REPORT OF THE

STUDY GROUP TO FRAME GUIDELINES

FOR

FOLLOW-UP OF BANK CREDIT

RESERVE BANK OF INDIA
BOMBAY
1975

Rs. 5-00

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INTRODUCTION

1.1 Till nationalisation of the major commercial banks in July 1969, the main contenders for bank credit were large and medium scale private industry and internal and external trade. Very little credit went to small industry, the self-employed and agriculture, or to the public sector, apart from the assistance given by a few banks. There has never been and there still is no tradition of bank lending for personal consumption.

1.2 Nationalisation of the major commercial banks, following upon social control, called for a new policy, both for deposit mobilisation through accelerated branch expansion and for equitable disbursal of credit. The banking system was asked to adopt a new approach as a credit agency, based on development and potential rather than on security only, to assist the weaker sectors of society and, later, to lend to the public sector also. Significant sectors of the economy, which were once outside the scope of bank lending, have now been brought within its ambit. While assistance to the new credit users has gone up substantially since nationalisation, the bulk of bank credit continues to go to organised industry, although its share as a percentage of total credit has now somewhat diminished.

1.3 Indian industry has not always made the best use of resources. Traditionally cheap labour, cheap money and a sheltered market have not been conducive to efficient resource employment. Few borrowers planned their credit needs and, until recently, few banks planned their resource mobilisation and credit disbursal.

1.4 A world-wide flare up of prices and stagnation in our agricultural and industrial production recently, fuelled an unprecedented rise in prices and, in turn, led to a rise in demand for credit. The unprecedented inflation has been, in fact, a phenomenon of the past two to three years. Alongside, monetary policy raised liquidity requirements of banks. Pressure on bank resources thus developed over the recent years.

1.5 To fit in with prevailing economic compulsions, the Reserve Bank has used selective credit controls, differential interest rates and varying liquidity requirements as part of monetary policy.

1.6 In 1973, when demand for credit rose steeply at a time when production was not rising, the Reserve Bank imposed certain credit restraints. Later in 1974, when inflation touched the unprecedented level of 31 per cent, a package of measures aimed at curbing it was introduced. Both steps, along with other fiscal measures, proved effective.

1.7 Along with these steps, it was felt that the time was opportune to bring about other reforms in the bank credit system, so that it could be geared to fulfil a developmental role in the economy in the coming years.

1.8 It was against this background that the Reserve Bank constituted, in July 1974, the Study Group to frame guidelines for follow-up of bank credit.

1.9 Its terms of reference were:

(i) To suggest guidelines for commercial banks to follow-up and supervise credit from the point of view of ensuring proper end-use of funds and keeping a watch on the safety of the advances and to suggest the type of operational data and other information that may be obtained by banks periodically from such borrowers and by the Reserve Bank of India from the lending banks,

(ii) To make recommendations for obtaining periodical forecasts from borrowers of (a) business/production plans, and (b) credit needs,

(iii) To make suggestions for prescribing inventory norms for different industries both in the private and public sectors and indicate the broad criteria for deviating from these norms,

(iv) To suggest criteria regarding satisfactory capital structure and sound financial basis in relation to borrowings,

(v) To make recommendations regarding the sources for financing the minimum working capital requirements,

(vi) To make recommendations as to whether the existing pattern of financing working capital requirements by cash credit/overdraft system etc., requires to be modified, if so, to suggest suitable modifications, and

(vii) To make recommendations on any other related matter as the Group may consider germane to the subject of enquiry or any other allied matter which may be specifically referred to it by the Reserve Bank of India.

1.10 The members of the Group were:

(i)	Shri Prakash Tandon, Chairman, Punjab National Bank, NEW DELHI.	Chairman
(ii)	Prof. S. K. Bhattacharyya, Indian Institute of Management, AHMEDABAD.	Member
(iii)	Shri P. P. Dhir, Director (Finance), Minerals and Metals Trading Corporation of India Ltd., NEW DELHI.	"
(iv)	Shri A. Ghosh, General Manager, Allahabad Bank, CALCUTTA.	"
(v)	Shri T. S. Kannan, Managing Director, Richardson & Cruddas (1972) Ltd., BOMBAY.	"
(vi)	Shri R. C. Maheshwari, General Manager, Texmaco Ltd., CALCUTTA.	"
(vii)	Dr. P. B. Medhora, Joint Managing Director, Industrial Credit and Investment Corporation of India Ltd., BOMBAY.	"
(viii)	Shri P. K. Nanda, Managing Director, Metal Box Company of India Ltd., CALCUTTA.	"

(ix)	Shri S. Padmanabhan, Chief Officer, Commercial and Institutional Banking, State Bank of India, Central Office, BOMBAY.	Member
(x)	Prof. Sampat P. Singh, Faculty Member, National Institute of Bank Management, BOMBAY.	"
(xi)	Shri Y. V. Sivaramakrishnayya, Assistant General Manager, (C & I Advances), Bank of Baroda, Central Office, BOMBAY.	"
(xii)	Shri A. K. Bhuchar, Joint Chief Officer, Department of Banking Operations and Development, Reserve Bank of India, Central Office, BOMBAY.	Member-Secretary
(xiii)*	Shri P. J. Fernandes, Additional Secretary and Director General, Bureau of Public Enterprises, Ministry of Finance, Government of India, NEW DELHI.	Member
(xiv)**	Shri N. Rajan, Adviser (Finance), Bureau of Public Enterprises, Ministry of Finance, Government of India, NEW DELHI.	"

(xv)* Dr. N. C. B. Nath, Director (Commercial), Steel Authority of India Ltd., NEW DELHI. — Member

* Later co-opted.

** Alternate to Shri P. J. Fernandes.

To assist the Study Group, the Reserve Bank provided the Secretariat comprising:

(i) Shri T. K. K. Bhagavat,
Deputy Chief Officer.

(ii) Shri M. K. Desai,
Assistant Chief Officer.

(iii) Shri A. D. Navaneethan,
Banking Officer.

(iv) Shri A. Qavi,
Staff Officer.

all attached to its Department of Banking Operations and Development, Central Office, Bombay.

1.11 Dr. R. K. Hazari, Deputy Governor, Reserve Bank of India, initiating the deliberations of the Group on the 6th August 1974, observed that various omnibus issues relating to credit were referred to one Group as it was necessary to take an integrated view of the several problems in framing the guidelines for supervision and follow-up of bank credit. Referring to norms for inventories, he said that there was a conflict of interest between corporate policy, which would aim at maximum profits by enlarging inventories, and economic policy in the present situation and that, therefore, any tendency towards speculative hoarding had to be curbed, in the overall interest and to prevent maldistribution of credit and other resources.

1.12 Touching upon the subject of information system which provided the basis of communication between the borrower, the operating agency of the bank, the bank's head office and the Reserve Bank, Dr. Hazari said that it should be so devised that it took care of the objective of credit supervision and also improved the responsiveness of the banking system to policy changes introduced from time to time.

1.13 For detailed preparatory examination of the issues referred to us, we set up three sub-groups; one on the subject of norms for current assets, another covering credit policy issues and the third for devising a suitable information system.

1.14 As a first step, we were asked by the Reserve Bank to submit an Interim Report on inventory norms for the 1974-75 'busy season'. Although it was appreciated that the time was short, it was felt by the Reserve Bank that some guidance in this regard from the Group would be helpful. An Interim Report was accordingly submitted in October 1974 (discussed later—paragraphs 5.4 and 5.5) which was accepted by the Reserve Bank.

1.15 We decided to pre-test some of our suggestions, like information requirements from the customers. As the induction of a credit planning, assessment and supervision system required the training of banks' staff, it was felt by us, and the Reserve Bank agreed, that an experimental set of statements for obtaining information from customers of the banks should be prepared and launched at a bankers' seminar. We submitted to the Reserve Bank our second Interim Report covering this subject (discussed later—paragraph 6.27) in December 1974. On the 13th January 1975, senior credit executives of 34 banks with deposits of Rs. 50 crores and above were invited to the Reserve Bank's Bankers Training College, Bombay, for a seminar and at the end of the day's discussion, each participating bank was asked to introduce the forms devised by us in the case of a minimum of five to ten customers, on an experimental basis. As a follow-up, a second seminar was held on the 22nd April 1975, attended by the same banks, to discuss their experiences, in order to help us crystallise our views for purposes of our final recommendations.

1.16 It is worth mentioning here that the Reserve Bank has been gratifyingly quick to react to our interim recommendations:

—It introduced, in November 1974, the norms suggested by us for the 'busy season' of 1974-75 which helped the banks, industry and our Group to gain a whole season's experience.

—It introduced, on a trial basis, the information system, that we had tentatively drawn up, among 34 banks, all with deposits of Rs. 50 crores and above. The results of the test run have helped us to simplify the forms.

1.17 The Reserve Bank has also taken an important step in appointing a Committee of Direction (discussed later—paragraph 13.6) for a frequent, on-going, review of our recommendations to take forward the work done by the Group. The Reserve Bank has also advised the banks with deposits of Rs. 50 crores and above to set up similar committees at their end.

1.18 We had the opportunity of meeting a wide cross-section of industry, private and public, chambers of commerce, industry associations, bankers, industrialists, business executives and academicians. The list of questions sent out is given in Annexure I. A list of those whom the Group and sub-groups invited for discussions is furnished in Annexure II. The response from all of them was good and has assisted us in finalising our views.

2

OUR TASK

2.1 From the terms of reference given to the Group, we have identified the following tasks as we saw them:

—What constitutes working capital requirements of industry which banks should finance and what is the end-use of credit?

—How is the quantum of bank advance to be determined?

—Can norms be evolved for build-up of current assets and for debt-equity ratio to ensure minimal dependence on bank finance?

—Can the current manner and style of lending be improved?

—Can an adequate planning, assessment and information system be evolved, to ensure a disciplined flow of credit to meet genuine production needs and its proper supervision?

2.2 We have attempted to answer these questions; we have also spelt out the operational tasks involved in implementing our recommendations and have suggested suitable systems, forms and procedures for banks to follow.

2.3 We would state that our recommendations relate only to financing of industry, and in that to working capital finance, as distinct from project finance.

3

EVALUATION OF THE PRESENT SYSTEM

Review

3.1 In the early years, bank lending in India was mostly directed to financing of movement of agricultural produce from the grower to the trader, the task of financing foreign trade being handled mostly by foreign banks. Advances were sanctioned against the security of stocks pledged or hypothecated to the banks. Based on English banking practice, the purpose of commercial bank lending in India has traditionally been seen as the provision of short term finance for business.

3.2 With the growth of industrialisation, the same system of bank lending continued with minor changes, and the banker saw his function as meeting also the industry's need for short term funds. Working capital finance was made available ostensibly for acquisition of current assets and as the advances were made available in cash credit accounts, repayable on demand, they were considered short-term in nature and self-liquidating in character. As industrialisation in India was largely promoted by the managing agency houses, the banker sought the guarantee of the managing agents, as an earnest of good management, in addition to the security of the current assets of the borrowing company; security-cum-guarantee advances thus became the pattern of lending to industry. The security-oriented system tended to favour borrowers with strong financial resources, irrespective of their economic function.

3.3 With the advent of planning for economic development and a growing social awareness of the role of bank credit in the economy, it was felt that the prevailing commercial bank lending system had little social content and that it aided concentration of economic power. It was felt too that the system was unresponsive to the needs of the weaker sectors of the economy, small industry and agriculture and concentrated instead on security-cum-guarantee-oriented lending to large customers.

3.4 The security-cum-guarantee system of lending was found inadequate also with the termination of the managing agency system. With the delinking of industrial units from the managing agency houses, the erstwhile guarantors sought termination of the guarantee obligations. The entry of new entrepreneurs into industry, with technical knowledge but lacking financial backing and managerial background, also called for a new approach to lending by banks.

3.5 The purpose and direction of commercial bank lending in the country was questioned by the National Credit Council's Study Group No. 2 (NCC Study Group) appointed in October 1968 to examine the extent to which credit needs of industry and trade were likely to be inflated and how such trends could be checked. Its report commented extensively on the shortcomings of the prevalent system of lending to industry and came to the conclusion that the security-oriented approach to lending had led to over-financing of industry in relation to production trends as also with reference to inventory in industry. The NCC Study Group recommended, inter alia, that the banking system should turn to financing of industry on the basis of a total study of the borrower's operations rather than on security considerations alone.

Supply of and Demand for Funds

3.6 Nationalisation of the major commercial banks in 1969 raised expectations of a new sense of direction in bank lending, and indeed advances to new claimants of credit, and especially to small industry and agriculture, have since gone up. The following table presents the changing picture of utilisation of bank credit:

SECTORAL UTILISATION OF CREDIT

	March 1968	June 1974	March 1968	June 1974
	Rs.	crores	% of total credit	
Industry	2068	4511	67.5	56.4
—Large & Medium	1857	3506 (188.7)	60.6	43.8
—Small Scale	211	1005 (476.3)	6.9	12.6
Agricultural & Allied Activities ..	67	749 (1117.9)	2.2	9.4
Food Procurement Advances ..	109	523 (479.8)	3.5	6.5
Other Internal Trade	479	869 (181.4)	15.7	10.9
Others	341	1347 (395.0)	11.1	16.8
—Services	N.A.	461	N.A.	5.8
—Personal Loans	,,	288	,,	3.5
—Miscellaneous	,,	598	,,	7.5
Total ..	3064	7999 (261.1)	100.0	100.0

Note : Figures in brackets indicate the ratios of the levels of credit in June 1974 to the corresponding level of credit in March 1968.

3.7 The public sector too has emerged as an important user of credit in recent years, due both to its growing dominance and its turning increasingly to commercial banks for its working capital finance instead of relying on Government. Its share in total bank credit has increased from 9.7 % in June 1969 to 16.7 % in June 1974 and this demand from public sector will continue to grow.

3.8 Another new source of demand is the growing awareness of the need to achieve an equitable geographical development of industry, and in its wake the distribution of credit. Many States, where advances as a percentage of deposits are low, are insisting upon a greater utilisation of the deposits collected from within the States for grant of additional advances in those States.

3.9 On the supply side, the resources available to the banking system for advances to the new credit claimants are only the incremental deposits generated every year, after providing for statutory liquidity requirements, because the bulk of its existing resources is already locked up with the existing borrowers. The statutory liquidity requirements have also risen over the years.

3.10 Banks are major mobilisers of savings and would be looked upon to finance a range of diverse productive and viable activities in the economy. In the last six or seven years, industrial production has risen at a slow pace, but the call on bank credit, essentially for maintaining inventories even at the same level, has gone up with increasing prices. If the growth process is resumed—as indeed it has begun to do—then perforce the volume of inventory required to maintain a higher level of production will increase and correspondingly the demand for bank credit. Banks will thus have to operate in a context in which demand for bank credit for growth requirements will be large and, to raise the matching resources, they will have to adopt some aggressive deposit mobilisation schemes and systems.

3.11 The banking system has no doubt recovered somewhat from the situation of 1973-74 busy season when several banks had to freeze credit abruptly, and the demand for funds in the busy season of 1974-75 has been reasonably met, aided negatively, though, by slack agricultural and industrial production during 1973 and 1974. But the system should get prepared for the year 1975-76 and onwards. When production and investment pick up and demand for credit rises, we will have to be careful not to let recent history repeat itself.

3.12 The problem of potential imbalance in demand for and supply of funds is accentuated by the manner in which banks extend credit under the present cash credit system of lending, where a banker sanctions a maximum limit within which the borrower can draw at his will. Under this procedure, the level of advances in a bank is determined not by how much a banker can lend at a particular point of time but by the borrower's decision to borrow at that time. When the borrower's need for funds is low, the banker is faced with the problem of large unutilised funds, and when the borrower's need for funds rises, the banker faces the problem of meeting the demand without notice. In fact, availability of funds with the banks and the customers' needs do not always match. For example, during the 'busy' winter months, the customers need more, while the banks have less lendable resources in relation to the demand.

Present Style of Credit

3.13 This state of affairs caused no problem in the years when the credit-deposit ratio in the banking system was low and a sudden spurt in credit demand could easily be taken care of and access to refinance from the Reserve Bank was easy. With control on monetary expansion as part of anti-inflationary policy and a rise in demand for funds—both from the old and the new claimants—the existing system of bank lending has come under considerable strain and the fundamental weakness of the system has been exposed.

3.14 It is not realised widely that the total limits sanctioned by the banking system exceed even the total deposits, without taking into account the liquidity requirements. As at end June 1974, deposits of scheduled commercial banks amounted to Rs. 10706 crores. As against this, the credit limits sanctioned aggregated Rs. 12880 crores, but the actual utilisation of credit limits granted was only 57 per cent; thus in effect, 43 per cent of the credit limits sanctioned had remained unutilised. With even a small increase in the percentage of utilisation, the entire system can be thrown out of gear; and this indeed was what happened at the end of 1973, when, as mentioned earlier, under a fear of credit shortage, everyone wanted to use his limits to the full and several banks were unable to meet the demand for funds under the limits they had sanctioned and were forced to resort to freezing of advances arbitrarily.

Weakness of the Cash Credit System

3.15 The weakness of the cash credit system can be illustrated by taking the following example of a borrower's financial position:

Current liabilities			*Current assets*		
Bank borrowings	Rs.	75,000	Inventory	Rs.	1,00,000
Other current liabilities	Rs.	10,000	Other current assets	Rs.	10,000
	Rs.	85,000		Rs.	1,10,000

3.16 Let us assume that the entrepreneur has raised equity and term loans for covering the cost of fixed assets as well as a portion of current assets. The banker's function is perceived as providing funds required for carrying the balance of the current assets. Against the total inventory of Rs. 1,00,000, an advance of Rs. 75,000 is sanctioned by way of cash credit. The advance is secured by a charge over inventory with an appropriate margin—in this case 25 per cent—the margin representing the borrower's contribution to carry the current assets.

3.17 So long as there is security, which is declared in the periodical stock statements, the borrower is permitted to draw up to the drawing limit, computed on the basis of the value of stocks less stipulated margin, or the sanctioned limit, whichever is lower.

3.18 Under this system, it is possible for a borrower to draw against available security and utilise the funds for purposes other than increasing his current assets or repaying his other current liabilities; he can, for instance, use the funds for acquiring fixed or non-current assets, as the following example illustrates:

Current liabilities		*Current assets*	
Creditors for purchase	Rs. 50,000	Inventory	Rs. 1,00,000
Bank borrowings	Rs. 75,000	Other current assets	Rs. 10,000
Other current liabilities	Rs. 10,000		
	Rs. 1,35,000		Rs. 1,10,000

3.19 Inventory of the value of Rs. 1,00,000 is carried to the extent of Rs. 50,000 by creditors for purchases; but the borrower is enabled to borrow up to Rs. 75,000, on the security of stocks worth Rs. 1,00,000 less the prescribed margin of 25 per cent, the drawing limit being Rs. 75,000. Had the customer drawn genuinely for meeting his current assets requirements only, his maximum eligibility (assuming nil contribution from him to carry the current assets) would have been Rs. 50,000; the excess of Rs. 25,000 he can divert to non-approved uses without the banker's knowledge.

NCC Study Group Report

3.20 This weakness was highlighted by the NCC Study Group which came to the conclusion that such diversion of bank funds was made possible by the banker's fixation on security under the cash credit lending system. Analysing the function of bank lending, the NCC Study Group felt that while theoretically commercial bank lending was for short term purposes, in actual practice it was not so. According to the NCC Study Group Report, a large part of bank lending was really long term in character and was repayable on demand only in name. To the extent that outstandings in a cash credit account never fell below a certain level during the course of a year, there was an element of what is called a 'hard core' borrowing which was in reality a quasi-permanent lock-up of bank funds in the borrower's business. The NCC Study Group thought that this 'hard core' borrowing should be repaid by the borrowers as early as possible. This recommendation, however, remained unimplemented. Presumably, the state of the capital market, available facilities to raise term loans and the earnings of the borrowers were thought to be inadequate to provide funds to repay the large quantum of the 'hard core'. The people whom we met were of the opinion that even the present state of the capital market was such that they did not consider it feasible that the 'hard core' part of the current assets requirements as identified by the NCC Study Group could be financed by industry out of equity in the foreseeable future and that the scope to plough back earnings for the purpose was also limited. During our discussions with representatives of the term financial institutions also, we were told that they could not undertake the responsibility of providing funds for the 'hard core', for they felt that this would only mean further financing of old units, instead of financing the promotion of new industrial activity.

Bankers' Involvement

3.21 Most banks in the past generally had a system of supervision and follow-up of the credit they disbursed which was primarily concerned with the safety of the funds lent and keeping the account in order. Competition among banks was not conducive to a bank taking a close look into the affairs of the customer for fear of upsetting and losing him.

Need for Change

3.22 The time is now opportune to review the existing system and effect changes. It has to be borne in mind that in the current context of shortages, bank credit, if not properly supervised, may be utilised for an undue build-up of stocks, which, while proving profitable to some, will result in misallocation of resources among all. Bank credit has thus a crucial role in allocation of resources to prevent such a chase of scarce materials which fuels inflation. The process of change has already set in since the NCC Study Group's findings in this regard and many banks have, in fact, toned up their credit appraisal and follow-up procedures. This trend was given a further impetus by the changes effected in the Credit Authorisation Scheme of the Reserve Bank in mid-1970. However, in the context of the need

—to meet larger credit demands arising from growth requirements in future, keeping in view also certain priorities laid down by Government and the Reserve Bank, from time to time,

—to curb, at the same time, any tendency on the part of borrowers to build up undue inventories or to misdirect credit, and

—to modify the style of credit so as to make credit planning effective, the process of change has to be taken even further.

3.23 Any new system should, in particular,

—make a customer plan his credit needs in advance and observe a discipline in its use,

—indicate to the banker the likely demand for credit and thus enable him to plan his own deposit-credit function,

—assure finance to industry for its genuine production needs, and

—having provided finance, enable the banker to receive from the customer adequate flow of information on the use of credit, but with inbuilt flexibility to suit changes in circumstances.

4

RATIONALE OF OUR PROPOSALS

Need for Funds

4.1 A borrower needs funds for his operation mainly to buy and stock necessary quantities of raw materials and stores and to stock necessary quantities of finished goods. If it is the market practice to give credit on sales, he would need funds for carrying his receivables too. He may also make advance payments for goods and services. All these constitute his needs for funds, to carry current assets.

Different Types of Current Assets

4.2 Inventory and receivables comprise the bulk of the current assets. The different types of inventory may be described as follows:

—Flabby inventory, comprising finished goods, raw materials and stores held because of poor working capital management and ineficient distribution.

—Profit-making inventory, representing stocks of raw materials and finished goods held for realising stock profit.

—Safety inventory, providing for failures in supplies, unexpected spurt in demand, etc.; in effect, an insurance cover.

—Normal inventory, based on a production plan, lead time of supplies and economic ordering levels. Normal inventories will fluctuate primarily with change in production plan. Normal inventory also includes reasonable factor of safety.

4.3 There could be yet another type of inventory, viz., excessive inventory, which even an efficient management may be compelled to build up for reasons beyond its control, as in the case of a strategic import or as a measure of Government price support of a commodity.

4.4 'Flabby' inventory should not be permitted, and 'profit-making' inventory ought to be positively discouraged—both are selfish and an inequitable and inefficient use of resources; as regards 'safety' inventory, good management should bring it down to what disciplined experience, subjected to periodical statistical checks, will justify. Carrying inventory in excess of the normal inventory, which includes reasonable factor of safety, is but an avoidable luxury which the banker should not encourage.

4.5 If one were to analyse the normal inventory further, this is of two parts--one which fluctuates and the other steady. In the steady part also, there is a further 'core' which is a fixed element; this 'core' represents the absolute minimum level of raw materials, process stock, finished goods and stores which are in the pipe line, so to speak, to ensure a continuity of production. Funds invested in core inventories, comprising process stock plus minimum raw materials and finished goods and stores, are therefore blocked, on long term basis, arising out of technological and business considerations, as is the investment in fixed assets such as machinery and buildings.

