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HIRE-PURCHASE LOANS FOR THE MECHANIZATION OF SMALL-SCALE INDUSTRIES: THE EXPERIENCE OF INDIA [1/]

by

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1/ This paper was prepared for UNIDO in 1966 and revised and updated in 1969 by the author. The Annex contains a critique of the hire-purchase programme by the International Perspective Planning Team of the Ford Foundation and is excerpted from its report on "Development of Small-scale Industries in India, 1962".

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INTRODUCTION

Productivity and efficiency of small manufacturing units do not merely depend on a single production factor, but on a combination and interaction of various "inputs". A single factor approach or a development programme designed to improve only one of these inputs will at best produce meagre results that may not be commensurate with the efforts put in. On the other hand, a comprehensive programme to improve a selected set of inputs is expected to prove highly effective. The latter approach was particularly inescapable in India where small industry sector was mainly characterized by outmoded techniques of production, ineffective or less effective management and marketing practices, lack of finance etc. The resuscitation and future growth of small industries in India required modernization of this sector as well as a network of institutions for providing finance, both for long- and short-term needs at reasonable terms.

Several difficulties of small industries are attributed to lack of finance. But shortage of finance itself is often due to low productivity and is, therefore, generally a symptom of other problems like outmoded techniques of production, ineffective marketing practices, bad product design, lack of cost accounting and proper planning, etc. Efforts towards modernization of small industries if conceived in the absence of adequate arrangements for the supply of credit would succeed, if at all, partially. However, the converse solution, where credit facilities are provided without several other aids for modernization (such as technical and industrial advisory services) would be equally inhibitive in its influence on small industry development. A combination of credit facilities along with efforts towards modernization of small industry through technical industrial advisory services and other developmental aids would better promote and accelerate the growth of small industries.

<u>Sources of institutional credit and government finance for small industries in India</u>

These are as set out as follows:

(1) State Directorates of Industries (State Government Departments) for loans to small industries under the "State Aid to Industries Act";

(2) State Finance Corporations;

(3) State Bank of India;

(4) Commercial Banks;

(5) National Small Industries Corporation (NSIC);

(6) State Small Industries Corporations;

(7) Reserve Bank of India; and,

(8) Industrial Development Bank of India (IDBI).

Nature of loans and growth of relative advances made to small industries

Some of these institutions viz. State Directorates of Industries for loans under State Aid to Industries Act, National Small Industries Corporation and State Small Industries Corporations, extend financial assistance exclusively to small-scale units, while others, namely, State Finance Corporations, State Bank of India and Commercial Banks handle credit advances for small industries along with their financial operations in other sectors of the economy. The "apex" bodies like the Reserve Bank of India and the Industrial Development Bank of India only offer credit guarantee and rediscounting facilities to the credit institutions, especially commercial banks, in respect of the credit accommodation provided by them to small-scale units and do not directly make available finance to small-scale units.

Credit institutions, namely, State Directorates of Industries, State Finance Corporations, State Bank of India and commercial banks make available cash loans both short- and long-term, while the National Small Industries Corporation and State Small Industries Corporations provide assistance in the form of actual deliveries of machines on an instalment credit basis. Recently, the State Bank of India and several other commercial banks have also started providing instalment credit to small-scale units for financing the purchases of machinery and equipment.

Until March 1969, institutional credit to the tune of $675.2 million (or Rs.507 crores) 1/ was pumped into the small-scale sector. The amounts of credits supplied by different financial agencies and the percentage share of each in the total amount of institutional credit are shown as follows:

1/ One US dollar = 7.50 rupees.

	31 March 1969		31 March 1965
	US $ million	Per cent	Per cent
Commercial Banks	282.7	41.8	9.0
State Bank of India	240.0	35.4	39.5
State Finance Corporations	58.7	8.9	13.0
State Directorates of Industries	49.8	7.4	17.5
National Small Industries Corporation	42.7	6.3	19.0
State Small Industries Corporation	1.3	0.2	2.0
Total	675.2	100.0	100.0

Primarily due to the recently imposed "Social Control" 2/ over the commercial banks in India, institutional credit provided to small-scale units has increased nearly twenty-five times during a short span of 3 to 4 years ending with March 1968. Part of this increase is, however, attributable to the extension of the definition of "small-scale units" in 1966 (following devaluation of the rupee), to include units having investment in fixed assets between $ 0.06 and $0.1 million. Nevertheless the increase in bank advances to the small-scale sector by commercial banks has been spectacular. Credit provided by other institutions has increased steadily, but at a slower rate. Therefore, there has been a shift in the relative position of advances supplied to small-scale units through various sources. Thus, notwithstanding the fact that all the credit institutions stepped up supply of credit to small-scale units, the relative share of every institution except that of commercial banks has gone down due to by far a bigger increase in supply of credit by the commercial banks.

The entire supply of credit through the National Small Industries Corporation and the State Small Industries Corporations was in the form of supply of machines on hire-purchase while only a little over 5.3 per cent of credit supplied by the State Bank of India and commercial banks during 1968-69 was in the form of five-year instalment credit for buying machinery and equipment. This means that about 93.5 per cent of the total credit provided during 1968-69, was in the form of cash loans and advances while the remaining 6.5 per cent was given in the form of machines on hire-purchase or instalment credit loans. Cash loans thus constitute a greater proportion of total advances to small industries as compared to those in

2/ Under the "Social Control", Banks have been directed to step up as well as apportion a sizeable proportion of their lendable resources for meeting the credit needs of three priority sectors, namely, Agriculture, Small Scale Industries and Export.

the form of actual purchase of machines and equipment.

Again, of the cash loans a major proportion is utilized as operational funds while only a small part (say 5.5 per cent) is given in the form of medium- and long-term loans for financing purchases of machinery and equipment. Purchases of machinery and equipment are thus financed partly through cash advances and partly through actual deliveries of machines on hire-purchase or instalment credit basis. Of the total institutional credit made available to small industries nearly 12 per cent is utilized for modernizing and rationalizing plant and equipment and the rest for operational funds. Nearly four years back, the former accounted for one-third of the total credit supplied to the small-scale sector. In spite of the fact that the total amount of instalment and hire-purchase credit has increased from $5.57 million by the end of 1964-65 to $80.9 million by the end of 1968-69, its relative share in total credit supply has gone down from 33 per cent to 12 per cent. This fall has occurred due to an out of proportion increase in credit supplied by the commercial banks (which supply mostly operational funds in the form of short-term advances) vis-à-vis other credit institutions.

Purchases of machinery and equipment are thus financed both by supplying machines on hire-purchase as well as by making cash advances for the purpose. Out of the credit made available for machinery and equipment, one-third is provided in the form of cash loans for machinery and equipment, while two-thirds are in the form of actual supplies of machines and equipment on instalment credit.

Need for and advantage of a hire-purchase system

One can hardly overstate the importance of institutional credit in the form of cash loans as a factor facilitating better utilization of installed capacity. However, the needs for renovation, rationalization and modernization of plant and equipment generate pressing demands for capital for the transformation of existing small units into viable enterprises with adequate in-built ploughing-back capacity. At earlier stages of small industries growth, a pattern of institutional credit where a major proportion is supplied in the form of cash loans for operational funds is quite understandable while at later stages when small industries go higher on the ladder of technical maturity and their demand for modern plant and sophisticated equipment catches up momentum, it is in the fitness of things that higher weightage is attributed to schemes intended to finance purchases of plant and machinery.

Besides, it has been estimated that in the case of small-scale manufacturing enterprises, fixed capital and working capital on an average account for 48 and 52 per cent respectively, in the total investment. As against this pattern of investment, only 20 per cent of the total credit supply has been made for acquiring fixed assets. This re-inforces the argument in favour of attributing higher weightage to the supply of credit for acquiring fixed assets, in a credit supply scheme for small-scale industries. Moreover, arrangements for supply of long-term finance are also required to afford an opportunity to the class of talented artisans and craftsmen for acquiring the status of self-reliant small industrialists. A gradual rise of such a class is indeed of considerable importance to the social and economic structure of India. The twin objectives of accelerating modernization and rationalization of existing small units on the one hand and stimulating the growth of talented artisans and craftsmen into a class of small industrialists on the other, underline the imperative need for supply of credit to small industries throughout the country for financing purchases of plant and equipment.

Supply of machines and equipment on hire-purchase has several advantages as compared to the granting of cash loans for financing the purchase of machinery. Firstly, since the hire-purchaser does not receive cash, this obviates any chance of the loan being utilized for unauthorized purposes. Secondly, the hire-purchaser is not required to furnish any security or surety for receiving equipment as is often the case in respect of cash credit accommodation. In fact, this aspect of the hire-purchase system enables it to be all-embracing, whereas a system of cash loans benefits primarily those who are in a furtunate position to offer tangible securities. Thirdly, even though the hire-purchaser receives the equipment, the legal entitlement or ownership does not pass on to him until he has paid all the instalments. Therefore, in the event of default in repayment by the hire-purchaser, the leasing agency can repossess the equipment. Fourthly, supply of machines on hire-purchase induces the mobilization of both capital and entrepreneurial skill. Fifthly, the hire-purchase system makes capital formation a <u>fait accompli</u>. It becomes obligatory on the part of the hire-purchaser to make payments of instalments during the subsequent years after procuring machines. The system of supply of machines on hire-purchase provides a ready means for future expansion of small enterprises. Sixthly, the disbursement of cash loans for financing purchases of machinery is not necessarily time-saving as compared to the actual supply of machines on an instalment credit basis. In the former case considerable time is taken by the borrowers to find suitable sureties and subsequently by the lending agencies in the valuation of securities so offered. On the other hand, the time taken by the lending agency in placement of supply orde and actual deliveries of machines would have been in any case involved even if the purchases were made direct by the borrowers after receiving cash loans. Finally, perhaps the most important advantage from the viewpoint of industrial development relates to the control and orientation afforded by the hire-purchase system over the investment in small industries. Through this system, investment can be channelled to promote the desired or priority industry groups, to help the growth of viable and optimum-sized small units, to achieve spatial dispersal of small industries and to foster a proper integration between large and small industrial enterprises through ancillary relationships (subcontracting) that would complement and not cut across the efforts made in different sectors.

