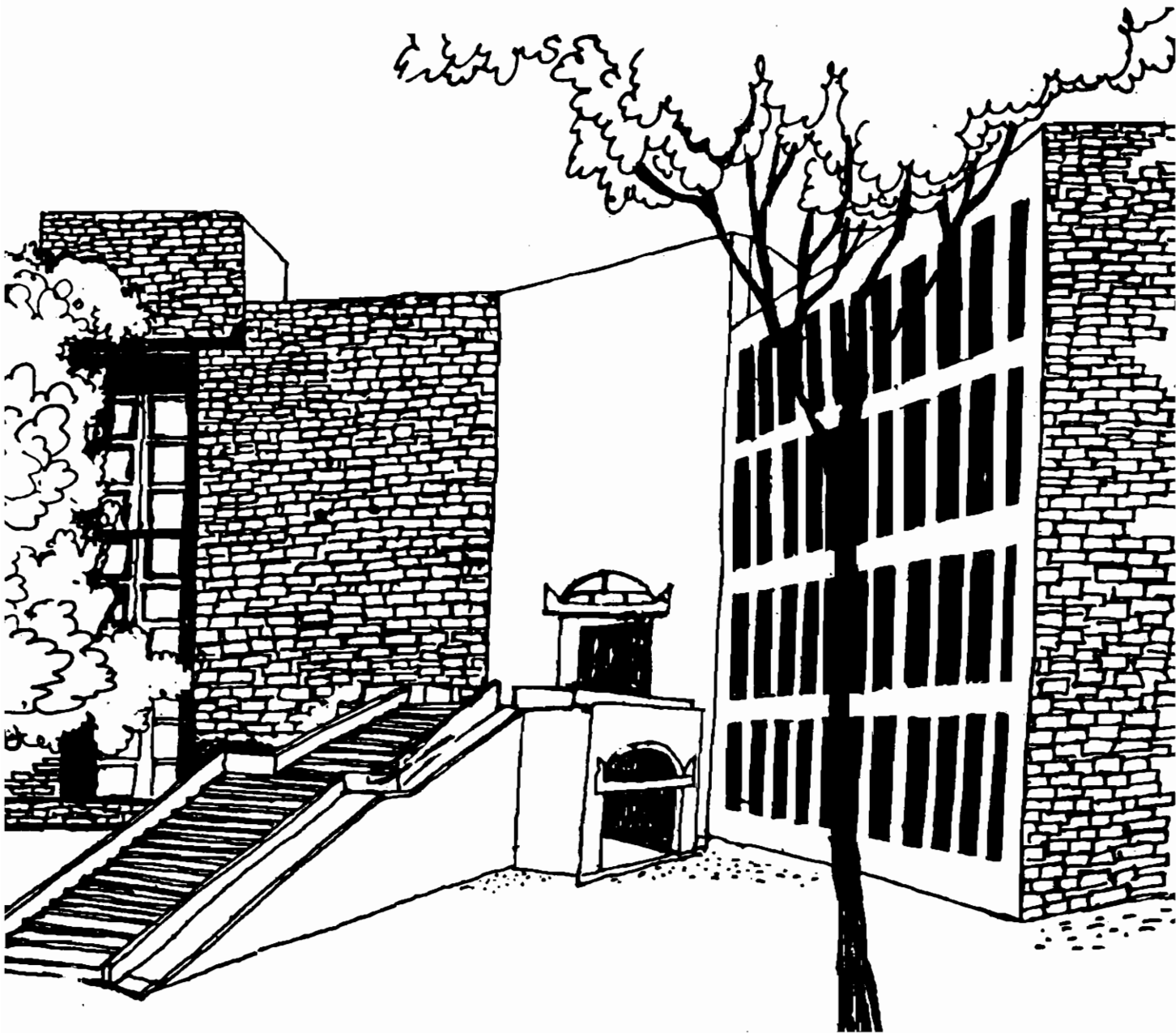




Working Paper



FINANCE FOR NON-FARM RURAL ACTIVITIES

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WP1072



WP
1992
(1072)

W P No. 1072
December 1992

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FINANCE FOR NON-FARM RURAL ACTIVITIES

Gurdev Singh

Facilities for Non-Farm Finance

While farm finance for the acquisition of agricultural inputs and farm machinery has been adequately emphasised and extensively studied, non-farm finance in rural India has not got the imagination of planners (barring coverage of some such activities under IRDP) till mid eighties when the National Bank for Agriculture and Rural Development introduced automatic refinance facility (ARF) for financing tiny, rural and cottage industrial activities.