4.6 There are three factors influencing the level of receivables, viz., the normal credit in tune with the borrower's and his industry's market practices, deliberate elongation of credit, and slow billing/collection procedures. Theoretically speaking, there is no irreducible minimum in receivables as these can be brought even to zero. Receivables not in tune with the unit's and its industry's practices should not be financed by the banker.

Reasonable Levels of Current Assets

4.7 There is no uniformity in approach among banks in assessing working capital requirements, especially with regard to inventories. This divergence is also sometimes found within the same bank. If bank credit is to be viewed as a tool of resource allocation in the economy, one cannot get away from the need to define norms for reasonable levels of inventories (including safety stock) and receivables in each industry. One of our terms of reference, therefore, appropriately requires us to make suggestions for prescribing inventory norms for different industries, both in the private and in the public sectors, and to indicate the broad criteria for any deviations from these norms.

Purpose of Bank Lending

4.8 In the new context, the main function of a banker as a lender is to supplement the borrower's resources to carry an acceptable level of current assets. The implications are two fold; one, the level of current assets must be reasonable and based on norms; two, a part of the fund requirements for carrying current assets must be found from long term funds comprising owned funds and term borrowings including other non-current liabilities.

5

NORMS FOR INVENTORY AND RECEIVABLES

Need for Norms

5.1 The rationale of norms and the need to link credit with production requirements is to us thus fairly clear; and we envisage that eventually the entire system of credit planning will be dovetailed with production planning, both to make good use of bank credit and also to create better management of cash, materials and receivables.

5.2 Industry representatives in their discussions with us generally agreed that it was necessary to prescribe some norms but they were doubtful about our ability to fit the wide spectrum of industry adequately into what we lay down. Their solution was that the norms should be applied flexibly.

5.3 While we realise that norms will have to be applied flexibly and not rigidly, responsive to any major change in environment and within the industry, we are unable to accept that uncertainties can be regarded as a reason for not laying down norms, an argument that some, happily not many, placed before us. In fact, the greater the uncertainties, the more is the need for planning.

Interim Report

5.4 Our first attempt at norms was in our Interim Report to the Reserve Bank. We suggested norms for inventory and receivables for ten major industries. The objective was to introduce a discipline and improvement in the maintenance of reasonable inventory and receivables levels consistent with encouragement of production on the basis of a helpful relationship between the banker and the customer.

5.5 The Reserve Bank accepted the suggested norms and advised all scheduled commercial banks to apply the norms in respect of these ten industries, both to the existing and new borrowers, on an experimental basis, and to furnish it with a feed-back of the experience. A copy of the Interim Report and the Reserve Bank circular letter are furnished in Annexures III and IV.

5.6 The approach for prescribing norms for inventory and receivables bristles with a variety of problems. We are, therefore, anxious that there should be an understanding of the total problem and a firm but helpful approach built into the suggested norms and their implementation.

Approach to Norms

5.7 We have now suggested norms taking into account the following:

(i) company finance studies made by the Reserve Bank,

(ii) process period in the different industries,

(iii) discussions with experts in the industries concerned,

(iv) general discussions with the industry interests,

(v) need for ensuring smooth production, depending upon the availability of the materials, seasonality, etc., and

(vi) reactions and feed-back on Interim Report.

Suggested Norms

5.8 We have extended our exercise to a total of 15 major industries, covering about one half of industrial advances of banks, and certain norms earlier suggested have been revised in the light of the feed-back received. The norms represent the maximum levels for holding inventory and receivables in each industry. Borrowers are not expected to hold more than these levels. Neither is the norm an entitlement to hold inventories or receivable upto this level. If a borrower has managed with less in the past, he should continue to do so. The suggested norms are as follows:

SUGGESTED NORMS FOR INVENTORY AND RECEIVABLES

Industry	Raw materials (including stores and other items used in the process of manufacture)	Stocks-in-process	Finished goods	Receivables* and bills purchased and discounted
(1)	(2)	(3)	(4)	(5)
(i) Cotton and Synthetic Textiles	Cotton 2 (Bombay and Ahmedabad areas) 3 (Eastern areas—Bihar, Orissa, West Bengal and Assam) 2½ (Other than the above areas) 2 Other raw materials	¾ (Composite textile mills) ½ (other mills)	——2¼——	
(ii) Man-made Fibre	1½	½	——1¾——	
(iii) Jute Textiles	2½	¼	1 (For domestic sales) and 1½ (For exports)	1½
(iv) Rubber Products	2	¼	——1¾——	
(v) Fertilisers				
(a) For nitrogenous plants	¾ (Units near refinery) 1½ (Units away from refinery)	Negligible	1 (Where stocks are in plant site) 1½ (Where stocks are also in upcountry centres)	1¼
(b) For phosphatic plants	2 (Units in port areas) 3 (Units away from port areas)	Negligible	1 (Where stocks are in plant site) 1½ (Where stocks are also in upcountry centres)	1¼
(vi) Pharmaceuticals	2¾	½	2	1¼
(vii) Dyes and Dyestuffs	2½	1	¾	2¼

SUGGESTED NORMS FOR INVENTORY AND RECEIVABLES

<table>
<tr><th>Industry</th><th>Raw Materials (including stores and other items used in the process of manufacture)</th><th>Stocks-in-process</th><th>Finished goods</th><th>Receivables* and bills purchased and discounted</th></tr>
<tr><td>(1)</td><td>(2)</td><td>(3)</td><td>(4)</td><td>(5)</td></tr>
<tr><td>(viii) Basic Industrial Chemicals</td><td>2¾</td><td>¼</td><td>1</td><td>1¾</td></tr>
<tr><td>(ix) Vegetable and Hydrogenated Oils</td><td>1</td><td>Negligible</td><td colspan="2">¾</td></tr>
<tr><td>(x) Paper</td><td>2-6 Bamboo and Wood (To be built up in stages from November to May and thereafter to be brought down)
2¼ Chemicals</td><td>"</td><td>1 (For controlled sales) and
¼ (For free sales)</td><td>¾</td></tr>
<tr><td>(xi) Cement</td><td>2¼ Gypsum
1¼ Limestone
¾ Coal
1⅓ Packing materials</td><td>⅛</td><td colspan="2">1</td></tr>
<tr><td>(xii) Engineering—Automobiles and Ancillaries</td><td>2¼</td><td>¾</td><td colspan="2">2½</td></tr>
<tr><td>(xiii) Engineering—Consumer Durables</td><td>2</td><td>¾</td><td colspan="2">2½</td></tr>
<tr><td>(xiv) Engineering—Ancillaries (other than Automobile Ancillaries) and Component Suppliers</td><td>2</td><td>¾</td><td colspan="2">2½</td></tr>
<tr><td>(xv) Engineering—Machinery Manufacturers and other Capital Equipment Suppliers (other than Heavy Engineering)**</td><td>2¾</td><td>1½</td><td colspan="2">3½</td></tr>
</table>

Notes: (*i*) Raw materials are expressed as so many months' consumption. They include stores and other items used in the process of manufacture.

(*ii*) (*a*) Stocks-in-process are expressed as so many months' cost of production.

(*b*) In individual cases, the bank may deviate from the norm for stocks-in-process if it is satisfied that the actual process time involved in any particular unit, say, in view of the nature of production, past experience and technology employed, is more than the norm suggested.

(*iii*) (*a*) Finished goods and receivables are expressed as so many months' cost of sales and sales respectively. These figures represent only the average levels. Individual items of finished goods and receivables could be for different periods which could exceed the indicated norms so long as the overall average level of finished goods and receivables does not exceed the amounts as determined in terms of the norm.

*(*b*) The norm prescribed for receivables relates only to inland sales on short term basis (i.e. excluding receivables arising out of deferred payment sales and exports).

(*iv*) Stocks of spares are not included for norms, since in financial terms they are not significant in many industries. Banks will ascertain requirements of spares for individual units. They should, however, keep a watchful eye if spares exceed 5% of total inventories.

**(*v*) Heavy Engineering will include supply of whole or substantial plants involving long manufacturing period, *i.e.* sugar, cement, steel and textile plants.

Heavy Engineering Industry

5.9 We have not suggested norms for the heavy engineering industry, as it has certain special characteristics. The engineering industry is diversified not only in terms of the product range but also in technology and size. We have attempted to classify some of the engineering units under four groups vide items (xii), (xiii), (xiv) and (xv) in the preceding paragraph. During recent years, the heavy engineering sector has grown considerably, particularly in the public sector. Though it may be difficult to attempt a precise definition of the heavy engineering units, their main distinguishing features are (i) manufacturing heavy capital equipment for other industries, (ii) technology-based manufacture of equipment to suit specialised processes and specific end-uses, and (iii) considerable lead time in design, manufacture, supply and commissioning of equipment. Heavy engineering industry is thus commonly understood to include units manufacturing heavy structurals, cranes, railway wagons, coaches, other heavy equipment for railways, heavy electrical equipment including transformers, generators, pressure vessels, heat exchangers and chemical equipment, boilers, steel plant equipment, mining machinery, etc. Much of the equipment manufactured in the heavy engineering sector is supplied to the core sectors of the economy which are predominantly Government projects, both in the Central and in the State sectors. The commercial terms are, therefore, related to the policies laid down by the various Government authorities from time to time.

5.10 By its very nature, the process time for completion of any particular contract or construction of any single equipment takes a long period—in some cases, as long as two to three years. Often, at various stages of manufacture, they use not the standard components, which are available on tap, but those which have to be tailor-made. There is also considerable difficulty in this industry in maintaining standard inventories, as the production pattern and product-mix vary in response to the changing needs of the user industries. It is, therefore, difficult to lay down norms for different components of inventory and receivables, i.e. for raw materials, work-in-progress, finished goods and receivables in the case of the heavy engineering industry.

5.11 The system of financing working capital varies in the heavy engineering industry from unit to unit. In some cases, principal raw materials like steel are supplied by the purchasers. In many cases, advance payments are made by the purchasers against orders as well as against procurement of components. Progress payments are also made against despatch of part equipment. Even so, the quantum of tie-up of funds in current assets in this industry, by virtue of the nature of its operations, is very large and the banking system may find it difficult to cope with the industry's demand for funds in its entirety. One solution to the problem could be that the funding pattern of the industry itself should be different from that in the other industries, so as to take care of not only the conventional margin money requirements for working capital but also something substantially more, to meet the fund needs stemming from the industry's large build-up of current assets. In that case, however, the capital structure will have to be so massive, to finance the very large need, that, in effect, it will be supporting the buyers of the manufacturing unit in their purchases and not the unit's infra-structure for which it is meant. The correct course will be that the buyer should pay for the purchases, not on delivery, but in progressive stages of manufacture. The banking system cannot take upon itself the responsibility of financing goods which remain in process over too long a period. This is so because, largely, the production is neither competitive nor market-oriented, but custom-tailored. Therefore, it is only appropriate that the buyer should take upon himself the responsibility of financing to a substantial extent what is produced for him specifically. This should be feasible as the heavy engineering industry supplies capital and other equipment to user industries which would have, at any rate, placed orders for the block assets only after a proper tie-up of financial arrangements for their projects/expansion schemes. However, for financing of inventory requirements in respect of items which are not tailor-made or those with short process period for which, consequently, no progress payments may be forthcoming, banks may extend support to a reasonable extent. Working capital requirements of the heavy engineering sector should, therefore, be assessed taking into account the foregoing factors, and the extent to which banks may meet the working capital needs may be determined, case by case, on merits.

5.12 Norms cannot be absolute or rigid. Allowance will have to be made for some flexibility under circumstances justifying a need for re-examination; thus, deviations from norms may be visualised under the following circumstances:

Deviations from Norms

—bunched receipt of raw materials including imports,

—power-cuts, strikes and other unavoidable interruptions in the process of production,

—transport delays and bottlenecks,

—accumulation of finished goods due to non-availability of shipping space for exports or other disruptions in sales but not under circumstances where a sales stimulation is needed through reduction in prices,

—build-up of stocks of finished goods such as machinery, due to failure on the part of purchasers for whom these were specifically manufactured to take delivery, and

—need to cover full or substantial requirement of raw materials for specific export contract of short duration.

5.13 It was represented to us that Government and its agencies delay payments and that sometimes large units in the private sector also do not pay promptly, particularly to the small ancillary suppliers. It was, therefore, suggested that such delayed payments also should be treated as circumstances warranting deviation from norms for receivables as there was need for the banks to give credit till such dues were realised. We feel that the matter should be tackled at the sources rather than throwing upon the banking system the burden of providing credit which, in effect, would amount to underwriting the delays. The Reserve Bank should discuss the matter with Government agencies and the Bureau of Public Enterprises to overcome such delays while in the case of private firms, the banker should put pressure upon the customers by insisting that they recover their dues in time, and should not encourage such delays by merely extending further credit facilities. We would add that the Reserve Bank should follow this up with the Government agencies vigorously and we are confident that Government and public enterprises would, no doubt, set a good example to the others.

5.14 The criteria for deviating from the norms need to be applied with great care, especially to prevent industry from taking them for granted and expecting concessions as a matter of course with very little economic function. For instance, the lead time required for obtaining supplies of materials, was often given as a reason for high inventories. This is apt to be overstated. Regular supplies can be arranged and high inventories avoided by careful planning in placing orders, allowing for the lead time, though it is not denied that at times some allowance may have to be made for exceptional circumstances such as those we have visualised above.

5.15 We reiterate that the criteria for deviations must be fully justified. The deviations should be for known specific circumstances and situations (which should be recorded) and allowed for agreed periods which should be relatively short; and there should be a return to norms when conditions revert to normal. It is important that flexibility in inventories and receivables should be both ways.

Coverage of Norms

5.16 To start with, these norms should apply to all industrial borrowers, including small scale industries, with aggregate limits from the banking system in excess of Rs. 10 lakhs and extended to smaller borrowers progressively as early as possible.

5.17 In industries not covered by us, it should not be assumed that no norms will apply and that the borrower is exempt from the discipline of norms. In such cases, banks should keep in view the purpose and spirit behind the norms when extending credit facilities.

5.18 We believe that norms for inventories and receivables should, in principle, be extended progressively to cover the entire spectrum of industry, both in the private sector and in the public sector. The list may, therefore, be extended with experience. The Committee of Direction may consider this task at specified intervals.

Norms and Public Sector

5.19 Further, the principles should be uniform for all like industries, both in the private and in the public sectors, although for certain industries, and some borrowers, by virtue of their special nature, separate considerations may be justifiable.

Application of Norms

5.20 We suggest that all requests for enhancement of credit limits may be considered in the light of the suggested norms. As for existing accounts, where no enhancements in limits are required, the banker should examine the existing levels of inventory and receivables and seek a reduction in levels where they are excessive. It is important that all banks should apply the norms uniformly. To the extent that inventory and receivables levels could be brought down, the outstanding dues to the bank and/or the other creditors should also go down. As regards the data to be obtained and the rate of interest to be charged to ensure implementation of the norms, we reiterate what has been said by us in paragraphs 16 to 18 of our Interim Report (Annexure III). But even charging of a higher rate of interest should not give a permanent immunity to the customer from conforming to norms and some further action should be considered. We have no doubt that the borrower will not wish to jeopardise his dealings with the bank if he realises that the bank means business.

Review of Norms

5.21 Study and prescription of norms should be an on-going process, extending to cover the area of industrial activity not covered by us and also searching to identify homogeneous groups of units in different industries where an industry does not respond to a single norm. We suggest that the norms should be kept under constant review.

6

OUR PROPOSED APPROACH TO LENDING

Working Capital Gap and Bank Finance

6.1 As discussed in Chapter 4, a banker's main role, as a lender, will be to supplement the borrower's resources in carrying a reasonable level of current assets in relation to his production requirements.

6.2 Stated differently, we would expect the borrower to hold only a reasonable level of inventory and receivables, according to the norms. The total current assets will be carried partly by a certain level of credit for purchases and other current liabilities. Funds required to carry the remaining current assets may be called the working capital gap which can be bridged partly from the borrower's owned funds and long term borrowings and partly by bank borrowings.

6.3 In the context of the above approach, there are three alternatives for working out the maximum permissible level of bank borrowings:

(i) Bank can work out the working capital gap, i.e., total current assets less current liabilities other than bank borrowings and finance a maximum of 75 per cent of the gap; the balance to come out of long-term funds, i.e., owned funds and term borrowings.

(ii) Borrower to provide for a minimum of 25 per cent of total current assets out of long-term funds, i.e., owned funds plus term borrowings. A certain level of credit for purchases and other current liabilities will be available and the bank will provide the balance. Total current liabilities inclusive of bank borrowings will not exceed 75 per cent of current assets.

(iii) Same as (ii) above, but excluding core current assets from total current assets on the theory that core current assets should be financed out of long-term funds, i.e., owned funds plus term borrowing.

6.4 The three alternatives may be illustrated by taking the following example of a borrower's financial position, projected as at the end of the next year.

Current liabilities		*Current assets**	
Creditors for purchases	100	Raw materials	200
Other current liabilities	50	Stocks-in-process	20
	150	Finished goods	90
Bank borrowings, including bills discounted with bankers	200	Receivables, including bills discounted with bankers	50
		Other current assets	10
	350		370

*As per suggested norms or past practice, whichever is lower, in relation to projected production for the next year.

1st Method

Total current assets	370
Less : current liabilities other than bank borrowings	150
Working capital gap	220
25% of above from long term sources	55
Maximum bank borrowings permissible	165
Excess borrowing	35
Current ratio 1.17 : 1	

2nd Method

Total current assets	370
25% of above from long term sources	92
	278
Less : current liabilities other than bank borrowings	150
	128
Working capital gap	220
Maximum bank borrowings permissible	128
Excess borrowing	72
Current ratio 1.33 : 1	

3rd Method

Total current assets	370
Less : core current assets (illustrative figure) from long term sources	95
Real current assets	275
25% of above from long term sources	69
	206
Less: current liabilities other than bank borrowings	150
	56
Working capital gap	220
Maximum bank borrowings permissible	56
Excess borrowing	144
Current ratio 1.79 : 1	

6.5 In case the existing net working capital (i.e. excess of current assets over current liabilities) exceeds 25 per cent of the working capital gap (in 1st Method) or 25 per cent of total current assets/real current assets (in 2nd and 3rd Methods), the contribution from long-term sources will ordinarily be to the extent of the already existing net working capital.

6.6 The 1st Method would mean the banker financing upto a maximum of 75 per cent of the working capital gap of 220, i.e., 165 and the borrower providing at least 55 out of his long-term funds, i.e., owned funds plus long-term borrowings. This method will give a minimum current ratio of 1:1.

6.7 The 2nd Method would mean the borrower financing a minimum of 25 per cent of total current assets (92) through long-term funds and the gap, i.e., maximum of 128(278-150), will be provided by the bank. This will give a current ratio of at least 1.3:1.

6.8 The 3rd Method would mean a further reduction in bank borrowing and strengthening of the current ratio.

6.9 It is important to note that in an exercise like this for computing the level of bank finance, the classification of current assets and current liabilities should be made as per the usually accepted approach of bankers and not as per definitions in the Companies Act. For instance, instalments of term loans payable within 12 months from the date of balance sheet are classified by the banker as current liabilities while it is not so in the balance sheet prepared in accordance with the requirements of the Companies Act. These differences in classification have been brought out in the form for analysis of balance sheet prescribed by the Reserve Bank under its Credit Authorisation Scheme.

6.10 We feel that the 3rd Method is an ideal to reach as it will provide the largest multiplier of bank finance; the next best method from this aspect is the second one, followed by the first. However, to avoid hardship to borrowers, we recommend that we should make a beginning with the 1st Method and then move to the 2nd and the 3rd Methods. It is necessary, though, to have a time-bound programme and we suggest that banks should initiate immediate action to place all borrowers, say, those having credit limits in excess of Rs. 10 lakhs from the banking system, on the 1st Method, beginning with the borrowers having weak financial position, as early as possible, say, within a period of about one year. At that stage, the Reserve Bank may review the system and chalk out a further programme for switch over to the 2nd and 3rd Methods, in stages, in the light of circumstances then prevailing.

6.11 As regards the proposed programme of change, the Chairmen of banks, whom we met under the auspices of the Indian Banks' Association, were actually in favour of the banks straightway switching over to the 2nd Method for the reason that some of the borrowers already fulfil the requirement of the 1st Method. Although most of them accepted the concept underlying the 3rd Method, they pointed out that much ground work would be necessary to work out core current assets for various industries, which would require detailed studies before this method could be accepted. We suggest that the Indian Banks' Association may consider setting up a Working Group to determine the core current assets in the different industries.

6.12 We also feel that lending up to 75 per cent of the working capital gap as in the 1st Method is liberal but it is our view that this should be considered as the upper limit. The limit of 75 per cent has been suggested as the first step, particularly to facilitate financial structuring of new companies, setting up projects in backward areas and also for flexibility in re-structuring of existing companies with a weak financial base. As mentioned earlier, we reiterate that starting with the 1st Method banks should gradually reach the ideal of the third. It should be understood that the aim should be to move forward and borrowers who already fall in the third or the second category should not increase their dependence on bank borrowings and revert to the second or first category, respectively. That is to say, their existing current ratio should not be impaired. Also, if the credit needs of such borrowers increase in future, they should not be allowed to slip back from a higher to a lower category.

6.13 Like all changes, our proposals will involve some hardship to those who are beneficiaries under the existing system. Some time is needed by them to adjust themselves to the discipline of the new approach. It is desirable for a banker to recognise the position of his borrower and guide him towards norms and the new system of lending within a reasonable time. The banks will work out the position of the existing customers and any excess over the finance, to which a borrower would be eligible under the new formula, will have to be reduced progressively by transferring the excess to a term loan, to be amortised over a suitable period, depending upon his cash generating capacity, ability to raise additional equity, etc. The amount to be amortised will stand at a higher level in the case of a borrower having a negative working capital (i.e., a working capital debt), as the already existing deficit in working capital will also have to be made up by him.

Aligning Credit with Priority Industries

6.14 The concept of bank credit forming only a portion of the working capital gap could also be used as an instrument for influencing the directional flow of credit. It should be possible for the concerned authorities to define from time to time the order of priorities in the economy for different industries and we visualise monetary authorities laying down different scales of financing, as percentage of the working capital gap for the different classes of industries as an important instrument of economic policy, for aligning credit with the priorities for industries. Thus, the relevant percentage could be comparatively low for the low-priority industries. Also, when a manufacturer has reached a stable level of production for a reasonable number of years, there is no reason why bank finance should continue to be made available to him on the same scale, because, if a portion of the finance earlier made available could be withdrawn from him, such funds would be available for promotion of new economic activity. It is thus possible to envisage part of the working capital bank finance also as an assistance for a limited period only, in the same manner as term loans for initial investment.

Funded Debt-Equity Relationship

6.15 The question arises whether there should be a reasonable relationship between the equity and total term loans (i.e., those from the financial institutions and banks). The term lending institutions insist upon a certain relationship between funded debt and equity according to certain accepted norms and also see that the long-term funds are adequate to provide for a margin for working capital purposes. No change is suggested in this practice. However, in future, while funding the new projects, the term lending institutions may provide for margins on the basis of our proposals. It will be useful if the bank which is to finance the working capital requirements is associated at this stage in determining the working capital and margin requirements. If this is done, there will be no need to deviate from the standards of relationship between funded debt and equity, which the term lending institutions normally follow.

6.16 In the case of old units, it may be necessary to transfer, as mentioned earlier, a part of the present cash credit borrowing to a term loan repayable over a period in order to bring financing in line with our proposals. In some of these cases, the funded debt and equity relationship may not immediately conform to the norms laid down by the term lending institutions and the borrowers may have to be given time to bring the position to normal over a period. The banks will, however, have to ensure that, in such cases the total outside liabilities to owned funds relationship is acceptable to them.