I. AGENCIES ENGAGED IN HIRE-PURCHASE BUSINESS

Until about 1965, the supply of machines on hire-purchase or instalment credit basis to small industries was, by and large, handled exclusively by Government agencies like the National Small Industries Corporation and some State Small Industries Corporations, since private industrial, commercial and financial agencies did not evince much interest in this activity. Some industrial houses, commercial establishments and banks did operate a hire-purchase system, restricted to the supply of durable consumer goods such as refrigerators, air-conditioners, sewing machines, cars and scooters, radios, electric fans, and other household electrical appliances. The efforts made and the size of business handled by a few industrial and commercial houses which started supplying low-cost machines, such as industrial sewing machines, electric motors etc., for industrial use on an instalment credit basis, remained meagre and insignificant, until recently.

One major reason why many industrial houses did not feel the urge to supply their end-products - industrial machines and plants - on hire-purchase was that their products used to have a seller's market in the country. As a result they did not feel the necessity to offer such incentives as credit accommodation in the form of hire-purchase facilities for boosting up the demand for their capital goods. Besides, the hire-purchase terms offered by some industrial houses were exorbitant and prohibitive. For instance, industrial sewing machines were supplied on hire-purchase by a private industrial house on an initial payment of about 40 per cent of the value of the machine, on an interest charge that worked out to about 20 per cent per annum and on repayment terms extending to 16 equal monthly instalments.

It was under these circumstances that it became necessary for the Government to make institutional arrangements for supplying machines on hire-purchase. The Government of India introduced the hire-purchase scheme in 1955 for supply of machines and equipment to existing as well as to prospective small industrialists by the National Small Industries Corporation. Later (i.e., in the early sixties) witnessing the tremendous scope and vast need for hire-purchase assistance for the modernization of small industries and the inspiring experience unfolded by the National Small Industries Corporation in operating its hire-purchase scheme, several State Governments also constituted State Small Industries Corporations for augmenting the supply of hire-purchase assistance in their respective States. However, even now the predominant share of hire-purchase business is handled by the National Small Industries Corporation. At the end of 1968-69, the National Small Industries Corporation had supplied machines of a value of $42.7 million as compared with machines of a value of $1.3 million supplied by the State Small Industries Corporation.

Industrial plant manufacturers and machine-tool industries were faced with a severe recession in the post 1965-period and the seller's market in their case was replaced by a buyer's market. However, industrial and commercial houses could not take up the supply of machines and plants on hire-purchase in any big way partly on account of paucity of funds and partly due to the general slackness in demand.

The establishment of the Industrial Development Bank of India in 1964 and the introduction of social control over commercial banks in 1967, turned the table as regards the agencies supplying instalment credit to small-scale units for financing the purchases of machines and industrial plants, in a short span of a few years. Whereas in 1964-65, the National Small Industries Corporation alone supplied machines worth about 98 per cent of total supplies of machines, in 1968 the Corporation and Commercial Banks accounted for one-third each, the State Bank of India for one-fourth and the State Small Industries Corporations for the remaining 8 per cent. Besides, during these few years, credit for the supply of machines on instalment basis increased from $ 5.57 million at the end of 1964-65 to $ 80.9 million at the end of

1968-69.

As the National Small Industries Corporation is the pioneer in the supply of machines on hire-purchase and has now operated the scheme for nearly fifteen years, the review and evaluation of the role played by hire-purchase activities in India towards the development of small industry, attempted in chapter IV, will be restricted to the scheme run by the National Small Industries Corporation. An appraisal of the instalment credit schemes operated and activated recently by the State Bank of India and other commercial banks may better be deferred to a later date when these schemes have had a fuller impact on the development of small-scale industries. Moreover, the instalment credit schemes of the commercial banks have been designed more or less on the same lines as the hire-purchase scheme of the National Small Industries Corporation. The former schemes differ only marginally from the latter in respect of terms of loan.

II. HIRE-PURCHASE SCHEME OF THE NATIONAL SMALL INDUSTRIES CORPORATION : PROCEDURES, TERMS AND CONDITIONS

Financial resources of NSIC

The National Small Industries Corporation - an autonomous undertaking with the Government of India as its only share-holder - was constituted in 1955. Among its various functions, the most important one related to supply of machines to small industries on hire-purchase terms. The Government subscribed the share capital equivalent to $ 0.67 million for activities of the National Small Industries Corporation, of which the hire-purchase activities are the most important. Besides, the loan equivalent to $ 15.7 million (Indian currency equivalent) from the Government was outstanding with the Corporation on 31 March 1968. In addition to this, the Corporation had received foreign exchange credit from Japan, the Federal Republic of Germany and the United States. These credits along with allocations made by the Government from credits negotiated with other foreign countries totalled up to about $ 8.5 million (in foreign currencies). Thus, part of the subscribed capital of $ 0.67 million and a borrowed capital of $ 24.2 million provided the capital base for hire-purchase activities of the Corporation. As against this, machines (both indigenous and imported) valued at about $ 47.5 million were delivered since inception to the end of March 1969. This was possible owing to the collection of instalments from the hire-purchasers which constituted a revolving fund for financing the future hire-purchase transactions. Nearly 82 per cent of present annual supplies of machines on hire-purchase are financed by earnest money deposited and instalments collected. This points to the self-financing aspect of the hire-purchase system whereby in a period of 15 years the system has started supporting a substantial proportion of its activities by itself notwithstanding the ever-growing demand for machines on hire-purchase terms.

Foreign exchange and hire-purchase scheme

During the last five years almost all imports of machinery and equipment by NSIC from abroad have been financed out of the credits negotiated by NSIC and the Government of India with the Japanese Export-Import Bank (Japan Small Plant Committee), the Kreditanstalt of the Federal Republic of Germany and the United States Agency for International Development. Due to the stringent foreign exchange situation in the country, the Corporation has to rely mainly on bilateral loans from foreign countries. Incidentally this situation restricts the sources of supply of imported equipment and, in turn, involves references to hire-purchasers, time and again, for changing and diverting their demand to foreign sources for which the Corporation holds foreign exchange. In short, the unavailability of regular foreign exchange allocation from the Government of India and of convertible foreign credits, introduces an element of uncertainty and delay in the delivery of imported equipment. Besides, it also makes difficult the procurement of imported equipment from the most competitive sources.

Administrative set-up

The Corporation has a Headquarters establishment at Delhi and four regional offices, one each at Bombay, Calcutta, Delhi and Madras. Matters relating to screening and acceptance of applications for hire-purchase assistance and placement of supply orders with the manufacturers, are attended to in the Head Office, while matters concerning collection of "earnest money" (or initial deposit), execution of agreement bonds, procurement of equipment from suppliers, actual deliveries of equipment to hire-purchasers and collection of instalments are handled by the regional offices.

Hire-purchase procedure

Parties apply for machines on a prescribed form (supplied by the National Small Industries Corporation) through the concerned State Industries Department. It is only where applicants are not in a position to make provision for requisite power and premises on the receipt of machines or where end-products involve processing of raw materials in critical short supply that the applications are not favourably recommended by the State Directorates of Industries.

Applications not recommended by the State Directorates are rejected forthwith while those recommended are scrutinized, to ensure that complete information has been furnished by the applicant. Applications for indigenous and imported equipment are then separated and placed before the Indigenous Machines Acceptance Committee and the Small Industries Committee respectively. The former Committee consists of officials of the Corporation and technical experts of the Central Small Industries Organisation, while the latter includes in addition a representative from the Office of the Chief Controller of Imports and Exports. These Committees on an average meet twice a month and their decisions are conveyed to the parties concerned. It is, however, open to an applicant whose application has been rejected to have his case re-examined by the "Reviewing Committee". This Committee consists of top officials of the Corporation and the Central Small Industries Organisation. Besides, it also includes a non-official representative of small industries, i.e., the Chairman of the Federation of Associations of Small Scale Industries.

The above arrangements help in expeditious consideration of applications on a uniform and centralized basis, and also make possible active participation by competent technical officers. In fact, at the time the scheme was launched, the applications were required to pass through two channels - the State Directorates of Industries and the Small Industries Service Institutes. Of these two, the latter was required to undertake technical scrutiny and recommend only such applications where manufacturing activity was feasible on a small scale and where technical know-how to operate the plant was available. To avoid delay, this arrangement was done away with and it was considered advisable to associate technical experts at the time the Corporation considers the applications for acceptance or rejection.

