Report of the

Study Group On The Extent To Which Credit Needs of Industry And Trade Are Likely To Be Inflated And How Such Trends Could Be Checked.

1969

Bombay

Confidential

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STUDY GROUP ON THE EXTENT TO WHICH CREDIT NEEDS OF INDUSTRY AND TRADE ARE LIKELY TO BE INFLATED AND HOW SUCH TRENDS COULD BE CHECKED

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BOMBAY

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Contd.

A N N E X U R E S

S T A T E M E N T S

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REPORT OF THE STUDY GROUP II

Subject: "The extent to which credit needs of industry and trade are likely to be inflated and how such trends could be checked".

I. INTRODUCTORY

The National Credit Council, at its meeting held on July 24, 1968, decided to set up five study groups to examine specific issues pertaining to the work of the Council. Our Group was constituted on the October 11, 1968 to examine "the extent to which credit needs of industry and trade are likely to be inflated and how such trends could be checked". The members of the Group are as under:

1.	Shri V.T. Dehejia, Chairman, State Bank of India, Bombay.	Chairman
2.	Shri N.M. Chokshi, Chairman, Bank of Baroda Ltd., Bombay.	Member (Upto June 25, 1969)
3.	Shri R.B. Shah, Chairman, United Commercial Bank Ltd., 10, Brabourne Road, Calcutta-1.	Member (Since June 26, 1969)
4.	Shri R.R. Morarka, 24B, Carmichael Road, Bombay-26.	Member
5.	Shri P.N. Dhar, Director, Institute of Economic Growth, University Enclave, Delhi-7.	"
6.	Shri R. Venkataswamy Naidu, 'Kamala Nilayam', Peelamedu, Coimbatore.	"
7.	Shri M.P. Chitale, Poonawadi, Hindu Colony, 167-C, Dr. Ambedkar Road, Dadar, Bombay-14.	"
8.	Shri A. Baksi, Deputy Governor, Reserve Bank of India, Bombay.	Convener

We had our first meeting on November 5, 1968 to settle the lines on which our preliminary enquiry should proceed. In accordance with the decision taken in this meeting, a questionnaire was sent to 15 major banks in the country which accounted for about 80 per cent of the total advances of all scheduled commercial banks (Annexure I). The second meeting of the Group was held on February 13, 1969 and the third meeting on March 10, 1969; on both these occasions, the subject assigned to the Group was discussed generally in all its aspects and certain broad and tentative conclusions were arrived at. The Chairman of the Group made available to the Vice-Chairman of the National Credit Council in its meeting held on March 26, 1969 at New Delhi, a brief note indicating the main lines of thinking of the Group as they emerged in these meetings. The fourth and the fifth meetings of the Group were held on July 25, 1969 and August 27, 1969, respectively for discussing the draft Report. The final Report was signed by the members of the Group in the first week of September 1969.

We record with deep regret the sad demise on June 25, 1969 of our esteemed colleague Shri N.M. Chokshi who had rendered valuable assistance to the Group in its discussion but could not go through this Report. Shri R.B. Shah, Chairman, United Commercial Bank was kind enough to accede to our request to join the Group in the vacancy caused by the death of Shri Chokshi.

<u>Gap between investment and voluntary savings and bank credit and bank deposits</u>

2. To facilitate a study of the subject in the right perspective, it was considered necessary at the outset to examine the trends in bank credit in recent years against the background of developments in the economy of the country, the framework of the credit policy of the Reserve Bank of India and the

pattern of distribution of commercial bank credit according to sectors. Under the programme of planned development in the country, voluntary domestic savings, together with external aid and utilisation of our balances abroad generally lagged behind aggregate investment resulting in sizeable budgetary deficit. The imbalance between investment and voluntary savings became wider between 1965-66 and 1967-68, following acute drought conditions in two successive years and the consequent fall in agricultural output and the slackening rate of rise in industrial production, apart from the general decline in the rate of investment in the economy. Although the position in this regard in 1968-69 was better, the need for harnessing the available resources to productive activity by an increase in the level of investment in conformity with the targets set out in the Fourth Five Year Plan is paramount. As short-term bank credit in India finances inventories to a large extent, the rising trend in prices until 1967-68, apart from entailing changes in the level of stocks with industry and trade, also aggravated the demand for credit. The level of scheduled commercial bank credit as at the end of March 1969 (Rs.3370 crores) was more than twice that in March 1963 (Rs.1588 crores). Moreover, in recent years net bank credit to the private sector* has been a significant factor in the expansion of money supply; in the busy season of 1966-67 and 1967-68, net bank credit to the private sector formed 78% and 76% respectively of the growth in money supply with the public. The proportion, however, declined to 43% in 1968-69 partly on account of a relatively faster growth in time deposits with scheduled commercial banks.((Statement I)

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* Financial assets of banks (banks' advances and holdings of private securities) <u>minus</u> banks' time deposits.

TABLE I

Scheduled commercial banks - Trends in deposits and credit

(Rupees in crores)

Year (April-March)@	Expansion in deposits	28% of * deposits	Net ** deposits	Expansion in bank credit
	(1)	(2)	(3) (1 - 2)	(4)
1963-64	243	68	175	228
1964-65	298	83	215	217
1965-66	367	103	264	254
1966-67	475	133	342	404
1967-68	432	121	311	339
1968-69	472	132	340	338

@ Based on last Friday figures.

* In terms of Section 24 of the Banking Regulation Act, 1949, banks are required to maintain 28 per cent of their deposit liabilities in the form of liquid assets comprising gold, cash, balances with Reserve Bank of India, balances with other banks on current account and approved securities.

** On the basis of minimum liquidity requirements in respect of accruals of deposits for each year.

Taking the financial year as a whole, the growth in bank credit was at a faster pace than the accrual of deposits available with the banks for financing credit with the exception of 1965-66 and 1968-69. In 1968-69, the surplus of net bank deposits over bank credit was nominal owing partly to the continued stagnancy in the level of public and private investment, the consequent continuance of recessionary conditions in certain industries and the absence of any marked expansion of credit in this year. The gap in scheduled banks' resources is markedly reflected only during the busy season of the year (November-April). This gap is made good by their recourse to short-term borrowings from the Reserve Bank, this reliance being very large for some banks, their aggregate peak level borrowings forming as much as 25% to 30% of their expansion in credit during the busy season.

TABLE 2

Scheduled commercial banks - Trends in Deposits, credit and borrowings from Reserve Bank of India

(Rs. in crores)

Year	Expansion in deposits in the busy season (November-April)	28% of column (2)	Net deposits (column 2 - 3)	Expansion in bank credit	Borrowings from the Reserve Bank(busy season average)	Peak level of borrowings from the Reserve Bank
1.	2.	3.	4.	5.	6.	7.
1963-64	85	24	61	376	41	107
1964-65	106	30	76	407	78	164
1965-66	214	60	154	309	36	107
1966-67	169	47	122	426	50	140
1967-68	220	62	158	508	42	148
1968-69	307	86	221	413	84	242

3. Recourse to central bank credit by the commercial banks is no doubt a necessary element in the expansion of seasonal bank credit, but it is essential that to the extent possible its volume and duration are kept to the minimum. One way of achieving this objective is for scheduled commercial banks to take further steps to mobilise deposits to the maximum possible extent; they have already moved in this direction by opening 664 branches - the largest number in any one year so far - in 1968. Another Study Group set up by the National Credit Council has already examined the issue of deposit mobilisation by banks. This Group is of the view that the role of banks as credit purveyors cannot be divorced from their role as deposit

mobilisers and that the expansion of credit, its wider dispersal and the spread of the banking habit are essential aspects in the process of deposit mobilisation. It is pertinent, so far as our study is concerned, to assess the measures which are necessary to keep the level of short-term bank credit broadly in alignment with the short-term credit requirements of industry, trade, agriculture and other sectors of the economy as also the magnitude of deposits available for credit expansion.

<u>Forms of bank credit in India</u>

4. A brief reference may be made at this stage, to the various forms in which scheduled commercial banks extend short-term credit. The forms of credit extended by banks to industry and trade differ as between countries, largely due to certain historical factors as also the stage of development of the country. In the U.K. and some countries following U.K. practices as well as in several European countries, the system of overdrafts prevails to a considerable extent, while in the U.S.A. credit is provided entirely by way of loans and bills. In France, credit usually takes the form of negotiation of bills. In Belgium, roughly one-third of all short-term lendings is by way of overdraft and the method of short-term financing through discounting of bills has developed substantially. The Indian banks have generally followed the practices of British banks. As on April 25, 1969 about 70% of total scheduled banks' financial assistance comprised cash credit and overdrafts, about 10 per cent loans, about 15 per cent inland bills purchased and discounted* and about 5 per cent foreign bills purchased and discounted. The relative importance of bills - which are self-liquidating in nature - in the composition of bank credit differs from country to country, partly due to the relative importance

* Includes usance bills converted from cash credit account for the purpose of borrowings from the Reserve Bank of India under the Bill Market Scheme.

of internal and international trade and partly to the pattern of financing of trade transactions. In Japan, about one-third of the commercial banks' credit is constituted by bills discounted, while in France the relative proportion is as high as 75%.

5. The ability of scheduled commercial banks to extend credit to industry, trade and other sectors in the economy is conditioned by the overall credit policy of the Reserve Bank of India. In the context of the rising demand for bank credit in relation to bank deposits, the Reserve Bank has been following a policy of controlled expansion of credit. This policy is designed to ensure broadly that genuine credit requirements of industry and trade are adequately met, while at the same time restraint is exercised on the use of bank finance for a speculative build-up of certain commodities and articles in short supply. Special concessions form part of the regulation so as to induce the flow of credit to priority sectors as determined from time to time in the light of the changing economic conditions. The technique adopted for this purpose has been to regulate the cost and availability of credit to the scheduled commercial banks from the Reserve Bank insofar as working capital requirements are concerned* and from the Industrial Development Bank of India in respect of term loans. Under the scheme of selective credit control, advances against commodities in relative short supply are regulated through

<u>Reserve Bank's credit policy</u>

* This took the form of a system of quotas for individual banks depending on their own resources and slab rates based on the extent to which the quota is exceeded for borrowing purposes by the individual banks. This remained in force from October 1960 to September 1964. Since then it has been substituted by a system of net liquidity ratio, which determines the rate at which each scheduled bank can borrow, subject to certain concessions in respect of loans to priority sectors.

prescription of minimum margin and/or ceiling limits on advances against them. By and large, the Reserve Bank endeavours to control the total supply of bank credit to the economy, the share of different sectors and the individual corporate and other borrowers in each sector being left to the discretion of the individual banks. In November 1965, as a part of its policy of regulation of bank credit, the Reserve Bank introduced a scheme for "credit authorisation" under which individual loan proposals of scheduled commercial banks which involve aggregate credit limits in excess of Rs.1 crore are required to be referred to the Reserve Bank. The Bank examines the proposals primarily from the point of view of the purpose served by the limits; it seems to have relied on the general indications of the scheduled commercial banks that the bulk of the credit requested for by borrowers was intended for financing their inventories and receivables.

Pattern of distribution of bank credit

6. It may be relevant at this stage to analyse the pattern of distribution of credit amongst the various sectors by the scheduled commercial banks. It would be noticed from Statement II that credit to the industrial sector as on March 31, 1967 accounted for roughly two-thirds of total scheduled bank credit. The proportion of credit to industry to total bank credit has shown a steady increase in recent years, the average incremental ratio since 1961 being nearly 77%. On the other hand, the share of advances to commerce declined steadily from 36% in March 1951 to 29% in April 1961 and further to 19% in March 1967. Out of the total credit extended to industries, agro-based industries had the

following share:-

Cotton textiles	15%
Jute manufactures	5%
Sugar	6%
Vegetable oils	2.7%

and the more modern industries accounted for the following percentages:

Engineering	25%
Iron and Steel	6%
Mining	2.5%
Chemicals, pharma-ceuticals, dyes and drugs	5.4%
Paper	2.5%

Both these categories between them accounted for about three-fourth of total industrial credit (Statement III). The bulk of the advances to commerce (91%) went to wholesale trade, the share of retail trade being 9%.

7. The Corporate sector (excluding Government companies) claimed nearly four-fifth of scheduled commercial banks' industrial advances as at the end of March 1967, while partnership and proprietory concerns, etc. accounted for more than two third of the advances to commerce. The share of State-owned and Stage-managed concerns was relatively small at 6% in industrial advances and 4.5% in commercial advances which compares with the respective share of 4.2% in 1961 and 3.2% in 1965 (Statement IV).

8. Against this background, we may now turn to an examination of the possible scope for "inflation of bank credit" to industry and commerce. Since the bulk of bank credit is short-term our enquiry would be primarily concerned with the "inflation" of short-term bank credit. The credit needs of industry or commerce may be considered to be inflated or they may be regarded to have received credit

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in excess of their genuine requirements, under various situations given below:

(i) If over a period of years, the rise in short-term credit is found to be substantially higher than the growth in industrial production;

(ii) If the rise in short-term credit is appreciably higher than the increase in inventories;

(iii) If there is a diversion of short-term bank borrowings for building up of fixed assets or other non-current assets such as loans and investments;

(iv) Double or multiple financing of stocks;

(v) If the period of credit is unduly lengthened.

