banks are more than 45,000 and the regional rural banks approximately 8000 covering 280 districts in the country. While a major portion of the commercial banks providing assistance to the industrial sector is for meeting the working capital requirements, these banks also meet a part of the term "Finance" requirement of industrial units. According to the data compiled by Reserve Bank of India (RBI) of all the advance given to small scale industries/ sector by the commercial banks the share of the term `Loan' is dearly 30%. As stated earlier, the lead in this regard was taken by the State Bank of India (SBI) in March, 1956 when a pilot scheme for guaranteed credit to small enterprises was started. Initially the scheme was confined to the branches of the State Bank of India at nine centres only; gradually it was extended to all other branches of the State Bank in the country. Subsequently some of the other commercial banks also introduced special schemes to assist small enterprises. Later on, the other commercial banks also adopted this scheme. Under this scheme, the banks provide to the small scale enterprises the medium term and instalment credit for acquiring fixed assets for the purposes of establishment and extension of their units and term credit for meeting their working capital needs. Instalment credit granted by the bank for purchase of machinery/equipment either new or old against the hypothecation of equipment proposed to be purchased out of the profits of these loans. The borrower is required to make a down payment of 20 to 33.1/3% of the cost of equipment to be purchased from one's own resource while the rest is financed out of the loan. The rate of interest charged on these loans varies from time to time as per directive of the RBI. The period for which this loan is granted varies from seven to ten years. These loans are repayable in half-yearly or yearly instalments. A notable step taken in the financing of the small scale industries by RBI is introduction of the "Lead Bank Scheme" under which each district, in the country has been allotted to one of the major Indian Scheduled Banks for intensive development of banking facilities.

In view of the fact that the small scale enterprises have a week capital base, and they often find it difficult to offer acceptable securities. Commercial banks and other financial institutions granting loans to them as also because of their unfavourable debt-equity ratio, these units are considered bad credit risks by the lending institution. With a view to removing this impediment, the Government of India have introduced a "Credit Guarantee Scheme" in 1960. Under this scheme, the guarantee organisation stands surety on behalf of the small enterprises and guarantees loans granted to them upto a certain limit against the default or bad debt. The idea behind the introduction of this scheme is that the banks and other lending institutions should have assurance of security while dealing with the small scale industrial sector. Initially the scheme was applicable to 22 districts but, later on, it was extended to the entire country and as at present a very large number of financial institutions are taking advantage of the same and are being offered guarantee cover. The scheme is reviewed from time to time and all efforts are made by the RBI to make the scheme to the best advantage of the small scale industrial units. The guarantee fee charged. by the guaranteed organisation is very nominal (1.5%). According to the figures released by the Reserve Bank of India, by the end of 1989 (March), number of accounts of small scale units was 26,59,000 and the amount outstanding was Rs. 13,130 crores. In spite of the declared policy of the Government as also of the RBI the commercial banks are still, operating with the concept of security. Consequently, branches which are located in the far flung areas in the country need much-to improve in their performance. Notwithstanding this lacuna it will be appropriate to mention here that the banks have got laudable scheme to assist in the promotion and development of small scale industries. Most of the banks have got specialised units in their administrative structure to take care of the financial needs of the small scale industrial units. The fixed capital needs or the long and medium term needs of the small scale units are presently being taken care of by the banks under their integrated scheme of credit for the small entrepreneurs. New units apart frorn the existing units are also eligible to avail of the advances financed to meet their medium and long-term credit needs for replacement of machinery, addition of the machinery, modernisation etc. The rate of interest charged normally from the small scale industrial units is between 12 and 15% as against 18% from the large scale units. Arrangements also exist in certain branches to help small entrepreneurs in filling up necessary forms and completing the other documents which are necessary for the banks to consider the loan applications from the small scale units. Unfortunately, in smaller town where the entrepreneur is yet diffident, it is considered to be in an unsurmountable difficulty with the result that many of them remain contented with the meagre resources which they can draw upon from among their family members, friends and relatives.

7.7 SCHEME FOR PROVIDING SELF-EMPLOYMENT TO THE EDUCATED. UNEMPLOYED YOUTH

In the successive five year plans special, consideration has been given to the unemployed particularly-among the educated youth. While the results obtained have not been as per the expectation, the very idea has created awareness, among the Planners, Administrators and Development Agencies to devise and chalk out special programmes of assistance to provide employment to the educated unemployed youth. One such scheme launched in 1983-84 was to provide assistance to the educated unemployed youth to become self-employed by starting their own industrial enterprises, services and business establishments through a package of monetary assistance. Under this scheme of providing self-employment to unemployed, youth who have successfully completed their matriculation and are in age group of 18 to 35 can take advantage of getting themselves registered with their district Industry Centres which number more than 400 all over the country. Under this scheme, beneficiaries are entitled to a composite loan not exceeding Rs. 35,000% for an industrial venture, Rs. 25,000/- for a service venture and Rs. 15,000% for a small business venture. The monetary aspect of the scheme is implemented through the lead bank in each district. The banks are not expected to insist on any collateral security for loan upto Rs. 35,000/-. The loans sanctioned under this scheme are charged interest @ 10% per annum (PA) in specified backward areas and 12% P.A. in other areas. Repayment of the loan is made in instalments, the first instalment falling due between 6 months and 10 months after the date of disbursement of the, loan. The period of instalment is spread over 3 to 7 year depending on the nature of venture and expected profitability. The recovery of the loan is the responsibility of the bank 'concerned. Local managers of the banks are allowed sufficient flexibility in dealing with the defaulting borrowers particularly by re-scheduling the recovery period in case of bonafide defaulters. The District Industry Centres have been asked to monitor the implementation of the scheme at district level. Besides educational qualifications and the beneficiaries mentioned above, the youth belonging to a family with an annual income of Rs. 10,000/- and below are eligible to avail of the scheme.

The progress of the scheme during the last five years as under:

Year	Target (in lakh nos.)	Application recd. (in lakh nos.)	Applications sanctioned by banks (in lakh nos.)	Amount sanctioned by bank (Rs. in crores)
1985-86	.2.50,	8.58	2.21	429.99
1886-87	2.50	9.10	2.17	469.91
1987-88	1.25	6.80	1.20	259.76
1988-89	2.50	6.11	1.92	404.61
1989-90	1.25	4.43	0.97	190.00

Source: Office of the Development Commissioner Small Scale Industries.

7.8 SUMMARY

In view of their inability to provide adequate collateral security, small enterprises in the past have found it difficult to meet their financing needs. From the third Five Year Plan onward, however, with the Government recognising and promoting the small sector as an important contributor to the national economy, things have changed for the better. Today in addition to the Small Industries Development Bank of India we have a number of institutions including commercial banks to meet the financing needs of small enterprises. This unit discusses the assessment of financing needs and the alternative ways of meeting these needs by the small entrepreneur.

7.9 SELF-ASSESSMENT QUESTIONS

1. What are thee main sources of short and long term finance for a small entreperneur?
2. Comment upon the position of commercial batiks vis-à-vis the financing of small enterprises:
3. Discuss the various types of financing requirements that a small entrepreneur may have.
4. Discuss in detail the role of SIDBI as an institution in the context of financing of SSEs.

7.10 FURTHER READINGS

Dan Strenhoff and JF Burgess, “Small Business Management Fundamentals, McGraw Hill Book Company (1986).”