After acceptance of an application, enquiries are sent to suppliers and firm quotations, when received, are sent to the applicant to intimate his choice and deposit the earnest money (viz. 20 per cent of value of the machines) with the Corporation's regional office. On hearing about the earnest money deposit, the Head Office places supply orders on the selected supplier. Copies of the supply orders are then endorsed to both the applicant and the regional office for completion of the remaining formalities. If the machines are to be imported, the Office of the Chief Controller of Imports and Exports is simultaneously approached by the Head Office for obtaining the import licence, which in turn is passed on to the regional office for opening the letter of credit.

On receipt of the copy of the supply order from the Head Office and proforma invoice from the supplier, the regional office prepares an agreement bond to be signed by the hire-purchaser. At this stage, the hire-purchaser is also called upon to complete other formalities relating to the insurance of factory premises, deposit of balance of earnest money or any other charge payable by him vide the proforma invoice. On completion of these formalities by the hire-purchaser, instructions are sent to the supplier to despatch the consignment duly insured for transit risk to the hire-purchaser, and to send the railway receipt of the goods receipt, as the case may be, to the regional office. The Corporation, after ensuring that all the formalities are completed, releases railway receipt or goods receipt to hire-purchasers for taking delivery of the machine. In the case of imported machines, the procedure is slightly different inasmuch as a hire-purchaser is asked to complete the hire-purchase formalities after the Corporation has received the shipping documents and as soon as these formalities are completed, the Corporation sends the shipping documents to the clearing agent for clearing the consignment from customs and despatching it to the hire-purchaser.

As per Corporation's terms of payment, the suppliers of indigenous machines are paid 95 per cent of the value on receipt of railway receipt or goods receipt by the regional office and the balance of 5 per cent on the hire-purchaser confirming that the equipment has been received in good condition. In the case of imported equipment, the foreign suppliers are paid 90 per cent of the value of the shipment and the remaining 10 per cent within four months after the landing date of the ship with equipment in India and after the Corporation's instructions to its bankers to the effect that the consignment has reached the consignee and the contents have been checked and found in order. In cases where machines are received in damaged or defective condition by the hire-purchasers, the Corporation tries to get these defects rectified by the suppliers or compensated by the insurance companies.

Terms and conditions

Hire-purchase assistance under this scheme is available to small industrial units with a "capital investment" 3/ of not more than $0.1 million (Rs.750,000) 4/ irrespective of the number of persons employed.

The value of machines supplied on hire-purchase is required to be repaid in bi-annual instalments spread over a period of 7 years in the case of imported and graded 5/ machines and five years in the case of ungraded machines. The provision for longer period (i.e. of one year) for the repayment of the first instalment has been made in view of the fact that hire-purchasers have to incur expenses towards the installation and operation of the machines immediately after taking delivery. Repayment of the entire instalment amount and transfer of ownership from the Corporation to the hire-purchaser is usually not permitted prior to the expiry of three years from the date of delivery of machines. This restrictive measure on the transfer of ownership of machine during the initial three years of procuring machines has been designed primarily to check speculative deals in machines (especially imported ones). Incidentally, this restrictive provision also sometimes blocks the transfer of general-purpose machines to product lines other than those earlier approved and agreed to by the Corporation.

3/ The term "capital investment" means investment in fixed assets like land, building, machinery and equipment. In the case of rented premises, capital valuation of such premises is taken into account at 150 times monthly rent. Workers' housing and welfare amenities are however excluded while assessing the prescribed limit. In the case of machinery and equipment the original purchase price is considered relevant.

4/ Revised to $100,000 (Rs.750,000), after the rupee devaluation of June 1966. According to latest definition, "capital investment" means investment of $100,000 in machinery only, excluding the cost of land, building and working capital.

5/ Machines that are manufactured according to certain laid-down specifications and standards are "graded".

The Corporation charges 7 per cent interest per annum and 6 per cent administrative charges on the total cost of the machine for the entire period of repayment. On this basis, the amount payable in equal bi-annual instalments is worked out.

The hire-purchaser has to pay initially 20 per cent of the cost of machines and 30 per cent of that of furnaces as earnest money in one instalment before the Corporation places a supply order.

Earnest money is not refundable after the machine goes into operation. It constitutes the hire-purchaser's contribution towards the cost of the machine. In other words, even though the hire-purchaser pays 20 per cent of the cost of the machine, the legal entitlement or ownership of the machine exclusively belongs to the Corporation. This provision relating to the payment of earnest money is primarily intended as a safeguard against depreciation or loss in value of machines in the case where the Corporation might have to reposess the machine.

Till recently the Corporation was offering concessional terms of interest, earnest money deposit, and larger periods of repayment for specific groups like industrial co-operatives, ancillaries to large industries and for machines of value less than $6,666 (or Rs.50,000). These concessions have since been withdrawn as it is felt that a stage has been reached when these groups no longer need the special incentives. Moreover, after operating the hire-purchase scheme for nearly a decade, it was also considered legitimate to put it on a self-supporting basis.

The supply of machines on hire-purchase to a single small-scale unit is restricted to $73,332 (Rs.550,000) c.i.f. for imported machines, $53,334 (Rs.400,000) f.o.r. for indigenous machines and $ 86,666 (Rs.650,000) in composite cases.

III. TERM LOANS AND INSTALMENT CREDIT SCHEMES OF THE STATE BANK OF INDIA AND REDISCOUNTING SCHEME OF THE INDUSTRIAL DEVELOPMENT BANK OF INDIA

Credit facilities provided by the State Bank of India and its subsidiaries

Financing of small-scale industries was undertaken by the State Bank of India in 1956. In the earlier stages, however, the Bank confined its operations to short-term lending by way of grant of credit accommodation against inventories and receivables. Subsequently, with a view to meeting the demand for modernization, renovation and expansion, the Bank commenced granting medium-term loans for acquisition of fixed assets like land, building, plant and machinery. Besides, the Bank has recently started operating a scheme for the grant of instalment credits in terms of which advances are granted to enable small-scale units to purchase machinery and equipment. In brief, the Bank currently provides small-scale units with: (a) credit accommodation for working capital; (b) medium-term loans for acquisition of fixed assets like land, building, plant and machinery; and (c) instalment credit for purchasing machinery and equipment. The terms and conditions in respect of the latter two schemes are set out below:

Medium-term loans

To start with, the facility of medium-term loans was restricted to only those small-scale units which already had borrowing arrangements with the Bank for their working capital requirements, but with the gradual experience gained, this requirement was relaxed. At present, applications in respect of term loans are also entertained from small units that are new to the books of the Bank or are about to be set up.

The existing assets of a unit, if any, and those proposed to be acquired with the proceeds of the loan are generally considered adequate and a registered simple mortgage covering these assets is obtained by the Bank. Normally, 50 per cent against land and building and 33 1/3 per cent against machinery are kept as margins by the Bank. The assets charged to the Bank are required to be kept insured against usual risks with an approved insurance company. The loan is disbursed in accordance with the schedule of disbursement drawn up at the time of sanctioning the loan. It is repayable over a period extending from 7 to 10 years either in monthly, quarterly, half-yearly or yearly instalments. The rate of interest chargeable on term loans is 8 1/2 per cent per annum.

Instalment credits

The main distinguishing feature of this loan is that it is intended to cover the purchase of movable equipment and machinery and, therefore, it is possible to obtain a hypotheoation charge. Normally hypothecation of equipment proposed to be purchased with the proceeds of the loan is considered adequate for securing the loan. The Bank usually retains as a margin 25 per cent to 33 1/3 per cent. The machinery is required to be kept insured against usual risks. The price of the machinery is generally paid to the suppliers directly. If the machinery has been acquired by the applicant out of his own funds within a period of 12 months prior to the date of the application, requests for reimbursement are also considered. Interest in respect of instalment credit is levied by way of a finance charge which is added to the principal amount of the loan. In terms of interest rate of reducing balances, the present rate comes to 9 per cent per annum. Loans are repayable in instalments over a period not exceeding five years.

On the merit of each case, especially where the amount of medium-term loan or instalment credit does not exceed Rs.25,000, the Bank considers relaxation of documentation formalities associated with registered mortgage, waiving of comprehensive insurance, lowering of margin limits and relaxation in start-up period in respect of repayments.

The technical and economic feasibility of medium-term loan and instalment credit are examined by the Bank with the assistance of the Central Small Industries Organisation of the Government of India. As a result of these arrangements, steady progress has been made in the grant of medium-term loans and instalment credits, as is evident from the following figures:

At the end of December	Medium-term Loans	Instalment credit
	in $ million	
1964	1.07	0.88
1965	2.38	2.61
1966	3.91	4.95
1967	6.55	6.40
1968	10.51	9.23

The quantum of medium-term loans and instalment credits together amounting to about $19.74 million is quite small as compared to the quantum of loans amounting to $ 200 million granted by the Bank for working capital as on 31 December 1968. This is primarily because, till recently, the main function of the Bank has been to make short-term advances only.

As regards terms and conditions of term loans and instalment credit, these are only marginally at variance with those of the hire-purchase scheme of the NSIC. For instance, while provisions in regard to security and insurance are identical in both institutions, a higher rate of interest, a shorter period of repayment and the retention of a bigger margin are prevalent in the Bank's advances compared to those in the hire-purchase scheme of the NSIC.

Schemes concerning instalment credits provided by indigenous machinery manufacturers, approved selling agents of machinery and commercial banks

In order to enable manufacturers of indigenous machinery and their selling agents to sell on a deferred payment basis to users or buyers of machinery, the Industrial Development Bank of India (IDBI) formulated a scheme of rediscounting bills of exchange and promissory notes covering instalments payable on sales of indigenous machinery on a deferred payment basis. The scheme came into effect from 1 April 1965 and ever since has been modified a number of times to widen its coverage as well as to relax the terms and conditions of rediscounting facilities.

