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MERGERS IN SMALL INDUSTRIES IN INDIA ^{1/}

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One of the most striking features of India's process of industrialisation is the spectacular growth of its small scale industries. In terms of the number of units (2.82 lakhs in 1972 registered with the State Directors of Industries), contribution of value added by manufacture (33% of the national total) and employment (47.2% of the total industrial labour), these industries occupy a significant position in the landscape of Indian industry. Added to this is a diversity of product range and sophistication and a fair dispersion all over the country. The growth of these industries has had a cause and effect relationship to widespread entrepreneurial development in India. All these results are in considerable measure due to governmental support and individual initiative. Mergers, it may be stated at the outset, have not been a significant contributory factor.

2. Mergers could arise out of a conscious and voluntary decision of the parties concerned in order to derive particular economic, financial or other benefits or could be forced on one of the parties due to one or other handicap. Mergers could be between small units and large units or between small units themselves. To what extent such mergers take place will depend on governmental policies as well as individual motivations which set the parameters, so to speak, for this process.

Government Provisions Relating to Mergers

3. Prior to the enactment of the Monopolies and Restrictive Trade Practices Act, 1969, the Government had no specific policy towards industrial integration and mergers. Government had neither expressly favoured nor disapproved of such combinations as a matter of policy, and under the Companies Act, mergers or amalgamations were left to the initiative of industrial units and to the decisions of courts on merits. Certain industries like coal, iron and steel and banking, however, implemented schemes of amalgamations and mergers at the instance of Government as such a step was considered beneficial for increasing efficiency. Similarly, formation of joint deals and export trade associations was also encouraged by the State. Thus the economic advantages of rational combines were not lost sight of even in the absence of any clear policy enunciation.

4. The Industries (Development & Regulation) Act, 1951 through a recent amendment and the Companies Act have provisions to facilitate and regulate industrial re-organization and mergers. Section 18 FC of the Industries (Development & Regulation) Act provides that in the case of an industrial undertaking the management of which has been taken over by the Government, on receipt of a report on the affairs and working of the undertaking, if the Government are satisfied that (a) in the interests of general public, or (b) in the

interests of the shareholders, or (c) to secure the proper management of the company owning the undertaking, it is necessary so to do, they may, by order, decide to prepare a scheme for the reconstruction of the company owning the industrial undertaking. Section 395 of the Companies Act, 1956 provides that if a scheme of merger is approved by nine-tenth majority of shareholders, it shall be binding on all. Section 396 empowers the Government to compel two or more companies to amalgamate in the national interest. In case the scheme of merger involves re-issue of capital, approval of the Controller of Capital Issues is also necessary.

5. The Monopolies and Restrictive Trade Practices Act, 1969 for the first time vested in the Central Government the authority to approve or disapprove or mergers or amalgamation involving companies which are covered by the provisions of the Act relating to concentration of economic power. One of its important objectives is to regulate mergers and expansion schemes of the larger houses. Schemes of mergers or amalgamation of an undertaking whose assets are not less than Rs. 20 crores or an undertaking which is either a dominant undertaking or which after the proposed merger is likely to become such, require approval by the Central Government under Section 27 (2) before the court can sanction them. In approving of the merger applications, the Central Government has to take into account all matters which appear in the particular

circumstances to be relevant and, among other things, give adequate consideration to the need, consistent with the general economic position of the country :

- (a) to achieve the production, supply and distribution, by most efficient and economical means, of goods of such type and qualities, in such volumes and at such prices as will best meet the requirements of the defence of India, and home and overseas markets;
- (b) to have the trade organised in such a way that its efficiency is progressively increased;
- (c) to ensure the best use and distribution of men, materials and industrial capacity in India;
- (d) to effect technical and technological improvements in trade and expansion of existing markets and the opening up of new markets;
- (e) to encourage new enterprises as a counteracting force to the concentration of economic power to the common detriment;
- (f) to regulate the control of the material resources of the community to subserve the common good; and
- (g) to reduce disparities in development between different regions and more especially in relation to areas which have remained markedly backward.