It is proposed to examine this problem from these various aspects on the basis of data available with us.

Bank credit to commerce or trade

9. Advances to commerce or trade do not now form a significant proportion of total bank credit. We may deal with this sector to start with and find out whether it had obtained excess of bank credit, before taking up the more important matter of credit to industry. It has, however, not been possible to make a study of the trends in bank credit in relation to the level of inventories with trade, because the balance sheets of companies engaged exclusively in trading are not readily available, and moreover, as stated earlier, a large proportion of bank credit to this sector goes to proprietory and partnership concerns. Further, the data on bank advances to 'commerce' obtained by the Economic Department of the Reserve Bank of India cover not only advances to trade against inventories but also credit for movement of goods within as well as outside the country i.e. finance for internal and external trade.

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An analysis of the data for trading companies (included in the study of company finance conducted by the Reserve Bank of India) shows that the ratio of bank borrowings to inventory which had risen from 52% in 1960-61 to 74% in 1965-66 came down to 68% in 1966-67.

TABLE - 3

Trading Companies

Ratio of bank borrowings to inventories

Years	Percentage Ratio
1960/61	52
1961/62	58
1962/63	64
1963/64	60
1964/65	63
1965/66	74
1966/67	68

Note:- Based on the studies of medium and large non-Government non-financial public limited companies made by the Reserve Bank of India. Data from 1960-61 to 1964-65 related to 74 companies and for 1965-66 and 1966-67 to 80 companies.

As a sequel to the Directive issued by the Reserve Bank of India in October 1966 stipulating that the major Indian scheduled banks and foreign banks should earmark at least 80% of their seasonal credit expansion in providing credit to industry and/or against export/import bills, there was in absolute terms a considerable slowing down in advances to commerce between March 1966 and March 1967. Thus, the rise in scheduled commercial bank advances to commerce between March 1966 and March 1967 was only Rs.25 crores as compared to Rs.129 crores in the preceding year.

10. An attempt is also made to study broadly the expansion in bank advances to trade in relation to the increase in value of production in two groups of commodities

it being assumed that advances to trade in these commodities would rise proportionately to the growth in their production.

11. The following table sets out the relevant data for traders engaged in wholesale trade in (a) chemicals, dyes and pharmaceuticals and (b) textiles (Cotton, Jute and Woollen, etc.)

TABLE - 4

(Rs. in lakhs)

Commerce	Advances as on March 31, 1963	Advances as on March 31, 1967	Level of Advances as in column (2) adjusted to percentage rise/fall in industrial production and prices during 1962-63 to 1966-67
	Rs.	Rs.	Rs.
(1)	(2)	(3)	(4)
1. Chemicals, dyes, paints and pharmaceuticals	820	13,39	13,89
2. Textiles	8540	99,44	105,44

It would appear from the above data that there was no excess credit to trade engaged in chemical products and textiles. This might be assumed to hold good for most other commodities. Though the Reserve Bank's Directive of October 1966 was withdrawn in April 1967, its restraining influence still appeared to persist. Moreover, the selective credit controls which, in the last 5 years covered foodgrains, sugar, raw cotton, raw jute, oilseeds and vegetable oils would have had an impact on the level of credit to trade.

Expansion in bank credit to industry in excess of output

12. In view of the dominant share of industry in the use of bank credit (vide paragraph 6), it would be worthwhile, for purposes of illustration, to study in greater depth the magnitude and composition of credit to industry in relation to its overall requirements as also the corporate borrowers in this sector. In a situation of rapidly expanding industrial capacity and

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production witnessed, especially during the first half of the current decade, industry required increasing amount of working capital as also funds for acquiring fixed assets, etc. The needs were enlarged further by the rise in prices which characterised this period. Inventories constitute the main item of current assets to which credit is generally related by banks in India. Over the past few years, industry appeared to have practised a fairly stable inventory behaviour as is reflected in the generally constant inventory/sales ratio (vide table below).

TABLE - 5

	Percentage Ratio of Inventory (of raw materials, finished goods and stores) to sales
1960-61	30.6
1961-62	30.8
1962-63	30.5
1963-64	28.9
1964-65	28.9
1965-66	29.7
1966-67	31.9

Note: Based on the studies of medium and large non-Government non-financial public limited companies made by the Reserve Bank of India. Data for 1960-61 and 1965-66 related to 1242 companies and for 1966-67 to 1402 companies.

It might, therefore, be expected that an increase in bank credit to industry over the past few years should broadly correspond to the rate of growth in the value of industrial output. The following table shows the correlation between bank credit and total industrial production during

1964-65 to 1966-67:-

TABLE - 6

Percentage increase over 1960-61 in the value of industrial output at current prices			Percentage increase over 1960-61 in bank borrowings by industry		
1964-65	1965-66	1966-67	1964-65	1965-66	1966-67
50.3	90.7	109.6	81.0	121.5	163.3

Note: The figures of bank borrowings by industry include those against stocks-in-process and fixed assets. Figures of industrial output, on the other hand, do not reflect the changes in stocks-in-process of industrial units. Despite these differences in the coverage of bank credit on the one hand and industrial output on the other the data are generally indicative of the broad magnitude of changes in bank borrowings in relation to changes in industrial output.

13. It is evident from the above table that bank credit expanded during this period at a higher rate than the rise in industrial output valued at current prices. This would also be corroborated by the available data on invenotires in relation to short-term bank credit. It will be seen from the following table that between 1961-62 and 1966-67, the rise in the value of inventories with industry was 80% while the rise in short-term bank credit was as much as 130%. The ratio of short-term bank borrowings to inventories went up from 40% in 1961-62 to 52% in 1966-67.

TABLE - 7

Year	Inventories (Rs. in crores) (1)	Short-term bank borrowings (Rs. in crores) (2)	Ratio of (2) to (1) (3)
1961-62	815	330 (estimated)*	40%
1966-67	1466	760@	52%
% rise	80%	130%	

Note: These data are based on the studies of medium and large non-Government non-financial public limited companies, made by the Reserve Bank of India. Data for 1961-62 related to 1242 companies and for 1966-67 to 1402 companies.

* Total term loans (including short-term credit rolled over by prior agreement) as revealed in the Survey conducted by the Economic Department of the Reserve Bank of India as at the end of April 1962 amounted to Rs.103 crores. The 1242 companies covered here would account for about 75% of the paid-up capital of non-Government non-financial public limites companies. The figure is adjusted for term loans.

@ Total term loans by banks to industry and trade as at the end of March 1967 amounted to Rs.194 crores. The 1402 companies covered here accounted for 80% of the paid-up capital of non-Government non-financial companies; the figure is adjusted for term loans. Thus the figures of bank borrowings relate to short-term credit and against the security of stocks and stores.

14. In the light of the figures mentioned in the foregoing three paragraphs, there would seem to be good reason to believe that, in the absence of specific restrains, there was a tendency on the part of industry generally to avail itself of short term credit from banks in excess of the amounts based on the growth in production and/or inventories in value terms.

15. The pattern of credit to industry in excess of the amounts based on the growth in production indicated above, no doubt, reflected the overall or the aggregate position. An attempt has been made to show approximately the rise in bank credit to certain specific industries between 1963 and 1967 in relation to the rise in their output valued at

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current prices (vide Statement V). The figures of excess or shortfall in bank credit shown in column 8 of the statement are not to be taken as a precise measure but only as indicators of the direction and magnitude of the change. In particular, it is appreciated that demand for bank credit at any point of time even from units of the same size in the same industry would not be identical, the variations being dependent, apart from their relative efficiency in the management of funds, upon the availability of other sources of finance. Also, aggregate bank credit as on a particular date, instead of average credit over a period of time, cannot be a reliable guide for drawing firm conclusions; besides seasonal factors would also distort the picture to some extent. As it has not been possible to make a study of this aspect on the basis of available data, the figures furnished in this statement are designed to assess the extent to which, on the supply side, the flow of bank credit kept pace with the growth in production as between different industries. Subject to these qualifications, it would appear from these figures that several industries, particularly those in the traditional group, seemed to have obtained credit from banks over and above the rise in their production, the 'extra' credit being particularly evident in respect of each of the following: iron and steel (Rs.51 crores), cotton textiles (Rs.25 crores), coal mining (Rs.18 crores), chemicals, drugs and pharmaceuticals (Rs.12 crores), fertilisers (Rs.9 crores) and jute textiles(Rs.8 crores). It would also be evident from the table below that in respect of several industries (including cotton textiles, jute textiles and engineering), there has been an increase in the ratio of bank borrowings to inventories during the period 1962-63 to 1966-67, the rate of increase varying as between different industries.

TABLE - 8

Bank Borrowings/Inventory Ratios in Selected Industries (1962-67) based on balance sheets covered in the Reserve Bank of India Study.

Industry	Percentage Ratio of Bank Borrowings* to Inventories				
	1962-63	1963-64	1964-65	1965-66	1966-67
1. Cotton textiles (256)	60.5	63.4	65.5	72.8	73.9
2. Jute textiles (54)	60.6	67.5	76.5	75.2	78.9
3. Sugar (82)	57.8	48.8	53.8	60.8	64.3
4. Engineering (187)	47.4	47.5	48.2	51.4	57.6
5. Chemicals (91)	64.7	69.6	72.5	71.1	64.8
6. Cement (16)	63.8	74.1	83.1	72.5	54.5
7. Paper and Paper Products (20)	46.1	57.1	76.8	87.2	93.2
8. All Manufacturing Industries (1054)	52.8	53.2	56.2	59.4	61.2

Note: (1) Figures are based on Study of Company Finances published by the Reserve Bank of India.

(2) Figures in brackets indicate the number of companies.

* Bank borrowings include term loans also.

16. It is evident from the preceding paragraphs that both in the aggregate and according to the industrial classification, the rise in bank credit in recent years was higher than the rise in output/inventories of certain industries. To examine this issue in depth, a further study has been made of the distribution of bank credit among individual corporate borrowers in two industries, viz. cotton textiles and chemicals, pharmaceuticals and medicines (both of which show a higher level of bank credit)

(vide Statement VI). These figures are also subject to the same limitations as are referred to in the preceding paragraph. Here again, it is obverved that quite a number of individual cotton textile units as well as the units in the pharmaceutical and chemical industries appeared to have obtained short-term bank credit in excess of the growth in their production.

17. The above analysis would thus bear evidence that a certain number of units in specific industries received credit from scheduled commercial banks in excess of the increase in the value of their industrial output and/or in the level of their inventories. We may now turn to an examination of the factors which might have led to this situation. The questionnaire issued to the banks referred to earlier was, inter alia, intended to find out how far the lending policy and procedures of commercial banks could have resulted in the supply of credit in excess of the growth in production and/or inventory levels.

<u>Fixation of credit limits by banks</u>

18. In any consideration of the size of bank credit in relation to the requirements of individual borrowers, the basis on which banks fix credit limits forms an important aspect; for this purpose, banks generally take into account several features of the working of the loanee concerns, such as production, sales, inventory levels, past utilisation, etc. The prevalent practices of banks in this regard are so varied that there is reason to believe that within their ambit they were unlikely to prevent the emergence of excess demand for credit from certain borrowers. For instance, some banks do not take note of the credit enjoyed by the borrowers in the purchase of raw materials. Even as regards the minimum period required for the stocking of raw materials and finished goods, there are differences

between banks in their approach to what is considered a reasonable level for units in the same industry. By and large, the scheduled banks are inclined generally to relate their credit limits to the security offered by their constituents but many do not appear to make any attempt to assess the overall financial position of the borrowers through a cash flow analysis and in the light of such a study fix their credit limits.

19. Banks also do not generally adopt a uniform method of valuation of stocks. The usual method for indigenous goods is based on 'cost' or 'market value' whichever is lower and for imported goods on landed cost. Even on the basis of 'cost' the amount of bank credit would differ for different producers, as their costs would normally vary. Where valuation is made on the basis of the selling price, it is the practice of banks to stipulate a higher margin to set off the element of profit. Banks usually relax the basis of their valuation, if they wish to facilitate the borrowers to tide over temporary difficulties or where the products enjoy a wide market. It would thus appear that the system of valuation *per se* does not constitute an important factor for the emergence of excess credit, although it may not rule out a few borrowers obtaining credit in excess of their needs warranted by the level of their inventories.

Basis of valuation

20. Similarly, there appears to be considerable divergence in practice as regards the prescription of margins by the banks. Some banks stipulate a lower margin on pledge advances as against hypothecation of stocks, while a few others do not make this distinction. The margin on advances against raw materials ranged between 15 to 35 per cent, on finished

Margin requirements

goods from 10 to 30 per cent and on stores between 30 to 50 per cent. Most of the banks do not insist on a margin on bills. According to the replies received to our questionnaire, banks appeared to relax their margin requirements generally (a) in favour of small units, (b) on imported materials, (c) in favour of sick but viable units, (d) on imports covered by letters of credit, (e) on exports under firm orders or letters of credit and (f) when large payments such as for payment of tax, bonus, etc. have to be made. While the structure of differential rates of margin might possibly lead to different amounts of credit to borrowers against identical security, it does not necessarily follow (with the exception of a few units) that this practice by itself, resulted generally in any excess credit to the industrial sector of the economy.