Under this scheme, rediscounting facilities are granted to all machinery manufacturing industries and their approved selling agents. The names of such concerns are, however, required to be approved by IDBI, before the facilities under the scheme are extended to them. As mentioned earlier, the IDBI does not discount bills but only rediscounts those discounted by commercial banks or approved financial institutions. The bills are to be drawn by an approved machinery manufacturer or selling agent, and discounted by a commercial bank or a financial institution before these are eligible for rediscounting facility from the IDBI. A separate bill should, however, be drawn to cover each instalment payable to the machinery supplier under deferred payment arrangement, and no bill offered to IDBI for rediscounting should have unexpired maturity of less than 6 months and usance of more than five years.

The following are the rates of rediscounting of bills or promissory notes by the IDBI:

Unexpired usance of bills or promissory notes	Rediscount rate (per cent per annum)
6 to 36 months	5½
36 to 60 months	5
60 to 84 months	4½

The rates of interest chargeable from the hire-purchaser are not permitted to exceed more than 2 per cent above the respective rediscount rate. Consequently, the rates of interest charged from the actual user or hire-purchaser on deferred payments are as under:

6 to 36 months	–	7½ per cent
36 to 60 months	–	7 per cent
60 to 84 months	–	6½ per cent

The minimum amount of transaction covering a set of bills for deferred payment has been fixed at Rs.50,000 generally and in the case of agricultural implements at Rs.15,000.

Taking advantage of the rediscounting scheme of the IDBI, several manufacturers of indigenous machinery and their approved selling agents have undertaken to supply machines on a deferred payment basis. Notable among them are the Hindustan Machine Tools Ltd. (a Government of India concern) and M/s. Batliboi and Co Pvt.Ltd. (a private selling agency of indigenous and imported machines). The latter has thus far supplied machinery and equipment on a deferred payment basis to the tune of $ 0.54 million.

All said and done, the facilities under this scheme have primarily benefited large, medium and small-scale units which have had the background of dealing with commercial banks. The rate of interest payable under this scheme is indeed more favourable to the hire-purchaser, though the duration of the loan is shorter, as compared to the scheme of the National Small Industries Corporation. This is explained by the fact that the provision of rediscounting facilities has been primarily intended to enable indigenous machinery manufacturers and suppliers to sell machines and equipment on a deferred payment basis, whereas facilities for longer periods are provided directly to the purchaser by institutions like the National Small Industries Corporation, the State Bank of India, and the State Small Industries Corporations.

<u>Hire-purchase scheme of the Hindustan Machine Tools Ltd.</u>

In addition to supply of machines on a deferred payment basis under the rediscounting facilities provided by the IDBI, as explained above, the Hindustan Machine Tools Ltd. (HMT) has very recently (i.e. from January 1969) introduced its own hire-purchase scheme for supplying certain categories of machines manufactured by it. The terms and conditions of this scheme are as follows:

1. The scheme has been restricted to the supply of the following machines manu-

factured by the HMT:

(1) Series of lathes;

(2) Turret lathes;

(3) Series of milling machines;

(4) Series of radial drilling machines;

(5) Gear-shaping machines; and

(6) Grinding machines.

2. Imported accessories are excluded from the purview of this scheme.

3. About 20 per cent of the value of the order plus sales tax need to be paid as advance with the order in such a way that the balance due for payment by way of instalments would be a multiple of Rs.1,000 (For instance, if the total value of the order plus sales-tax comes to Rs.28,343.60, the advance payable would be Rs.5,343.60, leaving a balance of Rs.23,000 to be paid in instalments).

4. The number of instalments would be twenty-five, payable in equal monthly instalments of the principal and interest. The interest is charged at the rate of 10 per cent per annum on the outstanding balance of the principal.

5. A penal rate of 12 per cent per annum is charged on defaulted instalments.

6. The first instalment of the outstandings becomes due one month after the date of despatch. The subsequent instalments will likewise fall due on the 2nd, 3rd and so on months after the date of despatch.

7. The hirer is required to issue twenty-five numbers of "On demand promissory notes" for payment of instalments of principal and interest at the time of executing the agreement. The promissory notes will be presented on the due dates for payment.

It is obvious from the above terms and conditions of HMT's hire-purchase scheme that - unlike the NSIC's scheme - the purpose of this scheme is merely to afford short-term accommodation to the buyers of HMT general-purpose machine-tools, in order to increase sales. Moreover, whereas NSIC's scheme is restricted to small-scale units, facilities under the HMT's scheme can be availed of by any buyer irrespective of the size and product line of the unit.

Terms and conditions of hire-purchase schemes operated by some of the state small industries corporations

1. Hire-purchase scheme of the Mysore Small Industries Corporation (MSIC)

The terms and conditions of supply of machinery as stipulated by the MSIC are:

(1) Twenty per cent of value of machinery is to be paid as earnest money deposit for general purpose machinery and thirty per cent in the case of furnaces;

(2) The balance is payable in fourteen half-yearly equal instalments starting from the completion of one year from the date of delivery of machinery. Only ten half-yearly instalments are permissible in the case of coir defibring machinery.

(3) The rate of interest chargeable is 7 per cent per annum on the amount outstanding towards principal.

(4) A service charge of 6 per cent for the entire period of repayment is also payable on the cost of machines supplied in addition to the rate of interest.

(5) The hirer is required to keep the machinery insured in favour of the Corporation at his own cost and also to execute a bond. Besides this, no additional surety is demanded from the hirer.

Thus far, the Corporation has considered only 48 applications for the supply of machines on hire-purchase and has supplied machines valued at $ 0.07 million only.

2. Hire-purchase scheme of the Uttar Pradesh Small Industries Corporation (UPSIC)

Under this scheme, only indigenous machines are supplied and other terms and conditions are as follows:

(1) At the first stage, the hire-purchase application is scritunized and sanctioned by the Screening Committee consisting of technical experts. Where the application has been accepted by the Screening Committee, the prospective entrepreneur is required to deposit nearly 22 per cent of the value of the machines as earnest money. He is required to submit alternative quotations in order to satisfy the Corporation about the soundness of the selected offer. Although the final selection invariably rests with the hirer, the Corporation tries to ensure that the machine proposed to be obtained is suitable for the job and is also reasonable in price. The Corporation thereafter places the order and makes the necessary payment to the supplier. The hirer is expected to set up his machines and get into production within one year of the delivery of the machines. Thereafter, he is required to make payment in 9 to 13 half-yearly instalments. Seven per cent per annum interest is charged on the

principal amount. Besides, an additional charge of 6 per cent for the entire period of repayment is also made towards the service rendered by the Corporation. While one-third of this charge is collected along with the earnest money, the rest is distributed in the instalments required to be paid half-yearly by the hirer.

(2) The early years of the operation of this scheme have revealed that the hirers were indifferent towards making the repayments, not so much due to their inability to pay the dues as on account of the absence of strict provision of legal action in cases of default. The Corporation thus had to adopt a more cautious approach and now the hirer is required to give one of three sureties, namely, (i) a guarantee bond executed by two solvent persons (ii) a bank guarantee, or (iii) an insurance guarantee.

Since the inception of UPSIC's hire-purchase scheme in 1965, the Corporation has received applications for machines valuing $ 3.96 million and accepted applications to supply machines to the tune of $ 1.24 million. Thus far, the Corporation has supplied machines valued at $ 0.45 million.

3. Hire-purchase scheme of the Maharashtra Small-Scale Industries Development Corporation (MSSIDC)

This Corporation started a "Scheme for Supply of Machinery on Hire Purchase basis" in the beginning of 1964. The terms and conditions of this scheme are:

(1) The Corporation would supply only Grade I quality-marked machines which are manufactured in Maharashtra State and where the value of machine does not exceed Rs.25,000 (or $ 3,330). In certain cases, this limit is extended up to Rs.100,000 (or $ 12,330).

(2) The hirer is required to pay 20 per cent of the value of the machine as earnest money and the rest is paid by the Corporation to the supplier of machines and is treated as loan to the hire-purchaser.

(3) A hire-purchase loan bears an interest at the rate of 9 per cent per annum and is repayable within a period of 6 years in 11 equal instalments, the first of which falls due after the expiry of 12 months from the date of delivery of the machines and the rest after every 6 months.

(4) The hirer is also required to pay a 5 per cent service charge to the Corporation on the total value of the transaction.

(5) Hirers are entitled to a one per cent rebate in interest rate where the

entire amount of the loan with interest has been paid within four years of taking delivery of the machines. In case of default in payments the hirers are liable to pay 12 per cent penal interest per annum.

(6) Generally, small-scale units located in less developed areas and small towns of the State are given preference in the supply of machines on hire-purchase.

Since the inception of this scheme, the Corporation has received 612 applications for machines valued at $ 1.0 million and accepted 271 applications (or 44 per cent) for supplying machines valued at $ 0.46 million. The Corporation has so far supplied machines to the tune of $ 0.39 million to 215 small-scale units. Experience regarding repayment of loans to the Corporation has been quite encouraging and after operating the scheme for 5 years, only 5 per cent of the receivables were in arrears.