Government Policies Relating to Small Industries

6. Government policies in India have a substantial bearing on the scope for mergers, or rather their relative absence, in small industries. Small scale industries are defined in India as those with investments in plant and machinery of the equivalent of \$ 100,000 or less. A whole set of promotional measures relating to finance, marketing, etc. support the entrepreneurs

in this sector. Similar measures exist for cottage industries and cooperatives. Side by side, regulatory measures provide that the field of small industries remains that of the small man and not of big business. In its anxiety to prevent concentration of economic power, the Government regulates growth of large business houses and believes that the active growth of small industries would countervail the trends towards concentration of economic power. The Government's Industrial Policy Resolution, 1956, stresses the role of cottage and village and small scale industries in the development of the national economy. It goes on to say "... the aim of the State policy will be to ensure that the decentralised sector acquires sufficient vitality to be self-supporting and its development is integrated with that of the large scale industry. The State will, therefore, concentrate on measures designed to improve the competitive strength of the small scale producer Many of the activities relating to small scale production will be helped by the organisation of industrial co-operatives. Such cooperatives should be encouraged in every way and the State should give constant attention to the development of cottage and village and small scale industries."

7. There is thus the specific and declared policy of the Government to ensure that the small scale sector does not become the hand-maid of the large business. While small scale units can be set up by all entrepreneurs without an industrial

licence, larger houses and foreign companies are specifically restricted from doing so without any industrial licence and if they apply for a licence they are likely to be refused one. The licensing regulations as such do not at present specifically prohibit the purchase of small units by large ones. However, administratively the procedure for registration of the small units with the Directors of Industries in State Governments which will confer on them the facilities for raw materials and other support, specifically discourage the association of large units. It has been specifically stipulated that units coming under any of the following categories shall not be entitled to any special assistance under the small scale industries programme of the Governments:

- a) where the unit is a subsidiary or associate of a company which does not come within the definition of a small scale industry;
- b) where a considerable portion of the unit is held by one or more firms which do not come within the definition of small scale unit;
- c) where the financial statements of the unit reveal considerable inter-locking of capital and loan funds between one or more concerns under the same management and where the loans finance only these transactions without any production of the unit; or
- d) where an advance has been guaranteed to the unit by big industrial units or persons possessing large means .

8. Another significant feature of Governmental policy is the reservation of a number of products (at present 177)

for further development exclusively in the small scale sector. In these product lines, large units cannot be set up afresh nor existing ones expanded, unless in either of these cases there is an export obligation of 75% of the production. In these product lines, therefore, small scale units tend to remain by and large small. In other product lines, the small units can grow bigger in the process of normal growth but instances of this type are not in practice particularly large.

Entrepreneurial Motivations

9. Entrepreneurial motivations also act in the same direction. The constellation of governmental policies is such that there are some advantages in remaining small. The need to protect small units is felt in such a measure that a Committee which recently went into the question of drafting special legislation for small units evolved a sub-category of units called tiny units with investments of roughly \$ 13,000 or less in plant and machinery. In such circumstances if the owner of a small scale unit wanted to reinvest his earnings he might rather start another small scale unit than expand the existing one. Socio-cultural attitudes are such that there is a sense of individualism and confidentiality about the operations of the individual small units and hence the possibilities of merger or collective action are relatively limited and confined to

situations where such collective action becomes a condition for survival. It should be remembered that as distinct from mergers in large units which are largely corporate mergers and hence impersonal, mergers in small units are often a highly personal affair where the leadership and sense of participation of one of the parties to the merger suffers a sea-change.

Inter-firm Action

10. All this would show clearly that it is not possible to look for mergers in the conventional sense of the term in the Indian context. In identifying what forms of collective action have taken place in the small scale industries in India, it is necessary to begin with a clear understanding of what the advantages of mergers are. Merger of units with a capital equipment of relatively unsophisticated nature cannot result in technological economies of scale except to the extent of better production planning and control. Advantages could however, arise from better viability in regard to finance, purchase and sales, raw material needs and utilisation and research and development. In these fields small size has definite disadvantages and it is therefore in these fields that the motivations for mergers have to be looked into.