Financing of receivables

21. The corporate sector, apart from borrowing from banks against their inventories, also discount with banks their documentary bills or borrow against their book debts whenever they extend credit to the purchasers of their goods. This need for extension of trade credit by the corporate sector according to the banks, seemed to have become marked in view of the emergence of a buyers' market in certain lines of activity in the last year or so. This trend was aggravated, particularly in respect of engineering, textile and electrical industries in the last two years or so following recessionary conditions in these industries. It has also been represented by banks that increasing sales by industry to Government Departments in recent times and the delay on the part of the Departments in settling their bills also resulted in a lock up of funds of industry in receivables and consequently increased their requirements for bank credit.

It is understood that while bills covering supplies to the Departments under the Defence Ministry are usually settled within a reasonable period, bills drawn on civilian departments of the Central and State Governments are held over for a much longer period. Similarly, small industrial units have complained that bills covering their supply of components, parts and finished items to major industrial companies are also delayed for a long period, thus entailing an increased dependence on their part on bank credit. The available data, however, are incomplete to lead to any conclusion whether or not the increase in trade credit by the corporate sector resulted in an increased demand for bank credit, as the analysis of company finance data does not present figures of "trade credit" separately from "loans and advances". However, during the period 1965-66 and 1966-67, for which separate figures of sundry debtors are available, the corporate sector relied on credit from its suppliers for Rs.90 crores as against Rs.52 crores of trade credit extended by it to its customers; on a net basis the corporate sector was a beneficiary of trade credit rather than a supplier. Thus, while the item sundry debtors showed a rise, it was not a contributory factor to the corporate sector's larger borrowings from banks, as this rise was more than counterbalanced by the net trade credit from their suppliers for financing their inventories.

22. We appreciate that to the extent to which the period of the trade credit is unduly elongated, resources of banks get tied up for unproductive purposes. It is considered that even allowing for competition between the manufacturers, the period of trade credit

Elongation of period of trade credit

should not normally exceed 60 days and in special circumstances 90 days (this excludes the sales of capital equipment on deferred payment terms). In whatever form working capital credit is extended by banks, it should be possible for them to ensure that receivables outstanding for more than 90 days are not financed by bank credit. In this connection, special reference must be made to the complaint against Government departments in regard to the inordinate delay in making payments to its suppliers. The payment of bills within the shortest possible time will be in the interest of the Government departments inasmuch as it would induce the suppliers to make adjustments in their quotations which at present would be loaded to take into account the interest element and that too at a high rate covering the long delay in settling the dues. Government departments and public sector undertakings should, in fact set an example to private industries in clearing their dues within a period of 60 days or 90 days. One possible way to discourage the undue delay in the settlement of bills by Government departments would be to arrange for the latter to pay interest on bills at a reasonable rate if they are not paid within 90 days after receipt of the bills (accompanied by approved inspection notes or such other safeguards as may be necessary for receipt of goods according to specification).

<u>Double or multiple financing</u>

23. In the present system of bank lending in India, certain types of credit facilities can result in double or multiple financing of stocks. For instance, where credit facilities are granted against receivables either by way of Documents against Acceptance bills or drawings against book debts, the purchaser is also in a position to obtain bank credit by way of hypothecation/pledge of the stocks

which have not been paid for. The risk of double or multiple financing would be greater where credit limits are sanctioned by banks against supply bills covering purchase of raw jute and Pucca Delivery orders covering sales of jute goods. A special Study Group has been set up by the Reserve Bank at Calcutta to examine the problem of credit against raw jute and jute goods including the scope for misuse of the system of supply bills and Pucca Delivery orders. Generally speaking, double or multiple financing can be eliminated if, at the time of assessment of credit requirements of a borrower, due account is taken of the credit received on its purchases. In other words, while fixing the credit limit to be granted to the borrower for carrying inventories, it is necessary that the amount of credit normally received by the borrower unit on its purchases should be deducted from its total requirements of bank finance. This would, to the extent of the deduction, eliminate the possibility of the buying units getting finance from sellers as also from banks in respect of identical inventories. It would appear that some banks have already been following this practice, but it does not seem to have been adopted by all banks as a normal practice when they assess the credit requirements of their borrowers.

24. It is our view that the factors referred to above could have only partly contributed to rise in <u>short-term</u> bank credit not warranted by increase in production/ inventories of certain types of borrowers. Some of the banks in their replies to the questionnaire had stated that there was a tendency on the part of some corporate borrowers to divert a part of their working capital to fixed or other non-current assets, mainly on account of the sluggish conditions in the capital market. To the

extent that a diversion of this nature took place, it would be reflected in a greater rise in current liabilities than in current assets, thereby leading to a fall in the current ratio of the borrowers.

25. For the purpose of assessing whether or not there was a diversion of short-term liabilities of corporate borrowers for acquisition of non-current assets and the extent of short-term bank finance involved in such a diversion, it was deemed necessary to analyse the balance sheets of such companies included in the Reserve Bank study as had witnessed a deterioration in the current ratio over a period of years. However, in view of the limited time and also the difficulty in getting balance sheets for the earlier years on a comparative basis, the analysis was confined to the balance sheets of those companies included in the Reserve Bank study as had in 1967 an adverse current ratio (excess of current liabilities over current assets) and had also recorded a deterioration in the current ratio between 1961-62 and 1966-67.*

26. One limitation in the analysis carried out by us is that it will be impossible to ascertain precisely from the balance sheets the extent of the diversion of short-term bank credit to investment in non-current assets, because the balance sheets contain information in this regard only

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*It may be noted that the study on company finances conducted by the Reserve Bank of India covered 1333 non-Government non-financial public limited companies for the period 1961-62 to 1965-66 but for the year 1966-67 the study covered 1501 companies, which included only 1226 companies from the earlier sample and 275 new companies. This change in the coverage, particularly the inclusion of additional companies for which balance sheets for the year 1961-62 were not readily available, brought about a reduction in the number of companies for the purpose of our analysis.

as on particular dates. In other words, unless we have data regarding _average_ bank borrowings during the period, it will not be possible to quantify the extent of the diversion. While this be so, it should be remarked that the data covered in our analysis pertain to those companies which had a negative current ratio during 1966/67. Having regard to the fact that the companies generally faced a deficit in their long-term resources, it would be safe to presume that the position of current liabilities/ current assets could not have shown much variation during the year. Consequently, during the year, there would have been only a variation in the composition of current liabilities _inter se_ (bank borrowings might have gone up while other liabilities went down during particular periods). From the point of view of our analysis, therefore, attention should be focussed not so much on the extent of diversion of short-term bank credit to long-term use but on the extent to which _current liabilities_ in the aggregate financed long-term assets. Another limitation would be that as companies close their accounts on different dates, the aggregation of the balance sheet data would not reflect the true position as on one date for all companies.

27. With the foregoing observations, we attach statement VI which contains an analysis based on a cash flow study of the major changes in the current, non-current and fixed assets and sources of finance of 255 companies which had an adverse ratio during 1966-67 and which had deterioration in their current ratio since 1961-62. It will be seen from the

table given below that -

TABLE - 9

Changes in liabilities and assets of 255 companies between 1961-62 to 1966-67

(Rs. in crores)

Increase in short-term assets	Increase in short-term liabilities	Column 2 - Column 1	Increase in long-term assets	Increase in long-term liabilities
(1)	(2)	(3)	(4)	(5)
118	201	+ 83	299	216

between 1961-62 and 1966-67, short-term liabilities of 255 companies recorded a rise of Rs.201 crores (of which bank credit accounted for Rs.91 crores) as against a rise of Rs.118 crores in their short-term assets; the excess of short-term liabilities amounting to Rs.83 crores was utilised for financing the gap between long-term assets and long-term liabilities of the companies during this period. A further analysis of data (vide table enclosed) revealed that about one-fifth of the gross fixed assets formation of the companies between 1962-67 was financed by the expansion in short-term liabilities including bank loans (Rs.59 crores). In addition, non-current assets comprising loans and investments were acquired to the extent of Rs.24 crores through utilisation of short-term liabilities. The rise in short-term borrowings of the companies from banks during the period was higher by Rs.10 crores than the rise in stocks and stores while increase in sundry creditors over sundry debtors was Rs.20 crores.

TABLE - 10

Changes in current,non-current and fixed assets and the sources of their financing of public companies (the current liabilities of which exceeded their current assets as at 1966/67 and which had witnessed a deterioration in the current ratio during the period 1961-62 to 1966-67)

(Rupees in lakhs)

No. of companies	Increase in stocks and stores	Increase in sundry debtors	Increase in other current assets	Increase in other non-current assets	Increase in fixed assets	Increase in net worth, deferred liabilities and provision for depreciation	Fixed assets formation financed by short-term liabilities (6 - 7)	Increase in bank borrowings (short-term)	Increase in sundry creditors	Increase in other current liabilities
1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.
255	8099	3685	44	2358	27467	21599	5868	9140	5666	5248

...28

28. An industry-wise analysis of corporate borrowers on the same lines revealed that the cotton textile industry had financed as much as Rs.24 crores of fixed assets and Rs.7 crores of other non-current assets through a rise in current liabilities (Rs.36 crores) and bank borrowings (Rs.29 crores). In respect of paper and paper products the rise in bank borrowings (Rs.9.4 crores) was in fact larger than the increase in inventories (Rs.6.9 crores) and bank borrowings coupled with other short-term liabilities had financed fixed assets to the extent of Rs.7.8 crores.

29. To probe the matter further an analysis was also made of manufacturing companies enjoying working capital limits of Rs.50 lakhs and over with a major bank (Statement VIII). The companies selected were those whose current ratio had declined over the period 1961/62 and 1966/67. It was noticed that out of 156 manufacturing companies, data in respect of which were available, as many as 114 companies recorded a deterioration in the current ratio between 1962 and 1967. The results of the analysis of these 114 companies are given in the enclosed table. It will be seen that in respect of these companies, short-term liabilities (including bank borrowings) were utilised to the extent of Rs.68 crores for acquisition of fixed assets (Rs.8 crores) and other non-current assets comprising mainly loans (Rs.54 crores).

TABLE - 11

Changes in current, non-current and fixed assets and the sources of their financing of public companies (which enjoy credit facilities for amounts of Rs.50 lakhs and over and had witnessed a deterioration in the current ratio during the period 1961-62 to 1966-67)

(Rupees in lakhs)

No. of companies	Increase in stocks & stores	Increase in book debts	Increase in other current assets	Increase in other non-current assets	Increase in fixed assets	Increase in net worth, deferred liabilities and provision for depreciation	Fixed assets formation financed by short term liabilities	Increase in short term bank borrowings	Increase in sundry creditors	Increase in other short-term liabilities	Non-current assets financed by short-term liabilities
1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.
114	9710	3887	31	5989	24738	23968	770	9680	6143	4564	6759

30. Normally, the acquisition of fixed assets is to be financed by long-term sources of funds such as an increase in paid-up capital and internal accruals, floatation of debentures, term loans, etc. It was in fact in anticipation of the need for meeting the requirements for medium-term credit by industry that the Reserve Bank set up the Refinance Corporation for Industry in 1958 to facilitate the entry of scheduled commercial banks into this field, through its scheme of refinance of term loans extended by them. The Industrial Development Bank of India (which took over the assets and liabilities of the RCI) continues to offer facilities of refinance in respect of term loans to industry granted among others by scheduled commercial banks. The object of the policy in this regard is that scheduled banks should, in the provision of term loans, supplement the efforts of the all-India term lending institutions (IDBI, IFC and ICICI) and the SFCs, in view of the vastness of the country, the advantages of their branch network and their close association with industrial concerns. Accordingly, scheduled commercial banks have been lending since then on a medium-term basis; the outstanding amount of their term loans as on the 31st March 1967 was of the order of Rs.226 crores representing 13% of their industrial credit and 8% of their total credit.

<u>Refinance facilities of Industrial Development Bank of India for term loans by scheduled commercial banks</u>

31. It looks as if over and above their facilities for formal term loans, scheduled commercial banks still continue their practice of 'rolling over' their short-term credit to industry.

32. The reasons for the tendency on the part of a number of units in industry to utilise short-term bank credit and other current liabilities for acquisition of non-current assets (over and above term loans presented in the table as deferred liabilities) as is evident from the data given above, are obvious and are briefly enumerated below:-

<u>Reasons for 'roll over' of short-term bank credit for acquisition of fixed and other non-current assets</u>

(a) In the first place, following the generally sluggish conditions in the capital market since 1962, there was reluctance on the part of industrial units to raise additional equity to finance their capital expenditure. Where a surplus drawing power was available in their cash credit/overdrafts account and it could reasonably be anticipated that a certain level of inventories would continue in future, it was quite easy for them to utilise this drawing power for financing their fixed and non-current assets. No doubt, this would result in a worsening of their current ratio, but the companies reckoned on future accruals to rectify the position.