Additional Requirement of Credit

6.17 Another question to be considered is as to how to take care of a request for additional credit from a borrower who already has an excess borrowing under any of the above methods. Such a need for additional credit will normally arise with an increase in production activity. We would expect that if the additional fund needs are on a regular basis, the borrower should bring a matching contribution required under the relevant method of lending. He could do this by retained earnings or by raising additional equity or by issuing debentures or by bringing in more funds in any other suitable manner for the purpose. In very exceptional cases, where the borrower is not able to raise the requisite funds immediately in the aforesaid manner, the banks may consider giving a term loan to a reasonable extent provided the cash generation capacity of the borrower is sufficiently good to take care of the amortisation of the existing term obligations as already stipulated as also the proposed additional loan within a short period acceptable to the bank. Where, however, the additional fund need is for a short duration (e.g. for executing a large export order or a Government contract) and cannot be met from the existing credit arrangement, it should be possible to consider additional credit for such needs without necessarily insisting on matching contribution, only to enable completion of the specific transactions/contracts, on the clear understanding that the borrower would return to the stage as in the relevant method of lending within the stipulated period.

6.18 Apart from the excess borrowing under any of the methods of lending, there may be excess borrowing representing the excess of inventory and receivables vis-a-vis the relative norms. In such cases, we do not visualise grant of additional credit facilities on a regular basis until such time as the current assets levels are brought down to the required levels. Grant of additional facilities on purely temporary basis, however, could be considered but only as an exception, say for purposes like execution of an export order, etc.

Proposed Style of Credit

6.19 Once the quantum of bank funds to finance a reasonable level of current assets is agreed to, there is also need to change the style of extending bank credit.

6.20 The drawbacks of the cash credit system of lending are well known but may be reiterated:

—A bank has no control over the level of advances in the cash credit accounts. No notice is required for drawing under limits that may remain unutilised for long periods.

—A bank is thus in no position to foresee demand for credit. This hampers its credit planning.

—The 'cost' of the operation of the system to the banker, on account of the attendant uncertainties, is high because whatever chances he may take in 'overselling' credit, there will always be a limit to how far he will 'oversell'. And this was indeed what happened in the 1973-74 'credit crisis' when some banks found themselves heavily 'oversold'.

6.21 It has been found in practice that the level of borrowings by industrial units during the course of a year fluctuates from month to month depending on the scheduling of purchases of raw materials and despatch of finished goods. It has also been observed that the outstandings in a cash credit account, particularly in non-seasonal industries, do not fall below a certain level which represent the stable fund requirement during the year.

6.22 We suggest that instead of making available the entire credit limit as a cash credit for a year, it may be bifurcated into a loan and a demand cash credit, which will be reviewed annually.

6.23 The loan component would comprise the minimum level of borrowing which the borrower expects to use throughout the year, while the cash credit part could take care of his fluctuating requirements. As the loan would carry interest throughout the year, it will induce a discipline in the customer to plan his need carefully to ensure that as little of it as possible lies idle—ideally none.

6.24 Non-seasonal industries as well as most agro-based industries with some degree of seasonality can conform to the suggested system without difficulty. In the case of industries with a very high degree of seasonality, assessment of bank finance, i.e., the overall credit limit, may have to be done on the basis of monthly cash budgets, as is being done at present for the sugar industry by certain banks and thereafter also drawings will be regulated by up-dated monthly cash budgets.

6.25 As the intention of introducing the new concept is to bring in a discipline in the system, we suggest that the demand cash credit should be charged a slightly higher rate of interest than the loan component. This approach will give the borrower an incentive for good planning. The cash credit, in any case, involves additional cost and uncertainty to the banker and, therefore, a slightly higher rate is not a penalty. The term loan representing the excess borrowing, to be amortised, as mentioned earlier, should also be at a slightly higher rate than the cash credit rate.

Proposed Information System

6.26 In order to ensure that customers do not use the new cash credit facility in an unplanned manner and thus create the same problems as are faced in the present system, we recommend that the financing should be placed on a quarterly budgeting-reporting system for operational purposes.

6.27 The customer will submit a quarterly budget to the banker. The system and the forms earlier envisaged for the purpose were outlined in our Interim Report (Annexure V). On the basis of the experience gained and the feed-back received from bankers and the borrowers, on whom they were tried out, we have simplified them considerably; the revised forms are given in Annexure VI.

6.28 It would be worthwhile mentioning here about the feed-back on forms received by us from borrowers. The points made were mainly in regard to the secrecy aspect, non-availability of audited financial statements, periodicity of the statements, inadequacy of systems and staff for the purpose in borrower's organisation and need for simplification of the forms. We are of the view that so long as banks provided the bulk of the funds for running the industry, there should be no hesitation on the part of borrowers to furnish to banks the information required by them. The proposed system envisages only un-audited information except for balance sheet at the year-end, though we would add that given a streamlined accounting system, one would not expect much divergence between audited and un-audited figures. As regards the periodicity of the data, as the forms are to be used on a roll-over basis, to enable the borrower and the banker to learn from the previous experience, it is only appropriate that the periodicity should not be longer than a quarter. We also expect that the larger borrowers of banks (say, those enjoying total credit limits of Rs. 1 crore and above) do have the organisational set-up to furnish the information and if they do not have it, they should, in any case, be able to build up the required systems in their organisations within a relatively short period. Let us add that, during our discussions, both banks and industries agreed with the quarterly information system in principle but only asked for it to be as simple as possible.

6.29 We would also like to sound a note of caution to banks in regard to the borrowers' concern about the secrecy and sensitive nature of the information proposed to be called for from them. It may be argued that borrowers have been furnishing to banks projected data even now, though not on quarterly basis. Even so, we can appreciate their anxiety and we expect banks to take due notice of their apprehension.

Bill Finance

6.30 There is an advantage in shortening the transaction cycle and we should consider moving to a 'cash and carry' system which is already being followed by some. However, a further detailed study of its implications may be necessary. While this could, therefore, be the direction of change, sometimes it may become necessary for manufacturing units to extend credit to maintain sales. In such cases, apart from loan and demand cash credit, a part of the total credit requirement, within the overall eligibility, could also be provided by way of bill limits to finance receivables. It is desirable that, as far as possible, receivables should be financed by way of bills rather than cash credit against book debts, though we do appreciate that the latter cannot be altogether eliminated, particularly when the period of credit is short and the amount is small. These bills could be on a demand basis or on a usance basis depending on the marketing practice in the industry. Some of the advantages of a bill arising out of sale of goods over the cash credit against book debts are:

—the transaction is easily identifiable,

—there is a definite date of repayment,

—the bill will carry more than one signature if it is on usance basis,

—it represents an easily shiftable asset, and

—when goods are sold on credit to a wholesaler instead of to a user-industry, bank finance for the transaction would in effect be credit for trading purposes; in such cases, bank finance by way of bill discounts would make for improvement in the quality of statistics in regard to financing of trade. From the stand-point of monetary policy also, such an arrangement would lend itself to better control.

6.31 We are also of the view that, to the extent feasible, the banking system should move towards financing the purchaser, who is in fact the debtor, rather than the seller, who is the creditor. In other words, the seller will be paid off immediately after the sale and bank credit will be extended only to the purchaser. As regards financing of the purchaser, however, there are two different points of view. One view is that purchases should also as far as possible, be on the basis of bills, for the following reasons:

—the amount will be drawn only at the time of actual need,

—the end-use of credit is automatically taken care of,

—credit to purchaser is directly related to his actual need, which is not the case with the seller's bills, where credit is extended as a measure of sales promotion, irrespective of the purchaser's ability to pay or his need for credit,

—a bill enables discipline to be imposed in respect of payments for purchases—it ensures timely payment to suppliers, which a system of book entries does not always ensure.

It is argued on the other side that under the revised system proposed by us, the cash credit mode of financing is superior to bill financing in respect of the borrower's purchase operations for the following reasons:

—drawals for non-approved purposes will be detected by the new information system proposed and by scrutiny of cheques; end-use of credit will be effectively taken care of by the proposed information system,

—the cost of operations to the borrower and the banker will be high; borrower will have to pay more for cost of stamp duty while the banker's administrative cost will go up because of additional paper work without the assistance of mechanisation or computerisation, and

—the advantages of centralised borrowing by way of a close watch over aggregate outstandings, debit and credit summations and borrowing trends would be lost.

In view of the foregoing, without attempting a definitive view on the subject, we would suggest that each bank may take its own decision, in consultation with the borrower, having regard to the size of his operations, the individual transactions and the administrative set-up obtaining in the bank.

Coverage of the Proposed Approach

6.32 We recommend that the proposed approach to lending and the style of credit be extended to all borrowers having credit limits in excess of Rs. 10 lakhs from the banking system as per the schedule suggested in paragraph 6.10. As regards the proposed information system, however, we suggest that, to start with, it may be introduced in respect of borrowers with limits of Rs. 1 crore and above from the entire banking system. Progressively, banks should extend this system, first to borrowers with limits of Rs. 50 lakhs to Rs. 1 crore and next to those enjoying limits of Rs. 10 lakhs to Rs. 50 lakhs.

7

OUR RECOMMENDED SCHEME

7.1 The mechanics of lending in the framework we have suggested so far will be as under:

(i) As a banker should be concerned with a borrower's total operations and not merely inventories or receivables, examination of the borrower's operational plan for the next year assumes special significance. It is in the customer's own interest to plan his operations, if he is to be assured by the banker of adequate credit to meet his genuine production needs.

(ii) Financial analysis will cover examination of the borrower's past and current financial position, profitability, production operations for the next year and projected financial position at the end of the next year.

The borrower should, therefore, furnish an operating statement and a funds flow statement for the whole year (i.e. the next year) as also a projected balance sheet as at the end of the next year, along with the application for advance or renewal. Any assumptions underlying the statements should be explained to and examined by the banker.

(iii) The current asset position will be examined to ensure conformity with inventory and receivables norms in relation to the projected production.

(iv) The working capital gap will be computed, the extent of bank finance will be arrived at and the overall credit limit will be fixed on the basis indicated in Chapter 6; fixation of a total limit will be necessary for purposes of registration of charge with the Registrar of Companies, credit authorisation from the Reserve Bank, documentation, etc.

In settling the quantum of bank finance, the operating, funds flow and projected financial statements provided by the customer may have to be amended.

This will lead to an understanding between the banker and customer on the financial needs arising from the next year's operations, covering both long term and short term finance, as well as projected disposition of the resources generated.

(v) In respect of existing advances, excess finance over and above the permissible level should be identified and placed on a repayment basis, to be adjusted over a period of time, taking into account customer's cash accruals and obligations and his capacity to raise additional equity.

(vi) The agreed quantum of bank finance will be made available in separate accounts; the minimum fund requirements during the year by way of a fixed loan for 12 months and the balance, by way of cash credit and/or bills.

(vii) There should be no rigidity, but a flexibility, in the matter of bifurcation of the limit between loan and cash credit, guided by the customer's past plans, how they compared with the actual pattern of drawings, and the expectation for the next year. For purposes of credit authorisation from the Reserve Bank, the banker will apply only for the total limit and not for the two limits separately.

(viii) Quarterly budget and performance data will be furnished in the prescribed forms. The quarterly operating statement and funds flow statement will constitute a segment of the annual plan submitted earlier, and the banker will see whether the quarterly plan is more or less in line with earlier expectations. Fund needs, not directly linked to production needs such as for investments in or loans to subsidiary firms or other companies, etc., will be evident from the quarterly funds flow statement, and the banker will have to take a view on what is not permissible.

(ix) Actual drawings within the sanctioned limit will be determined by the customer's inflow of funds and outflow of funds as reflected in the quarterly funds flow statement. The deficit in cash during the quarter will be the level of additional demand cash credit bank borrowings required in the quarter.

The permissible level of drawing in any quarter within the sanctioned limit will thus be the level as at the end of the previous quarter plus or minus the deficit or surplus shown in the funds flow statement. It must be borne in mind that the peak requirement within the quarter can conceivably be greater than what is shown in the funds flow statement, which will only show movement of funds between two dates. If so, the borrower will have to specifically indicate the peak requirement to the banker.

(x) Within the overall permissible level of drawing, the day-to-day operations in the account will be regulated on the basis of drawing power (subject to the margins stipulated by the banker against the different components of inventory and receivables) as per monthly stock statements, which will continue to be submitted. The drawing power remaining after providing for the fixed loan—vide item (vi) above (and excess finance, if any, placed on repayment basis—vide item (v) above) will be the drawing power available for the demand cash credit account/bills on account of purchases.

(xi) No budget or plan, however, carefully compiled, can always be correct. Variances are bound to arise and it is suggested that there should be flexibility in permitting drawings. Variance to the extent of say ± 10 per cent should be permissible, and beyond this, the banker and customer should discuss the reasons.

7.2 The system suggested is but an aid to a better understanding of the customer's acceptable requirements. There would still be need for banker's judgement.

7.3 It may be stated that we view our recommendations regarding inventory/receivables norms and the mechanics of lending as a package; it is an integrated scheme and the borrower is expected to subject himself to the entire discipline envisaged by us.

8

FOLLOW-UP, SUPERVISION AND CONTROL

Testing the Assumptions of Lending

8.1 A bank has to follow-up and supervise the use of credit to verify first, whether the assumptions on which the lending decision was taken continue to hold good, both in regard to the borrower's operations and the environment and second, whether the end-use is according to the purpose for which the credit was given. A banker will, therefore, need to know:

OPERATIONS

—Have the terms and conditions stipulated for the advance been observed?

—Is the borrower keeping to the original plan of operations, and are costs, sales, profits and funds flow according to plan?

—Is the security in order?

—Are there any danger signals and, if so, what remedial action can be taken to cover the deficiencies and restore operations to normal health?

MANAGEMENT

—Is the company properly managed?

—Have there been any changes in the ownership or management pattern?

ENVIRONMENT

—Have there been any changes in the business environment or in Governmental laws and regulations affecting the customer or the banker?

—Any other considerations which may adversely affect the bank's position in future; for example, whether there are arrears of payment to cane growers in the case of sugar mills (Reserve Bank has already suggested to banks a detailed procedure to watch this position) or whether adequate provision has been made for dues to employees, etc.

8.2 Some of these responsibilities assumed by a banker are sometimes viewed as transgression of a customer's right but, is it really so? In borrowing from the pool of public funds for which there are competing claimants, the customer cannot argue that so long as the banker's money is safe, he should remain content. A bank today, and a nationalised bank at that, cannot evade its social responsibility to ensure that the credit user, who has access to scarce national resources, makes proper and efficient use of the funds, which will bring about a multiplier effect in the economy. In fact, the customer should deem it a privilege that he receives a share of the scarce national resources, and he has, therefore, to justify both its need and its end-use. Moreover, the discipline expected of the customer is as much in his own interest as the banker's; besides, both the customer and the banker are instruments in the same national development and growth process.

Terms and Conditions

8.3 The terms and conditions stipulated by the commercial banker at present are generally limited to maintenance of security, margin, insurance arrangements and rate of interest. With some exceptions in special cases, it has not been customary to stipulate conditions in areas such as maintenance of a satisfactory financial status or plough back of earnings or curtailment of dividends, nor has the banker suggested strengthening managerial competence—these are areas where term lending institutions take active interest as a matter of course.

8.4 We feel that if the banker wants to get away from security-oriented lending to production-related credit with security serving a subsidiary but necessary role, he will have to keep in close touch with his borrower's operations. For instance, if the banker decides to lend on certain assumptions, then these will have to be stated, examined and followed up. Where a borrower states in the annual plan that acquisition of fixed assets will be restricted to routine additions and replacements, a decision to go in for substantial expansion during the course of the year should not be taken without consulting the banker, for it will affect the borrower's funds flow. Equally, the original funds flow estimates might have been based on a certain dividend level. If profits were to fall much short of expectations during the year, payment of dividends at the original level will affect the funds flow adversely and, under these circumstances, the banker should be consulted. A change in funds flow not only has an impact on the financial position of the borrower but could also lead to a need for larger borrowings from the banker for which he should be consulted and satisfied.

8.5 The problem can be approached from several angles. One way would be to stipulate, as certain foreign banks do, that the borrower shall maintain, during the currency of his borrowings, a debt-equity ratio and current ratio, or net working capital (i.e. excess of current assets over current liabilities) as the case may be, at agreed levels. A 'negative' lien is also taken whereby the borrower agrees not to create a charge on his assets in favour of third parties. This arrangement gives freedom to the borrower to take decisions without seeking the banker's agreement. Another way of meeting the situation would be to make no stipulations at all and leave it to the borrower to approach the banker for any changes from the original annual plan as agreed to beforehand with the banker. A third alternative would be to spell out in specific terms what type of deviations from the original plan would require prior consultation with the banker. These alternatives can be flexibly examined, but whatever is decided upon, there has to be some understanding reached between the banker and the borrower to make the information flow and its appraisal meaningful.

8.6 Barring exceptional cases, we would not suggest that commercial banks should go to the length of adopting all the terms and conditions stipulated by the term lending institutions. For example, it is not normally necessary for banks to have a say in appointments of the executives of the company, or in prescribing norms or guidelines for selling and purchasing arrangements. It will suffice if the terms and conditions stipulated by the banker cover areas which will have a material impact on the funds flow of the borrower, and which are directly relevant to the banker's commitment. We may add that since the projected funds flow statement would form the basis for determining the line of credit, a banker would be justified in laying down a condition that any material change, say around 10 per cent of the figure projected earlier, would require his prior approval. We suggest that for normal cases certain minimum terms and conditions could be stipulated. Thus, the bank could stipulate that the borrower should consult it sufficiently in advance to give it an opportunity to examine its own position, in the following matters:

—making other borrowing arrangements,

—taking up new projects or large scale expansion,

—making investments in or loans to subsidiaries, associate concerns, individuals or other companies, other than loans to employees under welfare schemes,

—effecting mergers and acquisitions,

—paying dividends other than out of current year's earnings, after making due provisions,

—giving guarantees on behalf of third parties,

—disposal of the whole or substantially the whole of the undertaking, and

—premature repayment of loans and discharge of other liabilities.

8.7 So long as the borrower operates within the original plan accepted by the banker, there would be no problem. Variances are only to be expected in all planning, and the quarterly review should take care of these variances. Once the system of planning and appraisal is stabilised, stipulation of specific terms and conditions may diminish in importance, or even be no longer necessary; but we have some way to go yet in that direction.

Financial Follow-up

8.8 The quarterly forms we have recommended for larger advances provide the basic framework of financial follow-up. Once the annual plan of operations and year-end financial position are accepted by the banker, the presumption is that the intervening funds flow will also ipso facto be acceptable. What the banker will be concerned with, during the course of the year, is the extent to which actual operational results conform to earlier expectations and signs, if any, of significant divergence reading as red signals to both the banker and the customer. We reiterate that variance of say, $\pm$ 10 per cent may be treated as normal, but anything beyond it will need examination, with particular attention paid to how it is going to affect profitability.

8.9 In addition to the quarterly data, we would suggest submission of a half-yearly pro-forma balance sheet and profit and loss account within two months from the end of the half-year for borrowers with credit limits of Rs. 1 crore and more from the banking system. We are convinced that large borrowers have sufficiently modern accounting systems to fulfil this requirement.

8.10 Many banks say that balance sheets of customers are delayed unduly. In the new system, it is in the borrower's own interest that audited balance sheets are produced as early as possible, say, in three months and we recommend that he should take positive steps in this direction. This is not at all a difficult proposition and is completely within the borrower's own control.

8.11 After the close of each year, detailed credit analysis should be done as in respect of new advances. The annual drill will, in fact, be a review of the past year's operations plus appraisal of the requirements for the next year, based on next year's plans. In conducting this annual review-cum-appraisal, the banker will re-examine the terms and conditions and make necessary changes.

Stock Statements

8.12 Stock statements will continue to be submitted but they need to be improved. The valuation in the stock statement does not often tie up with the financial data in the company's balance sheet. If the lending procedures of banks are to be based on a system of financial reporting by the borrowers, it is essential that the valuation in the stock statement should be congruent with that adopted for the financial statement. In operational terms, the borrower will be asked to value stocks in the stock statement in the same manner and adopting the same principles as for the financial statement.

8.13 A further improvement we would suggest is reconciliation of stocks from month to month, so that the opening stocks and closing stocks are reconciled on the following lines, based on the example of a textile mill:

	No. of bales	Value
Opening stocks of cotton in bales at the beginning of the month		
Issued to the factory during the month		
Purchases during the month		
Closing stocks of cotton in bales at the end of the month		

In the case of finished goods, the reconciliation would be as under:

Opening stocks of finished goods in bales at the beginning of the month		
Received from the factory during the month		
Sold/despatched during the month		
Closing stocks of finished goods in bales at the end of the month		

In the case of stocks-in-process, this type of reconciliation is not possible and what the banker would look for is a steady pattern from month to month, other things being equal.

8.14 The advantage in the above procedure is, firstly, a check on the financial data through the figures furnished in the stock statement. Secondly, the reconciliation suggested by us would facilitate in the inspection of stocks by the bank's inspecting officials.

8.15 Stock inspection poses problems particularly in large industries. Excepting perhaps the sugar industry, verification of quality and quantity of stocks would be difficult, e.g., as in the engineering industry. In heavy machine building and structurals, in particular, where the value of work-in-progress will be considerable extending over several months' production, verification of stocks by the banker can be an ineffective exercise. In such cases, there is no alternative to depending on financial follow-up, and the systems suggested by us should make the task manageable. What is more important than inspection in such cases is a system of plant visits by the banker, where opportunity is taken to talk to management on current problems and look at figures. Where a banker feels for special reasons that a detailed stock verification is called for, a regular stock audit may have to be arranged with the assistance of outside consultants. Such instances would, however, be few and restricted to difficult accounts.

Stock Inspections

8.16 If the stock inspections were to disclose a short-fall in stocks, the problem is serious. There are two possibilities; first, the figures furnished by the borrower are incorrect and the company's financial position and profitability are worse than what have been disclosed; second, since submission of the last quarterly budget, there has been a serious turn of events leading to lower profitability or losses, resulting in a lower level of current assets. In either event, the situation calls for serious notice being taken by the banker.

8.17 Managerial competence is an important factor in the efficiency of operations, reflected in profitability and working capital and financial management. Assessment of managerial efficiency is a detailed subject in itself and while we would not wish to enter into an in-depth discussion in this area, we would suggest that it would be advisable for the banker to keep in mind that appraisal of management may be essential, particularly as we place a new emphasis on viability and development rather than on security alone. Further, changes in ownership or managerial pattern may also have to be watched, where circumstances warrant.

Management Efficiency and Inter-firm Comparison

8.18 Inter-firm and industry-wise comparisons, where they are available, constitute a good way of assessing efficiency. Company finance studies published periodically by the Reserve Bank are useful. It would be of added advantage if companies in the same industry could be grouped under three or four categories, say according to size of sales and the group-wise financial ratios compiled by the Reserve Bank. These may be made available to banks regularly.

8.19 Industries too have a responsibility to strengthen the data-base in the country and we would like to see industry organisations themselves collecting data from their members and publishing whole-industry balance sheets, profit and loss accounts and relevant ratios.

8.20 In making inter-firm comparisons, banks have been accustomed to examining financial and operating ratios. We recommend that productivity also be examined to determine efficiency in use of resources—men, money, machines and materials. A banker can choose his own criteria, but some useful ones are :

LABOUR EFFICIENCY

Sales per worker

Value added per worker

Capital employed per worker

CAPITAL EFFICIENCY

Sales divided by capital employed

Percentage of profit before tax to capital employed

Value added divided by bank borrowings

FIXED ASSETS EFFICIENCY

Value added divided by gross fixed assets

Sales divided by gross fixed assets

8.21 The level of profitability is one index of managerial competence. Profitability can, however, be affected by changes in business environment, competition, product obsolescene and change in demand pattern, lack of research and development or even loss of key executives. Expressed differently, current profitability does not hold the key to future profitability. Profits in the future will be conditioned by the capacity of the management to think ahead, to anticipate changes in business environment and to plan and act accordingly. Many successful companies of yesterday are sick today for want of such foresight. The banker has to keep these aspects in view.