11. In regard to the functions just now enumerated there could be an integration or a partial merger to off-set the functional disadvantages. This can occur through governmental

support or inter-firm action. Government provides supporting services in terms of testing facilities, finance and credit facilities etc. The formation of apex organisations of co-operative societies for purposes for marketing etc. have also a similar effect of compensating the weaknesses of small units in regard to economies of scale. Apart from government action there are occasional instances of inter-firm action in regard to marketing, R & D, etc., which are the best possible approximations to mergers in the Indian scene. The experience in India in regard to functional mergers is described in the following sections in regard to (a) consortia (b) cooperatives and (c) ancillary units. The first two involve inter-firm action among small units themselves and the third involves inter-relationship between large and small units.

Consortia

12. A few cases of consortia have come to notice and a significant one in this respect is described below in detail.

13. Until a decade ago the manufacture of radio receiver sets was entirely in the hands of large houses. A small industry unit was licensed in 1962 to manufacture radios. Its capacity was limited to a mere 300 pieces a year. The technical know-how and spares for this manufacture were to be imported from Japan, but the collaborating firm refused to agree to a contract unless 12,000 sets were manufactured. Besides this,

the local unit had also the problem of procuring the necessary plastic cabinet moulds in the home market, as the price not only ruled high at the time but the supplying firm insisted that the minimum demand for cabinet moulds should be at least 5,000. Four years later three manufacturers located in different parts of India formed into a "consortium" with an aggregate capacity of 10,000 sets. In the consortium, the units together were able to manufacture more radio sets with the imported spares as the position had eased and components became more and more indigenous and easily available. One of the partners in the consortium, which could not earlier afford a qualified engineer, was able to recruit one at a high salary now. Production of sets increased.

14. At this stage, the three units were given licence to manufacture TV sets. They practically stopped making radio sets and were able to switch over to the manufacture of TV sets without encountering much difficulty. Two more units that were also licensed to manufacture TV sets joined the consortium in 1972. One firm withdrew immediately (for reasons unknown). The consortium of four manufacturers worked smoothly till the end of the year, but one of the firms broke away on difference of opinion and started its own production.

15. The consortium was not, however, affected. The

remaining three firms were soon joined by four newly licensed small firms located in different parts. The consortium, at present, is the largest manufacturer of TV sets in the country with a production of 3,000 sets. The consortium has, at the beginning of 1973, set up an Electronics Research Laboratory where the technical know-how is developed and improved and is available to member-firms at the royalty of one per cent on production or a lump sum payment of Rs. 25,000 (about \$ 3,300) per company.

16. What were the advantages derived out of such a consortium? The foremost advantage is in the technical area. The consortium has been able to have its own research facilities which individual firms cannot afford alone. Secondly, there is a common brand name under which the products seek to capture the market. Thirdly, the consortium has the advantage of retaining a sole distributing agency, which arrangement obviously saves the individual firms from high distribution costs. Fourthly, after-sales servicing becomes not only more efficient, but less expensive. Fifthly, advertising and publicity for the product is done in the common brand name and the cost of such sales promotion efforts come to about 4 per cent of ex-factory value of production. Sixthly, there is financial advantage in that economies of scale are possible, and also the members have better access to bank loans. Expertise that is available with one member-firm in the consortium is accessible

to others which do not either have it or can have it at a high price.

17. The consortium is managed by a Board of Directors on which each member-firm is represented. The policy pertaining to several aspects of the consortium is discussed in the Board meeting. The fundamental and binding factor is unanimity in decision-making. The leading partner and promoter does naturally have a "leading" voice in decisions arrived at and thus has a final say in policy making.

18. It is of interest to notice that, of the 4 new members of the consortium, three have been provided with the required know-how, but allowed to sell their product under a common brand which is different from that of the (parent) consortium. The fourth member-firm is a joint sector company promoted jointly by a State Industrial Development Corporation and the consortium. This company has financial collaboration with the leading partner in the consortium and the collaboration for technical know-how is with the research laboratory set up by the consortium.