A comparison between the terms and conditions of NSIC's hire-purchase scheme with those of the other State Small Industries Corporations would reveal that all these schemes have, by and large, identical features, except that the State Corporations have restricted their schemes to the supply of indigenous machinery only. One of the State Corporations, in fact, went a step further and restricted the supply of machines under its hire-purchase scheme to those manufactured within the State. Here the purpose of the Corporation was not only to afford long-term credit accommodation to small-scale units in procuring machinery and equipment but also to secure a market for the machine manufacturing industries in the State.

IV. AN APPRAISAL OF THE PERFORMANCE OF THE HIRE PURCHASE SCHEME OF NSIC

This appraisal has been attempted under the following headings:

(a) Applications received, accepted and orders placed; (b) applications rejected; (c) machines delivered - imported, indigenous and industry-wise; (d) default in repayment; (e) time taken in supply of machines; (f) quantitative impact of the scheme on small industries growth; (g) qualitative impact of the scheme on small industries growth; (h) promotional aspect of the scheme in respect of ancillary small enterprises, industrial co-operatives and development of less developed areas.

Applications received, accepted and orders placed

From the inception of the hire-purchase scheme in 1955 to the end of March 1969, the National Small Industries Corporation had received 31,496 applications for machines valued at $233.4 million (or Rs.175.05 crores).[6] After the initial scrutiny and detailed examination by the Acceptance Committee at the Headquarters Office, the Corporation accepted 22,174 cases for hire-purchase assistance of the value of $ 128.4 million (or Rs.96.34 crores) that is, nearly 70 per cent of the number received and 55 per cent of the value applied for.

The supply orders were, however, placed to the tune of about $ 43.0 million (or Rs.32.27 crores) that is, a little less than one-fifth of the value of machines applied for and one-third of what the Corporation agreed to supply. This points to quite a considerable amount of "lost efforts" involved from the stage of applications to the delivery of equipment on hire-purchase terms.

The gap between applications received and accepted is somewhat unavoidable inasmuch as the Corporation has to adopt a selective approach for utilizing its limited foreign exchange and rupee resources in accordance with the policy directives and plan priorities for small industry development. The important considerations in accepting or rejecting an application are whether it relates to a priority or non-priority end-product; whether it belongs to the industry group where sufficient capacity is already in existence or not; whether it concerns rural or urban location of enterprises, whether it relates to the processing of indigenous materials freely available within the country or such material (imported or indigenous) as are in short supply; whether it has been organized on a co-operative basis or not; and whether it undertakes to foster ancillary relationships between small industry and large industry either through subcontracting of manufacture of parts and components to small industry or "backward linkage" in the form of manufacture of end products by small industry from raw materials and components made by large industry. Lastly, the Corporation also keeps a watch to ensure that its lendable resources are shared by a large number of product lines and are not unduly concentrated in only a few lines. For instance, there was recently a clamour for obtaining imported plants on hire-purchase for the manufacture of polyvinylchloride (PVC) shoes. The Corporation did not consider it desirable to lock up a major proportion of its resources in this product line and, therefore, had the entire situation surveyed by the Economic Investigation Directorate of the Office of the Development Commissioner, Small Scale Industries. Subsequently, the Corporation decided to accept new applications only in

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6/ One crore = 10,000,000.

accordance with the recommendations of the investigation team which in fact had taken into account, among various other considerations, regional demand for PVC shoes in the country.

The gap between the applications accepted and orders placed is primarily due to the withdrawal of cases at the time applicants are called upon to deposit earnest money. This indeed poses a problem of reducing applications from not-too-serious applicants.

Applications rejected

The main reasons for rejecting applications are (i) that the industry is in the banned list or of low priority, (ii) that adequate industrial capacity exists vis-à-vis demand for the end-product, (iii) that the industry involves processing of scarce or imported raw materials, or (iv) that the project is not considered technically feasible on a small scale. By the end of March 1968, the Corporation had in all rejected applications for machines valued at $ 88.8 million. Of the applications rejected during 1965, nearly 40 per cent were rejected due to acute scarcity of raw materials intended to be processed, 35 per cent because adequate industrial capacity already existed in the line at the proposed location of the plant, 10 per cent because the proposed manufacturing activity was not considered technically feasible on a small-scale basis, and the remaining 15 per cent on account of miscellaneous reasons.

Machines delivered - imported and indigenous

By the end of March 1969, machines valued at $ 47.5 million (or Rs. 35.64 crores) were delivered to small enterprises in the country. Imported equipment constituted nearly 58 per cent of the total value of equipment supplied on hire-purchase during the afore-mentioned period of fourteen years. During the last four years (1964-65 to 1968-69), the proportion of imported equipment to the respective total equipment supplied fell appreciably below 60 per cent while during the preceding period of 10 years, this proportion remained a little on the higher side of 60 per cent.

At the initial stage of technological development, substitution of simpler low-cost imported machines by indigenously manufactured machines is possible, but at the same time imports of new types of machines that might be many times costlier than those imported earlier (for example, one imported gear hobbing machine costs nearly four times an ordinary imported lathe) are required.

As a result of these counter-pulls, the relative demand for imported equipment is likely to continue at the current proportion for a number of years to come.

In absolute terms, however, expansion and growth of the small industry sector would call for progressive increase in supplies of both imported and indigenous equipment.

Machines delivered -(industry-wise)

Industry-wise distribution of hire-purchase assistance is set out below:

Machines supplied industrywise (December 1968)

Industry Sub-group	Number of Units	Value in Rs.Million (Rs. 7.5 = $1)
Engineering (mechanical, electrical and metallurgical)	4400	175.5
Chemical	263	11.9
Plastic, rubber and leather-based	475	30.3
Printing, stationery and paper products	609	23.0
Textiles including wearing apparel	331	9.3
Food products	188	5.4
Timber-based	675	9.9
Miscellaneous	903	46.2
Total	7844	311.5

The most striking feature of this distribution is that about 56 per cent of the total number of small-scale enterprises assisted and of the total value of hire-purchase assistance provided belonged to the light engineering group. Industry groups engaged in servicing or processing indigenous raw materials that are not in short supply and are freely available (namely auto servicing, building materials, ceramics, food products, foundry, leather, printing and binding, rubber-based items, stationery, textiles, timber-based items and wearing apparel) among themselves received hire-purchase assistance to the tune of about 23 per cent. Other industry groups (namely agricultural implements, chemicals, containers, electric goods, metal wares, plastic conversion and scientific goods) requiring certain quantities of raw materials that are in short supply received about 21 per cent of the total assistance.

The pattern of dispersal of hire-purchase assistance indicated above points to the considerable headway that has been made during the last decade by small industry in India in the field of light engineering and also to the efforts undertaken by the Corporation in fostering the growth of simple capital goods industry (like machine-tools and machine building industries) and ancillary enterprises for the supply of components and parts to the large-scale engineering industries. Nearly half of the hire-purchase assistance in the light engineering group has gone to the machine-tools and ancillary units.

The fact that nearly a quarter of the hire-purchase assistance has been channelled to product lines relating to the processing of indigenous raw materials that are not in short supply is again primarily attributable to the priority accorded by the Corporation during recent years in supply of equipment. In fact, during the last three years, the Corporation has agreed to supply equipment only to those small enterprises which are concerned with processing or fabricating of raw materials that are readily available in the market or where the concerned State Directorate of Industries had guaranteed beforehand the supply of scarce items so that the equipment supplied does not remain idle or under-utilized due to non-availability of raw materials.

Small enterprises in the light engineering group received on the average hire-purchase assistance to the tune of about $ 5,332 per unit, groups of industries requiring certain scarce raw materials on an average received about $ 6,000 per unit, while those belonging to industry groups engaged in processing materials freely available received on an average only about $ 3,700.

Default in repayment

Under hire-purchase, a constant vigil on "instalments in default" is imperative since instalments collected from hire-purchasers constitute a revolving fund for financing the future supplies of machines. Arrears of instalments have, however, been mounting up from year to year during the last six years. The total amount of instalments in arrears has increased from $ 0.3 million (or Rs.2.2 million) in April 1963 to $ 3.7 million (or Rs.28 million) in March 1969. That is, these arrears have swollen more than twelve times in a short span of less than six years.

The following tables show the relationship between instalments in arrears and value of machines supplied on hire-purchase on the one hand and amount receivable by the Corporation on the other.

Default in Repayment

(continued)

In this context it is relevant to point out that the amounts shown as "instalments in arrears" have a dual character. While a portion of these arrears is recoverable, the other portion is non-recoverable, on account of bad debts and the depreciated realization of dues, when the equipment has to be repossessed from the hire-purchasers defaulting in payments. In so far as the recoverable part of the arrears is concerned, there is no financial loss to the Corporation, since the Corporation earns not only the normal rate of interest on the outstanding dues but, in fact, also charges, on the merit of every case, additional penal interest on delayed payments. It is, therefore, useful to distinguish the recoverable arrears from non-recoverable ones in order to assess the seriousness of the losses on account of hire-purchase transactions.

Thus far the Corporation has written off as bad debts about $ 60,000 or 0.11% of the total value of machines supplied on hire-purchase basis. In addition it has declared re-possessed machines valuing about $ 21,000 or 0.04 per cent of the total value of machines supplied as "junk". In other words, only 0.15 per cent of the value of the machines supplied has assumed the character of non-recoverable dues. Thus the financial loss arising from accumulated arrears in payment is not so grave a problem as is the stupendous task of collecting the recoverable arrears. This underlines the need for a corps of competent staff for the collection of instalments in any hire-purchase scheme.