8.22 For purposes of better control, it is our view that there should be a system of borrower classification in each bank, within a credit-rating scale.

Classification of Customers

To illustrate, there could be a five-point scale in which borrowers could be classified as Excellent, Good, Average, Below-Average or Unsatisfactory; an alphabetical range would do equally well.

Such a system of classification according to credit risk, will facilitate easy identification of the borrower whose affairs require to be watched with more than ordinary care. An incidental advantage of such classification will be the formulation of a rational base for purpose of fixing the rates of interest for the respective borrowers. For instance, borrowers who conform to the discipline suggested by us could be given an incentive by way of a lower rate of interest as their credit-rating will improve.

8.23 To sum up, the appraisal-cum-follow-up drill will be as under:

—detailed credit analysis at the time of sanction of advance, with suitable terms and conditions,

—monthly stock statement in the revised form,

—periodical stock inspection,

—quarterly performance/budget information,

—half-yearly proforma balance sheet and profit and loss account within 60 days,

—annual audited accounts within 3 months,

—annual review-cum-detailed credit appraisal, and

—a system of borrower classification.

End-use of Credit

8.24 We may now proceed to discuss the question of ensuring the end-use of bank credit. Verification of end-use of bank advances poses no problem where loans are granted for financing trade. It becomes somewhat blurred in industrial finance if the level of the advance is directly linked to availability of security, without taking into account the other current assets and other current liabilities.

8.25 In the revised scheme suggested by us, all current assets and current liabilities other than bank borrowings are taken into account in arriving at the working capital gap, of which the banker's share should not exceed a specified percentage. Consequently, a part of the working capital gap will always be met by the borrower out of long term funds, i.e., owned funds plus term borrowing. In this manner, one can ensure that the bank advance goes to support only a reasonable level of current assets. With the passage of time, borrower's share supporting current assets should increase.

8.26 A question is sometimes raised whether payment of cheques for wages, power, taxes, dividend etc., by a banker from a cash credit account would be proper end-use of funds lent. If all transactions of the aforesaid nature as also the sales realisations are put through the cash credit account, it would be unrealistic for the banker to differentiate between the purpose of one drawing and another in the account. The only feasible manner in which he can satisfy himself in regard to end-use of funds would, therefore, be to examine the relationship of the borrower's current assets to current liabilities from time to time. So long as the current ratio and the respective shares of the bank and the borrower's long term funds in meeting the working capital gap do not change adversely, the conclusion would be that bank finance has gone towards build-up of current assets. A more meaningful appreciation of the borrower's financial position and current operations could be made if the bank can call for appropriate operational data and figures relating to financial position at periodical intervals. These are incorporated in the information system recommended by us.

9

NORMS FOR CAPITAL STRUCTURE

9.1 The two basic financial ratios which a banker will always look to are the debt-equity ratio (i.e. total outside liabilities to equity) and the currrent ratio. Our proposed approach to lending discussed in Chapter 6 will take care of the aspect of a satisfactory current ratio. We have also to consider whether norms could be established for the relationship of debt-equity in an industrial organisation.

9.2 The experience of other countries in this matter may not be of much assistance to us in formulating guidelines in the Indian context. We have the case of American companies on the one hand whose financial position is strong and it would obviously be unrealistic to seek such standards in India, at this stage. In contrast, we also have the example of Japan where higher debt-equity ratios are encountered but this again cannot constitute a model for us.

9.3 Without entering into a discussion on monetary and fiscal policy or drawing a parallel with other countries, we would stress that the debt-equity relationship is a relative concept that depends on several factors and circumstances such as the state of the capital market at any one time, Government policy on created money, the need to maintain current assets at a specific level (which again is contingent on other factors), marginal efficiency of capital or the opportunity cost, etc.

9.4 The concept of debt-equity ratio in itself can be viewed from different angles. A widely held approach—and adopted by the Controller of Capital Issues and the leading term lending institutions—is that of relating long term or funded debt to equity. The banker, besides looking to this ratio, sees, in addition, the relationship of total outside liabilities of a borrower to equity; bankers in other countries also look to this relationship. The debt-equity ratio can also be viewed from a different stand point as the relationship of net worth to total assets of the company, the purpose being to ascertain the owner's stake in the business. In discussing norms for capital structure, we therefore have to keep in mind both the relationships—long term debt to equity and total outside liabilities to equity.

9.5 The impact of taxation in considering this subject is also important for, under the tax structure, it is advantageous to trade as much as possible on borrowed capital to maximise earnings per share. The higher the level of borrowings, or the leverage, the greater is the advantage; in view of this and coupled with the cheap money policy till recently, there has been limited incentive to the borrower for efficient management of funds. This position has changed somewhat of late with the introduction of higher interest rates in the banking system.

9.6 On the other side, the lending banker likes to see as high an equity stake as possible because it makes his advance safer and, in times of credit shortage, makes available bank funds go further.

9.7 In resolving this dichotomy of interest between the banker and the borrower, one cannot lose sight of the need to promote the capital market, the ultimate goal being to assist to maximise investment and production. If the end-product of industry has to be sold at a cheaper price and adequate dividends are also to be given to make equity attractive to the investor, no company can afford, even if it were possible, to trade entirely on owned funds, nor rely too heavily on borrowed funds. There has thus to be a balance between the two—what the company provides and what it borrows.

9.8 We have had the benefit of the statistics furnished by the Reserve Bank on the financial position of 1303 companies for three years, viz., 1970-71, 1971-72 and 1972-73. The data have been tabulated industry-wise for 16 industries, separately for public and private limited companies and is furnished in Annexure VII. These data should be up-dated periodically. Each industry group is more or less homogeneous. Long term debt-net worth and total outside liabilities-net worth ratios relate to capital structure and are of special interest to the lending banker. In each case, three ratios for latest three years have been provided. Median represents the industry average and quartiles one and three provide the range within which the normal cases fall. Extremes of top and bottom (25 per cent each) cases have been excluded. While these figures cannot, of course, be considered to be the ideal long term debt-net worth or total outside liabilities-net worth ratios for the industry, they do provide a benchmark of comparison for the banker and the borrower.

9.9 Where a company's long term debt-net worth and total outside liabilities-net worth ratios are worse than the medians, the banker would endeavour to persuade the borrower to strengthen his equity base as early as possible. We consider that this would be a more practical approach for the banker than attempting to legislate absolute standards of long term debt-net worth and total outside liabilities-net worth ratios for all industries or even industry by industry. We do not expect a perceptible improvement within a short period. But, the borrowers whose ratios are worse than the median should pursue to reach the median on the basis of the data up-dated by the Reserve Bank .

10

IMPACT ON BANKS' INTERNAL WORKING

10.1 The proposals we have made in the preceding chapters constitute a major departure from the existing approach and practices. It is necessary that the change-over should be effected with a minimum of inconvenience to the banker and the customer.

10.2 Lending is a dynamic activity and the banking system must always be ready to adapt itself to the challenges of new situations. One of the points made by most borrowers whom we met was an apprehension that unless banks re-oriented themselves both in terms of their attitudes and their working, the new system, however well thought of, was likely to be a fruitless exercise. They particularly mentioned the various levels through which a proposal had to go before it was sanctioned. They pleaded that these tiers should be reduced and decisions given quickly. This is a matter for each bank to examine in relation to its own administrative systems and procedures and take appropriate action.

10.3 These and related topics were discussed in the two bank seminars organised by the Reserve Bank where the forms for credit appraisal and follow-up of bank credit were pre-tested. Several senior officials dealing with advances expressed the view that the staff resources available with their banks were inadequate to do justice to the job. We do realise the difficulties faced by bank managements in providing adequate and competent staff in all departments; nonetheless lending is a crucial area and failures will seriously affect bank profitability, besides the loss of national resources. It will be necessary to keep this in mind in examining requests for additional staff.

10.4 More importantly, we would like to emphasise that the new system cannot succeed without the total commitment of the top management in each bank to the new approach.

10.5 While we advocate the acceptance of discipline within the industry, public or private, government and its agencies, we cannot over-emphasise the need for the banking system also to practise re-orientation. From the head office to branch level, some re-education in the new systems will be necessary, and also a change in the existing systems to make them speedier and smoother in dealing with the customer. In fact, banks could exercise a far-reaching influence through their own discipline on the discipline of the customers. Speed in appraisal, decision-making and flexible handling of the new system on the part of bank will also induce a corresponding speed among the customers. We, therefore, suggest extensive training facilities in credit appraisal for bank staff at all levels, with particular emphasis on the information system suggested by us and handling of inventory and receivables norms.

11

BANKER-CUSTOMER RELATIONSHIP

11.1 Three steps can distinguish the attitudes of banks towards their borrower customers:

(i) The protective attitude—concern primarily with the bank's protection,

(ii) The constructive attitude—a more intelligent, exacting analysis by which salient trends are brought out and future events prophesied with greater accuracy, and

(iii) The creative attitude—informing the customer of these trends and helping him to avoid unfavourable contingencies.

11.2 Indian banking has passed the first stage and could now be considered to be in the second stage. While the 'adversary relationship' between the banker and the customer may be on the way out, we have definitely not reached the stage of mutual confidence as between the banker and the customer. On the customer's side, the feeling still persists that having given security, there is no need for him to furnish what he considers unnecessary data to the banker who can make no purposeful use of the information; worse, the information might even be used by the banker against him to cut down the level of credit or otherwise. In our discussions with representatives of industry, the point was also frequently made that no matter what information the industry may furnish, the existing level of competence in the banking system might not be adequate to assimilate and analyse the information.

11.3 Perhaps this may be an overstatement, but we are not sure whether the banking system itself is not conscious of the need for general improvement. The security-oriented approach until recently was not such as to encourage the customer to go to the banker with his problems for advice, and cases where the banker has taken a deep, sympathetic and constructive interest in extending such advice could not have been the rule.

11.4 It is essential to realise that there are rights and obligations on both sides. The banker as the lender is entitled to information which he deems necessary for his appraisal and follow-up. The banker also has a duty in turn to appreciate that vicissitudes in industry's fortunes are not uncommon, with problems in the economy abundant; and it would be short sighted to insist on the borrower strengthening his security when he is passing through difficult times. On the borrower's side too, the right to obtain bank finance for his operations goes hand in hand with the obligation to furnish adequate information to the banker and the borrower cannot rest content merely with furnishing security. Under the new system that we suggest, the customer owes it to his banker to develop an accountability and the benefit he should receive in turn is flexibility and understanding on the banker's part.

12

SOME RELATED ISSUES

12.1 We have also considered certain related issues and our views are as follows:

ISSUES RELATING TO NORMS

12.2 Trade is highly diversified, and where it is handled by small traders (outside the corporate sector), we realise the difficulty of fixing inventory norms for the large number of commodities traded in. Nevertheless, bank credit cannot be made available to trade without constraint, thus enabling it to hold goods in any manner and to any extent it may desire. While financing trade, banks must keep in view, inter alia, the extent of owned funds of the borrower in relation to the credit limits granted, annual turnover, possible diversion to other units or uses and how much is being ploughed back from profits into the business. Normally, the total outside liabilities should bear a reasonable proportion to owned funds of the borrower, so that the creditors also may have a satisfactory margin. Goods which have already been obtained on credit should not be financed by the bank.

Norms for Trade

12.3 Since holding of large inventories with the aid of bank credit needs curbing, we appreciate the supplemental selective credit approach of the Reserve Bank, by which credit is controlled in respect of certain commodities by fixing of quantum of credit, margins and rates of interest, taking into account the market position, subject to periodical reviews.

12.4 In industries like cotton and jute textiles, the respective Government authorities prescribe inventory levels, sometimes to support the market and sometimes to prevent speculative holding. To the extent these may cut across the relative norms for inventory holding, it will be useful if these authorities consult the Reserve Bank before prescribing the stock levels.

Statutory Authorities and Norms

12.5 Efficient transportation and availability of wagons are necessary. A question was often asked whether railways should not assume some liability for undue delays as a part of their own discipline, as they do for damages in transit at railway risk. We see considerable force in this .

Transport delays

Supplies from Canalising Agencies and Public Sector Producers

12.6 There was much comment on supplies made to industry through the canalising agencies; the industry averred that supplies were often bunched, while the canalising agencies pointed out that industry did not always honour all its commitments made to them. A similar point was made regarding supplies of items like steel which, according to industry, due to irregular distribution procedures, meant customers carrying large stocks of mis-matched items, thus locking up bank funds.

12.7 The canalising agencies pointed out that the build-up of inventory with them was due to poor off-take by the customers. The off-take since then is reported to have improved. While these agencies must be aware of their problems and do have their own limitations, there is also a tendency on the part of the customers to over-indent their requirements. The canalising agencies assured us that they have rationalised their procedures inasmuch as sufficient advance notice of supplies is being given to their customers to enable the latter to make arrangements for necessary finance. We also understand that as far as steel is concerned, there have been attempts to change the procedures so that consumer industry will be able to hold minimum necessary stocks, while the producers will hold inventories for them in their stocks. We suggest that the canalising agencies and public sector producers may review, from time to time, their distribution procedures, so as to prevent unproductive lock up of bank funds.

Government Purchases

12.8 Delay in payment of bills for supplies effected to Government departments and public sector has been commented upon most widely in the past. The industry representatives mentioned to us that there had been no material improvement in the situation. Like the public sector, Government purchase agencies are the biggest buyers in the country. Tardy payments by Government and public sector will only increase the level of receivables of industry and consequently the working capital requirements from banks for unproductive purposes. Working capital management cannot yield best results if receivables remain high due to such delays in payments. A little understanding and a little discipline would bring about economies to the purchasers and also the industry. Government departments have already been following the accepted commercial practices in respect of their purchases from foreign suppliers but there seems to have been a reluctance on their part to follow similar procedures in respect of their internal purchases. It would be useful if the Reserve Bank could initiate discussions on this matter. We also feel that Government should, pending streamlining its procedures, agree to pay interest on established delayed payments.

12.9 The prevailing shortages in various sectors do not, in fact, justify sales on credit terms. While the emphasis of the monetary policy is on restraint in the use of credit, delayed payment by purchaser results in the purchaser forcing credit out of seller and the latter needing more credit from the banking system; in the process, the entire transaction cycle also gets elongated. Further, the purchaser may also, unless the bank is vigilant, obtain credit from the seller as also the bank for carrying the same stock. The present system thus dilutes monetary policy. We are, therefore, of the view that there should be a major change in the procedures of selling. We feel, as mentioned earlier, that there is a virtue in an efficient shortening of the transaction cycle, both in the private and public sectors, and wherever possible, a system of 'cash and carry' should be introduced, though after a detailed study, or at least credit period allowed by sellers should be progressively reduced. Banks could facilitate this shift to the 'cash and carry' system by extending the necessary credit line to the purchaser industry to pay off the suppliers on delivery. This would enable bank funds to achieve a larger multiplier.

Shift to Cash Sales

ISSUES AFFECTING BANKS

12.10 In the case of consortium advances, or where the borrower is financed by more than one bank, the concerned banks should evolve a procedure to ensure a uniform handling of the accounts in conformity with the inventory and receivables norms and the financial discipline suggested. The initiative for appraisal and review might be taken by a bank nominated as leader for the purpose.

Consortium Advances

12.11 As we see it, the benefits of the new system are not one-sided and the advantage to industry is considerable. For one thing, submission of a mass of unrelated data at irregular intervals and for indeterminate purposes would now be substituted by an orderly information system that would be of even greater value to the borrowers themselves. Equally, if not more important, we can also visualise a responsibility cast on the banker, as the system stabilises, to provide the required funds to the borrower on the basis of a periodic dialogue, in consonance with the overall credit policy. The most important advantage will be a convergence in the approach of the banker and the borrower which would lead to a better appreciation and understanding of the borrower's problems, enabling the banker to stand by the borrower in times of need. We are confident, therefore, that the mutual advantages will soon be realised and the necessary co-operation would be forthcoming from industry.

Banker's Leverage

12.12 While there can be no problem with progressive borrowers, we have considered how the banker would be in a position to enforce the new system with the not-so-progressive customers. There could be a few cases where borrowers may refuse to comply with the new requirements. We see no alternative in such cases for the banker but to take first a holding action by raising the rate of interest until such time as the requirements are fulfilled; but if this fails, the banker will have no option but to stop operations in the accounts, although we feel that such contingencies may not arise often.

Sticky Advances

12.13 It has been observed that sticky advances follow a particular pattern. Few advances are bad ab initio; they were all good to begin with. With a steady erosion of profitability, unnoticed by the banker, the borrower's liquidity declines and the first sign of difficulty is delayed payments to creditors, leading ultimately to default. With further deterioration in profitability, followed by losses, current liabilities exceed current assets or, in other words, a net working capital surplus becomes a net working capital deficit. At this stage, cases are not unknown where a borrower may be tempted to furnish incorrect stock statements in the fear that disclosure of the true state of affairs would precipitate bank action. The banker may be vaguely aware that the borrower is facing some problems, but feels reassured by the fact that stock statements show his security intact and is lulled into complacency. When the borrower's activities finally begin to waver, the banker attempts a detailed stock-taking, only to find large shortfalls in current assets, and ultimately a loss to the bank.

12.14 It is not that danger signals do not become available in advance, but what is more important is evolving a system of feed-back on the borrower's operations, or to appraise what information is available. Timely examination and discussion of the problem areas by the bankers with the borrowers would save many borrowing concerns from becoming sick. A customer has no longer an inherent right to conduct business in a manner which will end up in sickness if national funds have ultimately to bale out the operation.

12.15 It is true that even the best of systems cannot altogether prevent poor performance and sticky advances cannot entirely be avoided. However, once danger signals are thrown up and signs of difficulty emerge, speedy action is called for on the part of the banker and timely and firm handling are of essence. In dealing with large industrial advances in particular, the banker's interests are best served not by sale and recovery of the security charged to the bank, but by seeking implementation of appropriate measures to overcome the incipient difficulties.

12.16 In such cases, a major inhibiting factor has been the reluctance of the banker to offer advice to industry on what steps to take to restore health or to intervene firmly to improve management in specific areas of deficiency, or even to remove undesirable practices. In the past, competition has made banks hesitant in this regard and rather than lose an account they have hoped for the best and kept their fingers crossed. The consequential delay sometimes proves fatal both to the bank and the customer, although some customers manage to get away and leave the sick company in the lap of Government.

12.17 In such cases, there is a duty cast upon the banker to intervene even in management, if that is necessary, in the interests of all concerned and the public. The banker does not have to diagnose the ailment by himself. He can go to a consultant, and can then arrange for action, including a financial or structural reorganisation. We particularly stress this point because of the past record of many sticky advances where the banker's main anxiety was how his security could be strengthened or realised. And the suffers in the end were both the banker and the society at large.

Environment

12.18 We feel that a body like the Indian Banks' Association has an important role to play in a study of the environment and particularly the impact of regulations and enactments on the working of banks. Its contribution would be particularly advantageous to the smaller banks, some of whom cannot afford to arrange such facilities within their organisation.

12.19 Expertise has also to be built up in the banking system in organising industry-wise studies. A point was frequently made by representatives of industry that bank managers in India were not sufficiently aware of conditions in industry and were excessively pre-occupied with security. There is no doubt a clear need for bankers to keep themselves fully informed of conditions in each industry in which they are interested, its problems and prospects. Such studies should necessarily be on an on-going basis and should serve as a frame of reference for decision-making in regard to individual cases.

Lead Banks for Industry

12.20 In the light of the new responsibilities that we have envisaged for the banking system, it was suggested that instead of every bank attempting to make detailed studies of all the major industries and spreading its limited capabilities too widely, it would be beneficial if some selected banks—we would call them 'lead banks for industry' in this limited context—concentrate on one or two industries each for which they may be best fitted to study by virtue of their locational advantage or large involvement or for other special reasons. By such specialisation and division of labour, the quality of the studies would be greatly improved and the results could be made available to the other banks as also to the Reserve Bank. In course of time, sufficient expertise will thus be built up in the entire banking system, covering all major industries, which can be utilised to the mutual advantage of the banking system as well as the industry. We would, however, state in this context, that by 'lead bank for industry' we do not mean that the bank concerned will deal exclusively or predominantly in that industry; we only mean that the bank concerned will have a normal portfolio but in an industry in which it happens to have a predominant role in lending, it will use the knowledge it gains for conducting studies for the benefit of others.

12.21 We find considerable merit in this suggestion and the benefits flowing from such a pooling of resources are obvious. It would naturally not absolve the individual banks, particularly the larger ones, of the responsibility of carrying out their own studies in the industries in which they are involved. Indeed, such studies could help the 'lead banks for industry'. A question was raised about the confidentialness of information, but the 'lead banks for industry' would not provide firm-wise information and data, but only industry-wise aggregates.

Other Issues

Credit Authorisation Scheme

12.22 Delays in taking credit decisions referred to earlier could also be occasioned by the credit authorisation requirements of the Reserve Bank, although they arise largely out of non-submission of complete information to it in the first place. Be that as it may, it is opportune to examine whether the limits for credit authorisation should not be raised. The value of the rupee has altered since introduction of the Credit Authorisation Scheme in November 1965 and the borrowing limit required for a given level of operations has gone up. As mentioned earlier, there has already been a qualitative improvement in the approach of commercial banks and their lending skills, which will improve further under the system we are suggesting in this Report.

Public Sector Industry

12.23 We had the opportunity to discuss credit problems of public sector units with their managements. Financing public sector industry, though relatively new to banks, should pose no special problems. As stated earlier, public sector industry should conform to the same norms as are applicable to comparable private industry. In our discussions, public sector managers were insistent that their style of management 'necessitated larger inventories and receivables'. It is possible that in special cases norms may have to be relaxed, but only after a study in depth. We feel that it would be inappropriate for banks to take on themselves projects which are not obviously bankable.

Flow of Information to the Reserve Bank

12.24 One of the terms of reference given to us relates to the flow of information from the lending banks to the Reserve Bank. The type of information required by the Reserve Bank and the periodicity of such information flow would largely depend on the requirements of the Credit Authorisation Scheme on the one hand and credit planning on the other. The information furnished to the Reserve Bank at present comprises data embodied in the applications for credit authorisation, statements of analysis of advances, seasonal data furnished for the purpose of credit planning and certain other special statements called for from time to time. Besides, the Basic Statistical Returns also furnish a good data base. What specific changes should be introduced in the matter of information pertaining to borrowers would depend on the changes contemplated in the Credit Authorisation Scheme and in credit planning. We have suggested an information system for banks for obtaining data from their borrowers. The Reserve Bank may consider what part of the information it requires and the periodicity thereof. Such information flow from banks to the Reserve Bank may include data in regard to each industry indicating how inventory norms are being implemented, circumstances under which deviations have been made and also the progress made in switching over to the new system recommended by us. If we have refrained from offering detailed suggestions in this area, despite the term of reference, it is because of our feeling that decisions in this important area should await a detailed study.

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THE NEXT STEP

13.1 We are confident that, as we go along, with the implementation of the package of the systems recommended by us, the pressure on the banking system from the borrowers will ease considerably, enabling better re-allocation of credit in the economy.

13.2 We suggest that the inventory and receivables norms should be given effect to immediately (subject to observations in Chapter 5), while action should be initiated to implement the new approach to lending with a time-bound schedule as proposed in Chapter 6. It should, however, be noted that, in all cases where borrowers seek additional credit facilities on a regular basis, while the limits will be fixed on the basis of norms (or the past practice, whichever is lower), the financing pattern should also be simultaneously brought in line with the 1st Method of lending and the excess finance to be amortised should be identified and placed on a repayment basis.

13.3 Alongside, steps should be taken to introduce the information system suggested by us, for all industrial borrowers with limits aggregating Rs. 1 crore and above from the banking system, and the process completed within six months. The borrowers who have the information system should commence submitting the quarterly data straightway, while the intervening period of six months will be utilised by the borrowers who do not have the requisite information system to build up such a system. Banks, on their part, will utilise this period for conducting training sessions for their operating officials.