19. The research laboratory claims improvements of electronic valve circuit by introducing hybrid circuiting with the use of IC (Integrated Circuit). A further advance has now taken place in the research laboratory by transistorisation of hybrid circuit into an all solid state circuiting. The laboratory has also produced

an all-channel tuner which is distinct from the multi-channel tuner and has developed boosters for increasing the strength in fringe areas of TV transmissions. This is an instance of what a cooperative endeavour among small units can achieve in the field of technology.

Industrial Co-operatives

20. In India there has been a significant merger among skilled workers, artisans and craftsmen and small industrialists in the form of co-operatives. It is a form of organization capable of attracting particularly the small men. The encouragement of co-operative form of enterprise in the field of industry is a matter of national policy.

21. Industrial co-operatives in India have been organised in different circumstances by different groups of persons e.g.

- (i) Artisans and craftsmen in traditional industries normally prefer to work in their own cottages but the introduction of improved tools and techniques has necessitated their working under a common shed, as has been the case in some oil pressers cooperatives.
- (ii) Special assistance, conditional upon their forming such a co-operative, has acted as an incentive to some groups, e.g. handloom weavers.
- (iii) In the mechanized industries there are some societies formed by factory workers as a result of strike or retrenchment, for example, an abrasive co-operative at Uran in Maharashtra or an engineering workers' co-operative society at Calcutta.

- (iv) Some societies have been formed by factory workers who belonged to different factories but were anxious to have their own production unit controlled by themselves and, therefore, came together in a co-operative organisation, for example, a hosiery cooperative at Ludhiana.
- (v) There are a few cases where former entrepreneurs have preferred to convert their concerns into workshop co-operatives of this type. A chalk and pencil manufacturing co-operative at Delhi and a light engineering co-operative at Rajpura are examples of this type.
- (vi) Some societies have been formed by trainees of technical institutions while in some cases government production-cum-training centres have been converted into co-operatives, e.g. a bolt and nut co-operative at Sriperempudur or a carpentry and smithy co-operative in Tripura. Amongst technical institutions there is a case of unemployed engineers forming a society e.g. Kerala technicians' engineering co-operative for manufacture of scooter in Kerala.
- (vii) A few societies have been formed of persons who were entirely untrained, the job of training as well as production thus falling on the society. Match manufacturing and other co-operatives organized by the Central Social Welfare Board are examples of this type.

22. The magnitudes of this form of co-operation will be seen from the following table :-

Type of Society	No. of Societies	No. of Members (Lakhs)	Working Capital (Rs. Million)	Sales (Rs. Million)	Employment (Thousand)
I. Societies of Traditional Artisans and Craftsmen.	40,785	28.7	1723	1556	791
II. Societies of Workers and Small Industrialists.	5,987*	1.7*	309*	89	60*

Type of Society	No. of Societies	No. of Members (Lakhs)	Working Capital (Rs. Million)	Sales (Rs. Million)	Employment (Thousand)
III. Societies of Producers of raw materials.	1,453	9.8	4042	2569	N.A.
IV. Industrial Co-operative Banks.	27	0.3	187	-	-

*includes industrial estates.

23. The bulk of the traditional artisans co-operatives belong to the category of production-cum-sales societies. The members mostly work in their own cottages, but on society's account. Very few of them like to work in common sheds. Where, however, modern tools and implements have been introduced, the members start working in the society's workshop, as happened when powerlooms were introduced by weavers' societies. Workers trained in modern factories have shown keener interest in the establishment of workshops usually owned and operated by them.

24. Some traditional craftsmen prefer to avail of only a few services of the society and continue to bear the risk of production themselves. They have organized a few purchase and sales societies, some of which have also established common facility workshops. A few supply and sales societies are organized by small industrialists. There is a good scope

for organization of service societies of small industrialists which could provide them supply, sales, common workshop and similar other facilities.

25. 151 societies have been organized by 12,000 small industrialists for setting up co-operative industrial estates. There are two types amongst them (i) those that develop land and leave it to the member to construct his own workshop and (ii) those where construction is undertaken by the society. More prosperous members are able to gain from the first type but the poorer members find it difficult to get their sheds constructed by themselves. The second type of industrial estates which are more numerous particularly in Maharashtra have succeeded better.