The value of machines re-possessed from the hire-purchasers on account of non-payment aggregated to $ 537,000 or 1 per cent of the total value of machines supplied and 15 per cent of the total outstanding arrears. Of the machines re-possessed, $ 214,000 or 40 per cent of the value has already been recovered through resale,[1] $ 21,000 or 4% has been declared "junk", while the remaining $ 302,000 or 56 per cent yet remained to be disposed of.

1/ Re-possessed machines are auctioned by the Corporation on an outright sale basis and are not supplied on hire purchase *de novo*

The low percentage of outstanding arrears that could be recovered by re-possessing the machines (i.e. 15 per cent) on the one hand and the realisation of only 40 % of the value of the machines re-possessed through resale, underline the tardy nature of the process of re-possession as well as the losses resulting therefrom. There is, therefore, a need for streamlining the process of re-possession and also for obtaining such legal immunities for the Corporation as are enjoyed by the banking institutions in the country. It is in this context that the legal basis of the hire-purchase scheme needs to be strengthened, so that hire-purchase arrears could be recovered in the same manner as arrears of "State Revenue". It goes without saying that such measures would in the ultimate analysis help in reducing the outstanding arrears.

Besides the financial aspect, there is a developmental aspect to the question of "outstanding arrears". In so far as the instalments collected from the hire-purchasers constitute a revolving fund for financing the future supplies of machines, the arrears result in reducing the fund available for the expansion of hire-purchase transactions and thereby adversely affect development of small-scale industries. For the maximum utilization of hire-purchase funds, it is imperative to reduce arrears in payment to the minimum. This again points to the need for concerted efforts for collecting the hire-purchase dues.

The reasons for defaults in payments may be broadly grouped under three categories: (i) Economic causes, e.g., inability of the hire-purchaser to utilize adequately the industrial capacity installed due to non-availability of requisite quantities of raw materials, lack of adequate finance or other industrial inputs, general recession in the economy and consequent marketing difficulties etc.; (ii) defective supplies of machines and equipment from the machinery suppliers, and (iii) wilful non-payment of instalments. Of these, the first one accounts for nearly two-thirds of the total amount of arrears, the second for 30 per cent of the arrears and the third for the remaining three to four per cent of the arrears.

Comparison of arrears from applicants in Intensive Campaign Areas with arrears in total hire-purchase transactions does not indicate a higher proportion of arrears in the former case. In respect of intensive compaign cases, the arrears amounted to only 4.9 per cent of the total value of machines supplied, as against 6.8 per cent in case of all hire-purchase transactions.

Relationship between "Instalments in arrears" and machines supplied on hire-purchase

As on last date of the month	Instalments in arrears ($ million)	Machines supplied on hire-purchase since inception ($ million)	Percentage of Col. 2 to Col. 3
1	2	3	4
July 1963	0.345	17.33	1.9
Jany 1964	0.458	21.64	2.1
July 1964	0.626	25.63	2.4
Jany 1965	0.849	28.36	3.0
July 1965	1.075	30.30	3.5
Jany 1966	1.290	31.90	4.0
March 1967	2.087	36.44	5.7
March 1968	2.843	41.50	6.8
March 1969	3.734	47.52	7.8

Relationship between "instalments in arrears" and "amount receivable" by the Corporation

As on last date of the month	Instalments in arrears ($ million)	Amount receivable ($million)	Percentage of Col. 2 to Col. 3
1	2	3	4
March 1965	0.887	16.69	5.3
March 1966	1.381	17.55	7.8
March 1967	2.087	18.27	11.4
March 1968	2.843	19.57	14.5

The above table indicates that the arrears as percentage of receivables have been increasing year after year and touched an alarming figure of 14.5 per cent in March 1968. This points to the need not only for concerted efforts towards collection of arrears but also for rethinking of the surety backing and legal basis of the hire-purchase scheme.

Time taken in supply of machines

An oft-spoken shortcoming of the hire-purchase scheme relates to the time taken in processing hire-purchase applications and the supply of machinery.

A selective study conducted into the handling of hire-purchase cases has revealed that the Corporation was able to supply machines in respect of nearly one-third of the cases in a period of less than a year, in another one-third of the cases between 13 and 18 months, while in the remaining one-third it took more than 18 months. In this context, it needs to be mentioned that but for the stringent foreign exchange position obtaining in the country, which proved to be a very serious bottleneck in the supply of imported machines, the position regarding the disposal of cases would have been far more encouraging.

An apportionment of total time taken in the disposal of hire-purchase cases between the three main parties, namely, the National Small Industries Corporation, the hire-purchaser and the suppliers has revealed that the Corporation on an average took 40 per cent of the total time taken, the hire-purchasers took another 40 per cent and the suppliers the remaining 20 per cent.

Machines were supplied to about 10 per cent of the hire-purchasers within three months of depositing earnest money, to about half of them within 3 to 12 months, to a quarter of them within one to two years and to the rest 15 per cent within 2 to 4 years.

Quantitative impact of the schemes on the growth of small industries

A study for assessing the impact of hire-purchase assistance on small industries in three states, namely, Punjab, Delhi and Madhya Pradesh, has revealed that hire-purchase assistance has made a spectacular contribution towards the growth of small industries in these states. As a result of this assistance, employment in the assisted small enterprises had increased by nearly 140 per cent (i.e. from 4,937 to 11,828), output by about 170 per cent (i.e. from $ 60.8 million to $ 164.7 million) while potential capacity to turn out end-products recorded an increase of 255 per cent (from $ 83.0 million to $ 296.0 million). These growth indices, however, relate to only 15 per cent of the total hire-purchase assistance given throughout the country. Assistance channelled in other states, when taken into account, would indeed reveal a proportionately higher magnitude of small industry growth.

Another important impact of hire-purchase assistance relates to the mobilization of capital resources that might otherwise have remained untapped. A selective study of nearly 800 small enterprises revealed that seed capital provided by the Corporation in the form of machinery and equipment on hire-purchase resulted in the mobilization of nearly double this amount by the hire-purchasers on their own account. No appreciable difference has, however, been noticed between the rate of mobilization of capital resources by the new small enterprises brought into existence by hire-purchase assistance and old enterprises engaged in manufacturing activity even prior to the receipt of assistance.

In spite of the fact that the capital invested in small industries is mainly "additional capital" that would not have otherwise assumed the character of productive or developmental funds and, therefore, it is not very relevant whether large or small industries would more speedily augment their original investment, a comparison between growth rates of investment in these two industrial sectors has been, nonetheless, attempted below.

A study of 378 small enterprises which received hire-purchase assistance revealed that total gross investment (after deducting the value of equipment supplied on hire-purchase but making allowance for repayments) increased from 1955 to 1963 at an annual average rate of 20 per cent. This compares very favourably with the average annual rate of gross total assets formation (1956-60) of 8.1 per cent in private limited companies and 9.9 per cent in public limited companies studied by the Reserve Bank of India. A sample study conducted by the Central Small Industries Organisation has, however, revealed a growth rate of 7.2 per cent per annum in total investment.

In the case of gross fixed assets, enterprises receiving hire-purchase assistance registered an annual rise of about 25 per cent while small sample enterprises (studied by the Central Small Industries Organization), private limited companies and public limited companies (studied by the Reserve Bank of India) recorded increases of 6.2, 10.9 and 11.6 per cent respectively.

It is sometimes argued that capital-saving manufacturing activities organized on a diffused small-scale basis may save capital currently but would prove to be more capital-expensive compared with large industries in the long run due to lower reinvestment or investment growth rate. Such an argument is somewhat irrelevant in the c... t of small lustries which draw primarily on additional capital or capital that would otherwise remain outside the orbit of industrial or developmental activity. Furthermore, this argument has not been borne out by experience. The small enterprises benefiting from hire-purchase have had conspicuously higher rates of growth in gross as well as fixed assets formation compared with large-scale enterprises. Thus, hire-purchase scheme seems to have stimulated adequate in-built saving capacity as well as mobilization of funds from other resources kept out of industrial activity initially. It is also quite conceivable that an increment in the form of machinery and equipment, required for balancing or rationalizing the industrial processes in small enterprises with outmoded equipment and technology of production, may result in a proportionately larger increase in output especially at initial stages of rationalization and thereby make larger re-investment possible. Thus supply of equipment on hire-purchase, both for rationalization and modernization of existing small enterprises as well as for new modern viable small enterprises, not only helps in efficient production currently but also stimulates faster future growth of the enterprises by making a fairly high re-investment rate possible.

Qualitative impact of the scheme on the growth of small industries

Apart from the mobilization of financial resources and direct increases in production, capacity and employment, the machinery supplied by the Corporation has had a salutary impact of a qualitative nature on the growth of small industries.

The hire-purchase scheme, by offering access to machinery and equipment to aspiring artisans or factory workers of drive and ability who have seen problems and achievements of industrial management at short range, affords them an enviable opportunity for transformation into independent self-reliant owner-industrialists.

Of the total 5,989 enterprises supplied machines on hire-purchase, nearly 2,500 are new enterprises belonging mainly to persons who were formerly employed as worker artisans and had managed to muster small savings for the purpose of starting industrial ventures of their own. The hire-purchase scheme, as mentioned earlier - unlike other industrial credit schemes -, does not require any security or surety from any one wishing to avail of the assistance offered. It is this aspect of the scheme which has endeared it so much to the artisans and craftsmen since they are seldom in a position to offer any tangible security for credit accommodation. Hire-purchase assistance has thus been able to foster the growth of a new class of small entrepreneurs - an achievement which is both of a social and economic importance.