(b) In their replies, scheduled commercial banks stated that credit applications received for short-term bank credit are examined in great detail ranging from an assessment of short-term working capital requirements based on an analysis of the optimum inventory holdings, cash flow, profitability and and meaningful ratios. However, as referred to earlier, the depth of appraisal of credit applications differs as between banks and, at any rate, it is common experience that the appraisal is considerably limited in nature as compared to the detailed examination undertaken by term lending institutions on applications for medium-term loans. This is evident from the limited nature of financial and credit information called for by scheduled commercial banks on requests for short-term working capital advances. The theory of cash credit/overdraft lending in India proceeds primarily on the relationship between credit limits and the anticipated level of inventories.

(c) Medium-term loans are subject to repayment schedules and the borrower is under an obligation to earmark future cash accruals for honouring repayment instalments. Moreover, the loan agreements contain several covenants to ensure good behaviour and financial prudence during the currency of the loans. Although short-term bank credit is technically repayable on demand, limits are renewed periodically subject to a minimum standard of financial performance. No repayment is envisaged because such credit is regarded as short-term and expected to be adjusted out of sales turnover.

<u>The genesis of the cash credit system</u>

33. It may now be considered to what extent the present system of bank lending is responsible for the tendency on the part of certain segments in industry to borrow short-term for long-term use. The lending system, as is prevalent in Indian banking, would appear to have greatly assisted certain units in industry in increased reliance on short-term debt to finance not only their current operations but also their non-current investment. The so-called short-term working capital advances are granted in India by way of

cash credit limits which are only technically repayable on demand. The system has its original in British banking. In the initial stages, the system was suited to finance the requirements of trade and seasonal industries. Also, the system was found convenient in view of the emphasis placed by banks on the security aspect; it was possible for banks to believe, so long as the advance was fully secured by the value of the current assets, that it was well-covered and hence a good credit risk. However, in view of the considerable changes in the pattern of bank lending in the past few years with increasing share of credit to industry, it is now necessary to examine how the system has been operated and how short-term credit was in fact put to long-term use.

Its rationale

34. The basis of the cash credit system is that it is a purely temporary phenomenon, that a satisfactory current ratio provides a proper cushion to the banker and that since the security (in the form of current assets) is capable of being converted into cash in the course of the borrowers' operations, the advance is necessarily short-term in nature and self-liquidating in character. The presumption is that since the advance is secured by current assets, there is a continuous process of repayment and fresh loans in the form of fluctuations in outstandings which reflect receipts in respect of sale proceeds and payments for acquisition of fresh current assets. While this may possibly be true of purely seasonal advances which are repaid during the conventional slack season or of companies with a strong current ratio, the recent Indian experience as applicable to a large number of companies shows that it no longer holds valid in the current pattern of bank lending to industry and that the

cash credit advances have lost the character of being short-term and self-liquidating inasmuch as although cash accruals arising from sales are adjusted in a cash credit account from time to time, it is found that on a large number of accounts no credit balance emerges or debit balance fully wiped out over a period of years as the withdrawals are in excess of receipts.

35. The reasons why a cash credit advance is no longer self-liquidating are not far to seek. The theory underlying the supposedly short-term character of cash credit advance is that, as the security is of a liquid nature, the advance also should be regarded as liquid. As an extreme example, if a constituent borrows against the security of Government paper, which is one of the most liquid forms of current assets, the advance is regarded as short-term in character, more so as the advance is repayable on demand. If the borrower, however, uses the advance for a long-term purpose such as for construction of a house, he can only repay the outstandings over a period. Another illustration would clarify the point further. Under the cash credit system, it is common to grant limits on the basis of the assessment of the lock-up of borrowers' funds in various current assets such as stocks, stores, stocks-in-process and receivables. The advances are considered as short-term as they are repayable/ on demand and are secured by current assets. Inasmuch as the ostensible purpose of the advance is to finance working capital, further questions regarding the end-use of the funds are rarely asked and the documents obtained in connection with the pledge/ hypothecation of liquid assets merely enjoin on the borrower the obligation to maintain stock-in-trade of sufficient market value, less margin to cover the outstandings.

<u>The manner of its operation in India</u>

Thereafter, the use of the limit is not examined closely with the result that a borrower may utilise the advance for purposes which are not short-term. For example, in respect of an industrial unit, which has financed a part of its current assets out of its own funds and has accordingly maintained a good current ratio, it is possible for it to secure from the bank a credit limit on the basis of the level of inventories normally carried by it, though the advance would not be required for the acquisition of further current assets. It has become fairly common for some industrial units to utilise the surplus drawing power of this nature for financing capital expenditure programme or for investments. It may be argued that this system of borrowing is really the conversion into cash of surplus liquid assets. This point is readily conceded but what we wish to stress is that the advance granted should not be regarded as short-term. Repayment of the additional 'short-term' borrowing cannot come about in the short run - as is the theory underlying the system of cash credits - but only out of surplus cash accruals after meeting dividend commitments, further capital expenditure programmes, repayment of existing term obligations, etc. The result is that cash credit advances have no longer remained short-term or self-liquidating in character and if the industrial unit is in a position to maintain a certain level of inventories, it is under no obligation to repay any part of the bank loan so long as there is no sharp deterioration in its financial position warranting a recall of the advance and it can use the advance almost as a permanent source of finance to be used for such purposes as it may desire. Table 12 contains illustrative examples which would show that in respect of certain cash credit accounts repayments of the short-term bank credit has been negligible though the advances are intended to be short-term.

TABLE - 12

(Rupees in lakhs)

Company	Nature of industry	Credit limit	Outstandings 1966		Outstandings 1967		Outstandings 1968		Cash accruals			Disposal of cash accruals		
			Maximum	Minimum	Maximum	Minimum	Maximum	Minimum	1966	1967	1968	1966	1967	1968
A	Vegetable oils	590	406	308	468	413	447	362	42	64	150	The entire cash accruals were utilised for capital expenditure		The cash accruals were utilised partly for capital expenditure & partly for repayment of short-term unsecured loans obtained other than from banks.
B	Paper and paper products	450	347	294	436	350	450	387	- 4	324	271	-do-		A major portion of cash accruals was utilised for capital expenditure and the remainder was utilised partly for repayment for term liabilities & partly for meeting a portion of the increased working capital requirements.
C	Jute textiles	400	333	146	400	240	400	283	41	72	N.A.	The entire cash accruals were utilised for capital expenditure.		
D	Engineering	285	129	72	142	115	164	69	42	74	- 146			

36. It is the common experience of most banks that this constituted the essential feature of a large number of cash credit advances extended by them and as a result the borrowers tended to treat bank borrowings in most instances almost as 'quasi-equity' It would, therefore, appear that the possibility of heavy reliance on bank credit (which is the subject matter of the present Report) arises mainly out of the way in which the cash credit system has been operated in recent times. Most of the factors cited as contributing to excess credit needs could really be accounted for, among others, by the way in which the facilities of the system have been used. For devising measures to check the tendency on the part of a segment of industry to continue to rely on short-term credit at a certain level over a long period of time without its bearing a definite relationship to inventory/production levels, cash accruals, etc. as also to exercise a rather more rational system of controls on short-term credit to industry, it is necessary to consider what modifications can be introduced in the present system of cash credit (accounting for 70% of total bank credit as stated in paragraph 4).

37. For this purpose, it would be necessary to consider the entire question of short-term lending from the point of view of the end-use of the cash credit/overdraft and not from the stand-point of the character of security. As a major portion of bank credit is at present treated as for short-term working capital requirements, it would be useful to examine the concept of working capital with precision and clarity. It would not be correct to say that the entire working capital requirements of the borrower are necessarily short-term in character merely because the

working capital represents an investment in current assets. In the present method of financial planning, it is common for industrial units to provide for long-term resources to cover only fixed assets, non-current assets, and what is termed "margin for working capital". (And, the long-term resources tend to get further attenuated, if project costs, preoperative losses, etc. should increase beyond the provision for contingencies, thus eroding the initial working capitalprovided.) Based on the level of inventories and receivables, a cash credit limit is sought to be obtained for the remainder of the working capital (less sundry creditors as stipulated by some banks). It is clear that the lock-up of funds in working capital this way would not be short-term in character inasmuch as this amount of capital (or an increased amount depending on the price level) is permanently needed by the unit to carry on its operations and there is little likelihood of the level of borrowings coming down in the course of years. (One result of this type of financial planning is a negative current ratio, namely, an excess of current liabilities over current assets, a feature so commonly noticed in the country). What is necessary in the financial planning of a borrowing unit is to see what would be the permanent lock-up of funds in working capital as distinct from the purely temporary requirements of funds to arrange for term finance subject to the observance of a proper debt-equity ratio.

38. It is difficult on the basis of the available data to make any precise quantitative estimate of the extent to which bank credit has been put to long-term use; but sufficient illustrative examples have been given earlier to show that this tendency exists to a significant degree to warrant notice being taken.

Moreover, our analysis in this report relates to the position up to 1966-67 but since then there is reason to believe that the position might actually have worsened. We are of the view that unless measures are taken now to check this tendency, it may assume wider dimensions over the next few years.

39. Our first suggestion is that the appraisal of credit applications should be made with reference to the total financial situation, existing and projected, as shown by cash flow analysis and forecasts submitted by borrowers. This would overcome the present deficiencies in the operation of the cash credit system of lending, which primarily stem from the tendency to determine the quantum of the advance by relating it to the level of inventories and book debts likely to be carried. A proforma of a suggested cash flow statement is attached (Annexure II). These statements would exhibit the borrower's investment intentions and it would be possible, by obtaining periodical data of production, sales and the working capital position, to correlate actual performance to the forecasts furnished earlier. It is obvious that the cash flow forecasts would keep on changing depending on the trends revealed by actual performance and it will be necessary to obtain fresh forecasts in the light of actuals and probable future tendencies. An analysis of the type referred to, which is normally done by the term lending institutions, would be a highly useful control measure available to banks. It is also suggested that borrowers be asked to provide half-yearly balance-sheets and profit and loss accounts as a further aid to control. In short, what is required is a periodical analysis in some depth of the borrower's operations as a whole. Having regard to the large number of accounts involved, it may be difficult to

introduce this type of analysis in all cases. To start with, advances of, say Rs. 50 lakhs and over which account for over a third of the total bank credit could be analysed this way and gradually extended to borrowers with advances of over Rs. 10 lakhs which account for over 60% of the total advances. A classification of loans and advances outstanding as at March 31, 1967 analysed according to the size of the accounts is furnished below to indicate what would be the volume of work involved:

TABLE 13

Classification of loans and advances according to size of accounts (outstanding as on March 31, 1967)

Accounts with outstanding amounts	Amount (Rs. in lakhs)		Number of accounts	
	Amount	As per cent to total	Number	As per cent to total
Up to Rs. 10 lakhs	1044,58	38.4	10,50,839	99.5
Over Rs. 10 lakhs and up to Rs. 50 lakhs	668,05	24.6	4,075	0.4
Over Rs. 50 lakhs and up to Rs. 1 crore	369,25	13.6	664	0.1
Over Rs. 1 crore	635,37	23.4	437	-
Total	2717,25	100.0	10,56,015	100.0

40. Recourse to balance sheet and cash flow analyses would help diagnose the extent to which current liabilities of industrial units have been put to non-current use and the manner in which liabilities and assets of borrowers are likely to move over a period of time. Broadly speaking, there are likely to be three categories of borrowers. One would relate to companies which have a strong current ratio and which have maintained this ratio in successive years. The second category would relate to those companies the current ratio of which, although marginally positive at the

moment, has shown a declining tendency over the years which are likely to continue to use current liabilities to finance the acquisition of non-current assets. The third category would relate to companies the current ratio of which has been negative over a period of time. It is obvious that mere analyses of balance sheets and cash flow forecasts would not by themselves remedy the existing stituation where borrowers utilise current liabilities for acquiring non-current assets. Accordingly, it has to be considered what solutions are feasible in the current situation in respect of the second and third categories of the companies mentioned above. A simple example of a borrower the current ratio of which is negative is furnished below to place the problem in proper perspective.

(Rs. in lakhs)

Fixed assets	345	Equity	150
Non-current assets	55	Term loans	150
Total long-term assets	400	Total long term resources	300
Current assets	350	Current liabilities	450
	750	(composed of:	750

Bank borrowings	320
Sundry creditors	120
Provisions and other liabilities	10
	450

Shortfall in long-term resources in relation to long term assets Rs. 100 lakhs.

It will be seen from this example that current liabilities aggregating Rs. 100 lakhs have been put to long-term use. Assuming that the minimum quantum of current assets, represented by the low point in inventories and receivables, is Rs. 250 lakhs and that the high point is Rs. 400 lakhs, it will be readily evident that bank borrowings would ordinarily never fall below Rs.250 lakhs, assuming that the company can have recourse to sundry creditors to a minimum extent of Rs.100 lakhs at any given point of time. An analysis of the above nature would go to indicate the level of bank borrowings which would continue to be rolled over from year to year. We have indicated earlier that Rs.250 lakhs would be the low point for their current assets requirements. Deducting the minimum level of sundry creditors of Rs.100 lakhs from this figure, the company would need to borrow not more than Rs.150 lakhs to finance its minimum working capital requirements. Actually, the company would continue to borrow not less than Rs.250 lakhs at any given point of time in the foreseeable future. It is evident from the simplified analysis that Rs.100 lakhs of current liabilities have been put to non-current use. Further, it will be evident that the bulk of existing borrowings of Rs.250 lakhs would continue to roll over from period to period without any possibility on the part of the company of repaying the amount to the bank on a specified date. This, we can determine, as the hard core of bank borrowings effected by the company.