26. Co-operatives can thus be formed among workers as well as firms. In the marketing field apex co-operatives are formed among the smaller co-operatives themselves. There are many such instances of apex co-operatives in India.

Ancillary Industries

27. The large and small-scale industries are to a great extent inter-dependent and contribute to each others' prosperity. On the one hand, small-scale industries turn out products on the basis of basic materials like iron and steel, aluminium, chemicals, etc., produced in large-scale units. On the other hand, large-scale units buy components, spares,

sub-assemblies etc. from small units to manufacture their final products. It is generally felt that interdependence of this type is very essential and should be fostered for the sustained growth of the small-scale sector. Such a relationship has been working with success in some of the advanced countries especially Japan, U.S.A and U.K. For example, in 1966, about 53 per cent of all medium and small-scale enterprises in Japanese manufacture were subcontractors to a greater or a lesser extent.

28. According to estimates made by the Small Scale Industries Development Organisation of India, although about 11,000 small-scale units were reported to be supplying parts and components to large units, only about 400 units had so far been registered as ancillary units. About 200 large units obtain supplies regularly from ancillary units. The dependence of automobile manufacturing units in ancillaries is considerable, say from 40% to 70%. In particular, 17 public sector enterprises and 10 private sector enterprises have shown considerable interest and development in this regard. The Government has identified 16 industries where the scope for ancillaries is maximum and needs to be pursued with vigour.

29. Space would not permit us to recount in detail the various measures taken by the Government for the promotion

of ancillary industries. In regard to functional mergers with which the Council had at present no note of (a) sub-contracting exchanges and (b) the case history of a public sector unit in relation to ancillary enterprises.

Sub-contracting exchanges.

30. Sub-contracting exchanges would on the one hand provide a useful medium and forum for gaining knowledge and understanding of the requirements and problems of both large and small units and on the other they would ensure effective marketing arrangements for products of ancillary units. Two sub-contracting exchanges have been set up in Bombay and Madras with UNIDO assistance. During the period 1971-72, the exchanges in Bombay and Madras approached 3008 and 1700 small-scale units respectively to ascertain details of spare capacity available with them and also their ability to take up additional job works. They processed about 1837 and 655 enquiries respectively for about 365 diverse items. The exchanges have already started catering to the needs of the units even outside the city limits of Bombay and Madras. All large and small, private and public sector units are being brought under the purview of the exchanges. The volume of work handled at the exchanges is increasing rapidly. Efforts are being made to establish some more exchanges in other important industrial towns.

31. As regards public sector units, the experience of Hindustan Machine Tools (HMT) will be described. Before it is done, it will be useful to take note of the general guidelines issued by Government to all public sector enterprises for the development of ancillaries :

1. Every public sector undertaking where ancillary development is possible, should set up an ancillary division and designate a senior officer primarily re-sponsible for the development of ancillary units.
2. The public sector undertakings would identify items which could be farmed out for setting up ancillary units in and around the undertaking and to specify imported items for which indigenous capacity has either developed or could be developed.
3. The public sector undertakings should also take upon themselves the responsibility of developing ancillary industrial estates in co-operation with the State Government authorities, who would provide the basic infra-structure facilities.
4. The public sector undertakings should also come forward to help the ancillary units with the scarce indigenous/imported raw materials and also to provide necessary technical know-how so that the parts and components could be manufactured to their specifications.
5. There would be an understanding between the enterprises and the ancillary units regarding prices, the period of validity of contract for supply of the various parts and components and also a reasonable period (90 days) during which payments would be made to the ancillary units.

32. The HMT Industrial Estate at Bangalore covers an area of about 20 acres and consists of 50 workshops, 27 of 'A' type, 18 of 'B' type and 5 of 'C' type, besides amenity buildings

like an administration block, canteen, ancillary units' co-operative society etc. Each workshop accommodates an office, show-room, work floor and services. The 'A' type have a covered area of 3,000 sq. ft; the 'B' type 1,500 sq.ft. and the 'C' type 4,800 sq.ft.