Further, entrance of a new class of artisans and traders in the manufacturing activity, facilitated by the hire-purchase scheme, has in turn resulted in the introduction of a large variety of industrial end-products. For example, manufacture of modern items like contraceptives, cycle tyres and tubes, water meters, photo flash bulbs, latex-jute fabric, nettings, polythene-coated packing paper and industrial gears and hardwares, plaster of Paris, etc., was taken up for the first time in the small-scale sector as a result of the machines supplied on hire-purchase. Moreover, practically every hire-purchaser was enabled to take up the manufacture of certain additional ranges of end-products with the help of machines procured on instalment credit. Thus hire-purchase credit machines not only helped in the diversification of items manufactured by each hire-purchaser.

Besides, hire-purchase assistance, more often than not, has helped the hire-purchasers by providing modern equipment to reduce production costs, diversify industrial production and improve the quality of output. All this in turn has helped the small enterprises to strengthen their competitive position and has thereby instilled in their operation much growth potential and dynamism. Hire-purchase assistance has in fact facilitated the transformation of a good number of small-scale enterprises into medium-sized and large-scale industrial enterprises.

Besides creating a favourable impact on the quality of end-product of the hire-purchasers, the supply of modern precision machines on hire-purchase has also helped a number of other small enterprises in untertaking jobbing activities. For instance, a gear hobbing machine, besides fabricating accurate gears for the hire-purchaser's requirements, is also used for doing job work for other small-scale units. This, in consequence, enables other small-scale units to improve the quality of their end-products and also to overcome a bottle-neck in their production efforts arising from inadequate capacity to produce gears. Similar are the effects of, for instance wood-seasoning equipment and plaster of Paris making plant (supplied on hire-purchase) on wood-based industries and crockery manufacturing small enterprises respectively.

Promotional aspect of the scheme

The approach of the hire-purchase scheme towards the development of "ancillary" enterprises, industrial co-operatives and small enterprises in less developed areas has been primarily promotional to start with without being unbusinesslike. Special concessional terms relating to payment of earnest money, rate of interest, and period of repayment, used to govern the supply of equipment to small enterprises bearing these characteristics. In addition, enterprises belonging to these categories were also given priority consideration in the supply of equipment.

Development of ancillary industries

Development of small ancillary enterprises engaged in the manufacture and supply of parts and components to large industrial enterprises for assembly has received a special attention in the developmental programme for small industries. In fact, a great growth potential has been visualized for small industry in the sphere of activities complementary or ancillary to large industry. It has also been appreciated that an efficient industry system thrives best where large and small enterprises are integrated through complementary and ancillary relationships.

In the later part of 1963, the Corporation withdrew all special concessions granted earlier to ancillary enterprises and it was considered wholesome as well as adequate that encouragement for the development of small ancillary enterprises might be provided by giving them priority in the supply of equipment rather than by affording simultaneous concessions in hire-purchase terms. A beginning was made in 1960 by introducing a comprehensive programme for the establishment of an industrial estate to house enterprises ancillary to Hindustan Machine Tools Ltd. - a public sector undertaking engaged in the manufacture of machine-tools at Bangalore. Facilities offered under this programme to entrepreneurs included provisions of (a) industrial shed with suitable amenities on reasonable rent; (b) supply of equipment on hire-purchase by the National Small Industries Corporation against an initial deposit of 5 per cent only; (c) technical assistance to be provided by the Hindustan Machine Tool Ltd. for installation of plant and equipment as well as for the manufacture of parts and components; (d) raw materials and requisite stores to be drawn by small enterprises from Hindustan Machine Tools Ltd., at cost; and (e) technical supervision and assistance in advance planning of production. Of all these measures, the supply of equipment on hire-purchase brought to bear a gravitational pull for initiation and operation of ancillary enterprises.

Hire-purchase assistance to the tune of $ 8,000,000 (Rs.60,000,000) was provided to 45 ancillary enterprises in the Hindustan Machine Tools industrial estate. Forty enterprises had already gone into production and were manufacturing spares and components valued at $ 1,133,333 (Rs. 8,500,000) annually.

The National Small Industries Corporation also collaborated in another similar programme for the establishment of an ancillary complex for Enfield India Madras (Private) Ltd. - a large private industrial enterprise engaged in manufacturing motor cycles, scooters and engines for industrial and agricultural purposes. The Corporation supplied equipment valued at about $ 910,400 (Rs.6,828,000) to 20 ancillary enterprises and these provided employment to 404 persons and manufactured goods worth about $ 1,200,000 (Rs.9,000,000) annually.

By the end of 1965 the Corporation had, in all, supplied equipment amounting to $ 3.34 million (Rs. 25,000,000) to 100 small ancillary enterprises which in turn provided employment to 2,000 persons.

Development of less developed areas

Before proceeding to discuss the distribution of hire-purchase assistance among the areas with varying levels of development, it may be mentioned that about 60 per cent of the total hire-purchase assistance has gone to 10 major cities. At first glance this may appear inconsistent with the objective of dispersal of small industries. But in the early stages of small industry growth, it is both unavoidable as well as desirable that industries be fostered in areas that have not only adequate economic overheads but also absorptive capacity. Once the growth of small industries has gathered a certain momentum, it is opportune to steer these industries towards semi-urban and less developed areas. To this end, the Corporation on its own initiative, started undertaking "intensive campaigns" for the promotion of small industries in less developed areas, whereby applications for supply of machines on hire-purchase are accepted on the spot. These intensive campaigns are an attempt at making special efforts for encouraging the development of small industries in less developed areas by short-circuiting the normal official procedures.

Besides the message of industrialization is taken to the very doorsteps of potential or promotable entrepreneurs through this technique. They are apprised of the vast industrial opportunities existing in the country and the help available to them from various institutions and agencies. The various steps adopted under an intensive campaign are set out below:

(1) Meetings in localities, small enough to guarantee personal touch, are arranged and the various kinds of assistance, incentives and facilities provided by the Central and state Governments, the National Small Industries Corporation, the State Bank of India and the State Financial Corporation, are explained to the attending businessmen and others;

(2) Demonstration with the assistance of mobile vans are conducted in order to show artisans and intending entrepreneurs the operation of modern wood-working machines, machines for making leather footwear and smithy and machine tools;

(3) Exhibition of industrial films of interest to the entrepreneurs is arranged at all places;

(4) Prospects for developing particular industries in which interest is evinced are discussed in detail and the industries holding potential for development from the point of view of available local resources as well as general market demand are indicated.

(5) Visits to existing local industrial enterprises are arranged and the current position and problems of the enterprises are studied and suggestions concerning measures for improvement and expansion are made;

(6) Schemes for suggested items of manufacture to suit investment capacities of potential entrepreneurs are prepared;

(7) Printed publicity pamphlets and priced "model schemes" and "analysis and planning reports" issued by the Development Commissioner for Small Scale Industries are distributed or sold;

(8) Entrepreneurs are helped in completing the forms for hire-purchase assistance and in the making of declarations, if any, before magistrates;

(9) Necessary verifications are obtained from the Assistant Director of Industries on the spot;

(10) New industries which can utilize idle power capacity in existing units are suggested; and,

(11) The operation of existing industrial co-operatives are studied with a view to suggesting measures for development and improvement.

Results achieved through intensive campaigns

The intensive campaigns organized in the country have gone a long way in attaining the twin objectives, namely, mobilization of entrepreneurial skill and dispersal of new small-scale units. This fact is amply brought out by the figures set out below:

State	Hire-purchase applications received normally during 1956-66		Hire-purchase applications received in the course of intensive campaigns	
	Number	Value (Rs.in millions)	Number	Value (Rs. in millions)
Andhra Pradesh	584	23.1	2,151	109.8
Bihar	141	9.1	344	25.3
Gujarat	556	41.7	782	71.5
Jammu and Kashmir	67	3.7	523	27.0
Kerala	1,022	33.3	2,001	55.0
Madhya Pradesh	2,077	48.8	876	68.6
Orissa	96	5.5	241	12.3
Pondicherry	29	2.0	306	19.4
Rajasthan	150	8.3	253	18.3
Tamil Nadu	-	-	360	10.9

The above table reveals at a glance that in the case of all the states, the number and value of applications received for machines on hire-purchase during ten years (that is 1956-66) were smaller than the number and value of applications received in the course of a few weeks of intensive campaigns, (except Madhya Pradesh where the number of applications received at the time of the intensive campaign was smaller while value of applications was higher and in line with other states). This points to the immense response of prospective entrepreneurs for setting up small-scale industries in less developed areas. Intensive campaigns are in fact deliberate efforts made for spreading the diffusion of small industry in industrially less developed small towns.

An analysis of the distribution of hire-purchase cases among all districts in India according to levels of their development indicates that 60 per cent of the small units provided with hire-purchase assistance outside the three metropolitan cities (Calcutta, Madras and Bombay) were located in districts at highest level of development (i.e. Group IV), 24 per cent in districts at lesser level of development (Group III), 11 per cent in districts at low level of development (i.e. Group II) and 5 per cent in districts at the lowest level of development (Group I). This pattern of distribution of hire-purchase assistance among the districts at varying levels of development can be considered as indicative of the fact that the hire-purchase scheme having worked during its initial period without giving weightage to the dispersal factor, has already started making inroads in the lesser developed areas. But for the efforts put in through intensive campaigns and the favourable bias or the weightage given lately by various Committees, at the time of accepting applications, to the parties located in less developed areas (i.e. rural and semi-urban areas), the hire-purchase assistance would not have had made such noticeable inroads in these areas. Nonetheless, in the years to come this trend will have to be further strengthened.