After the formation of the National Bank in 1982, special responsibility for financing village, cottage, tiny/rural industries was entrusted to it. Seven task forces were constituted in various fields to study the credit requirements of each sector and extension of financial assistance for the National Bank. On the basis of recommendations of these task forces the National Bank formulated several schemes which are grouped under two arrangements, namely, composite loan upto Rs. 30,000 covering term loan as well as working capital loan, and integrated loan upto Rs. 5 lakhs ensuring incremental working capital needs upto next five years. Currently the corresponding limits are enhanced to Rs. 50,000 for composite loan and Rs. 7.5 lakhs for integrated loan. The facility has been availed of by the banks on an automatic basis and the National Bank does not undertake any pre-disbursement security of the individual loan application. Such security is done by the financing banks. The primary objective is to extend refinance support to non-farm sector to encourage rural industrialisation and attendant service units. To regulate the refinance support to subserve the objectives and to ensure that the loans for purely business activities are not availed of under the ARF, it was decided that the National Bank refinance would be available against loans granted by the banks for non-farm sector activities identified by KVIC as eligible for its support and activities covered under 22 broad groups of cottage and small scale industries (Appendix 1) and the units undertaking service activities such as pumpset repairs, electrical wiring/repairing, electronic repairing/sub-assembly, automobile/tractor repairing, machine cutting, grinding, polishing, etc. For financing service units not established for assisting an industrial activity, specific approval of concerned Regional Office of the National Bank may be obtained. Under the ARF though the project approach is not followed the financing banks are required to prepare a brief outline or profile giving all the important particulars about the party, activity undertaken, unit cost estimates including break up of cost of fixed assets and working capital which should be kept in the respective file together with appraisal and sanction notes indicating the terms and conditions of sanction. How this financing arrangement has worked is the focus of this paper. The observations are based on some 12 case studies conducted at the Indian Institute of Management, Ahmedabad on financing of non-farm activities in different parts of the country (Appendix 2). In what follows is a brief description of those case studies.

The Case Studies

The case studies referred to as above covered production units for electronic items, synthetic gem cutting, brass lamps, plastic pipes, drilling machine, coconut fibre, marble cutting, poultry feed, woollen carpets, Pankhi making, bakery items and leather shoes. Mostly the products are non-standard and non-brand. While some of the products are final consumption items (shoes, bakery), others are intermediate raw materials (poultry feed, coconut fibre) and still others are investment items (drilling machine). While for some products the raw materials were locally produced (coconut fibre, marble) in others these were arranged from outside (plastic, electronics). While some products have local market (poultry feed) others have distant markets (Pankhi, electronics) and still others international market (gems, Galicha). For some activities skills are locally available (Galicha, Pankhi) for others the skills are acquired from outside (electronics). Similarly in some cases simple tools are used in others sophisticated machines are employed.

As stated earlier all these activities are financed under the ARF of the National Bank under schematic finance. Schematic financing is done on the basis of some generalised norms according to which only financial considerations are examined. While information was collected on certain technical and financial aspects of the activity by the financing banks, project analysis is ignored. As such complete loan appraisal is rarely carried out.

Performance under ARF

The financing institution revealed that financing under ARF facility has been very low and the progress was poor. The reasons could be many such as lack of expertise with the financing banks about large number of non-farm activities, lack of supporting facilities, lack of demand for such credit, lack of interest among the entrepreneurs to take up these activities. It was also revealed that the recovery under the ARF has been quite low. The case studies show that many a time default occurs because of either over finance (plastic pipes, poultry feed) or under finance (electronics). In case of the activity being a captive unit for the main production activity such as poultry feed as it is consumed in own poultry unit and no cash inflows are generated for repayment of loan. In case of some consumption items such as shoes, commercial aspects are ignored at the time of financing. Though product may be financially viable it did not find ready market and hence remained unsold causing irregularity in repayment of loan. While production of some items may be viable as a decentralised activity, they failed because of non-viable decentralised marketing/processing. Further working capital was financed only for a cycle and financing beyond the first cycle from normal banking was generally not available easily. Hence the production schedule could not be followed and as a result repayment became irregular. Also working capital component of the composite loan was recoverable along with investment loan component which made the repayment instalment bigger. As working capital did not generate returns the entrepreneur had no incentive to repay it and hence default occurred.