33. Each unit has been allotted with specific products to be sub-contracted by HMT and these units have been planned by the entrepreneurs under the technical advice of HMT on the requirements of machinery and equipment, floor space and layout, raw material, labour, fixed and working capital, technical know-how, etc. The items catered by the ancillary units to HMT can be classified generally into the following groups :

- (a) Standard and Special accessories to be supplied with HMT machines.
- (b) Non-ferrous castings - aluminium and bronze for components.
- (c) All types of standard fasteners and other standard parts required for manufacture and assembly of machines.
- (d) Electrical items such as brake magnets; control transformers; coolant groups etc. required for assembly of machines.
- (e) Wooden packing cases required for packing and despatch of machines and accessories.
- (f) Some of the components of HMT machines either for processing all manufacturing operations or sub-operations. Orders for such components/operations are placed only in special circumstances when either facilities are not existing or there is shortage of capacity to process them in HMT factory.

34. One of the most important considerations observed by HMT while selecting an entrepreneur for a unit should be technically competent to handle the rather intricate technical components and accessories. This is largely possible if the entrepreneur is a technician with a broad administrative and financial knowledge of running a small business and hence preference has been given to HMT employees. Also, HMT has considered in its selection the retired public servants with meritorious service in the Government who are assisted by competent engineers to run small scale engineering undertakings.

35. The approach of HMT to assisting the ancillary units is that they do require assistance from the parent organization to conduct their business satisfactorily; however, this assistance should be restricted only for a certain period initially and gradually "upon fading" should be discontinued, as otherwise, the ancillary units will depend upon the parent organization for almost everything they require. This would not only increase the burden of responsibility of the parent organization but also kill the initiative and enterprise of the entrepreneurs and make them incompetent to run their units by themselves. However, in areas where the entrepreneurs are not expected to be self-sufficient, the parent organization should render the assistance.

36. The following facilities have been extended to the

ancillary units by IIT.

- (i) All ancillary workshops with office and with power, water facilities and access roads shall be on reasonable rent.
- (ii) Assistance in securing hire purchase facilities from the National Small Industries Corporation to the extent of 95 per cent for the purchase of machines and equipment repayable in the half yearly instalments at 6 per cent interest.
- (iii) Imported materials and other materials which are difficult to procure in the indigenous market are made available to them at book value and recovered from their bills. (In the initial period for about 1 to 2 years, all raw materials were supplied by IIT on credit).
- (iv) The technical services are free in the sense that IIT have stationed a manager with all services facilities such as Production Planning; Progress; Quality control; Inspection; etc.
- (v) Free use of one shift load by IIT for one year from the time of commissioning the ancillary unit and thereafter work load to the maximum extent possible with full liberty to take up outside work if desired.
- (vi) Facilities for in-plant training for the employee or the entrepreneur are provided in IIT training centre at a nominal charge of Rs. 50/- per trainee per month instead of Rs. 200/- per month as is charged for any outsiders.
- (vii) Production services such as tools, jigs and fixtures; heat treatment and tool room facilities etc. are made available to entrepreneurs on request and the hire charges for providing the same are recovered from their bills. This is to relieve the entrepreneurs from investing their working capital in these items.
- (viii) Credit facilities and financial assistance. (This however has been stopped now in view of a recession for IIT as well as due to the fact that the units are sufficiently old and can seek credit facilities from Banks).