41. On the basis of the foregoing analysis, it would be possible to distinguish outstandings in cash credit accounts as between (i) "the hard core" which would represent the minimum level of raw materials, finished goods and stores which the industry is required to hold for maintaining a given level of production and (ii) the strictly short-term component which would be the fluctuating part of the account. The latter part of the account would represent the requirements of funds for temporary purposes e.g. short-term increase in inventories, tax, dividend and

bonus payments, etc., the borrowings being adjusted in a short period out of sales.

42. Having assessed the extent of current liabilities utilised for non-current investment and its impact on the current ratio of a company, the stage would be set for exploring what possible solutions are feasible in the current credit situation. A single solution of universal applicability is, of course, not possible inasmuch as each case would have its own peculiar features. It is, however, obvious that the solution lies in a proper reconstruction of the pattern of the liabilities of the companies concerned. Where a company's debt paying capacity is good and its other ratios not unhealthy, the hard core element in the cash credit borrowing could be segregated from the normal short term part of the account and put on a formal term loan basis and subjected to a repayment schedule. Where the borrowers' financial position is, however, not too good or the size of the hard core is so large that repayment cannot be expected within 7/10 years (this would be the case where there is considerable dependence on current liabilities) it would be difficult for the banks to continue to carry these liabilities over a long period of time Here, the possible solutions to be attempted would be: additional issue of equity or preference capital, a debenture issue with a long maturity, the bringing in of long-term deposits and unsecured loans by the promoters and their friends.

43. Where the hard core is to be placed on a formal term loan basis, the proposal should be subject to a detailed appraisal in order to examine whether the borrowing unit would have necessary supporting inventories as security and it would have the capacity to generate adequate surplus to meet maturing obligations. In short, the appraisal will have to be on the same lines as for term loans for capital expenditure.

44. We are aware that the determination of the hard core may present some practical difficulties to banks at least in the initial stages. This would depend upon how the minimum working capital requirements of a particular borrower are computed and this, in turn, would depend on what norms are adopted in regard to the minimum inventory levels and the normal trade terms in various industries. One way this question can be tackled would be to assess what would be the minimum level of working capital required by a borrower as represented by the level of its inventories and receivables. As we have noted earlier, there is no uniformity of view among banks as to what should be the normal level of stocks which units in the same industry may hold. It will be seen from the following table that the quantity of stocks of raw materials held by the various industries during 1966-67 showed a wide divergence.

TABLE 14

Name of the Industry	Stock of raw materials in terms of consumption No. of months
1. Cotton textiles	2.2
2. Jute Textiles	2.6
3. Iron and Steel	2.0
4. Electrical Machinery, apparatus, appliance, etc.	4.0
5. Machinery (other than Transport and electrical)	4.8
6. Basic Industrial Chemicals	4.2
7. Medicines & Pharmaceutical preparations	3.1
8. Other Chemical Products	2.0
9. Cement	2.8
10. Paper and paper products	4.5

Note: Data based on study of 1501 companies covered in the Reserve Bank of India Study.

While the cement industry held stocks of raw materials equivalent to nearly 3 months' consumption, several other industries engaged in manufacture of machinery, basic industrial chemicals, and paper and paper products held stocks of raw materials of over 4 months' consumption. The quantity of stocks required to be held as between various industries would depend upon several factors such as (a) level of production, (b) nature of the commodity, (c) seasonality in supply, (d) process of production, (e) relative importance of imported materials, (f) transport arrangements, etc. It has not been possible for us within the limited time at our disposal to make an industry-wise study for assessing the reasonable level of stocks which units in an industry will ordinarily be required to hold for uninterrupted production schedule. Such a study would be helpful in providing guidelines to commercial banks in determining the 'hard core'. While it is appreciated that it would be difficult to adopt any rigid standards in this regard broad guidelines of this nature would help banks in assessing and segregating the 'hard core' element of the cash credit/ overdraft from the purely temporary or seasonal requirements of their borrowing units; it is our suggestion that deviations, if any, from the guidelines would have to be justified on the basis of special factors. It would be worthwhile to attempt industry-wise norms, perhaps the Indian Banks' Association and Reserve Bank of India could give thought to this question.

Basis for negotiating the 'hard core' of cash credit

45. The duration of the loan on a term basis to be granted for working capital purposes (the hard core of the cash credit referred to earlier) would depend on the capacity of the unit to generate cash

accruals for reducing the outstandings. It would, therefore, be necessary that such loans should be subject to a repayment programme on the same lines as for term loans granted by banks and term-lending institutions for financing fixed assets. Applications for term finance for working capital loans would, therefore, have to be subject to a detailed appraisal in order to examine whether the borrowing unit would have the necessary supporting inventories as security, the capacity to generate adequate accruals for meeting repayment obligations and the appraisal would have to be on the same lines as for term loans for capital expenditure. It may not be necessary for such working capital term loans to be secured by a mortgage of fixed assets and possibly the existing charge over the borrower's liquid assets may be sufficient. This would, however, be governed by the circumstances of each case. The documents should, however, contain convenants in regard to the end-use of the loan, repayment obligations, restriction on investment in shares and debentures, prohibition of dividend distribution beyond agreed levels and borrowings except with the bank's prior consent, maintenance of a certain agreed level of working capital, etc.

<u>Provision for separate term loans - Its implications</u>

46. One possible objection to the suggestion made by us for distinguishing the hard core in cash credit accounts and placing it on a term loan basis would be that borrowers would be required to repay (a) that part of the outstandings which represent the diversion of short-term borrowings for long-term investment and (b) also that part of the outstandings which represent financing of current working operations. Inasmuch as the function of commercial banks is to finance working capital

requirements of borrowers, it could be contended that this would be too drastic a solution with its concomitant result of bringing down the present outstandings to nil at a future point of time. This may be answered in two ways. One is that the financing of the minimum working capital requirements of the borrowers without any obligation to repay is in reality a more or less permanent investment of the working funds of banks in the operations of a selected group of borrowers. Secondly, where a borrower's operations are not expanding and where realisations more than match any increase in prices, a cash credit account must, by definition, be reduced to nil out of accruals over a period. In proposing our solution of a term loan for working capital, we have no more than taken the latter fact into account. Without a formal term loan, it would be quite possible for borrowers in the latter category to divert borrowings for investment elsewhere without the knowledge of the financing institution. It must, therefore, be clarified that the intention in suggesting this type of lending on a term basis for working capital is not to deny credit assistance to expanding industrial units. Nor is it the intention to bring down immediately the present level of bank credit to industry. Where the units have undertaken a capital expenditure programme, the credit assistance from banks and other term-lending institutions would be available by way of term loans against fixed assets. Where there is an expansion in the operations of a unit and accordingly its working capital requirements go up, the borrower would always be in a position to negotiate with banks for an additional term loan for working capital on the lines suggested above and the application can be considered by banks in the light of the financial viability of the project, its past performance in respect of repayment obligations and its capacity to generate cash accruals. It would be seen that, in genuine cases, the borrowers would not be starved of bank credit although they would be subject to greater financial discipline concerning the use of bank credit and cash accruals. The climate for a gradual changeover from a cash credit system to term loans for working capital would also seem to be favourable inasmuch as several banks in their replies to the questionnaire issued by us made a plea for a switch-over from a system of cash credit to loans as in the U.S.A.

47. We wish to emphasise further that the proposed changes in the cash credit/overdraft of banks would have little impact on a majority of units in the corporate sector. It is noticed that out of 1501 companies covered in the Reserve Bank study for 1966-67, 360 companies (accounting for about 24% of the total number of companies and 20% of the total assets) had an adverse current ratio in 1966-67. In addition, 277 companies (accounting for 19% of the total number of companies and 18% of the assets) had in 1967 a current ratio of 1.5:1 which could be regarded as marginal and just adequate to meet the margin on working capital advances. Among the companies with adverse current ratio in 1966-67 for which back data were available, 255 companies witnessed a deterioration in the current ratio since 1961-62 and the impact of our proposal would be particularly

felt on these companies and also to some extent on 277 companies which had a current ratio of up to 1.5 in 1966-67. Some impact may also be felt by other companies which had a negative current ratio in 1967 but which showed some improvement in their position since 1962. Companies presenting these characteristics but outside the group of companies studied by the Reserve Bank would also be subject to some discipline. We would like to reiterate that in the long run these companies would stand to benefit inasmuch as the type of discipline implicit in our proposal would help to place the finances of these companies on a sound footing in course of time.

It may also be stressed in this connection that the companies with strong liquid position and having a current ratio of, say, 2.5:1 or more would not normally require long-term loans for working capital since, even under the present cash credit system, such companies resort to cash credit advances only by way of purely, short-term accommodation,unless they embark upon a large scale capital expenditure programme which is likely to impair their liquid position. The observations in the foregoing paragraphs regarding the assessment of the borrower's requirements and the manner in which they should be financed (both by way of term credit as well as short-term credit) could be equally applicable to new credit proposals which banks would be called upon to handle, in future.

48. The changes in the pattern of lending on the above lines would have certain distinct advantages as under:-

<u>Advantages of the proposed change in lending under cash credit</u>

(a) As is evident from the data given above, under the present cash credit system, it is not possible to achieve any meaningful regulation of a bank's credit portfolio as the bank has no control over the end-use of the loan. For instance, in a situation where the scheduled commercial banks are required, in the context of the requirements of the economy, to discourage the use of bank finance for excess inventory accumulation, banks are unable to implement their objectives. This is particularly so in the case of the borrowers who have borrowed to the extent of the security available. Moreover, where borrowers have surplus drawing power, the possibility of utilising this (i) for speculative purposes or for investments in shares and debentures, (ii) for acquiring controlling interest in new concerns or (iii) for building up further fixed assets is always present.

(b) The proposed lending system would also make the resources planning of banks more meaningful. Under the present cash credit system, banks are committed to large credit limits sanctioned to borrowers which, as experience shows, remain substantially unutilised. As at the end of April in the last three years, the proportion of unutilised limits for all the banks, on an average, was about 40%. This ratio was markedly higher for a few banks. As banks are committed to the limits sanctioned by them, the amount of unutilised limits represent potential demand which the borrowers can make on them and in a situation when banks' resources are stretched, they are normally reluctant to undertake fresh commitments of any substantial magnitude. As a result, there is always a possibility of new projects being denied their due share of bank credit. It may be added in this connection that although technically banks have at present every right to freeze the credit limits in the light of their resources position and the objectives of the credit policy, this can rarely be translated into practice at short notice, as any sudden restrictive measures taken by them are only likely to result in great dislocation in credit distribution and consequent curtailment of production.

(c) One handicap from which commercial banks suffer at present is that they are not in a position to regulate extension of credit on the basis of the efficiency of the borrowing concerns. This is because since no repayments are stipulated on cash credit advances, once the credit limit is sanctioned, the borrower is not normally regarded to have committed a default in honouring his obligations to the bank so long as the drawings in the account are within the drawing power available on the basis of the inventories carried from time to time. This has resulted in the inability of banks to impose any controls on inefficient units as there are no covenants on the part of the borrowers to maintain a minimum standard of financial performance. Under the system recommended, since specific repayment instalments would be stipulated, the failure of the borrowers to meet their repayment obligations or honour their other covenants would constitute a default and the banks, protected by the covenants in the loan documents, will be entitled to take remedial action and at any rate would exercise caution in granting further loans to such units. This would go a long way in introducing the much needed financial discipline amongst banks' borrowers.

(d) This system should also be advantageous from the point of view of borrowers. A number of companies in India now have a negative current ratio, i.e., their current liabilities exceed their current assets for the reasons described earlier on in the report. By segregating the cash credit outstandings into two parts and transferring one part thereof to a term loan account, the current ratio would improve and the companies would also have an assurance that the loan would be continued during the currency thereof subject to continued adherence to the covenants of the loan agreement. We would, however, stress that the mere improvement of the current ratio will not impart financial strength where the company has a high debt : equity ratio. In such cases, fresh injection of equity would be necessary.

49. It would be of interest to notice what a recent article published in the "Three Banks Review" (March 1969) entitled, "The liquidity of commercial banks in the United States in the twentieth century" by J.R. Sclater had to say on the subject considered by our Group:-

"....At the beginning of this century the commercial loan theory, which had originated with Adam Smith in Britain during the eighteenth century, still prevailed in the United States. According to this theory, the earning assets of banks should consist essentially of short-term, self-liquidating loans to businesses for working capital purposes. The logical basis of the doctrine was that bankers borrow short and should therefore lend short.

The theory was unsound, however, in three major respects. First, no loan is truly self-liquidating; repayment in almost every case depends on the successful completion of transactions involving numerous third parties. Second, the theory was based on the legal right to withdraw all deposits rather than on the actual behaviour of deposits; deposits in fact are relatively stable, and to that extent banks can properly hold longer-term assets. And third, the theory provided liquidity only in relation to defensive needs; it took no account of the aggressive liquidity which might be required to meet loan expansion.