13.4 We suggest that special courses should be organised by the National Institute of Bank Management and the Bankers Training College. These institutions should also concentrate, to start with, on training the trainers so that these trained instructors in turn could carry out extensive training programmes in their own training institutes; the process of change over to the new system would then be speedier, smooth and fruitful. These institutions may also help banks in preparing operational manuals based on our recommendations and assist banks in bringing about the necessary changes in their systems and procedures.

13.5 We also suggest that each bank should conduct banker-borrower seminars to create an understanding between the operating officials in the respective banks and their customers so that a better appreciation of each other's problems and points of view could be gained. After six months, a bankers' seminar could be convened in the Bankers Training College where operating officials can compare notes and attempt to find solutions to the operational problems that might have been thrown up in the interim.

13.6 Follow-up and supervision of bank credit and ensuring that borrowers take effective action to improve their financial strength is a continuous exercise. In this, the role of the Committee of Direction already appointed by the Reserve Bank, with which are also associated some commercial bankers, will be wide and varied. But its prime contribution will be to take forward the work of the Study Group to a continuing function of a dialogue with industry and banks, to make sure that the new system suggested by us runs smoothly and changes in the environment warranting any revision are picked up quickly and examined. It could also assist the Reserve Bank in formulating its policies in this regard. We reiterate the value of setting up this Committee, particularly as it will place the work of the Study Group on to a dynamic basis.

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SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

1. Till nationalisation of the major commercial banks in July 1969, the main contenders for bank credit were large and medium scale private industry and internal and external trade. Nationalisation called for a new policy and the banking system was asked to adopt a new approach as a credit agency, based on development and potential rather than on security only, to assist the weaker sectors of the society, and later to lend to the public sector also (Paragraphs 1.1 and 1.2).

2. In the early years, bank lending in India was mostly directed to financing of movement of agricultural produce from the grower to the trader. Advances were sanctioned against the security of stocks charged to the banks. With the growth of industrialisation, the same system of bank lending continued with minor changes, the general pattern of lending to industry being security-cum-guarantee advances. The security-oriented system tended to favour borrowers with strong financial resources, irrespective of their economic function. This system aided concentration of economic power (Paragraphs 3.1 to 3.3).

3. Since nationalisation, there has been a new sense of direction in bank lending and indeed advances to new claimants of credit, and especially to small industry and agriculture, have since gone up. The public sector too has emerged as an important user of credit in recent years. Another new source of demand is the growing awareness of the need to achieve an equitable geographical development of industry, and in its wake the distribution of credit (Paragraphs 3.6 to 3.8).

4. In the last six or seven years, industrial production has risen at a slow pace but the call on bank credit, essentially for maintaining inventories even at the same level, has gone up with increasing prices. If the growth process is resumed—as indeed it has begun to do—then perforce the volume of inventory required to maintain a higher level of production will increase and correspondingly the demand for bank credit. Banks will thus have to operate in a context in which demand for bank credit for growth requirements will be large (Paragraph 3.10).

5. The problem of potential imbalance in demand for and supply of funds is accentuated by the manner in which banks extend credit under the present cash credit system of lending. Under this system, the level of advances in a bank is determined not by how much a banker can lend at a particular point of time but by the borrower's decision to borrow at that time. This makes credit planning difficult in banks. Also, cash credit advances are repayable on demand only in name. To the extent that outstandings in the cash credit account never fell below a certain level during the course of a year, there is an element of what is called a 'hard core' borrowing which is in reality a quasi-permanent lock up of bank funds in the borrower's business (Paragraphs 3.12 to 3.20).

6. In the light of the foregoing, time is now opportune to review the existing system and effect changes in such a way that under the new system the borrower would plan his credit needs and the banker also would be able to plan, having known the borrower's credit requirements (Paragraphs 3.22 and 3.23).

7. A borrower needs funds for the operation, mainly to carry current assets required for the purpose. Inventory and receivables comprise the bulk of the current assets. There is no uniformity in approach among banks in assessing working capital requirements, especially with regard to inventories. If bank credit is to be viewed as a tool of resource allocation in the economy, one cannot get away from the problem of defining reasonable levels of inventories (including safety stock) and receivables in each industry and hence the need for norms for these current assets (Paragraphs 4.1, 4.2 and 4.7).

8. In the new context, the main function of a banker as a lender is to supplement the borrower's resources to carry an acceptable level of current assets. The implications are two-fold; one, the level of current assets must be reasonable and based on norms; two, a part of the fund requirements for carrying current assets must be found from long term funds comprising owned funds and term borrowings including other non-current liabilities (Paragraph 4.8).

9. Norms have been suggested for 15 major industries, taking into account, inter alia, company finance studies made by the Reserve Bank, process period in the different industries, discussions with the industry experts and feedback received on the Interim Report. The norms proposed represent the maximum levels for holding inventory and receivables in each industry. If, however, a borrower has managed with less in the past, he should continue to do so (Paragraphs 5.7 and 5.8).

10. In view of the special characteristics of the heavy engineering industry, particularly the large tie-up of funds in current assets, the banking system may find it difficult to cope with the industry's demand for funds in its entirety. The working capital requirements of the heavy engineering sector should, therefore, be assessed taking into account the alternative ways of financing the needs and the extent to which banks may meet them may be determined, case by case, on merits (Paragraphs 5.9 to 5.11).

11. Norms cannot be absolute or rigid. Deviations from norms may be visualised under certain circumstances, e.g., bunched receipt of raw materials, power cuts, strikes, transport delays, etc. However, delayed payments by Government agencies and sometimes by large units in the private sector cannot be treated as circumstances warranting deviations and the matter should be tackled at the sources rather than throwing upon the banking system the burden of providing additional credit. The Reserve Bank should discuss the matter with Government agencies and the Bureau of Public Enterprises; Government and public enterprises should set an example in prompt payments (Paragraphs 5.12 and 5.13).

12. Concessions under the criteria for deviating from norms should not be expected as a matter of course but must be fully justified. Deviations should be for known specific circumstances and situations (which should be recorded) and allowed for agreed periods which should be relatively short; and there should be a return to norms when conditions revert to normal (Paragraphs 5.14 and 5.15).

13. Norms should apply to all industrial borrowers, including small scale industries, with aggregate limits from the banking system in excess of Rs. 10 lakhs and extended to smaller borrowers progressively as early as possible (Paragraph 5.16).

14. In the case of industries not covered by norms at present, the purpose and spirit behind the norms should be kept in view when extending credit facilities (Paragraph 5.17).

15. The list of industries covered by norms should be extended with experience. Norms should be kept under constant review (Paragraphs 5.18 and 5.21).

16. The principles should be uniform for all like industries, both in the private and public sectors. Thus, public sector industry should conform to the same norms as are applicable to comparable private industry, though in

special cases, norms may have to be relaxed, but after a study in depth (Paragraphs 5.19 and 12.23).

17. All credit limits, whether enhancement is sought for therein or not, should be considered in the light of the norms and where the levels of inventory and receivables are excessive, they should be reduced, bringing down also the dues to the bank and/or other creditors (Paragraph 5.20).

18. The process of adjustment of inventories and receivables should be completed in about two months, other things being equal. In the event of default, as a first step, the bank should charge a higher rate of interest. But even charging of a higher rate of interest should not give a permanent immunity to the customer from conforming to norms and some further action should be considered (Paragraph 5.20).

19. The working capital gap, viz. the borrower's requirement of finance to carry current assets (based on norms) other than those financed out of his other current liabilities, could be bridged partly from his owned funds and long term borrowings and partly by bank borrowings (Paragraph 6.2).

20. The maximum permissible level of bank borrowings could be worked out in three ways. In the 1st Method, the borrower will have to contribute a minimum of 25% of the working capital gap from long term funds, i.e. owned funds and term borrowings; this will give a minimum current ratio of 1:1. In the 2nd Method, the borrower will have to provide a minimum of 25% of total current assets from long term funds; this will give a current ratio of at least 1.3:1. In the 3rd Method, the borrower's contribution from long term funds will be to the extent of the entire core current assets, as defined, and a minimum of 25% of the balance current assets, thus strengthening the current ratio further (Paragraphs 6.3 to 6.8).

21. The classification of current assets and current liabilities for computing the permissible level of bank finance should be made as per the usually accepted approach of bankers (Paragraph 6.9).

22. The 3rd Method will provide the largest multiplier of bank finance; however, to avoid hardship to borrowers, a beginning may be made with the 1st Method, placing all borrowers in this method within a period of about one year, and the ideal of the 3rd Method may be reached in stages. The liberal approach under the 1st Method has been suggested as the first step, particularly to facilitate financial structuring of new companies, setting up projects in backward areas and also for flexibility in restructuring of existing companies with a weak financial base (Paragraphs 6.10 and 6.12).

23. The aim should be to move forward and borrowers in the third or second category should not revert to the second or first category respectively by increasing their dependence on bank borrowings. Also, when credit needs increase, the borrower should not slip back from a higher to a lower category (Paragraph 6.12).

24. Banks will work out the position of existing customers and any excess over the finance, to which a borrower would be eligible under the new formula, will have to be reduced progressively, by transferring the excess to a term loan, amortised over a suitable period (Paragraph 6.13).

25. The concept of bank credit forming only a portion of the working capital gap could also be used as an instrument for influencing the directional flow of credit, according to the priorities for industries indicated by the authorities concerned from time to time by varying the scales of finance. Also, when a manufacturer has reached a stable level of production for a reasonable number of years, there is no reason why bank finance should continue to be made available to him on the same scale, because if a portion of the finance made available to him could be withdrawn, such funds would be available for promotion of new economic activity (Paragraph 6.14).

26. In future, while funding new projects, the term lending institutions may provide for margins on the basis of recommended proposals and the bank which is to finance the working capital requirements should be associated at this stage in determining the working capital and margin requirements. In the case of old units, where a part of the present cash credit borrowing is transferred to a term loan, to bring the borrowings in line with the recommended proposals, the funded debt and equity relationship may not immediately conform to the norms of the term lending institutions. In these cases, borrowers may have to be given time to bring the position to normal, but the total outside liabilities to owned funds relationship will have to be acceptable to the banks (Paragraphs 6.15 and 6.16).

27. A request for additional credit on a regular basis from a borrower who already has an excess borrowing under any of the three methods may be considered provided the borrower brings in matching contribution required under the relevant method of lending. In very exceptional cases, however, if the cash generating capacity of the borrower is sufficiently good, banks may grant a term loan for the purpose to a reasonable extent for a short period acceptable to the bank. If, however, the additional fund need is for a short duration for specific transactions/contracts, the bank may consider giving additional credit for such needs without insisting on matching contribution, on the clear understanding that the borrower would return to the

stage as in the relevant method of lending within the stipulated period. Borrowers having excess borrowing in relation to inventory norms will not be eligible for additional limits on a regular basis until such time as the current assets are brought down to the required levels (Paragraphs 6.17 and 6.18).

28. The annual credit limit may be bifurcated into a loan, which would comprise the minimum level of borrowing throughout the year, and a demand cash credit, which would take care of the fluctuating requirements, both to be reviewed annually. There should, however, be no rigidity in the matter of bifurcation of the overall credit limit between loan and cash credit (Paragraphs 6.22, 6.23 and 7.1).

29. In the case of industries with a very high degree of seasonality, assessment of bank finance may have to be done on the basis of monthly cash budgets (Paragraph 6.24).

30. The demand cash credit should be charged a slightly higher interest rate than the loan component. This approach will give the borrower an incentive for good planning. The term loan representing the excess borrowing to be amortised should also be at a slightly higher rate than the cash credit rate (Paragraph 6.25).

31. In order to ensure that customers do not use the new cash credit facility in an unplanned manner, the financing should be placed on a quarterly budgeting-reporting system for operational purposes, as in the suggested forms (Paragraphs 6.26 and 6.27).

32. The borrowers expressed concern about the secrecy and sensitiveness of the information proposed to be called for from them. Banks are expected to take due notice of their apprehension (Paragraph 6.29).

33. Apart from loan and cash credit, a part of the total credit requirement, within the overall eligibility could also be provided by way of bill limits to finance seller's receivables. It is desirable that, as far as possible, receivables should be financed by way of bills rather than cash credit against book debts. As regards the question whether purchases may be financed by way of cash credit or bills, each bank may take its own decision in consultation with the borrower, keeping in view the size of his operations, the individual transaction and the administrative set up obtaining in the bank (Paragraphs 6.30 and 6.31).

34. The proposed system of lending and the style of credit may be extend-

ed to all borrowers having credit limits in excess of Rs. 10 lakhs from the banking system, while the information system may be introduced, to start with, in respect of borrowers with limits of Rs. 1 crore and above from the entire banking system and then extended progressively to others (Paragraph 6.32).

35. The mechanics of lending suggested covers examination of the borrower's total operational plan as also his past and current financial position. The borrower should, therefore, furnish to the banker an operating statement and funds flow statement for the whole year (i.e. the next year) as also projected balance sheet as at the end of the next year, along with the application for advance or renewal, for fixation of the overall credit limit (Paragraph 7.1).

36. The working capital gap will be computed, the extent of bank finance will be arrived at and the overall credit limit will be fixed, on the basis indicated in Chapter 6 (Paragraph 7.1).

37. Actual drawings within the sanctioned limit will be determined by the customer's inflow and outflow of funds as reflected in the quarterly funds flow statement and the permissible level of drawing will be the level as at the end of the previous quarter plus or minus the deficit or surplus shown in the funds flow statement (Paragraph 7.1).

38. Within the overall permissible level of drawing, the day-to-day operations in the account will be regulated on the basis of drawing power (subject to the margins stipulated by the banker against the different components of inventory and receivables), as per the monthly stock statements, which will continue to be submitted (Paragraph 7.1).

39. Variances are bound to arise in any budget or plan; variances to the extent of say $\pm$ 10 per cent should be permissible, and beyond this, the banker and customer should discuss the reasons (Paragraph 7.1).

40. The recommendations regarding inventory/receivables norms and the mechanics of lending are to be viewed as a package; it is an integrated scheme and the borrower is expected to subject himself to the entire discipline envisaged (Paragraph 7.3).

41. A bank has to follow up and supervise the use of credit to verify first, whether the assumptions of lending in regard to borrower's operations continue to hold good and second, whether the end-use is according to the purpose for which the credit was given (Paragraph 8.1).

42. If the banker is to get away from security-oriented lending to production-related credit with security serving a subsidiary but necessary role, he will have to be in close touch with the borrower's operations. Since projected funds flow statement would form the basis for determining the line of credit, a banker would be justified in laying down a condition that any material change, say around 10 per cent of the figure projected earlier, would require his prior approval. Thus, the banker may stipulate certain minimum terms and conditions relating to matters having a material impact on the funds flow of the borrower (Paragraphs 8.4 to 8.6).

43. From the quarterly forms, the banker will verify whether the operational results conform to earlier expectations and whether there is any divergence reading as red signals; however, variance of, say around 10 per cent, may be treated as normal (Paragraph 8.8).

44. In addition to the quarterly data, the larger borrowers should submit a half-yearly proforma balance sheet and profit and loss account within two months of the end of the half-year (Paragraph 8.9).

45. In the new system, it is in the borrower's own interest that audited balance sheets are produced as early as possible, say, in three months, and he should take positive steps in this direction (Paragraph 8.10).

46. After the close of each year, detailed credit analysis should be done as in respect of new advances, when the banker will re-examine the terms and conditions and make necessary changes (Paragraph 8.11).

47. Stock statements will continue to be submitted but they need to be improved. The basis of valuation in the stock statements and the balance sheet should be uniform. The stocks should be reconciled in the stock statements, showing the opening and closing stocks, quantity-wise and value-wise (Paragraphs 8.12 and 8.13).

48. Stock inspection poses problems particularly in large industries. In such cases, there is no alternative to depending on financial follow-up. Where a banker feels, for special reasons, that a detailed stock verification is called for, a regular stock audit may have to be arranged with the asssistance of outside consultants (Paragraph 8.15).

49. Managerial competence is an important factor in the efficiency of operations, reflected in profitability and working capital and financial management. Banker should keep in mind that appraisal of management may be

essential particularly as we place a new emphasis on viability and development rather than on security alone (Paragraph 8.17).

50. To facilitate inter-firm and industry-wise comparisons for assessing efficiency, it would be of advantage if companies in the same industry could be grouped under three or four categories, say, according to size of sales and the group-wise financial ratios compiled by the Reserve Bank for furnishing to banks (Paragraph 8.18).

51. Industry organisations should also collect data from their members and publish whole-industry balance sheets, profit and loss accounts and relevant ratios (Paragraph 8.19).

52. In making inter-firm comparisons, besides examining financial and operating ratios, certain productivity ratios may also be examined to determine labour efficiency, capital efficiency and fixed assets efficiency (Paragraph 8.20).

53. For the purpose of better control, there should be a system of borrower classification in each bank. This will facilitate easy identification of the borrowers whose affairs require to be watched with more than ordinary care and will also provide a rational base for purposes of fixing rates of interest for the respective borrowers (Paragraph 8.22).

54. The only feasible manner in which the banker can satisfy himself in regard to end-use of funds would be to ensure, by calling for appropriate operational data and figures relating to financial position at periodical intervals, that the borrower's current ratio and the respective shares of bank finance and borrower's long term funds in meeting his working capital gap do not change adversely; if the position in this regard does not change adversely, the conclusion would be that bank finance has gone towards build-up of current assets (Paragraph 8.26).

55. Apart from the current ratio, the bank will look to the debt-equity ratio, which may be looked at as funded debt-equity relationship or total outside liabilities-equity relationship. It is not practicable to legislate absolute standards for these ratios. Where the debt-equity ratios of a borrower are worse than the median for his industry, the banker would endeavour to persuade the borrower to strengthen his equity as early as possible and the latter should pursue to reach the median on the basis of the data up-dated by the Reserve Bank (Paragraphs 9.1 to 9.9).

56. The change-over recommended should be effected with a minimum of

inconvenience to the banker and the customer. Borrowers suggested that banks should reduce tiers and take quicker decisions. This is a matter for each bank to examine in relation to its own administrative systems and procedures and take appropriate action. There should be total commitment of the top management in each bank to the new approach. Extensive training facilities in credit appraisal should be provided for bank staff at all levels, with particular emphasis on the suggested information system and handling of inventory and receivables norms (Paragraphs 10.1 to 10.5).

57. A customer can no longer take a stand that having given security, there is no necessity for him to give any data to banks. There are rights and obligations on both sides. The banker as the lender is entitled to information which he deems necessary for his appraisal and follow-up and also has a duty in turn towards the borrower to appreciate his difficult situations. On the same basis, the customer should also develop an accountability to his banker (Paragraphs 11.2 to 11.4).

58. While financing trade, banks should keep in view, inter alia, the extent of owned funds of the borrower in relation to the credit limits granted, the annual turnover, possible diversion to other units or uses and how much is being ploughed back from profits into the business. They should avoid financing of goods which have already been obtained on credit (Paragraph 12.2).

59. It will be useful if Government authorities like the Textile Commissioner or Jute Commissioner consult the Reserve Bank before prescribing stock levels for the industries concerned to the extent these may cut across the relative norms for inventory holding (Paragraph 12.4).

60. In view of the need for efficient transportation and availability of wagons, railways should assume some liability for undue delays as a part of their own discipline, as they do for damages in transit at railway risk (Paragraph 12.5).

61. The canalising agencies and public sector producers may review, from time to time, their distribution procedures so as to prevent unproductive lock-up of bank funds (Paragraphs 12.6 and 12.7).

62. Government and the public sector are the biggest buyers in the country and tardy payments by them will only increase the level of receivables and, consequently, the need for bank credit. Government departments have already been following the accepted commercial practices in respect of their purchases from foreign suppliers but not in respect of their internal pur-

chases. It will be useful if the Reserve Bank could initiate discussions on this matter. Further, Government should, pending streamlining its procedures, agree to pay interest on established delayed payments (Paragraph 12.8).

63. The possibility of switching over from credit sales to cash sales, wherever possible, both in the private and the public sectors, should be examined, or at least credit period allowed by sellers should be progressively reduced, in order to shorten the transaction cycle and enable bank funds to achieve a larger multiplier (Paragraph 12.9).

64. In the case of consortium advances or where a borrower is financed by more than one bank, the concerned banks should evolve a procedure to ensure a uniform handling of the account in conformity with the inventory and receivables norms and the financial discipline suggested (Paragraph 12.10).

65. If a borrower refuses to comply with the new requirements, there will be no alternative to the banker but to take first a holding action by raising the rate of interest until such time as the requirements are fulfilled; but if this fails, the banker will have no option but to stop operations in the account (Paragraphs 12.11 and 12.12).

66. Once danger signals are thrown up in the case of a borrower and signs of difficulty emerge, speedy action is called for on the part of the banker and timely and firm handling are of essence. In such cases, the banker may intervene even in management, if that is necessary, in the interests of all concerned and the public. To diagnose the ailment, the banker can go to a consultant and can then arrange for action, including a financial or structural reorganisation (Paragraphs 12.13 to 12.17).

67. The Indian Banks' Association has an important role to play in a study of the environment and particularly the impact of regulations and enactments on the working of banks (Paragraph 12.18).

68. Expertise has to be built up in the banking system in organising industry-wise studies, on an on-going basis, which should serve as a frame of reference for decision-making in regard to individual cases (Paragraph 12.19).

69. Instead of every bank attempting to make detailed studies of all the major industries it would be beneficial if some selected banks concentrate on one or two industries each, for which they may be best fitted to study; the

results of their study could be made available to the other banks as also the Reserve Bank (Paragraph 12.20).

70. It is opportune to examine whether the limits for the credit authorisation requirements of the Reserve Bank should not be raised, in view of the altered value of the rupee since the introduction of the Credit Authorisation Scheme and the qualitative improvement in the lending skills of commercial banks (Paragraph 12.22).

71. Inventory/receivables norms should be given effect to immediately, while action should be initiated to implement the new approach to lending within the time-bound schedule as proposed in Chapter 6 (Paragraph 13.2).

72. Steps should be taken simultaneously to introduce the suggested information system for all industrial borrowers with limits aggregating Rs. 1 crore and above from the banking system and the process completed within six months (Paragraph 13.3).

73. Banks should utilise this transitory period of six months for conducting training sessions for their operating officials (Paragraph 13.3).

74. Special courses should be organised by the National Institute of Bank Management and the Bankers Training College for training the banks' operating officials. These institutions may also help banks in training the trainers, preparing operational manuals, and in bringing about changes in their systems and procedures (Paragraph 13.4).

75. Each bank should conduct banker-borrower seminars to create an understanding between the operating officials in the respective banks and their customers (Paragraph 13.5).

76. After six months, a bankers' seminar may be convened in the Bankers Training College where operating officials can find solutions to any operational problems that might have been thrown up in the interim (Paragraph 13.5).

77. The prime contribution of the Committee of Direction appointed by the Reserve Bank will be to take forward the work of the Study Group to a

continuing function of a dialogue with industry and banks to ensure smooth running of the new system and to take care of the need for any revision (Paragraph 13.6).

Prakash Tandon

Chairman

S. K. Bhattacharyya	P. P. Dhir
A. Ghosh	T. S. Kannan
R. C. Maheshwari	P. B. Medhora
P. K. Nanda	N. C. B. Nath
S. Padmanabhan	N. Rajan
Sampat P. Singh	Y. V. Sivaramakrishnayya

A. K. Bhuchar

Member-Secretary

BOMBAY

August 9, 1975.

ANNEXURES

I

ANNEXURE

LIST OF QUESTIONS

1. What are the broad categories of principal raw materials required by your unit and what are the main products manufactured by it?

2. What are the key considerations that shape management decisions relating to inventory in an industrial organisation and your unit in particular?