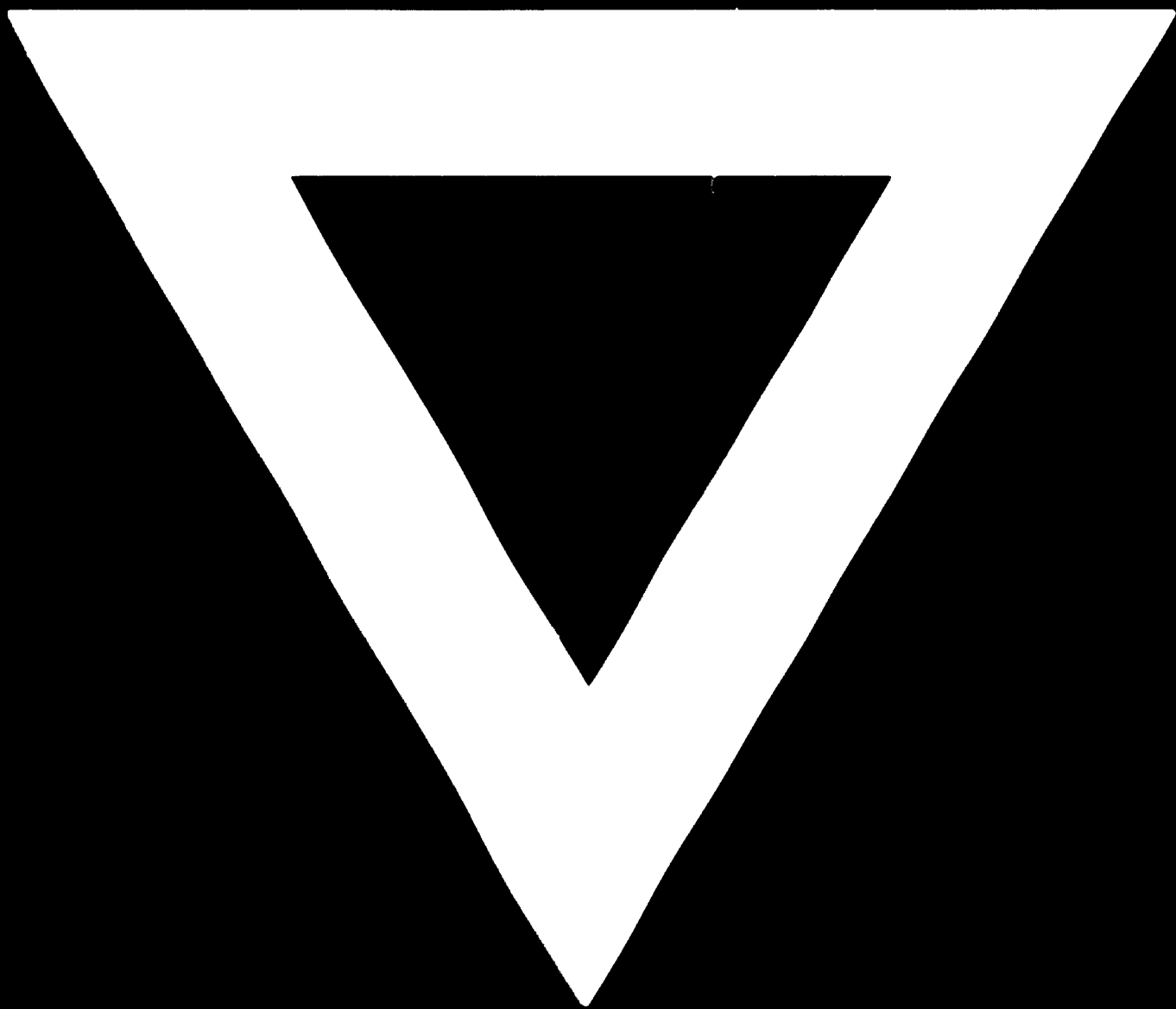
- (ix) Prompt payments for the supplies made by the ancillary units to the maximum extent possible.
- (x) The pricing formula adopted by HMT for its ancillary industries is quite attractive.

37. Among large units in the private sector, there are some significant examples of sound ancillary development. This needs to be developed further in more large units and on a sound and sustained basis. Two trends may, however, be mentioned in passing. In some instances, the ancillaries are developed by the friends and relations of those who run the larger units. Sometimes small units produce goods to specifications laid down by larger firms, which market them, and thus overcome their weaknesses in marketing. This happens particularly in the field of shoes. Another trend which has developed fast in recent years is the marketing by oil companies in their filling stations of automobile spare parts purchased from small units.

Conclusion

38. Text book mergers are thus few and far between in the Indian scene. A combination of the impact of Government policies and individual motivations has contributed to this result. Mergers are mainly functional, particularly in the marketing function. The experience of India in regard to consortia, co-operatives and ancillaries has been described above. The absence of complete mergers has neither inhibited the growth of small scale industries nor accelerated it.





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