Changes Needed

- i) Financing under ARF puts all activities under straight "jacket approach of schemes". It is necessary to evolve norms of viability for major groups of activities separately and individual applications may be appraised. In fact for integrated finance project approach should be followed to avoid failure at implementation stage.
- ii) In some cases where processing of final product is more viable if manufacturing of parts is carried out as decentralised activity, ancillarisation is the answer. Many a time the processors take care of production finance for decentralised production activity.
- iii) Further under decentralised production for centralised marketing/processing financing at two levels should be considered together. Cooperatives or producers guilds may take up the centralised activity. The decentralised production finance should follow cluster approach to minimise cost of financing.
- iv) The financing bank may examine financing of full requirements of the activity including working capital needs after the first production cycle. Similarly felt needs of the producers may be considered. In case of custom made products the cost of designs, R&D, and product development may be included in the production finance.
- v) The financing banks should follow review of composite loans from time to time to provide additional finance if needed at some stage. This will help in continuous flow of income.

Appendix 1

Groups of Products Eligible for Financing under ARF

1. *Handicrafts* : Artistic textiles, bangles and beads, carpets, ceramics, conch shell, flax and fibre, hand printing, jewellery, metalware, stonework, woodwork, bamboo, etc.
2. *Village industries* : Carpentry, blacksmithy, apiculture, cottage matches, soaps, gramudyog, bidi making, broom making, etc.
3. *Leather industry* : Flaying, tanning, charmkar, footwear, leather garments, leather goods and artistic items
4. *Pottery* : Earthenware, decorative pottery, porcelain, chinaware, clay moulding, stoneware, artistic pottery
5. *Paper products* : Tissue paper, wax paper, paper bags, paper plates, cups and napkins, teleprinter rolls, file covers, file boards, decorations
6. Printing, book binding, lithography
7. *Glass* : Ceramics, bangles, mirrors, beads, slides, thermometers
8. *Rubber goods* : Footwear, cycle tubes and tyres, gloves, brushes, electric wires
9. *Construction and building materials* : Stone crushing, quarrying, concrete, bricks, tiles, marbles, lime, cement, chalk making, blocks, Jallies
10. *Chemicals and chemical products* : Polishes, soaps, tooth paste/powder, cologne, creams, powders, salt, soda, fireworks, pharmaceutical, gums, adhesives
11. *Petrochemicals* : Films, PVC granules, buckets, mugs, boxes, tubs, folders, thermoplasting products
12. *General engineering* : Umbrellas, metal sheets, locks, utensils, wire gauge, knives
13. *Electronic/ automobile engineering* : Electric and radio accessories, motor and bicycle parts, public address, regulators, dryers
14. *Sports goods* : Cocks, balls, bats, sticks, physical fitness equipment, pads, gloves
15. *Stationary items* : Inks, pens, pencils, paper pins, clips,
16. *Agro-industries* : Input manufacturing, machinery, agro-processing, food processing.
17. Tailoring and readymade garments
18. *Sericulture* : Rearing, reeling, twisting, weaving
19. *Coir* : Mats, fibres, ropes
20. *Handlooms/powerlooms* : Yam making, spinning, textiles,
21. Forest/ tribal area based products
22. Miscellaneous

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i. Integrated Loan for Tiny Industries

Commercial banks and cooperative banks could extend financial assistance to individuals, groups of individuals, proprietary/partnership concerns upto Rs. 5 lakhs by way of block capital loan or integrated loan including working capital requirements for one operating cycle. All small scale industries approved by Development Commissioner (SSI) are eligible. The margin was 5 per cent of block capital for loans upto Rs. 30,000 and 10 per cent for bigger loans. The rate of interest was 12.5 per cent to ultimate borrower (8 per cent to the bank). Repayment period is 10 years with a moratorium of one year. Refinance is 100 per cent under automatic sale.