3. What are the main variables affecting inventory levels (raw materials, stocks-in-process, finished goods and consumable stores) in your industry and your unit in particular?

4. What are the usual levels of inventories [under various categories, expressed in terms of number of days'/months' consumption (raw materials and stores)/production (stocks-in-process)/sales (finished goods)] for your industry and your unit in particular, the basis on which they have been determined and the circumstances under which there are departures from the usual levels?

5. What do you consider to be the criteria for determining safe minimum levels of the different categories of inventories for your industry/unit? If the minimum levels of inventory are governed by seasonal factors, please indicate the minimum safe levels that will have to be maintained during the different periods of the year (expressed in terms of the number of days'/months' consumption/production/sales).

6. What is the cycle of production in your industry/unit? If you are manufacturing more than one item, the cycles for the major items may be indicated, together with the relative importance (in percentages) of those items in the total production. What is the relationship between your cycle of production and your holding of raw materials?

7. What is the procurement system and the nature of inventory control in your industry/unit and what improvements can be made therein?

8. What are the methods of carrying inventories? Is there a practice of letting others carry stocks on behalf of your industry/unit on payment of interest/commission etc.? What is the proportion of inventories carried by others for you?

9. How to achieve smoother production without abnormal inventory build up? What are your specific problems in inventory management, but for which, perhaps, you could have carried on with much lower levels of inventories? In particular, what are your suggestions for improving the methods of supplying materials by agencies such as MMTC, STC, SAIL, etc. and obtaining imports?

10. What is the usual credit given by your suppliers?

11. What portion of your sales is on credit basis? What is the period of credit allowed by you or the general trade practice in your industry in this regard? How are the credit sales financed?

12. What is the system of receivables management in your unit and what are the specific problems faced in this regard?

13. Is there a system of forecasting production/business plan for your unit? If so, on what basis and at what intervals it is drawn up? How is the business plan correlated with the financial arrangements? A specimen set of the forms used for the purpose by the unit may please be furnished?

14. What are the various sources from which your industry/unit meets its working capital finance and the relative shares of these sources? The difficulties, if any, experienced and suggestions for improvement in the pattern of financing may be given.

15. What are your views on replacing the cash credit/overdraft system of financing working capital by banks by a mix of fixed loans, bills and cash credit?

16. What should, in your opinion, be a suitable credit policy for financing inventories by banks?

II

ANNEXURE

NAMES OF PARTIES WHO MET THE STUDY GROUP/SUB-GROUPS

Chambers of Commerce and Industry

1. Andhra Chamber of Commerce and Industry, Hyderabad.
2. Bengal Chamber of Commerce and Industry, Calcutta.
3. Bengal National Chamber of Commerce and Industry, Calcutta.
4. Bharat Chamber of Commerce, Calcutta.
5. Bihar Chamber of Commerce and Industry, Patna.
6. Bombay Chamber of Commerce and Industry, Bombay.
7. Federation of Andhra Pradesh Chambers of Commerce and Industry, Hyderabad.
8. Federation of Indian Chambers of Commerce and Industry, New Delhi.
9. Gujarat Chamber of Commerce and Industry, Ahmedabad.
10. Indian Chamber of Commerce, Calcutta.
11. Indian Chamber of Commerce, Cochin.
12. Indian Merchants Chamber, Bombay.
13. Maharashtra Chamber of Commerce, Bombay.
14. Punjab Haryana and Delhi Chamber of Commerce and Industry, New Delhi.
15. South Indian Chamber of Commerce, Madras.

Industry Associations

1. Ahmedabad Mill Owners' Association, Ahmedabad.
2. All India Manufacturers' Organisation, Bombay.
3. All India Rubber Industries Association, Bombay.
4. Association of Indian Engineering Industry, Calcutta.
5. Federation of Co-operative Sugar Factories, New Delhi.

6. Fertiliser Association of India, New Delhi.
7. Indian Cotton Mills' Federation, Bombay.
8. Indian Electrical Manufacturers' Association, Bombay.
9. Indian Jute Mills' Association, Calcutta.
10. Indian Paper Mills' Association, Calcutta.
11. Indian Sugar Mills' Association, New Delhi.
12. Indian Tobacco Association, Guntur.
13. Mill Owners' Association, Bombay.
14. Organisation of Pharmaceutical Producers of India, Bombay.
15. Silk and Art Silk Mills' Association, Bombay.
16. Vanaspati Manufacturers' Association of India, Bombay.

MANAGEMENT INSTITUTE

National Institute of Bank Management, Bombay.

BANKERS' ASSOCIATION

Indian Banks' Association, Bombay.

INDIVIDUALS

1.	Shri Praful Anubhai	Rustom Jehangir Vakil Mills Ltd.
2.	Shri A. M. M. Arunachalam	Tube Investment of India Ltd.
3.	Shri C. Balakrishnan	Associated Chambers of Commerce and Industry of India.
4.	Shri T. V. Balan	Associated Cement Companies Ltd.
5.	Shri M. G. Balasubramanian	Department of Banking, Government of India.
6.	Shri N. Balasubramanyam	Coromandel Fertilizers Ltd.
7.	Shri S. C. Banatwala	Glaxo Laboratories (I) Ltd.
8.	Dr. A. K. Banerjee	Unit Trust of India.
9.	Shri Brij Berry	Vazir Sultan Tobacco Co. Ltd.
10.	Shri R. M. Bhandari	Controller of Capital Issues, Government of India.

11.	Shri N. S. Bhat	Associated Chambers of Commerce and Industry of India.
12.	Shri M. V. Bhatt	Hindustan Construction Co. Ltd.
13.	Dr. H. C. Bhatt	Unit Trust of India.
14.	Shri S. K. Birla	Kesoram Industries Ltd.
15.	Mr. C. J. T. Blease	Dunlop India Ltd.
16.	Mr. M. V. Bourcier	Mettur Beardsell Ltd.
17.	Shri S. P. Chandavarkar	Union Bank of India.
18.	Shri Asit Chandmal	Tata Engineering & Locomotive Co. Ltd.
19.	Shri D. K. Chakravorty	Bureau of Public Enterprises, Government of India.
20.	Shri V. V. Chari	Industrial Development Bank of India.
21.	Dr. A. C. Chatrapati	Vanaspati Manufacturers' Association of India.
22.	Shri A. Nagappa Chettiar	India Leather Corporation.
23.	Shri R. N. Chopra	Hoechst Pharmaceuticals Ltd.
24.	Shri M. G. Damani	Simplex Mills Ltd.
25.	Dr. S. A. Dave	Industrial Development Bank of India.
26.	Dr. R. Dhar	National Institute of Bank Management
27.	Shri O. P. Dhir	Engineering Construction Corporation Ltd.
28.	Shri Arun Desai	Hindustan Lever Ltd.
29.	Shri S. V. Desai	Amar Dye Chem Ltd.
30.	Shri C. K. Doraivelan	Leather Export Promotion Council.
31.	Shri D. Y. Gaitonde	Century Enka Ltd.
32.	Shri S. K. Ghosh	Bird & Co. (P) Ltd.
33.	Shri D. P. Goenka	Octavius Steel Co. Ltd.
34.	Shri R. A. Gulmohamed	Dena Bank.
35.	Shri I. K. Gupta	Indian Telephone Industries Ltd.

36.	Shri R. S. Gupta	Fertiliser Corporation of India.
37.	Shri P. P. S. Hariprasad	Madras Fertilisers Ltd.
38.	Shri C. K. Hazari	Escorts Ltd.
39.	Shri N. L. Hingorani	National Institute of Bank Management.
40.	Shri S. H. Jain	Bharat Heavy Electricals Ltd.
41.	Shri M. N. Kale	Industrial Development Bank of India.
42.	Shri M. V. Kamath	Tube Investment of India Ltd.
43.	Shri Shrenik Kasturbhai	Arvind Mills Ltd.
44.	Shri A. M. Khadiresan	Indian Overseas Bank.
45.	Shri C. D. Khanna	Industrial Finance Corporation of India Ltd.
46.	Shri O. M. Khosla	Electric Construction and Equipment Co. Ltd.
47.	Shri D. C. Kothari	Kothari (Madras) Ltd.
48.	Shri S. Kumarasundaram	Industrial Credit and Investment Corporation of India Ltd.
49.	Shri I. Malhotra	Madura Coats Ltd.
50.	Shri K.M. Mammen Mapillai	Madras Rubber Factory Ltd.
51.	Shri Paul Mampilly	Indian Institute of Management, Ahmedabad.
52.	Shri C. V. Mariwala	Vanaspati Manufacturers' Association of India.
53.	Dr. N. C. Mehta	National Institute of Bank Management.
54.	Shri S. S. Mehta	Industrial Credit and Investment Corporation of India Ltd.
55.	Shri J. P. Mishra	Orient Paper Mills Ltd.
56.	Shri Mohd. Fazal	Engineering Projects (I) Ltd.
57.	Shri A. R. Motafram	Merck Sharp & Dohme of India Ltd.
58.	Prof. V. L. Mote	Indian Institute of Management, Ahmedabad.

59.	Shri R. Monani	I.T.C. Ltd.
60.	Dr. Shishir K. Mukherjee	Indian Institute of Management, Ahmedabad.
61.	Shri S. A. Muraliprasad	India Cements Ltd.
62.	Shri M. Narasimham	Ministry of Finance, Government of India.
63.	Shri R. Narasimhan	Southern Petrochemical Industries Corporation Ltd.
64.	Shri N. S. L. Narasimhan	Organisation of Pharmaceutical Producers of India.
65.	Shri V. L. Narayan	Guindy Industrial Estates Association.
66.	Shri K. S. Narayanan	India Cements Ltd.
67.	Shri S. Narayanaswamy	South Indian Chamber of Commerce.
68.	Shri H. N. Parekh	National Rayon Corporation Ltd.
69.	Shri H. T. Parekh	Industrial Credit and Investment Corporation of India Ltd.
70.	Shri A. D. Parpia	Southern Region Export Promotion Council for Finished Leather.
71.	Shri Baldev Pasricha	Industrial Finance Corporation of India Ltd.
72.	Shri B. G. N. Patel	Larsen & Toubro Ltd.
73.	Shri S. K. Patel	Mafatlal Fine Spg. & Wvg. Mills Ltd.
74.	Shri S. V. S. Raghavan	Bharat Heavy Electricals Ltd.
75.	Shri W. S. Rajadhyaksha	Ceat Tyres of India Ltd.
76.	Shri S. Ramachandran	Minerals and Metals Trading Corporation of India Ltd.
77.	Shri R. Ramanujam	T.V.S. Group.
78.	Shri V. V. Ramachandra Rao	Indian Tobacco Association.
79.	Shri C. S. S. Rao	Indian Telephone Industries Ltd.
80.	Shri C. S. Venkat Rao	Industrial Development Bank of India.
81.	Shri R. N. Ratnam	E.I.D. Parry Ltd.

82.	Shri S. K. Sadasivan	Southern Petrochemical Industries Corporation Ltd.
83.	Shri T. S. Santhanam	T.V.S. Group.
84.	Shri G. V. Seshagir	Glaxo Laboratories (I) Ltd.
85.	Shri D. S. Seth	Tata Chemicals Ltd.
86.	Shri C. C. Shah	Pfizer Ltd.
87.	Shri Viren J. Shah	Mukund Iron & Steel Works Ltd.
88.	Shri D. Sharma	Industrial Development Bank of India.
89.	Shri P. Bhoja Shetty	Shibsha Instruments (I) Pvt. Ltd.
90.	Shri M. L. Shrikant	Mukund Iron & Steel Works Ltd.
91.	Shri D. N. Shukla	Bank of India.
92.	Shri S. S. Shukla	State Trading Corporation of India.
93.	Shri Jagjit Singh	Indian Drugs and Pharmaceuticals Ltd.
94.	Shri B. H. Singhania	Indian Jute Mills Association.
95.	Shri B. K. Sircar	Industrial Development Bank of India.
96.	Shri N. A. Soonawala	Tata Consultancy Services.
97.	Shri N. T. Srinivasan	Bharat Heavy Electricals Ltd.
98.	Shri S. Srinivasan	Southern Petrochemical Industries Corporation Ltd.
99.	Shri K. R. Srivastava	Southern Petrochemical Industries Corporation Ltd.
100.	Shri A. Subramanian	Leather Export Promotion Council.
101.	Shri R. K. Talwar	State Bank of India.
102.	Shri D. V. Taneja	Central Bank of India.
103.	Shri K. N. Taneja	Sarabhai M. Chemicals Pvt. Ltd.
104.	Shri V. D. Thakkar	Bank of Baroda.
105.	Shri N. H. Thanawalla	Mafatlal Fine Spg. & Mfg. Co. Ltd.
106.	Shri T. N. C. Veeraraghavan	Bharat Heavy Electricals Ltd.
107.	Shri A. Venugopal	Binny Ltd.
108.	Shri R. L. N. Vijayanagar	Mill Owners' Association

109.	Shri S. Vijji	T.V.S. Group.
110.	Shri M. P. Wadhwan	Steel Authority of India Ltd.
111.	Shri T. Abdul Wahid	M/s. Abdul Wahid & Co.
112.	Mr. P. D. Whiteley	Binny Ltd.

BANKERS WHO ASSISTED THE STUDY GROUP/
SUB-GROUPS IN CERTAIN SPECIFIC MATTERS

1.	Shri S. P. Sen Gupta	State Bank of India.
2.	Shri N. R. Kulkarni	State Bank of India.
3.	Shri R. Viswanathan	State Bank of India.
4.	Shri T. V. Sunder Rajan	Punjab National Bank.
5.	Shri A. B. Telang	Punjab National Bank.

NAMES OF PARTIES WHICH WERE INVITED BUT DID NOT RESPOND

1. Assam Chamber of Commerce & Industry, Shillong.
2. Association of Man-Made Fibre Industry, Bombay.
3. Cochin Chamber of Commerce & Industry, Cochin.
4. Federation of Karnataka Chamber of Commerce and Industry, Bangalore.
5. Goa Chamber of Commerce & Industry, Goa.
6. Leather Goods Manufacturers and Dealers Association, Bombay.
7. Man-made Fibre Spinners' Association, Bombay.
8. Madhya Pradesh Chamber of Commerce & Industry, Gwalior.
9. Nag-Vidarbha Chamber of Commerce, Nagpur.
10. Orissa Chamber of Commerce & Industry, Cuttack.
11. Rajasthan Chamber of Commerce & Industry, Jaipur.
12. Upper India Chamber of Commerce & Merchants' Units of Uttar Pradesh, Kanpur.

III

ANNEXURE

INTERIM REPORT ON INVENTORY NORMS

BACKGROUND

1. For examining the issues involved, the Study Group set up two Sub-Committees. One Sub-Committee examined industry-wise requirements of inventory while the other looked into the banker's approach to short term financing of industry. Both Sub-Committees met a representative cross-section of leaders of industry, industrial organisations as well as several professionals. Data placed before us by certain industries, committee members and the Study Group's Secretariat have also been examined.

COMPONENTS OF INVENTORY

2. Inventory could be in three parts:

(a) Minimum level of inventory in plant based on technical requirements.

(b) Additional inventory for strategic reasons to maintain uninterrupted cycle of production and sales.

(c) Excess inventory either for reasons of stock profit or conservative policy or inefficient management.

NORMS

3. The minimum level of inventory in plant depends on technological requirements and norms could be thought of in this area. Inventory for strategic reasons also could conform to norms. Inventory in excess of these requirements will have to be considered excessive.

4. The case for norms is fairly clear. To the extent that some units have access to more resources than others, imbalance develops in the system. As current assets are largely supported by bank finance, distortions in allocation of bank credit can also arise. Norms of inventory holding for major industries would ensure more equitable distribution of resources and, therefore, better allocation of credit for production.

DIFFICULTIES ENCOUNTERED

5. However, our examination and discussions reveal certain problem areas in establishing norms. These are as under:

(a) Certain industries such as Heavy Engineering do not have a sufficiently large sample for deriving conclusions.

(b) Geographical diversity results in diversified needs.

(c) Product-mix of units in several industries differ materially.

(d) Inadequacies in areas such as transportation systems, licensing for imports and purchase and selling trade channels result in wide swings in inventory levels.

(e) Bunching of canalised and imported supplies also cause distortions in inventory levels.

6. In view of these factors, establishment of norms requires considerable study at the unit level and assembling and analysis of data. The time at our disposal was too short to undertake such detailed staff work. Even industrial representatives who were expected to furnish meaningful data, could not do so. In some instances, industry representatives were not in a position even to give general guidelines on the factors having a bearing on inventory levels in their industry.

STUDY GROUP'S VIEWS

7. Under these circumstances, the members feel that in-depth studies should be undertaken industry-wise and that we should approach some consultants to discuss the methodology of this study. We would, therefore, like to defer our recommendations on norms until completion of these studies. It is, however, understood that Reserve Bank of India will still like to have our preliminary views on the basis of the data we have collected and the discussions we have had with industry representatives so far. We are, accordingly, attaching a statement suggesting certain general guidelines industry-wise. We would stress that these guidelines are based on a study of the limited material available to us and should be viewed more as flexible guidelines than as rigid norms. Variations would be permissible under the following circumstances:

(a) Bunched receipts of raw materials.

(b) Power cut, strikes and other unavoidable interruptions in the process of production.

(c) Transport bottlenecks.

(d) Accumulations of finished goods due to non-availability of shipping space for exports or other disruptions in sales.

(e) Build-up of stocks of finished goods such as machinery, due to failure on the part of purchasers—for whom these were specifically manufactured—to take delivery.

(f) Necessity to cover full requirements of raw materials for specific export contracts of short duration.

SUGGESTED NORMS

8. A statement is attached suggesting norms of inventories and receivables for the following industries:

(a) Cotton textiles

(b) Synthetic textiles

(c) Jute textiles

(d) Pharmaceuticals

(e) Rubber products

(f) Fertilisers

(g) Vanaspati

(h) Paper

(i) Light engineering

(j) Medium engineering

9. It will be noted that stocks-in-process and stores have been left out. This is because of the wide divergence between unit and unit. It can be left to the banker to ascertain the actual process time and stores requirements for each borrowing unit, which should not be difficult.

10. Heavy engineering has been left out. This industry covers heavy structurals and heavy machine building units which are not many in number. The requirements of this sector cannot be generalised. The banker will have to examine each case separately on merits taking into account the extent of financing the unit has to do at various stages of production, the availability of advances, 'on account' payments, clients' raw material, etc. One interesting observation which has been made in this context is that the Heavy Engineering units' tie-up in the net current assets (inventories plus receivables minus advances received and creditors for purchases) should

not normally exceed 50 per cent of value of annual production. This will be examined further by us.

11. We have also not dealt with the sugar industry. The norms being suggested by us are for holding of inventory by each industry. Sugar industry being entirely seasonal, the stocks of sugar—which is the main item of inventory—will be determined entirely by the availability of cane on the one hand and Government's release policy on the other. Therefore, no norms need be suggested for this industry.

12. Raw material levels have been expressed as so many months' consumption of raw materials required to support planned operations in the ensuing year. Finished goods and receivables are expressed in terms of so many months' sales.

Application of Norms

13. The norms represent reasonable levels of holding of inventory and receivables in each industry. In assessing working capital requirements, the banker will take these levels as what should reasonably be held by the borrower concerned. If any borrower were to hold higher levels of inventory, the banker would assume that the excess inventory should be off-loaded, except where circumstances warrant otherwise for special reasons; excess receivables will also be realised.

14. In dealing with fresh requests for advances or for enhancements in limits, the banker should ask for the relative data in the usual manner. While computing current asset levels, the suggested norms will be taken as the maximum levels (subject to flexibility as indicated) and the gap in resources to be financed by bank borrowings worked out.

15. As for existing accounts where no enhancements in limits are required, our expectation is that the banker will examine the existing levels of inventory and receivables and seek a reduction in the levels where they are excessive. To the extent that inventory and receivables levels could be brought down, the outstanding dues to the bank should also go down.

16. Our suggestion is that existing borrowers should be asked to furnish the following additional data along with their stock statements:

	Last month	Current month	Projected for current year
Sales			
Production			
Consumption of raw materials			

17. Where the stock statements represent only a part of the total stocks of the borrower, a summary of the total stocks (inclusive of stocks not shown in the stock statement) should be called for along with the stock statement, classified into raw materials, stocks-in-process, finished goods, stores and spares and book debts including bills discounted.

18. The banker should examine the existing stock position and level of receivables in relation to the norms on receipt of the next stock statement. Where the current assets are excessive, the matter will be taken up with the borrower. A dialogue should be established with the borrower and a programme for phased reduction in levels worked out; meanwhile the operations in the borrowers' accounts may not be stopped. The position will be watched in the next stock statement and we would expect the process of adjustment to be completed in about two months. Where, asset levels continue to be high at the end of two months, our suggestion is that the banker may charge a rate of interest higher by 2 per cent on that part of the borrowings which would be considered excessive. The excess borrowings will be the value of excess stocks/receivables carried by the borrower on the reasoning that had the asset levels been brought down—other fund-flows remaining unaffected—borrowings from the bank would have gone down to that extent.

It should be reiterated that the objective is to introduce a discipline and improvement in the use of working capital, especially in the maintenance of reasonable inventory levels consistent with encouragement of production and maintenance of usual working relationship between banker and customer.

19. As we have provided for different contingencies in which relaxations would be permitted, there is room for sufficient flexibility in operating the norms.

Conclusion

20. As mentioned earlier, our intention is to proceed with further studies industry-wise and the norms suggested by us are only an interim measure. We expect to get valuable feed-back from industry and banks in the next few months on the application of these norms. This will assist us in finalising our views.

21. We have examined whether the norms should be applied to all industrial borrowers. While this could be left to the bankers to decide, our own view is that, to start with, norms could be applied to large industrial borrowers with aggregate limits in excess of Rs. 10 lakhs and extended to even smaller borrowers as early as possible.

A Word About Cotton and Jute Textile Industries

22. Although these are seasonal, we have not provided for higher stock levels for the season. This is on the reasoning that it is not the function of industry to carry stocks in excess of what is required for current operations, as otherwise, industry will be taking over the functions of the trader. We are also not taking into account the need or otherwise of price-support operations and buffer stock operations. We presume that the Reserve Bank would take into account these factors and decide how and by whom the marketed stocks of raw cotton and jute should be financed.

23. In regard to the textile industry in particular, while we have adopted the norms stipulated by the Textile Commissioner, we have not included the exemptions given by him. On what grounds the Textile Commissioner has provided for exemptions is not clear. Here again, we would leave it to the Reserve Bank of India to decide whether these exemptions should also be extended.

General

24. Norms have been suggested by us only for some of the major industries. As regards industries not covered by norms, we would expect the banks to observe the purpose and spirit behind the norms while dealing with their proposals. It is also needless for us to stress that the banks should be on their guard against any attempts to defeat the purpose of the norms in one way or the other as, for example, by over-estimation of production or undervaluation/understatement of stocks.

Bombay, 26th October, 1974.

SUGGESTED INVENTORY NORMS

	Raw materials (1)	Finished goods (2)	Receivables and inland bill discounts (exclusive of foreign bill discounts) (3)
1. Cotton textiles ..	1½ (Bombay & Ahmedabad areas)	2	
	2½ (Eastern areas-Bihar, Orissa, West Bengal and Assam)		
	2 (other than the above)		
2. Synthetic textiles ..	1–1½	½ to 1	¼
3. Jute textiles ..	2–2½	1 (for domestic sales)	1
		1½ (for export)	
4. Pharmaceuticals ..	2–2½	2	1
5. Rubber products ..	2	½	½
6. *Fertilisers* :			
(*i*) For nitrogenous plants ..	½–¾ (near the refinery)	¾ (where stocks are in plant site)	½–1
	1–1½ (for inland units)	1½ (where stocks are also in upcountry centres)	
(*ii*) For phosphatic plants ..	2 (for units in port areas)	-do-	-do-
	3 (for inland units)		
7. Vanaspati ..	1	½	
8. *Paper* :			
(*i*) Bamboo and wood	4–8 (to be built up in stages from November to May and thereafter to be brought down)	(*i*) Controlled sales ¾	½
		(*ii*) Free sales ¼	-do-
(*ii*) Chemicals ..	2½		
9. Light engineering ..	3	2	
10. Medium engineering ..	3	-do-	

Note : 1. Raw materials are expressed as so many months' consumption.