But the commercial loan theory died as a working tool not so much on account of its conceptual flaws as of its sheer impracticality. Although bankers were mostly slow to learn about marketing they could not fail to see that their customers wanted far more than the sort of loans for which the theory provided. American consumers wanted instalment loans and businessmen term loans on an ever-growing scale. Consequently the commercial loan theory gradually became obsolete to the point where today its requirements are probably met by less than 20 per cent of bank loans....."

".......In response to the changing environment a new view of liquidity, known as the doctrine of anticipated income, developed in 1949 by Herbert V. Prochnow. Prochnow noted that for a decade or more the terms of bank loan contracts have been changing - with major implications for bank liquidity. The old practice was to lend on a short-term basis, even if the proceeds were to be invested in a medium or long term project. At maturity the loan would be rolled over, unless the borrower's credit had deteriorated, and a facade of conformity with the commercial loan theory was thus preserved. This facade, which still very often obtains in the United Kingdom, left borrowers in a limbo of doubt about renewals at maturity, led to haphazard debt repayment in the absence of a firm schedule, and exposed the banks to unnecessarily random fluctuations in their cash flows.

The new type of loan contract, being on an amortised basis, was superior to the old in systematically adapting the repayment schedule to the expected cash flow of the borrower. Prochnow concluded that most loans were now not self-liquidating but were rather repaid over a period from what the borrower earned on his transactions with many other parties. The vitally important instalment repayment schedule gave a substantial boost to bank liquidity."

50. Apart from the change in the cash credit system proposed in this report, there are certain other points on which suggestions may be made to reduce the excess demand for bank credit.

Commitment charge on unutilised limits

51. A reference has been made earlier to the large proportion of limits sanctioned by banks remaining unutilised. No doubt, recourse to cash-flow analysis as well as the bifurcation of the working capital advances proposed by us would help considerably in tailoring the supply of bank credit to the genuine requirements of the borrowers. A suggestion has been made that as a further check on extension of extra bank credit, it would be desirable to levy a commitment charge on the unutilised limits coupled, if necessary, with a minimum interest charge. It is not possible to indicate how deterrent a commitment charge by itself would be in preventing a rise in credit limits. Nevertheless, a levy with a minimum interest charge may prove to be complementary measures to those suggested earlier. From the point of view of administrative convenience, at the initial stages, limits sanctioned up to Rs.10 lakhs may be exempted but for serving the desired purposes, the commitment levy may be progressively raised with the size of the unutilised limits.

52. Yet another aspect of the banking practice bearing on the subject of our enquiry is the relatively small proportion of bills in the composition of bank credit.

Need for greater recourse to bill finance

This is partly because we understand that a sizeable amount of short-term finance provided by banks for sale of stocks (trade credit) is in the form of cash credit against the collateral of book debt. Such a practice may in most instances result in an elongation of the period of bank credit as there is no discipline imposed on the purchasers to pay the dues within a stipulated time. Therefore, in our view, it seems worthwhile to promote the practice of culminating credit sales by issue of usance bills. This would not only impose financial discipline on the purchaser but also help the supplier or producer to plan his financial commitments in a realistic manner. In the case of Usance Bills, excepting risk of bad debt, which could be noticed immediately and steps taken for recovery, there is no further risk to the bank. In the cash credit system, however, banks cannot in the nature of things be expected to possess expertise in the matter of identifying the nature and quality of goods or their serviceability. Moreover, the value of stocks will remain subject to price fluctuation, and abuses such as pilferage or disposal of stocks without bank's knowledge will not be discovered by the bank soon enough. The supplier of goods is in a better position to assess the nature and quality of goods. Finance to the supplier through discounting of bills would be a superior method of financing to providing finance to the industry by means of cash credit against inventories. Credit control would be far more effective if finance for industry is provided not to the industry holding the inventory but to the supplying industry or trade. We realise that this will not be feasible in all cases and also not immediately possible. Nevertheless for commercial banks extension of credit through Usance Bills which are self-liquidating in nature would considerably reduce the cost of credit administration, as against pledge or hypothecation advance. The borrower would also benefit from the system of Usance Bills for he need no longer engage himself in the bothersome and expensive task of chasing and collecting of customers dues. An adequate growth in the volume of Usance Bills would also facilitate the development of genuine Bill Market in India. We, therefore, are of the view that commercial banks, industry and trade should try, where feasible and administratively convenient, to initiate and develop the practice of issue of usance bills and their acceptance for the purposes of trade credit and for securing discounting facilities against them. We also recommend that with a view to encouraging the development of bill market in India, the Central Government may consider a reduction in the stamp duty on usance bills; we believe that the loss in revenue following a reduction in stamp duty would be more than made good by the resultant larger volume of usance bills.

<u>Control of inventories</u>

53. We have so far concentrated primarily on the supply side of bank credit. Since supply of credit is essentially function of demand for credit, it is necessary to examine how far the credit demand could have been a factor resulting in the flow of excess credit to industry and,

if so, how it could be kept to the minimum without hampering production. This is an aspect of inventory control to which considerable attention is being paid in advanced countries such as the U.K., U.S.A., Japan and West Germany. In India, some of the large and well established industrial companies appear to have been paying attention to the problem of inventory control but it has not been possible to assess the degree of success achieved by them in this regard.

54. The total investment in inventories as at 1966-67 of 1501 companies covered in the Reserve Bank's study amounted to Rs.1522 crores which formed about 30% of capital employed (gross fixed assets + inventories) in these companies which compared with 26% in U.K. and 28% in Japan. It will be seen from the following table that in 1966-67 the inventory held by 1501 companies referred to above covered 3 to 6½ months' production requirements although the inventory held in 1966-67 would be partly inflated on account of recession:

TABLE 15

Inventories in stocks (of raw materials, finished goods, stores)/number of months sales

	1960-61	1965-66	1966-67
1. Cotton textiles	3.6	3.6	3.7 months
2. Jute textiles	2.9	3.0	3.3 "
3. Iron and Steel	4.1	3.6	4.8 "
4. Electrical machinery, apparatus, etc.	4.4	3.9	5.1 "
5. Machinery(other than transport and electrical)	5.2	4.9	6.4 "
6. Basic Industrial Chemicals	4.1	3.9	4.4 "
7. Medicines & Pharmaceuticals and other Chemical Products	3.7	3.4	3.4 "
8. Cement	3.2	3.4	3.8 "
9. Paper and paper products	3.3	3.6	4.1 "

In the preceding year i.e. in 1965-66 the quantity of stocks held ranged between 3 to 5 months' production requirements. It may be noted that between 1960-61 and 1965-66, the quantity of inventories held in relation to production went up in respect of jute textiles, cement and paper and paper products. We are aware that there are various factors which influence the holdings of inventories as between the different industries. It has not been possible for us within the limited time available to us to go into the question of adequacy or otherwise of stocks of inventories held by various industries and the scope for minimising the stocks need by industry. We, however, consider that as an integral part of restraining the demand for bank credit by industry, adequate attention should be paid to this problem, especially in regard to a few major industries. The Federation of Chambers of Commerce and Industry, the All-India Manufacturers' Organisation and such other Associations of Industries may be requested to take up this subject for examination and offer guidelines to their industry-members.

<u>Multiple banking</u>

55. In some countries such as the U.K., West Germany and Norway, a customer normally routes his entire business through one bank. Such a system is normally convenient to the borrower as well as the bank and could, with advantage, be adopted in our country. This would considerably reduce the scope for double or multiple financing of stocks by banks in the present form of bank lending. Even if the lending system recommended above is adopted, it would be in the interests of both the borrowers and the banks if the borrower could confine his dealings to one bank only as the borrower would not be tempted to go to another bank for temporary facilities to cover up the default committed under the borrowing arrangement with his bank. It is, therefore, suggested that as

a general rule at least the major banks (say those banks having deposits of Rs.100 crores and above and which would account for three-fourths of total bank credit) might consider entering into a gentleman's agreement that they would not accommodate a customer who is banking with any other bank except with the prior intimation to the lending bank. We realise that there may be circumstances in which borrower may have to approach another bank for his reasonable requirements in case the proposal does not fit in with the norms or policies of his existing bank; our suggestion would not be applicable to such cases. We understand that there is joint collaboration as between banks, on a limited scale, where credit requirements of borrowers are very large and could not be met out of resources of one bank. We commend the adoption of such consortia arrangements by banks for large loans.

56. To sum up, it would be desirable to adopt the following proposals for ensuring the best possible use of limited resources of banks (1) the adoption of the 'cash flow analysis' of the financial position of the borrowers (large and medium), (2) the determination of what may be deemed as (i) the hard core and (ii) fluctuating components of existing and proposed cash credit advances and seek appropriate solutions to lessen the use of short-term bank credit for long-term use as also reduce over a period of time the dependence of borrowers on the short-term bank credit for 'hard core', (3) examine the scope and effectiveness for the levy of a commitment charge on unutilised credit limits, (4) the increasing use of bills wherever possible, (5) the adherance to a rule, as far as possible, that each borrower confines his dealings to one bank, and (6) recourse to better methods of inventory control by industrial units.

...59.

57. Some of the suggestions made in this report would call for a considerable degree of reorientation in the outlook, attitudes and methods of loan operations of banks and borrowers, particularly the latter. A certain measure of financial discipline implicit in the suggestion would, in the ultimate analysis, help the corporate and other borrowers in formulating financial plans, maintaining a better control over their inventories, regulating production on a more rational basis and economising in the demand for bank credit. As regards banks, a periodical release of part of the resources at present locked up in 'roll over' cash credit/overdraft to industry would enable them to meet on a larger scale the demands of the priority sectors of the economy, viz. agriculture, exports and small industries. It would also facilitate a widening of their credit base which at present is very narrow inasmuch as the total number of accounts with banks as at March 1967 was hardly about 10.6* lakhs as against deposit accounts of 140.1 lakhs. There would thus seem to be considerable scope for commercial banks to diversify their loan transactions in terms of number of borrowers. Moreover, the pattern of bank credit in India which is at present heavily tilted in favour of industry as compared to several other developed countries, would seem to afford further scope for diversification of advances to other sectors such as retail trade, transport operators, construction activity, etc. This, in its turn, would increase the scope for mobilisation of deposits. In other words, commercial banks would thus be able to play a more effective role in serving the community and the ends of social justice.

Some Implications of the Proposals

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* Data on number of borrowers are not available.

Nationalisation of banks

58. Since the above report was finalised, 14 major Indian scheduled commercial banks (with deposits above Rs.50 crores) have been nationalised. The organisation and the administrative structure of the nationalised banks are not known so far. We, however, consider that our recommendations, which have a vital bearing on the principles governing extension of credit to major borrowers by the commercial banks would in fact be of considerable significance in the new context.

Acknowledgements

59. We are grateful to the Department of Statistics of the Reserve Bank of India for making available to us the balance sheets of companies obtained by them for their study of company finance. Particular mention has to be made of the detailed work done over several weeks by Shri K.N.R. Ramanujam and Shri D.G. Borkar of the Reserve Bank and Shri K.J. Natarajan and Shri N.R. Kulkarni of the State Bank in the matter of collection of data and the preparation of draft paragraphs. But for their hard labour, cheerfully undertaken, the Working Group would have had enormous difficulty in preparing this report.

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SUMMARY

The gap in the accrual of deposits available with the commercial banks for financing credit is markedly reflected during the busy season of the year, and is made good by their recourse to short-term borrowings from the Reserve Bank. The volume and duration of such borrowings should be kept to the minimum. (paragraphs 2 and 3).

2. The Reserve Bank endeavours to control the total supply of bank credit to the economy, the share of different sectors and the individual corporate and other borrowers in each sector being left to the discretion of individual banks. (paragraph 5).

3. The industrial sector accounted for roughly two-thirds of total scheduled bank credit as on March 31, 1967. The share of bank credit to industry showed a steady increase while that of commerce had declined. The corporate sector (excluding Government companies) claimed nearly four-fifths of scheduled commercial banks' industrial advances as at the end of March 1967 while partnership and proprietary concerns, etc. accounted for more than two-thirds of advances to commerce. (paragraphs 6 and 7).

4. The credit needs of industry or trade may be considered to be inflated if, over a period of years, (i) the rise in short-term credit is substantially higher than the growth in industrial production or the increase in inventories; (ii) there is a diversion of short-term bank borrowings for building up of fixed assets or other non-current assets; (iii) there is a double or multiple financing of stocks and (iv) the period of credit is unduly lengthened. (paragraph 8).

5. The ratio of bank borrowings to inventory after rising up to 1965-66 came down in 1966-67. A study of the expansion in bank advances to trade in relation to the increase in value of production in two groups of commodities viz. (a) chemicals, dyes, paints and pharmaceuticals and (b) textiles showed that there was no excess credit to trade engaged in the production of these industries. This might be assumed to hold good for most other commodities. (paragraphs 9-11).