ii. Composite Loan

Automatic refinance facilities extended to banks for financing composite loan to individual artisans for the purpose of investment in equipment and tools and for working capital requirements covering all SSI classified under 27 groups identified by Development Commissioner. The maximum amount per beneficiary was Rs. 30,000

at the rate of interest 10 per cent to the beneficiary and 6.5 per cent to the bank. The repayment period is 10 years with a moratorium of 12 months. Refinance is 100 per cent.

- iii. **Composite Loan through PACS/LAMPS/FSS/Primary Level Societies**
Excepting repayment period which ranged from 1-10 years . All terms and conditions are as under (ii).
- iv. The particulars under (i) and (ii) are available to service oriented industries having investment upto Rs. 5 lakhs . Small borrowers can get composite loan of Rs. 30,000 and bigger upto Rs. 5 lakhs provided the activity is not purely trade/business and there exists sufficient scope for industry in the area.
- v. **Composite Loan for ISB Component of IRDP**
Loans to ISB identified under IRDP and those covered under ST/SC Action Plan of SC/ST Development Corporation. 10 per cent refinance is available upto loan of Rs. 10,000 (net of subsidy) per beneficiary and with prior approval of NABARD if exceeds Rs. 10,000. Interest was 10 per cent and period of repayment was 3-10 years.
- vi. **Biogas**
Installation of biogas plants - 10%, 20% for cupboard, 75 to 90 per cent for other banks.
- vii. **Long term Loan for Registered Institutions**
To institutions registered under Societies' Registration Act, 1860 for investment in plant and machinery and tools relating to khadi and/or those connected with village industries. Loan can be availed of for watershed, godowns, show rooms, delivery van/trucks. Interest rate is 9 per cent (with interest subsidy of 5 per cent through KVIC for KVIC sponsored societies). Period 3-10 years. Moratorium 2 years.
- viii. **Purchase of Shares of Coops.**
Seven and half per cent to State Cooperative Banks and 9 per cent to weavers. Member contribution of 5 per cent upto share holding of Rs. 500.
- ix. **Powerlooms** - upto 4 and loan not exceeding Rs. 25,000 per loom or actual cost whichever is less. For societies, the total loan amount not exceeding SSI limits.
- x. **Individual Weavers** - at 10 per cent for 3 to 5 years.

<i>Appendix 2</i> Case Studies Referred	
Case study	Authors
Nagaraja Bakery; Big Bazaar Street	SP Seetharaman UK Srivastava
Drilling Future	PM Shingi SL Bapna
Rai Instruments and Systems Company	SP Seetharaman Gurdev Singh
Sri Shankar Fibres at Sholavandan Village in Madurai District	SP Seetharaman UK Srivastava
Galicha Making: A Small Scale Industry	SL Bapna PM Shingi
Synthetic Gem Cutting Unit of Mr. Jamal Mohammad	SP Seetharaman UK Srivastava
Ramakrishna Metal Works at Nadiarkoil	SP Seetharaman UK, Srivastava
Marble Cutting: A Potential Rural Industry	SL Bapna PM Shingi
Gauri's Pankhy: Tripping Away	PM Shingi SL Bapna
Pargai Plastic Pipes	Gurdev Singh SP Seetharaman
Birju Poultry and Cattle Feeds	Gurdev Singh SP Seetharaman
On a Shoe-string Budget	PM Shingi SL Bapna
* These case studies were presented at the National Consultation for Marketing of Non-farm Products held on August 8-10, 1990 at IIM, Ahmedabad	

Author **Butler, Sir Richard**

Duplicate

Title **Tensions in U.S. E.².C. Relations: The
Agriculture Issue - Latest edn.**

Publisher **National Planning Association Publications,
Washington DC \$3.00**

Reviewed in **Publisher's Catalogue**

*Recd. 1986
9/4/92*

Recommended by **Prof. Anil K Gupta**

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