2. Finished goods and receivables are expressed as so many months' sales. These figures represent only the average levels. Individual items of finished goods and receivables could be for different periods which could exceed the indicated norms so long as the overall average level of finished goods and receivables does not exceed the amounts as determined in terms of the norm.

IV

ANNEXURE

Telegrams:
"Reservbank"
Bombay.

RESERVE BANK OF INDIA
CENTRAL OFFICE

Post Box No.
1030

DEPARTMENT OF BANKING OPERATIONS AND DEVELOPMENT
BOMBAY-1

CONFIDENTIAL

Ref. DBOD. No. CAS. BC. 113/C.446-74

November 8, 1974
Kartika 17, 1896 (Saka)

To

All Scheduled Commercial Banks.

Dear Sirs,

Study Group to frame guidelines for follow-up of bank credit—Inventory norms for financing of industries by commercial banks.

Please refer to paragraph 9 of Governor's circular letter DBOD. No. Dir. BC. 109/C. 96-74 dated the 29th October 1974. We now enclose for your information and necessary action a copy of the interim note on inventory norms furnished to the Reserve Bank by the above Study Group. The Reserve Bank has accepted the tentative suggestions of the Group.

2. Norms have been suggested by the Group only for certain major industries. These norms are to be applied in respect of both the existing and new borrowers. All fresh proposals (including those from existing borrowers seeking enchanced credit facilities) may now be assessed in the light of the norms suggested by the Study Group. In the case of all existing borrowers (whether or not they have sought for enhancement in credit limits, if the levels of inventories and receivables are excessive on the basis of the suggested norms, a dialogue should be established with them and a pro-

gramme for a phased reduction therein worked out. In case the excess level persists without justification, while the banks may not abruptly stop operations in the borrower's accounts which may upset his normal functioning, they may, as suggested in paragraph 18 of the interim note of the Group, consider after a reasonable period, say about 2 months, whether they should charge a higher rate of interest on the portion of borrowings considered as excessive in the light of the norms suggested by the Group. To keep a watch in this regard, banks may call for additional information as suggested in paragraph 16 of the note. The control should, however, be exercised with due flexibility and understanding of the circumstances which may warrant deviation from the norms, for temporary periods, as mentioned in the Group's interim note.

3. As regards stocks-in-process and stores, etc., no norms have been suggested by the Group. In fixing credit limits, banks should, however, carefully ascertain the actual process time involved in the case of each borrowing unit and arrive at the value of the process stocks. As regards stores and spares, banks should normally finance consumable stores, the level of which should not be out of tune with the past trends.

4. Although norms have been suggested by the Group only for some of the major industries, it is expected that as regards other industries, banks would endeavour to observe the purpose and spirit behind the norms suggested in the note while appraising the relative credit proposals.

5. It may be clarified that the norms suggested by the Study Group will be subject to the Reserve Bank's selective credit control directives wherever applicable. Also, in respect of cotton and jute, the stock holding of which is regulated by the Textile Commissioner and Jute Commissioner respectively, while the actual maintenance of stocks by the borrower would be subject to the levels that may be indicated by the concerned authority, the credit limit extended by the bank should be broadly related to the norms suggested by the Study Group, unless otherwise specifically advised by us.

6. It should be noted that the norms suggested by the Group are at this stage in the nature of an experiment. The Group expects to get valuable feedback from industries and banks in the next few months on the application of these norms. The Group hopes that this feedback information will assist it in finalising its views when it submits its final report. We would, therefore, request the banks to submit a report to us furnishing comments, industry-wise, in regard to their experience in applying the norms, together with suggestions, if any, for improvement. In order to enable the Group to make its final recommendations expeditiously, it would be helpful if the

banks could arrange to send this report so as to reach us not later than the end of February 1975.

7. We may also mention that in view of the restrictions placed on the distribution of dividends by companies under the Companies (Temporary Restrictions on Dividends) Act, 1974, to the extent these provisions result in the retention of a larger share of profits within the business, the borrowing companies' dependence on outside borrowings would be reduced and this should result in reducing the demand for bank credit. Banks will no doubt keep this aspect in mind while assessing the credit needs of borrowers.

8. Please acknowledge receipt.

Yours faithfully,

Sd/-

(R. K. Hazari)
Deputy Governor.

V

ANNEXURE

INTERIM REPORT ON FOLLOW-UP OF BANK CREDIT

INTRODUCTION

1.1 One of the tasks of the Study Group is to suggest guidelines for commercial banks to follow-up and supervise credit from the point of view of ensuring proper end-use of funds and keeping a watch on the safety of the advances and to suggest the type of operational data and other information that may be obtained by banks periodically from borrowers.

1.2 In this context, the Group is attempting to suggest a new approach to appraisal and follow-up of bank credit with a view to gearing bank credit to the borrower's production plan and the anticipated gap in his resources for implementing the plan, and introducing a system of review of the performance of the borrowers at shorter intervals.

1.3 While the Group is examining the subject in detail and from different angles, and will suggest an integrated scheme in the main report, considering the importance of the subject, it has prepared this interim note and devised the enclosed forms in regard to the operational and financial data which may be obtained by banks from borrowers.

2. COVERAGE

2.1 The Group has considered the question of the coverage of the new follow-up scheme and has come to the conclusion that it is not feasible to introduce the proposed system immediately in respect of all or even larger accounts for the following reasons:

(a) Discussions amongst members and with the senior operating officials in some banks reveal that certain basic difficulties of the banking system will have to be reckoned with. The operating staff dealing with advances will require to be trained in administering the new system, if this has to be effective. There is also need for evolving suitable operating instructions to enable the staff to utilise the forms being recommended by the Group to the maximum benefit.

(b) There is need for understanding the concepts involved from the borrowers' side too. Used as they are to the long established practice of submitting stock statements and certain other minimal information, the borrowers may require some time to switch over to the more meaningful system the Group has in view.

(c) The Group's discussions have revealed some other problem areas in administering the new system as, for example, in dealing with multi-product and multi-locational companies.

(d) The organisational structure to administer credit differs from bank to bank, and the levels at which these forms will have to be received and examined vary widely. Procedures will have to be evolved in each bank to suit its requirements for proper implementation of the new system.

2.2 The Group, therefore, suggests that the appraisal and follow-up on the basis of the data proposed to be obtained in these forms may be tried out in the first instance on an experimental basis on certain selected borrowers. This would enable the Group to take care of any unforeseen problems which might be thrown up before finalising the forms for introduction on a wider scale.

2.3 While in the long run the data would form the basis for determining the credit needs and regulating the drawings, in the experimental stage the objective should be limited to testing the feasibility of obtaining and processing the data and identifying the problems that may arise both at the borrowers' and the bankers' levels in switching over to the new system. The system may be tried out on at least five to ten borrowers in each bank with deposits of Rs. 50 crores and above. The aim should also be to monitor the operation of this system in order to meet problems as and when they arise.

2.4 In designing forms for appraising bank credit and follow-up, the objective has been to obtain data which would ensure that the amount of credit requested is realistic in relation to the needs of business operations and is used for approved purposes. Consequently, having regard to the many variables in the current business environment, the Study Group has come to the conclusion that it will be more practicable to relate such needs to a period for which the borrowers' operational plans (in terms of production, sales, inventories, costs and profits) could be projected more precisely. The Group has, therefore, formulated its recommendations in terms of a scheme which requires the borrower to furnish detailed operational plans for a *quarter* rather than at longer intervals. This would also facilitate reviews of bank credit in relation to such short term projections. The proposed system provides for a self-disciplining mechanism for the borrower as he will have to furnish explanations for variations between projections and actuals for each quarter.

3. Suggested Forms

3.1 It is suggested that the following forms, which are a part of an integrated scheme for review of bank credit and follow-up, may be introduced at this stage, on an experimental basis:

Form I—Projected quarterly operational plan, and estimates of current assets and current liabilities.

Form II—Projected quarterly funds-flow

3.2 The two forms (I and II) should normally be sufficient for the purpose in view. However, there may be cases of difficult accounts calling for a closer monitoring. In such cases, it may be advisable also to call for cash flow statements with *monthly* projections. The form which may be used for the purpose (Form III) is also attached.

4. Implementation

4.1 The forms could be tried out by all banks with deposits of Rs. 50 crores and above. It would be worth-while to involve the major foreign banks also in this exercise.

4.2 As the intention is to test the forms on an experimental basis, banks could choose those borrowers who would earnestly co-operate. Incidentally, several in industry whom the Group has met thought that compiling such forms would be quite feasible. The expectation also is that, inasmuch as the exercise would lead to a better understanding on the part of the banker of the credit needs of the borrower, it would also help the latter in getting the necessary credit support and induce him to readily furnish the data to banks in the proposed forms.

4.3 In selecting customers, banks should aim at a coverage of different industries as also a good cross-section comprising the very large, large and medium-sized borrowers.

5. Preparatory Steps

Having regard to the importance of the matter, it is necessary to ensure that adequate preparatory steps are taken to ensure a smooth change over to the new system. The following suggestions are made in this regard:

(a) The Reserve Bank should conduct a seminar in the Bankers Training College at Bombay for briefing one official from each participating bank regarding the scope and content of the suggested forms and interpretation of the data reported therein.

(b) Five members of the Study Group could guide the deliberations of the proposed seminar.

(c) The participating banks may be asked to nominate an official, who would be charged with the responsibility of introducing the proposed system in the bank, to participate in the seminar.

(d) The officials concerned should thereafter brief, in the respective banks, the other officials who would be involved in the implementation of the scheme of bringing into use the new forms.

(e) The composition of the samples selected by the banks will also be discussed and depending upon the reaction, the exact number of accounts that each bank will test will also be decided.

6. Evaluation

The evaluation of the experience gained by banks in introducing the forms on a pilot basis in the case of the selected borrowers may be made in the last week of March or first week of April 1975. For this purpose, another seminar may be organised by the Reserve Bank of India in the Bankers Training College at two levels, viz., the senior management level and the operating level. The consensus arrived at the seminar will be a valuable feedback to the Study Group, which will be taken into account for the Group's final recommendations.

QUARTERLY OPERATING STATEMENT £

Form—I

(000's omitted)

	Actuals for previous accounting year (Whole year)+	Projections for current accounting year (Whole year)	Previous quarter ended			Current quarter ending	Next quarter ending	Subsequent quarter ending ......
			Budget	Actuals @	Variance	Actuals/‡‡ Estimate	Budget	Budget
Part—A	1	2	3	4	5	6	7	8
1. Sales								
2. *Less* Excise duty								
3. Net Sales (item 1 — item 2)								
4. Cost of Sales:—								
(a) Raw materials consumption								
(b) Power and fuel								
(c) Salaries and Wages								
(d) Consumable stores								
(e) Repairs and maintenance								
(f) Other manufacturing expenses								
(g) Depreciation								
Sub-Total								

QUARTERLY OPERATING STATEMENT £—*Contd.*

(000' omitted)

	Actuals for previous accounting year (Whole year)+	Projections for current accounting year (Whole year)	Previous quarter ended			Current quarter ending	Next quarter ending	Subsequent quarter ending ......
			Budget	Actuals @	Variance	Actuals/‡‡ Estimate	Budget	Budget
	1	2	3	4	5	6	7	8
Sub-Total:								
Add: Opening stocks-in-process and finished goods								
Sub-Total :								
Deduct : Closing stocks-in-process and finished goods								
Total cost of sales:								
5. Gross profit (item 3—item 4)								
6. Other overheads :								
(a) Interest								
(b) Selling, general and administrative expenses.								
7. Operating profit (item 5—item 6)								
8. Other income/expenses—Net (±)								
9. Profit before tax (item 7 + item 8)								

QUARTERLY OPERATING STATEMENT —£*Contd.*

(000's omitted)

	Previous quarter ended......			Current quarter ending	Next quarter ending	Subsequent quarter ending ......
	Budget	Actuals @	Variance	Actuals/‡‡ Estimate	Budget	Budget
Part—B	1	2	3	4	5	6
Current Assets						
I. Inventory						
(i) Raw materials*—Imported						
Indigenous						
(ii) Stocks-in-process**						
(iii) Finished goods***						
(iv) Consumable stores*						
II. Receivables*** (including bills discounted with bankers)++						
III. Advances to suppliers of raw materials and stores						
IV. Other current assets						
Total Current Assets						

QUARTERLY OPERATING STATEMENT £—*Contd.*

(000's omitted)

	Previous quarter ended......			Current quarter ending	Next quarter ending	Subsequent quarter ending ......
	Budget	Actuals @	Variance	Actuals/‡‡ Estimate	Budget	Budget
	1	2	3	4	5	6
Current Liabilities:—						
V. Short term bank borrowings (including bills discounted with bankers) @@ +++						
A						
B.						
C.						
VI. Creditors for purchases of raw materials and stores+++						
VII. Advances from Customers ..						
VIII. Accrued expenses						
IX. Statutory liabilities						
X. Other current liabilities						
Total current liabilities						

(i) Information in this form is to be furnished for each line of activity/unit separately as also for the company as a whole and where any particular line of activity/ unit is financed by more than one bank, the activity/unit-wise data and data relating to the whole company should be furnished to each financing bank.

@ (ii) Where estimates have been given under the head "actuals", reasons may be given.

‡‡ (iii) As the form has to be furnished during the current quarter, vide note below, the actuals would not be available for the whole quarter. For the period actuals are not available, estimates may be taken into account for arriving at the figure to be furnished in column 6 of Part A and column 4 of Part B.

(iv) In columns (1), (2), (4), (5) and (6) in Part B of the statement, also indicate, within brackets, under each figures (against item I (i), (ii), (iii), (iv) and (II), how many months' consumption */cost of production ** /sales *** the relative item represents in relation to the annual projected production/sales. Further, if the budgeted levels of inventory/receivables (columns 5 and 6 in Part B) are higher than the norms indicated by the bank, reasons may be given in an annexure.

@@ (v) Outstandings with different banks should be given separately.

+ (vi) In case audited balance sheet and profit and loss account for the previous accounting year are not available, estimated/provisional figures for the previous year may be furnished in column (1) and the figures for the preceding year based on audited balance sheet should be given in an additional column before column (1).

++ (vii) Amount of bills discounted with bankers, included in items II of Part B, should be indicated separately.

+++ (viii) Amount of bills discounted with bankers in respect of purchases, included in item V or item VI of Part B, should be indicated separately.

NOTE:—DATA IN THE FORMS SHOULD BE SUBMITTED AT LEAST ONE WEEK BEFORE THE COMMENCEMENT OF THE NEXT QUARTER.

QUARTERLY FUNDS FLOW STATEMENT

Form—II

(000's omitted)

	Actuals for previous accounting year (Whole year)	Projections for current accounting year (Whole year)	Previous quarter ended			Current quarter ending ...... Actuals/‡‡ Estimate	Next quarter ending ...... Budget	Subsequent quarter ending ...... Budget
			Budget	Actuals@	Variance			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Sources								
Long term **:**								
1. Profit before tax (+)/Loss (—)$								
2. Depreciation								
3. Sub-total (item 1+item 2)								
4. Sale of fixed assets								
5. Capital issue								
6. Term loans/debentures/ deferred credits								
7. Public deposits								
8. Others (specify)*								
9. Sub-total (item 3 to 8)								

QUARTERLY FUNDS FLOW STATEMENT—*Contd.*

(000's omitted)

	Actuals for previous accounting year (Whole year)	Projections for current accounting year (Whole year)	Previous quarter ended			Current quarter ending	Next quarter ending	Subsequent quarter ending ......
			Budget	Actuals@	Variance	Actuals/‡‡ Estimate	Budget	Budget
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Short term :								
10. Decrease in current assets :								
(*a*) Inventory								
(*b*) Receivables (including bills discounted with bankers)								
(*c*) Others (specify)*								
11. Increase in current liabilities :								
(*a*) Creditors for purchases of raw materials and stores								
(*b*) Short-term bank borrowings (including bills discounted with bankers)								
(*c*) Other short term payables								
(*d*) Others (specify)*								
12. Sub-total (item 10+item 11)								
13. Grand Total (item 9+item 12)								

QUARTERLY FUNDS FLOW STATEMENT—*Contd.*

(000's omitted)

	Actuals for previous accounting year (Whole year)	Projections for current accounting year (Whole year)	Previous quarter ended			Current quarter ending	Next quarter ending	Subsequent quarter ending ......
			Budget	Actuals@	Variance	Actuals/‡‡ Estimate	Budget	Budget
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Uses								
Long term :								
14. Additions to fixed assets								
15. Repayment of term loans/debentures/deferred credits								
16. Repayment of public deposits								
17. Investments in subsidiaries and affiliates								
18. Advances to subsidiaries and affiliates								
19. Payment of taxes								
20. Dividends								
21. Others (specify)*								
22. Sub-total (item 14 to 21)								

QUARTERLY FUNDS FLOW STATEMENT—*Contd.*

(000's omitted)

	Actuals for previous accounting year (Whole year)	Projections for current accounting year (Whole year)	Previous quarter ended ...... Budget	Previous quarter ended ...... Actuals@	Previous quarter ended ...... Variance	Current quarter ending ...... Actuals/‡‡ Estimate	Next quarter ending ...... Budget	Subsequent quarter ending ...... Budget
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Short term :								
23. Increase in current assets :								
(*a*) Inventory								
(*b*) Receivables (including bills discounted with bankers)								
(*c*) Others (specify)*								
24. Decrease in current liabilities								
(*a*) Creditors for purchases of raw materials and stores								
(*b*) Short-term bank borrowings (including bills discounted with bankers)								
(*c*) Other short term payables								
(*d*) Others (specify)*								
25. Sub-total (item 23+item 24)								
26. Grand Total (item 22+item 25)								
27. Balance (item 13—item 26) : Surplus (+)/ Shortfall (—)								
28. Opening cash and bank balance								
29. Closing cash and bank balance (item 27+item 28)								

@ (*i*) Where estimates have been given under the head "actuals", reasons may be given.

‡‡ (*ii*) As the form has to be furnished during the current quarter, vide note appended to Form I, the actuals would not be available for the whole quarter. For the period actuals are not available, estimates may be taken into account for arriving at the figure to be furnished in column 6.

* (*iii*) If any significant amount/s is/are included in this item, particulars thereof may be furnished separately.

$ (*iv*) The figure should tally with item (9) in Part A of Form I.

QUARTERLY CASH FLOW STATEMENT

Form—III

(000's omitted)

	Previous quarter ended			Current quarter ending	Next quarter ending ...... Budget			Subsequent quarter ending ...... Budget
	Budget	Actuals@	Variance	Actuals/‡‡ Estimate	Month I	Month II	Month III	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Cash Inflows :								
1. Opening cash/bank balance								
2. Realisation from sales								
3. Advances from customers								
4. Capital issue								
5. Term loans/debentures								
6. Public deposits								
7. Others (specify)*								
8. Total (item 1 to 7)								
Cash Outflows :								
9. Payments to suppliers of raw materials and stores								
10. Advances to Suppliers								
11. Salaries, wages and bonus								
12. Power, fuel and other manufacturing/ miscellaneous operating expenses								
13. Excise duty and sales tax								

QUARTERLY CASH FLOW STATEMENT—*Contd.*

(000's omitted)

	Previous quarter ended			Current quarter ending	Next quarter ending ...... Budget			Subsequent quarter ending ...... Budget
	Budget	Actuals@	Variance	Actuals/‡‡ Estimate	Month I	Month II	Month III	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
14. Interest and other financial charges								
15. Income tax								
16. Capital expenditure								
17. Repayment of term loans/debentures/ deferred credits								
18. Repayment of public deposits								
19. Dividends								
20. Closing cash/bank balance								
21. Others (specify)*								
22. Total (items 9 to 21)								
23. Cash deficit (—) / surplus (+) (item 8—item 22)								
24. Opening short term bank borrowings (including bills discounted with bankers)								
25. Closing short term bank borrowings@@ (including bills discounted with bankers) (item 23+item 24)								

@ *(i)* Where estimates have been given under the head "actuals", reasons may be given.

‡‡ *(ii)* As the form has to be furnished during the current quarter, vide note appended to Form I, the actuals would not be available for the whole quarter. For the period actuals are not available, estimates may be taken into account for arriving at the figure to be furnished in column 4.

**(iii)* If any significant amount/s is/are included in this item, particulars thereof may be furnished separately.

@@*(iv)* Peak requirements in each month may be indicated, within brackets, against item 25 under columns 5 to 7.

VI

ANNEXURE

FORMS FOR QUARTERLY INFORMATION SYSTEM

Form I

QUARTERLY OPERATING STATEMENT

(000's omitted)

	Last year Actuals+	Current year Budget	Previous quarter ended		Current quarter ending ......
			Estimate	Actuals	Estimate
	(1)	(2)	(3)	(4)	(5)
Part A					
1. Sales					
2. *Less* : Excise duty					
3. Net sales (item 1—item 2)					
4. Cost of sales					
(*a*) Raw materials consumption					
(*b*) Stores and spares consumption					
(*c*) Salaries and wages					
(*d*) ....*					
(*e*) Other manufacturing expenses, including depreciation					
Sub-total :					
Add : Opening stocks-in-process and finished goods					
Sub-total :					
Deduct : Closing stocks-in-process and finished goods					
Total cost of sales					
5. Gross profit (item 3-item 4)					
6. Interest and other overheads					
7. Other income/expenses—Net (±)					
8. Profit before tax—(item 5—items (6+7)					

(*Please see Page 117 for notes*)

	Previous quarter ended		Current quarter ending ......
	Estimate	Actuals	Estimate
	(1)	(2)	(3)
*Part B***			
Current Assets			
I. Inventory			
(*i*) Raw materials			
(*a*) Imported £ (months' consumption)@			
(*b*) Indigenous £ (months' consumption)@			
(*ii*) Stocks-in-process (months' cost of production)@			
(*iii*) Finished goods (months' cost of sales)@			
(*iv*) Consumable stores (months' consumption)@			
II. Receivables—including bills discounted with bankers++ (months' sales)@			
III. Advances to suppliers of raw materials and stores			
IV. Other current assets including cash and bank balances			
Total current assets			
Current Liabilities :			
V. Short term bank borrowings including bills discounted with bankers+++			
..........................Bank			
..........................Bank			
..........................Bank			
VI. Creditors for purchases of raw materials and stores+++ (months' purchases)@			
VII. Advances from customers			
VIII. Accrued expenses			
IX. Statutory liabilities			
X. Other current liabilities			
Total current liabilities			

(Please see Page 117 for notes)

Form II

QUARTERLY FUNDS FLOW STATEMENT

(000's omitted)

	Last year Actuals +	Current year Budget	Previous quarter ended		Current quarter ending ......
			Estimate	Actuals	Estimate
	(1)	(2)	(3)	(4)	(5)
Sources :					
Profit before tax					
Depreciation					
Funds generated from operations					
Increase in capital					
,, in TL/Deb/ D. P. Liab.					
,, in public deposits					
Decrease in inter-corporate investments & advances					
Increase in short term bank borrowings (including bills discounted)					
,, in other current liabilities					
Decrease in inventory					
,, in receivables (including bills discounted)					
,, in other assets					
Total funds available					
Uses :					
Increase in fixed assets					
Decrease in TL/Deb/D.P. Liab.					
,, in public deposits					
Increase in inter-corporate investments & advances					
Decrease in short term bank borrowings (including bills discounted)					
,, in other current liabilities					
Increase in inventory					
,, in receivables (including bills discounted)					
,, in other assets					
Payment of taxes					
Dividends					
Total uses of funds					
Surplus (+)/ deficit (—)					
Opening cash & bank balances					
Closing cash & bank balances.					