6. Over the past few years industry appeared to have practised a fairly stable inventory behaviour as reflected in the generally constant inventory/sales ratio. The rise in bank credit to industry during each of the years 1964-65 to 1966-67 was substantially higher than the increase in value of industrial output valued at current prices. The ratio of short-term bank borrowings to inventories also rose from 40% in 1961-62 to 52% in 1966-67. Some industries, particularly those in the traditional group and several industrial units obtained credit from banks over and above the rise in their production. It, therefore, appears that in the absence of specific restraints, there was a tendency on the part of industry generally to avail itself of short-term credit from banks in excess of the amounts based on the growth in production and/or inventories in value terms. (paragraphs 12-14).

7. The prevalent practice of banks in fixing credit limits for industrial borrowers are so varied that there is reason to believe that within their ambit they are unlikely to prevent the emergence of excess demand for credit from certain borrowers. By and large, the scheduled commercial banks are inclined generally

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to relate their credit limits to the security offered by their constituents. Banks also do not generally adopt a uniform method of valuation of stocks nor do they have a uniform practice as regards the prescription of margins. The varying practices, however, cannot be said to constitute important factors in the emergence of excess credit. (paragraphs 18-20).

8. The need for extension of trade credit by the corporate sector, seemed to have become marked in view of the emergence of a buyers' market in certain lines of activity in the last year or so. The available data are, however, incomplete to lead to any conclusion whether the increase in trade credit by the corporate sector necessarily resulted in an increased demand for bank credit. (paragraph 21).

9. With a view to preventing undue elongation of the period of trade credit and the tying up of resources of banks for unproductive purposes, it is considered that the period of trade credit should not normally exceed 60 days and in special circumstances up to 90 days (excluding sales of capital equipment on deferred payment terms). The undue delay in the settlement of bills by Government Departments could be discouraged by stipulating that the latter should pay interest on bills if they are not paid within 90 days after their receipt (accompanied by approved inspection notes or through such other safeguards as may be necessary for receipt of goods according to specifications). (paragraph 22).

10. In the present system of bank lending in India, certain types of credit facilities such as advances against receivables can result in double or multiple financing of stocks. This can be eliminated if, at the time of assessment of credit requirements of a borrower,

due account is taken of the credit received on its purchases. (paragraph 23).

11. The factors referred to above could have only partly contributed to the rise in <u>short-term</u> bank credit not warranted by increase in production/inventories of certain types of borrowers. A study of 255 companies as had witnessed a deterioration in their current ratio over a period of years revealed that between 1961-62 and 1966-67, the increase in short-term liabilities were utilised for financing the gap between long term assets and long term liabilities. One-fifth of the gross fixed assets formation of these companies was financed and in addition non-current assets comprising mostly loans were acquired by expansion in short-term liabilities including bank loans. An industry-wise analysis of the companies on the same lines also confirmed the same trend. (paragraphs 24-29).

12. The tendency on the part of a number of industrial units to utilise short-term bank credit and other current liabilities for acquisition of non-current assets can be due to (a) generally sluggish conditions in the capital market since 1962, (b) the limited nature of the appraisal of applications for short-term loans as compared to medium term loans and (c) stipulation of repayment scheduled for medium-term loans. (paragraph 32).

13. The prevalent lending system would appear to have greatly assisted certain units in industry on increased reliance on short-term debt to finance their non-current investment. The working capital advances of banks are granted by way of cash credit limits which are only technically repayable on demand. The system was found convenient in view of the emphasis placed by banks on

the security aspect. These short-term advances though secured by current assets are not necessarily utilised for short term purposes. The result is that cash credit advances have no longer remained short-term or self-liquidating. The possibility of heavy reliance on bank credit by industry arises mainly out of the way in which the system of cash credit which accounts for 70% of total bank credit has been operated in recent times. (paragraphs 33-36).

14. A substantial part of the working capital advance is permanently needed by the unit to carry on its operations. Therefore, in the financial planning of the borrowing unit it is necessary to see what would be its permanent lock up of funds in working capital as distinct from its purely temporary requirements and to arrange for term finance subject to observance of a proper debt:equity ratio. (paragraph 37).

15. Unless measures are taken now to check the tendency, for diversion of bank credit for acquiring long term assets it may assume wider dimension in the next few years. The suggestions for checking this tendency are :

(1) Appraisal of credit applications should be made with reference to the total financial situation, existing and projected, as shown by cash flow analysis and forecasts submitted by borrowers. Initially advances of, say Rs.50 lakhs and over should be analysed this way and then the system may gradually be extended to other advances. (paragraphs 38-39).

(2) Outstandings in cash credit accounts should be distinguished as between (i) "the hard core" which would represent the minimum level of raw materials, finished goods and stores which the industry is required

to hold for maintaining a given level of production and (ii) the strictly short-term component which would be the fluctuating part of the account. The latter part of the account would represent the requirements of funds for temporary purposes, e.g. short term increase in inventories, tax, dividend and bonus payments etc., the borrowings being adjusted in a short period out of sales. Where the company's debt-paying capacity is good and its other ratios not unhealthy, the hard core element in the cash credit borrowings could be segregated and put on a formal term loan basis and subject to repayment schedule. Where the financial position is not too good or the size of the hard core is large, the possible solutions to be attempted would be : additional issue of equity or preference capital, a debenture issue with a long maturity, the bringing of long term deposits and unsecured loans by the promoters and their friends. Where the hard core is to be placed on a formal term loan basis, the proposal should be subject to a detailed appraisal. The documents should contain covenants in regard to the end-use of the loan, maintenance of minimum financial ratios, repayment obligations, restrictions on investments in shares and debentures, etc. (paragraphs 40-45).

16. As the determination of the hard core element of the cash credit account may present some practical difficulties to banks, it would be worthwhile to attempt study of industry-wise norms for minimum inventory levels. (Paragraph 44).

17. The intention in suggesting this type of lending on a term basis for working capital is not to deny credit assistance to expanding industrial units or to bring down immediately the present level of bank credit to industry. The borrower would only be subject to a

greater financial discipline and a repayment of such loans over a period of time; this will provide a more effective use of bank's funds. (paragraph 46).

18. The proposed changes in the cash credit/overdraft accounts of banks would have little impact on a majority of units in the corporate sector. Only units which witnessed a deterioration in the current ratio resulting now in a negative ratio or a current ratio of 1.5 and below are likely to be affected. (paragraph 47).

19. As a complementary measure to check the extension of extra bank credit, it would be desirable to levy a commitment charge on the unutilised limits in cash credit accounts coupled, if necessary, with minimum interest clause. (paragraph 51).

20. Also, banks should promote the practice of culminating credit sales by issue of usance bills. This would not only impose financial discipline on the purchaser but also help the supplier or producer to plan his financial commitments in a realistic manner. With a view to encouraging the development of bill market, the Central Government may consider reduction in the stamp duty on usance bills. (paragraph 52).

21. On the side of demand for bank credit it would be worthwhile to go into the question of adequacy or otherwise of stocks of inventory held by the various industries. (paragraph 54).

22. To reduce the scope for double or multiple financing of stocks, a customer should generally be required to route his entire business through one bank and the major banks may consider entering into a gentleman's agreement for the purpose. (paragraph 55).

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23. A certain measure of financial discipline implicit in the above suggestions would ultimately help the corporate and other borrowers in formulating financial plans, regulating production on a more rational basis and economising in the demand for bank credit. As regards banks, a periodical release of the part of the resources at present locked up in 'roll over' cash credit/overdraft to industry would enable them to meet on a larger scale the demands of priority sectors of the economy and to diversify their loan transactions. (paragraph 57).

ANNEXURE I

RESERVE BANK OF INDIA
CENTRAL OFFICE
INDUSTRIAL FINANCE DEPARTMENT
"COMMERCIAL MANOR"
CHINCH BUNDER
BOMBAY-9.

No. C.290(D)-932.

December 16, 1968
Agrahayana 25, 1890 (Saka).

Dear Sir,

Study Group II set up by the National Credit Council - Subject "the extent to which the credit needs of industry and trade are likely to be inflated and how such trends could be checked"

In recent years, the demand for credit from trade and industry has been far ahead of the deposit resources which have been accruing to the banking system. While the subject matter of mobilisation of deposits has been assigned to another Study Group, the issue to be considered by this Study Group is to what extent the principles governing extension of credit by banks could be improved upon and their methods streamlined. To facilitate this work and in the absence of any readily available information on the methods followed by banks extending credit, I have been asked by the Convener of the Study Group to approach the major scheduled banks for information on the following points :

(a) The Study Group would like to know if you have set any guidelines for assessing the working capital requirements of your corporate borrowers. It would be useful if a concrete example showing how the working capital requirements of a corporate borrower have been assessed and how the quantum of the limits is related to the stocking of raw materials and finished goods and the stocks-in-process, is given.

Sundry creditors form one source of finance for the borrower. How is this taken into account in fixing the quantum of the limit? An illustration would be welcome.

(b) Is a uniform system of valuation of stock-in-trade followed to determine the drawing power on an account? What is the basis of this valuation? In what circumstances is it relaxed?

(c) It has been suggested that the level of outstanding credit from banks is higher than necessary because of the large amounts carried as sundry debtors by borrowers and the long period taken for the settlement of the debt. Would it be possible for you to set out your experience in this matter? In what fields of activity are debtors unduly high and what type of debtors particularly account for delayed payment?

(d) The Study Group would like to know the usual margins prescribed by you for the different types of advances to your customers (pledge, hypothecation, bills, etc.) and the circumstances in which the margins are relaxed and also when advances are made on a clean basis.

(e) Kindly indicate how often and what type of review is undertaken in respect of credit limits sanctioned by you for purposes of working capital.

(f) It is evident that in recent years there has been a tendency on the part of corporate borrowers, in the context of the conditions in the capital market, to use funds availed of for working capital purposes for acquisition of fixed assets or other non-current assets. The Study Group would appreciate if you could kindly suggest appropriate safeguards as also the steps to be taken to ensure that such advances are gradually repaid.

(g) Do you consider that the lending practices of banks at present have resulted in double or multiple financing of stocks of raw materials and finished goods? If so, can you kindly identify the procedures/practices which are responsible therefor and also indicate the steps to rectify the position?

(h) The Study Group invites comments from you on the subject matter assigned to it; more particularly suggestions which you may like to make on the present lending practices of banks and whether any changes or modifications should be made therein are welcome.

A reply to this questionnaire not later than January 20, 1969 will be very much appreciated.

Please acknowledge receipt.

Yours faithfully,

Sd/-

(K.N.R. Ramanujam)

ANNEXURE II

Sources and uses of.funds during

		(Rs. in lakhs) Inflow	Outflow
Net profit/loss (before taxes but after depreciation)	...		
Increase in Share Capital	...		
Provision for depreciation	...		
Provision for taxation	...		
Dividends	...		
Deferred Liabilities			
(a) Increase/Decrease in Term Loans	...		
(b) Increase/Decrease in Debentures/ Mortgage Loans	...		
(c) Increase/Decrease in Other Deferred Liabilities	...		
Short-Term Borrowings			
Increase/Decrease in Short-term bank borrowings	...		
Increase/Decrease in Other short-term borrowings including deposits	...		
Other Current Liabilities			
(a) Increase/Decrease in Sundry Creditors	...		
(b) Increase/Decrease in Other Current Liabilities	...		
Increase/Decrease in Other funds	...		
Increase/Decrease in Fixed Assets	...		
Investments			
(a) Increase/Decrease in Investments in Subsidiaries and Affiliates	...		
(b) Increase/Decrease in Investments in Other Companies	...		
Current Assets			
(a) Increase/Decrease in Raw Materials	...		
(b) Increase/Decrease in Finished goods and work-in-progress	...		
(c) Increase/Decrease in Stores, spares etc.	...		
(d) Increase/Decrease in Book Debts	...		
(e) Increase/Decrease in Other Current Assets	...		
Loans and Advances			
(a) Increase/Decrease in Loans to Subsidiaries and Affiliates	...		
(b) Increase/Decrease in Loans to others	...		

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Statement I

Changes in Net Bank Credit to Private Sector in relation to Money Supply

(Rupees in crores)

Busy Season (November - April)	Increase in money supply with the public	Increase in Net Bank Credit to Private Sector (3 + 4)	Increase in Reserve Bank Credit to Private Sector	Increase in Bank's Net Credit to Private Sector (5 - 6)	Increase in Bank's Advances and Holdings of Private Securities	Increase in Bank's Time Deposits	Percentage of (2) to (1)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1966-67	456	358	3	355	408	53	78
1967-68	546	415	4	411	519	108	76
1968-69	585	250	2	248	436	188	43

Source: Reserve Bank of India Bulletin.

Statement II

Distribution of Bank Credit to various sectors

(In crores of Rupees)

Sector	March 1951		March 1956		April 1961		March 1966		March 1967	
	Amount	Percentage to total	Amount	Percentage to total	Amount	Percentage to total	Amount	Percentage to total	Amount	Percentage to total
Industry	198.9	34.0	285.7	37.1	663.8	50.8	1471.0	62.7	1748.0	64.3
Commerce	210.6	36.0	281.0	36.5	373.2	28.6	502.3	21.4	526.5	19.4
Financial	74.0	12.7	71.9	9.3	67.1	5.1	77.6	3.3	96.7	3.6
Personal	39.7	6.8	51.1	6.6	87.9	6.7	107.8	4.6	114.5	4.2
Agriculture	12.4	2.1	15.6	2.0	40.5	3.1	56.5	2.4	56.7	2.1
Government	-	-	-	-	-	-	-	-	13.1	0.5
Others	49.0	8.4	64.9	8.4	73.7	5.6	131.6	5.6	161.8	5.9
Total	584.6	100.0	770.2	100.0	1306.2	100.0	2346.8	100.0	2717.3	100.0

Source: Reserve Bank of India Bulletin - December 1968.