A selective study into the nature of equipment supplied in urban and rural areas has revealed that enterprises in the former areas have received a much higher proportion of imported equipment than that received by the enterprises in the latter areas. Industry in rural and semi-urban areas being at an early stage of development requires simple and less sophisticated equipment manufactured mainly at the industrial centres within the country. Contrary to this, demand for machines emanating from industry in urban areas consists usually of sophisticated machines and automatic plants available mainly from the sources outside the country. The hire-purchase scheme has thus served as an important lever for fostering a welcome link between rural and urban industry whereby industry in the former areas with simpler equipment and specializing in the manufacture of less sophisticated end-products plays a complementary role to that in urban areas engaged in more sophisticated end-products. Enterprises in rural and semi-urban areas on an average acquired machines valued at $ 2,200 each, while the corresponding average for enterprises in urban areas was about $ 5,400. It was to stimulate the growth of smaller enterprises that concessional hire-purchase terms were afforded to demands of value less than $ 6,666 (Rs. 50,000) each. As mentioned earlier, these concessions have since been withdrawn.

ANNEX

A CRITIQUE OF THE HIRE-PURCHASE PROGRAMME OF THE NATIONAL SMALL INDUSTRIES CORPORATION

(Excerpted from the Report of the International Perspective Planning Team, sponsored by the Ford Foundation, on "Development of Small-Scale Industries in India: Prospects, Problems and Policies", Government of India, Ministry of Industry, 1963).

During the visits of the team to various states, both state industry officers and numerous small industry entrepreneurs called attention to the uncertainties, delays and paper work involved in using NSIC facilities. At the same time, it was known that the Corporation had instituted several administrative and procedural changes to overcome these difficulties. The working group for the international team, therefore, was asked to study the operation of the hire-purchase scheme. The study consisted of 95 random sample cases drawn from a total of 2,069 accepted applications in the northern region comprising six states. Of these 95 cases studied, it was found that machines were delivered to 35 applicants, 39 applications were withdrawn, and 21 were yet to be finally disposed of. Thirty-five applicants had failed to pay the "earnest money" deposit, ranging from 5 to 20 per cent of the value of the machines, properly required before machines are ordered. A considerable amount of lost effort was involved in delivering machines to less than 40 per cent of the applicants.

Industry-wise analysis of the applicants reveals heavy concentration in machine-tools and parts, light mechanical engineering and chemicals. This distribution reflects the deliberate policy of CSIO and the Corporation to encourage certain types of industries in preference to others. In industrialised Delhi and Punjab, two-thirds of the applications were from existing firms, but in less developed Jammu and Kashmir, this proportion was reversed, and all the applications from undeveloped Himachal Pradesh were from new entrepreneurs.

The time between initial application to the State Director of Industries and delivery of machines by the Corporation ranged from 7 to 42 months, with 25 to 30 months as the most common period required. Since 1961, there has been a significant reduction in the average disposal time, both by the states and the Corporation. For example, cases disposed of by the Corporation within 12 months increased from 17 to 80 per cent.

Until the exhaustion of funds for imports in late 1962, nearly 77 per cent of the value of machinery supplied was imported, with only 23 per cent supplied from domestic sources. It is obvious that the scheme was much more useful, given foreign exchange shortages, for the procurement of imported than domestic equipment, and that applicants for domestic equipment generally were able to find other sources of funds for their requirements.

At the end of November 1962, payments for 359 machines were in default from 145 small units, in the amount of Rs. 6.25 lakhs out of a total of Rs. 309.35 lakhs of machinery supplied in the Northern Region. Instalments were long overdue for 188 machines, and 171 came into default during the single month of November. The fact that payments were in default for about 15 per cent of the machines supplied in the region indicates that a serious situation is likely to develop in this regard if raw material shortages persist.

Some of the defaulters interviewed in the study blamed the Corporation for the situation for various reasons, but the majority of the delayed payments appear to be the result of lack of raw materials or proper planning. It is evident that improved co-ordination is needed among the agencies concerned, not only in assessing the economic potential and financial and management strength of the individual applicants, but also in the subsequent supply of materials, power and components. Unless special action is taken promptly to alleviate raw material problems of small industry, consideration should be given on loan applications to see whether assisted firms will have sufficient supplies to operate economically, and be able to repay hire-purchase loans.

It is ironic and unfortunate that the simplified procedures, instituted in 1962, designed to shorten the period between application for and delivery of machinery, came at a time when free foreign exchange loans for this purpose were being exhausted. This has caused a virtual halt in the operation of the Corporation's activities in supplying imported machinery and raises basic questions regarding its future if further imports cannot be provided. Also, as noted elsewhere in this report, because of the present excess capacity in small units due in large part to shortages of raw materials and components, there is probably greater necessity to provide these essential materials until a better balance of capacity untilization is attained in the small scale sector. There are, though, still the important key equipment shortages of many firms producing priority capital goods for the economy, what appears necessary at this time is a review of the over-all equipment and materials situation for the small-scale sector and the formulation of policies, based on these findings, which would include the delineation of the proper role for the National Small Industries Corporation during the shortage period.

A review of the problems of small business should be undertaken to see whether small firms actually require the services of the Corporation to purchase domestic machinery for them. Also, it should be considered whether there is need for NSIC financing of such purchases or whether medium-term state or centre loans might not serve the needs adequately. Similarly, it might be considered whether the foreign import requirements of small industry need necessarily to be tied with a compulsory loan provision. Given the shortages of foreign equipment, the granting of import licence privileges alone might suffice. A better case for further foreign exchange loan assistance from aiding countries and institutions could be made if additional equipment or supplies for small industry could be assured to flow into priority product lines, i.e., those needed for capital and defence goods production.

As a Government Corporation, the National Small Industries Corporation should be a model of efficiency and integrity in all its procedures and dealings. The Team recommends, along with the above considerations, the installation of the most modern accounting and control systems consistent with the Corporation's scale of operations. More suitable office space would also be in order to improve efficiency and reduce operating costs. The present system, though significantly improved, might be reviewed to delete still unnecessary cautionary checking on prices, quality, and other purchase aspects which go beyond considerations of supplying machinery. Some of these advisory services now provided at the centre could be better delegated to state officers in the spot.

As every state has, or is contemplating, a Small Industry Corporation to perform a range of activities similar to or even greater than those of the National Small Industries Corporation, we question whether there is any longer a need for continuing the branches of the National Small Industries Corporation. Their functions could progressively be transferred to the State Corporation agencies in their respective states. This would initially require consideration of a system of training, liaison, and reporting, especially if foreign exchange functions were to be handled in the centre with accountability to foreign lending agencies. However, it is believed that the National Small Industries Corporation schemes could thereby benefit greater number of small industrialists much more efficiently, and repayments would be improved, without commensurate increases in the administrative burden or undesirable duplication of facilities.

The national and state hire-purchase organizations should be operated with strict profit and loss accountability. We do not believe that they should lend funds at lower interest rates than the lending agencies must pay. The services provided should stand on their own merits. Several other interest charge practices might be reviewed. Instead of the present practice of adjusting interest rates in relation to the size of the loans, the Corporation lending rates should be uniform regardless of amount and should be adjusted periodically to reflect changes in financial market conditions and national economic policies. Judged by these criteria, the present rates are too low, as has been noted by the Corporation in its presentation to the Small Industries Board in the spring of 1963.

On the other hand, it should be noted that the present low rates do not fully reflect additional hire-purchase advantages to the borrower. Interest rates savings are, despite changes made in the Corporation, still offset to a large degree by uncertainties, delays and other factors inherent in Corporation practices. This is even more true in the operation of state corporations. When such corporations hold earnest money furnished by the applicants for any period of time, the real cost of the loan to the borrower rises significantly. Equity requires that small borrowers be paid interest on such deposits at market rates until the actual date of delivery of the machines. These implicit interest payments may be deducted from the amount of the first instalment due.

It may be deemed necessary for various reasons to retain concessional rates to co-operatives at a slightly lower rate than that charged to private entrepreneurs. However, it is believed that there should be no concessions in interest rates made to ancillary firms, as noted in the section on ancillaries in this report. We do not believe that these and other concessions to ancillaries are influential in the establishment and maintenance of meaningful ancillary relationships with larger firms. These relationships depend to a much larger extent upon quality and reliability of product, definite delivery schedules, and other product and price improvements. Such special concessions are open to a host of abuses: the vagaries of ancillary contractual relationships, units being ancillaries today and not tomorrow, and captive or false ancillary firms to take advantage of these privileges. For similar reasons, capital ceiling limitations should apply equally to all individual borrowers, whether or not they are ancillaries.

The study made of operations of the Corporation indicated that much of its efforts were absorbed in dealing with less than serious applicants. We recommend that each application for hire-purchase loans should be accompanied by a handling charge deposit of Rs. 100 regardless of the value of the machine desired. This would be returnable only if the Corporation could not provide the machinery desired within an originally agreed-upon time limit. The charge would tend to wood out tentative applicants and permit the Corporation to handle its business more expeditiously. Interest would be paid to the borrowers until the machinery was delivered. The additional 5 per cent service charge would be returned.

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