(*Please see Page 117 for notes*)

Notes : (*i*) Data in these forms should be submitted not later than a fortnight from the commencement of the current quarter.

(*ii*) Information in these forms is to be furnished for each line of activity/unit separately as also for the company as a whole and where the different activities/units are financed by different banks, the concerned activity/unit-wise data and data relating to the whole company should be furnished to each financing bank.

(*iii*) The valuation of current assets or current liabilities and recording of income and expenses in these forms should be on the same basis as adopted for the statutory balance sheet, and should be applied on a consistent basis.

+(*iv*) In case audited balance sheet and profit and loss account for the previous accounting year are not available, estimated/provisional figures for the previous year may be furnished in column (1) of Forms I (Part A) and II and the figures for the preceding year based on audited balance sheet should be given in an additional column before column (1).

*(*v*) Any item of expenditure which forms a significant proportion, say 15% or more, of the total cost of production or has special significance otherwise, e.g., power in the case of aluminium industry, the information may be furnished separately, under appropriate heads.

@(*vi*) The period is to be shown in relation to the annual projection for the relative item. If the levels of inventory/receivables are higher than the norms indicated by the bank, reasons may be given.

£(*vii*) If the canalised items form a significant part of raw materials inventory, they may be shown separately.

++(*viii*) Amount of bills discounted with bankers, included in item II of Part B in Form I, should be indicated separately.

+++(*ix*) Amount of bills discounted with bankers in respect of purchases, included in item V or item VI of Part B in Form I, should be indicated separately.

**(*x*) The classification of current assets or current liabilities should be made as per the usually accepted approach of bankers and not as per definitions in the Companies Act (e.g. instalment of term loans payable within 12 months from the date of balance sheet should be classified as current liabilities).

VII

ANNEXURE

IMPORTANT FINANCIAL RATIOS IN CERTAIN INDUSTRIES

1. COTTON TEXTILES

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of companies		270	270	270	53	53	53
Current assets/ Current liabilities	.. Q^1	1.37	1.33	1.40	1.15	1.15	1.16
	.. M	1.10	1.09	1.16	0.88	0.91	0.92
	.. Q^3	0.82	0.85	0.91	0.72	0.68	0.70
Long term debt/ Net worth	.. Q^1	0.16	0.15	0.15	—	—	0.15
	.. M	0.39	0.34	0.34	0.10	0.19	0.34
	.. Q^3	0.81	0.74	0.67	0.51	0.55	0.67
Total outside liabilities/ Net worth	.. Q^1	1.36	1.53	1.44	1.68	1.68	1.42
	.. M	1.90	2.12	2.15	2.24	2.60	2.32
	.. Q^3	3.30	3.39	3.26	3.08	3.71	3.79
Net sales /Net fixed assets	.. Q^1	5.77	6.14	6.56	5.16	5.52	6.53
	.. M	3.71	3.84	4.47	3.63	3.92	4.06
	.. Q^3	2.23	2.47	2.81	2.75	2.88	3.02
Net sales/Current assets	.. Q^1	3.04	3.12	3.02	3.29	3.43	3.34
	.. M	2.36	2.32	2.33	2.58	2.74	2.59
	.. Q^3	1.87	1.81	1.96	1.87	2.04	1.91

2. SILK AND RAYON TEXTILES

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of companies		18	18	18	20	20	20
Current assets/ Current liabilities	.. Q^1	1.47	1.67	1.84	1.30	1.27	1.34
	.. M	1.22	1.31	1.33	1.17	1.16	1.14
	.. Q^3	0.99	0.97	1.09	1.03	1.02	1.03
Long term debt/Net worth	.. Q^1	0.09	0.09	0.07	—	—	—
	.. M	0.13	0.18	0.20	0.04	0.07	0.03
	.. Q^3	0.29	0.31	0.29	0.17	0.22	0.16
Total outside liabilities/ Net worth	.. Q^1	0.77	0.75	0.77	1.63	1.78	1.55
	.. M	1.31	1.13	1.15	2.17	2.22	2.37
	.. Q^3	1.89	1.70	1.97	2.52	3.24	4.59
Net sales/Net fixed assets	.. Q^1	5.11	4.80	5.97	7.59	11.06	10.71
	.. M	3.68	3.54	3.62	5.17	5.28	6.04
	.. Q^3	2.32	2.37	2.53	3.36	3.49	2.95
Net sales/Current assets	.. Q^1	2.65	2.68	2.94	1.73	2.05	1.85
	.. M	2.04	1.83	2.02	1.55	1.61	1.49
	.. Q^3	1.65	1.48	1.61	1.25	1.25	1.18

3. JUTE TEXTILES

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of companies		43	43	43	3	3	3
Current assets/ Current liabilities	.. Q^1	1.27	1.35	1.28	—	—	—
	.. M	1.09	1.15	1.11	1.10	1.09	1.16
	.. Q^3	0.90	0.99	0.99	—	—	—
Long term debt/ Net worth	.. Q^1	0.07	0.07	0.07	—	—	—
	.. M	0.31	0.24	0.21	0.34	0.26	0.29
	.. Q^3	0.44	0.38	0.34	—	—	—
Total outside liabilities/ Net worth	.. Q^1	1.82	1.69	1.89	—	—	—
	.. M	2.31	2.44	2.46	2.40	3.17	1.70
	.. Q^3	3.60	3.22	3.02	—	—	—
Net sales/Net fixed assets	.. Q^1	7.36	9.01	8.81	—	—	—
	.. M	5.42	6.39	6.13	5.50	6.47	6.16
	.. Q^3	3.37	4.94	5.15	—	—	—
Net sales/Current assets	.. Q^1	2.61	2.99	3.28	—	—	—
	.. M	2.26	2.72	2.73	2.70	2.42	2.93
	.. Q^3	1.72	2.20	2.31	—	—	—

4. RUBBER & RUBBER PRODUCTS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of companies		15	15	15	13	13	13
Current assets/ Current liabilities	.. Q^1	1.78	1.57	1.71	1.25	1.17	1.18
	.. M	1.52	1.43	1.46	1.12	1.05	0.99
	.. Q^3	1.03	1.16	1.25	0.96	1.00	0.90
Long term debt/ Net worth	.. Q^1	0.18	0.09	0.12	—	—	—
	.. M	0.44	0.41	0.39	0.31	0.24	0.38
	.. Q^3	0.70	0.74	0.89	0.65	0.77	0.70
Total outside liabilities/ Net worth	.. Q^1	1.10	1.14	0.83	1.65	1.88	1.73
	.. M	1.34	1.47	1.10	1.84	2.21	2.61
	.. Q^3	1.98	2.21	2.74	3.04	2.69	2.97
Net sales/Net fixed assets	.. Q^1	4.71	4.47	6.00	7.51	6.29	5.24
	.. M	3.65	3.77	3.52	4.19	5.37	3.64
	.. Q^3	1.71	2.00	1.61	3.37	2.65	2.16
Net sales/Current assets	.. Q^1	2.40	2.03	2.41	2.78	3.19	2.71
	.. M	2.12	1.91	2.25	2.42	2.49	2.44
	.. Q^3	1.28	1.43	1.76	2.26	1.91	1.77

5. CHEMICAL FERTILISERS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of companies		15	15	15	—	—	—
Current assets/ Current liabilities	.. Q^1	1.50	1.56	1.75	—	—	—
	.. M	1.15	1.12	1.19	—	—	—
	.. Q^3	0.94	0.64	0.74	—	—	—
Long term debt/ Net worth	.. Q^1	0.01	0.01	—	—	—	—
	.. M	0.19	0.18	0.11	—	—	—
	.. Q^3	0.84	1.20	0.90	—	—	—
Total outside liabilities/ Net worth	.. Q^1	1.15	1.13	0.75	—	—	—
	.. M	1.86	1.65	1.41	—	—	—
	.. Q^3	2.60	2.58	1.64	—	—	—
Net sales/ Net fixed assets	.. Q^1	4.56	4.13	3.85	—	—	—
	.. M	2.21	2.35	2.65	—	—	—
	.. Q^3	0.69	0.86	0.92	—	—	—
Net sales/Current assets	.. Q^1	2.03	2.30	2.61	—	—	—
	.. M	1.68	1.90	2.33	—	—	—
	.. Q^3	1.47	1.50	1.47	—	—	—

6. PHARMACEUTICALS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1972–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		42	42	42	21	21	21
Current assets/ Current liabilities	.. Q^1	1.82	1.68	1.69	1.27	1.22	1.22
	.. M	1.27	1.33	1.33	1.12	1.04	1.07
	.. Q^3	1.18	1.16	1.13	0.77	0.89	0.88
Long term debt/ Net worth	.. Q^1	—	—	—	—	—	—
	.. M	—	0.02	0.01	—	—	—
	.. Q^3	0.32	0.27	0.24	0.04	0.06	0.28
Total outside liabilities/ Net worth	.. Q^1	0.92	0.95	0.95	1.54	1.58	1.87
	.. M	1.29	1.38	1.54	2.52	2.41	2.42
	.. Q^3	2.16	2.15	2.19	4.38	3.83	4.09
Net sales/Net fixed assets	.. Q^1	5.63	6.68	6.19	9.24	9.75	11.36
	.. M	4.20	4.73	4.79	6.64	6.70	7.18
	.. Q^3	2.79	2.71	3.00	2.09	2.70	2.28
Net sales/Current assets	.. Q^1	2.26	2.09	2.12	2.19	2.25	1.98
	.. M	1.79	1.78	1.87	1.82	1.80	1.75
	.. Q^3	1.33	1.48	1.48	1.48	1.57	1.48

7. INDUSTRIAL CHEMICALS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		55	55	55	18	18	18
Current assets/Current liabilities	.. Q1	1.86	1.99	1.98	1.46	1.45	1.65
	.. M	1.40	1.41	1.38	1.18	1.14	1.09
	.. Q3	1.09	1.08	1.07	0.93	0.88	0.91
Long term debt/ Net worth	.. Q1	—	—	—	—	—	—
	.. M	0.21	0.16	0.19	—	—	—
	.. Q3	0.68	0.60	0.72	0.51	0.38	0.36
Total outside liabilities/ Net worth	.. Q1	0.82	0.77	0.62	0.79	0.94	0.86
	.. M	1.31	1.09	1.12	1.27	1.54	1.55
	.. Q3	2.02	1.40	1.79	3.49	3.97	3.99
Net sales/Net fixed assets	.. Q1	2.94	2.80	3.85	4.95	4.42	4.89
	.. M	1.55	1.87	1.86	3.11	3.44	3.31
	.. Q3	0.89	0.94	1.01	1.01	1.11	1.22
Net sales/Current assets	.. Q1	1.95	2.02	2.16	1.91	1.61	1.88
	.. M	1.63	1.70	1.72	1.62	1.36	1.67
	.. Q3	1.11	1.18	1.25	0.99	0.96	1.07

8. VEGETABLE & HYDROGENATED OILS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970-71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		14	14	14	21	21	21
Current assets/Current liabilities	.. Q1	1.27	1.21	1.22	1.27	1.20	1.31
	.. M	1.14	1.06	1.06	1.10	1.04	1.11
	.. Q3	0.88	0.80	0.81	0.81	0.77	0.83
Long term debt/ Net worth	.. Q1	—	—	0.01	—	—	—
	.. M	0.23	0.26	0.23	—	—	—
	.. Q3	0.37	0.41	0.34	0.22	0.34	0.33
Total outside liabilities/ Net worth	.. Q1	1.48	1.92	1.99	1.23	1.23	1.51
	.. M	2.15	2.61	3.17	2.60	2.30	2.98
	.. Q3	3.05	4.03	5.09	3.81	4.81	4.00
Net sales/Net fixed assets	.. Q1	24.40	20.93	20.09	23.95	23.00	24.77
	.. M	17.46	13.72	14.54	14.27	10.16	12.70
	.. Q3	8.16	6.86	8.91	6.78	5.97	8.23
Net sales/Current assets	.. Q1	6.95	6.67	6.18	7.73	7.79	5.87
	.. M	6.32	5.45	5.43	5.19	5.77	5.26
	.. Q3	4.33	3.33	3.21	3.22	3.67	3.66

9. PAPER AND PAPER PRODUCTS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970-71	1971-72	1972-73	1970-71	1971-72	1972-73
No. of Companies		36	36	36	10	10	10
Current assets/ Current liabilities	.. Q^1	1.39	1.41	1.45	—	—	—
	.. M	0.98	0.94	0.93	1.23	1.16	1.12
	.. Q^3	0.63	0.69	0.69	—	—	—
Long term debt/ Net worth	.. Q^1	0.13	0.18	0.13	—	—	—
	.. M	0.53	0.48	0.39	—	—	0.15
	.. Q^3	1.01	0.74	0.70	—	—	—
Total outside liabilities/ Net worth	.. Q^1	1.01	0.88	0.89	—	—	—
	.. M	2.12	1.68	1.57	1.52	1.20	1.04
	.. Q^3	2.82	2.65	3.01	—	—	—
Net sales/Net fixed assets	.. Q^1	2.35	2.21	2.06	—	—	—
	.. M	1.48	1.66	1.58	3.10	3.50	2.52
	.. Q^3	0.82	0.83	0.95	—	—	—
Net sales/ Current assets	.. Q^1	2.66	2.82	2.45	—	—	—
	.. M	1.95	2.04	2.08	1.97	2.23	2.01
	.. Q^3	1.53	1.45	1.50	—	—	—

10. MOTOR VEHICLES

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970-71	1971-72	1972-73	1970-71	1971-72	1972-73
No. of Companies		32	32	32	21	21	21
Current assets/ Current liabilities.	.. Q^1	1.76	1.78	1.85	1.61	1.55	1.75
	.. M	1.22	1.31	1.23	1.29	1.32	1.17
	.. Q^3	0.92	1.03	1.02	0.96	0.99	1.01
Long term debt/ Net worth	.. Q^1	—	0.04	—	—	—	—
	.. M	0.23	0.23	0.20	—	0.01	0.04
	.. Q^3	0.49	0.42	0.46	0.22	0.27	0.26
Total outside liabilities/ Net worth	.. Q^1	1.09	0.80	0.83	0.84	1.12	1.06
	.. M	1.57	1.47	1.59	1.69	1.91	2.11
	.. Q^3	2.86	2.33	2.36	2.93	2.87	3.19
Net sales/ Net fixed assets	.. Q^1	3.75	4.51	4.97	4.64	6.61	6.32
	.. M	2.89	3.15	3.39	3.92	4.09	4.91
	.. Q^3	1.86	1.98	2.53	2.06	2.71	2.97
Net sales/ Current assets	.. Q^1	1.75	1.71	1.92	2.18	2.04	1.88
	.. M	1.53	1.51	1.63	1.45	1.38	1.57
	.. Q^3	1.14	1.16	1.28	1.09	1.10	1.05

11. OTHER TRANSPORT EQUIPMENT

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		12	12	12	6	6	6
Current assets/ Current liabilities	.. Q^1	1.53	1.60	1.49	—	—	—
	.. M	1.14	1.03	1.16	1.13	1.10	1.08
	.. Q^3	0.84	0.88	0.80	—	—	—
Long term debt/ Net worth	.. Q^1	—	—	0.03	—	—	—
	.. M	0.14	0.09	0.07	0.35	0.24	0.17
	.. Q^3	0.32	0.46	1.01	—	—	—
Total outside liabilities/ Net worth.	.. Q^1	0.90	0.95	1.30	—	—	—
	.. M	2.07	3.51	2.87	2.51	2.22	2.06
	.. Q^3	5.08	7.65	8.04	—	—	—
Net sales/ Net fixed assets	.. Q^1	5.52	4.92	5.74	—	—	—
	.. M	4.03	3.11	4.10	3.83	4.31	3.81
	.. Q^3	1.98	1.85	1.98	—	—	—
Net sales/Current assets	.. Q^1	1.88	1.84	1.74	—	—	—
	.. M	1.39	1.33	1.36	2.37	2.14	2.17
	.. Q^3	0.95	0.78	1.12	—	—	—

12. ELECTRICAL MACHINERY, APPARATUS, APPLIANCES, ETC.

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		108	108	108	42	42	42
Current assets/ Current liabilities.	.. Q^1	1.42	1.45	1.42	1.25	1.25	1.16
	.. M	1.17	1.20	1.19	1.11	1.09	1.03
	.. Q^3	0.99	1.03	1.00	0.84	0.89	0.89
Long term debt/ Net worth	.. Q^1	0.02	0.04	—	—	—	—
	.. M	0.22	0.24	0.18	0.10	0.08	—
	.. Q^3	0.57	0.48	0.44	0.42	0.29	0.27
Total outside liabilities/ Net worth	.. Q^1	1.28	1.25	1.23	1.20	1.17	1.61
	.. M	1.99	2.15	2.19	2.42	2.62	2.36
	.. Q^3	3.16	3.13	2.97	4.80	3.88	4.16
Net sales/Net fixed assets	.. Q^1	5.33	6.01	6.02	7.62	8.34	8.75
	.. M	3.03	3.90	3.86	3.78	4.37	4.83
	.. Q^3	1.62	2.17	2.19	1.74	1.72	2.47
Net sales/Current assets	.. Q^1	1.66	1.76	1.74	2.30	2.20	2.27
	.. M	1.36	1.48	1.45	1.55	1.44	1.55
	.. Q^3	1.02	1.07	1.05	0.87	0.97	0.86

13. FOUNDRIES & ENGINEERING WORKSHOPS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		45	45	45	43	43	43
Current assets/Current liabilities	.. Q^1	1.47	2.00	1.48	1.55	1.52	1.35
	.. M	1.04	1.14	1.07	1.19	1.19	1.20
	.. Q^3	0.74	0.77	0.80	1.04	1.05	1.07
Long term debt/ Net worth	.. Q^1	0.05	0.05	0.10	—	—	—
	.. M	0.45	0.38	0.43	0.03	0.03	0.03
	.. Q^3	1.01	0.61	1.28	0.22	0.23	0.25
Total outside liabilities/ Net worth	.. Q^1	0.90	1.00	1.14	0.86	1.01	1.13
	.. M	1.77	1.64	1.83	1.39	1.33	1.44
	.. Q^3	2.29	2.00	2.94	2.08	2.20	2.65
Net sales/ Net fixed assets	.. Q^1	2.76	3.31	3.63	7.51	6.50	8.87
	.. M	1.56	1.56	1.60	4.25	3.75	5.46
	.. Q^3	0.78	1.03	1.07	2.30	2.11	2.69
Net sales/Current assets	.. Q^1	2.07	1.84	1.87	3.28	2.58	3.18
	.. M	1.43	1.47	1.47	2.07	2.04	2.49
	.. Q^3	1.07	1.13	1.05	1.61	1.47	1.81

14. FERROUS & NON-FERROUS METAL PRODUCTS

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		72	72	72	58	58	58
Current assets/Current liabilities	.. Q^1	1.58	1.59	2.68	1.41	1.29	1.25
	.. M	1.26	1.22	1.24	1.13	1.07	1.12
	.. Q^3	0.96	0.97	1.01	0.80	0.84	0.88
Long term debt/ Net worth	Q^1	—	—	—	—	—	—
	.. M	0.16	0.14	0.18	0.04	0.03	0.01
	.. Q^3	0.46	0.46	0.49	0.42	0.35	0.27
Total outside liabilities/ Net worth	.. Q^1	0.87	0.95	0.87	0.94	1.14	1.30
	.. M	1.66	1.67	1.72	1.89	2.02	2.16
	.. Q^3	2.30	2.42	2.49	2.95	3.15	3.27
Net sales/Net fixed assets	.. Q^1	4.16	5.24	5.75	6.62	6.53	7.26
	.. M	2.85	3.26	3.75	3.35	3.73	4.25
	.. Q^3	1.22	1.45	1.67	1.71	1.75	2.09
Net sales/Current assets	.. Q^1	1.87	1.95	2.11	2.51	2.27	2.32
	.. M	1.41	1.46	1.60	2.03	1.60	1.58
	.. Q^3	1.19	1.06	1.14	1.23	1.11	1.05

15. MISCELLANEOUS MACHINERY

IMPORTANT FINANCIAL RATIOS

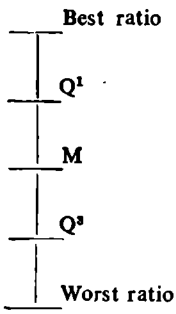
Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies ..		122	122	122	35	35	35
Current assets/Current liabilities	.. Q^1	1.53	1.43	1.52	1.45	1.37	1.39
	.. M	1.18	1.19	1.18	1.13	1.10	1.10
	.. Q^3	1.02	1.02	1.00	0.97	0.96	1.00
Long term debt/ Net worth	.. Q^1	—	—	—	—	—	—
	.. M	0.25	0.19	0.19	0.14	0.08	0.09
	.. Q^3	0.47	0.45	0.40	0.37	0.29	0.24
Total outside liabilities/ Net worth	.. Q^1	1.20	1.16	1.18	1.26	1.25	1.07
	.. M	2.04	2.07	2.07	2.20	2.14	2.41
	.. Q^3	3.34	3.49	3.13	4.71	3.56	3.65
Net sales/ Net fixed assets	.. Q^1	4.70	5.58	5.00	5.53	6.95	7.08
	.. M	2.78	2.91	3.40	3.31	3.67	4.44
	.. Q^3	1.57	1.73	1.87	1.74	2.33	2.57
Net sales/ Current assets	.. Q^1	1.39	1.44	1.47	1.59	1.70	1.80
	.. M	1.09	1.14	1.22	1.23	1.31	1.31
	.. Q^3	0.86	0.79	0.91	0.97	1.05	1.01

16. CONSTRUCTION

IMPORTANT FINANCIAL RATIOS

Category of Companies		Public Limited Companies			Private Limited Companies		
Year		1970–71	1971–72	1972–73	1970–71	1971–72	1972–73
No. of Companies		17	17	17	23	23	23
Current assets/Current liabilities	.. Q^1	1.14	1.15	1.09	1.19	1.18	1.21
	.. M	1.04	1.04	1.02	1.00	1.00	0.99
	.. Q^3	0.97	0.95	0.94	0.90	0.88	0.91
Long term debt/ Net worth	.. Q^1	—	—	—	—	—	—
	.. M	0.01	0.06	0.03	—	—	—
	.. Q^3	0.31	0.32	0.29	0.37	0.19	0.08
Total outside liabilities/ Net worth	.. Q^1	1.59	1.68	2.44	1.65	1.81	2.45
	.. M	3.17	3.72	3.88	2.93	3.71	3.31
	.. Q^3	8.17	14.38	10.76	8.57	7.35	10.72
Net sales/Net fixed assets	.. Q^1	13.52	6.25	4.99	7.86	10.33	9.32
	.. M	3.58	3.08	3.40	4.40	4.13	4.99
	.. Q^3	1.23	1.29	1.44	1.51	2.09	2.37
Net sales/Current assets	.. Q^1	1.56	1.49	1.07	2.55	2.28	2.33
	.. M	1.24	0.99	0.91	1.23	1.56	1.48
	.. Q^3	0.29	0.12	0.22	0.83	0.66	0.53

NOTES (1) Individual units make the industry and their performance is the performance of the industry. Depending upon their efficiency, the units show different performance which is indicated by different values of ratios. If these values are arranged in a descending order of favourableness from the point of view of the lending banker, the range shows different shades. For easy comparison, it can be divided into four quartiles as shown in the figure alongside, so that the best 25% ratio values fall above Q^1 and the worst 25% below Q^3, M being the median value of the industry. The units showing the ratio values above Q^1 level can be graded as class A, those between Q^1 and M levels, as class B, those between M and Q^3 levels, as class C and those below Q^3 level, as class D. These three quartile values of 5 important financial ratios in respect of 16 industries for 1970-71, 1971-72 and 1972-73 are shown in the preceding tables.



(2) Q^1 = First Quartile.

M = Median.

Q^3 = Third Quartile.