Statement II

Distribution of Bank Credit to various sectors

(In crores of Rupees)

Sector	March 1951		March 1956		April 1961		March 1966		March 1967	
	Amount	Percentage to total	Amount	Percentage to total	Amount	Percentage to total	Amount	Percentage to total	Amount	Percentage to total
Industry	198.9	34.0	285.7	37.1	663.8	50.8	1471.0	62.7	1748.0	64.3
Commerce	210.6	36.0	281.0	36.5	373.2	28.6	502.3	21.4	526.5	19.4
Financial	74.0	12.7	71.9	9.3	67.1	5.1	77.6	3.3	96.7	3.6
Personal	39.7	6.8	51.1	6.6	87.9	6.7	107.8	4.6	114.5	4.2
Agriculture	12.4	2.1	15.6	2.0	40.5	3.1	56.5	2.4	56.7	2.1
Government	-	-	-	-	-	-	-	-	13.1	0.5
Others	49.0	8.4	64.9	8.4	73.7	5.6	131.6	5.6	161.8	5.9
Total	584.6	100.0	770.2	100.0	1306.2	100.0	2346.8	100.0	2717.3	100.0

Source: Reserve Bank of India Bulletin - December 1968

Statement III

Bank credit to selected industries/ groups under the main sectors

(In crores of Rupees)

	March 1956		April 1961		March 1967	
	Amount	Percentage to total	Amount	Percentage to total	Amount	Percentage to total
A. Industry	285.7	37.1	663.8	50.8	1748.0	64.3
1. Cotton Textiles	62.7	8.1	145.1	11.1	268.8	9.9
2. Jute Textiles	23.1	3.0	32.1	2.5	77.4	2.9
3. Other Textiles	18.9	2.4	20.0	1.5	74.3	2.7
4. Sugar	48.8	6.3	99.9	7.7	107.0	3.9
5. Vegetable Oils & Vanaspati	13.8	1.8	27.4	2.1	48.6	1.8
6. Mining & Quarrying	7.1	0.9	12.6	1.0	43.9	1.6
7. Iron & Steel	7.7	1.0	33.9	2.6	99.1	3.7
8. Engineering	32.9	4.3	122.4	9.4	432.8	15.9
(a) Heavy	-	-	46.0	3.5	228.0	8.4
(b) Light	-	-	76.4	5.8	204.8	7.5
9. Chemicals, dyes, drugs & pharmaceuticals	10.3	1.3	33.0	2.5	92.0	3.4
B. Commerce	281.0	36.5	373.2	28.6	526.5	19.4
1. Wholesale trade	265.8	34.5	353.0	27.0	476.8	17.6
(a) Agricultural Commodities	132.1	17.2	143.0	10.9	212.3	7.8
(b) Non-Agricultural Commodities	133.7	17.3	210.0	16.1	264.5	9.7
2. Retail	15.2	2.0	20.2	1.5	49.7	1.8
C. Financial	71.9	9.3	67.1	5.1	96.7	3.5
1. Co-operative Banks	0.9	0.1	1.7	0.1	19.2	0.7
2. Shroffs	13.1	1.7	17.2	1.3	14.5	0.5
3. Others	57.9	7.5	48.2	3.7	63.0	2.3
D. Agriculture	15.6	2.0	40.5	3.1	56.7	2.1
Plantation	-	-	35.1	2.7	47.1	1.7
E. Personal	51.1	6.6	87.9	6.7	114.5	4.2
F. Government	-	-	-	-	13.1	0.5
G. Others	64.9	8.4	73.7	5.6	161.8	6.0
H. GRAND TOTAL	770.2	100.0	1306.2	100.0	2717.3	100.0

Source: Reserve Bank of India Bulletin - December 1968.

Statement IV

Industrial advances by type of Borrowers

(Amount in crores of Rupees)

	April 1961*		March 1966		March 1967	
	Amount	As per-cent of total In-dustrial advances	Amount	As per-cent of total In-dustrial advances	Amount	As per-cent of total Indus-trial advances
	(1)	(2)	(3)	(4)	(5)	(6)
1. State-owned and State-managed concerns	29	4.2	76	5.2	105	6.0
2. Limited Companies** (Public & Private)	567	83.4	1201	81.6	1380	79.0
3. Co-operatives	-	-	-	-	9	0.5
4. Partnerships and Others	68	12.4	194	13.2	254	14.5
Total Industrial Advances	664	100.0	1471	100.0	1748	100.0

* Data for 1961 have not been reclassified in line with the classification adopted for 1967 survey as the break-downs are not available.

** Other than Government Companies.

Advances to commerce by type of Borrowers

(Amount in crores of Rupees)

	March 1965*		March 1966		March 1967	
	Amount	As per-cent of total advances to commerce	Amount	As per-cent of total advances to commerce	Amount	As per-cent of total advances to commerce
	(1)	(2)	(3)	(4)	(5)	(6)
1. State-owned and State-managed concerns	17	3.2	54	10.8	24	4.5
2. Limited Companies** (Public & Private)	150	27.9	122	24.3	139	26.4
3. Co-operatives	-	-	-	-	4	0.8
4. Partnerships and Others	370	68.9	326	64.9	360	68.3
Total Advances to Commerce	537	100.0	502	100.0	527	100.0

* Data for 1965 have not been reclassified in line with the classification adopted for 1967 survey as the break-downs are not available.

** Other than Government Companies.

Statement V

Statement showing variations in Prices, Production and Bank Credit during 1963 - 1967

(Bank Credit in crores of rupees)

Industries	Bank credit as on March 31, 1963	Percentage rise in prices during 1962-63 to 1966-67	Bank credit in col.2 raised by percentage rise in prices in col.3	Percentage rise/fall in industrial production during 1962-63 to 1966-67	Bank credit as in col.4 adjusted to percentage rise/fall in industrial production as in col.5	Bank credit as on March 31, 1967	Excess(+) or deficit(-) (col.7 - col.6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1. Cotton textiles	196.52	14.1	224.23	+ 8.9	244.19	268.83	+ 24.64
2. Jute textiles	50.84	46.0	74.23	- 6.7	69.26	77.43	+ 8.17
3. Rayon, Nylon and Silk textiles	20.51	21.4	24.90	+ 34.1	33.39	39.82	+ 6.43
4. Other textiles (Woollen)	20.75	21.4	25.19	- 29.5	17.76	23.01	+ 5.25
5. Iron and Steel	29.73	21.7	36.18	+ 34.0	48.48	99.09	+ 50.61
6. Coal Mining	6.73	19.6	8.05	+ 11.2	8.95	27.04	+ 18.09
7. Heavy machinery (Prime movers, boilers, steam generating plants, mining, earth moving and construction machinery and industrial machinery)	49.12	31.2	64.45	+ 41.9	91.45	77.14	- 14.31
8. Motor vehicles & ancillaries	24.54	29.7	31.83	+ 35.8	43.23	35.16	- 8.07

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Statement V (Contd.)

(Bank credit in crores of rupees)

Industries (1)	Bank credit as on March 31, 1963 (2)	Percentage rise in prices during 1962-63 to 1966-67 (3)	Bank credit in col.2 raised by percentage rise in prices in col.3 (4)	Percentage rise/fall in industrial production during 1962-63 to 1966-67 (5)	Bank credit as in col.4 adjusted to percentage rise/fall in industrial production as in col.5 (6)	Bank credit as on March 31, 1967 (7)	Excess(+) or deficit(-) (col.7 - col.6) (8)
9. Bicycles and Parts	8.23	29.7	10.67	+ 53.8	16.41	10.15	- 6.26
10. Sugar	86.76	23.4	107.06	+ 6.7	114.23	106.97	- 7.26
11. Vegetable oil crushing, Refining including Vanaspati	31.96	124.3	71.69	-	71.69	48.63	- 23.06
12. Chemicals, Drugs & Pharmaceuticals	47.41	24.9	59.22	+ 35.6	80.30	91.98	+ 11.68
13. Fertilisers	4.61	24.9	5.76	+ 65.0	9.50	18.87	+ 9.37
14. Paints and Varnishes	4.70	24.9	5.87	+ 1.4	5.95	7.05	+ 1.10
15. Cement	21.61	53.3	33.13	+ 25.0	41.41	29.40	- 12.01
16. Paper and Paper Products	19.01	53.3	29.14	+ 41.6	41.26	44.26	+ 3.00
17. Rubber products	13.05	53.3	20.01	+ 29.2	25.85	23.87	- 1.98

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Statement V (Concld.)

(Bank credit in crores of rupees)

Industries	Bank credit as on March 31, 1963	Percentage rise in prices during 1962-63 to 1966-67	Bank credit in col.2 raised by percentage rise in prices in col.3	Percentage rise/fall in industrial production during 1962-63 to 1966-67	Bank credit as in col.4 adjusted to percentage rise/fall in industrial production as in col.5	Bank credit as on March 31, 1967	Excess(+) or deficit(-) (col.7 - col.6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
18. Glass and Glassware	2.88	53.3	4.42	+ 38.2	6.10	7.40	+ 1.30
19. Tea	26.40	2.1	26.95	+ 7.9	29.08	37.43	+ 8.35

Note: 1) The classification of industries for the purpose of data on production does not strictly confirm to that adopted for the purpose of bank advances to industry and hence only those industries have been included as would ensure comparability of data as far as possible.

2) For working out the rise in prices during 1962-63 to 1966-67, prices of those commodities for which separate data are available have been taken into account; in other cases, the price rise in the two groups, namely, industrial raw materials and manufactures are taken into account.

Source: 1) Reserve Bank of India Bulletin - April, August and September 1963, January and July 1967 and December 1968.

2) Report on Currency and Finance for 1966-67.

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Statement VI

Statement showing Increase/Decrease in value of production and Bank Credit during 1962-63 to 1966-67 of Individual Companies

(In lakhs of Rupees)

Cotton Textiles

Company	Bank Credit in 1963 (Short-term)	Production* in 1963	Production* in 1967	Percentage rise/fall in industrial production	Bank Credit in Col.2 adjusted to percentage rise/fall in industrial production in col.5	Bank Credit in 1967 (Short-term)	Excess (+) or deficit (-) over actual credit (7 - 6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A	0.52	356	669	+ 88.3	1	95	+ 94
B	39	365	538	+ 47.5	57	45	- 12
C	15	196	269	+ 37.6	20	46	+ 26
D	3	1020	1411	+ 38.4	4	147	+ 143
E	11	100	121	+ 21.4	14	0.42	- 13.58
F	3	694	1223	+ 76.3	5	192	+ 187
G	59	260	346	+ 33.2	79	113	+ 34
H	58	273	270	- 1.1	58	34	- 24
I	192	675	1007	+ 49.1	286	435	+ 149
J	34	244	300	+ 22.8	42	98	+ 56
K	109	273	319	+ 16.7	128	97	- 31

Statement VI (Contd.)

(In lakhs of rupees)

Company	Bank Credit in 1963 (Short-term)	Production* in 1963	Production* in 1967	Percentage rise/fall in industrial production	Bank Credit in col.2 adjusted to percentage rise/fall in industrial production in col.5	Bank Credit in 1967 (Short-term)	Excess (+) or deficit (-) over actual credit (7 - 6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L	208	793	1936	+ 144.3	509	528	+ 19
M	72	162	194	+ 19.5	86	52	- 34
N	140	357	551	+ 54.2	216	240	+ 24
O	88	229	267	+ 16.5	102	138	+ 36
P	35	169	273	+ 61.4	57	26	- 31
Q	421	1256	1575	+ 25.5	528	292	- 236
R	69	298	345	+ 15.5	80	98	+ 18
S	135	413	754	+ 82.7	846	174	- 72
T	100	246	259	+ 5.1	105	134	+ 29
U	220	432	414	- 4.3	211	126	- 85
			Chemicals, Pharmaceuticals and Medicines				
A1	7	77	60	- 22.3	5	26	+ 21
A2	11	21	46	+ 115.1	24	7	- 17

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Statement VI (Concld.)

(In lakhs of rupees)

Company	Bank Credit in 1963 (Short-term)	Production* in 1963	Production* in 1967	Percentage rise/fall in industrial production	Bank Credit in col.2 adjusted to percentage rise/fall in industrial production in col.5	Bank Credit in 1967 (Short-term)	Excess (+) or deficit (-) over actual credit (7 - 6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A3	16	17	21	+ 24.4	19	10	- 9
A4	35	227	508	+ 123.8	78	105	+ 27
A5	138	249	568	+ 127.6	314	271	- 43
A6	8	16	126	+ 682.3	63	53	- 10
A7	116	233	633	+ 171.6	316	200	- 116
A8	4	41	84	+ 102.2	9	44	+ 35
A9	342	750	826	+ 10.1	377	531	+ 154

* Production = Sales during the year + Closing stocks - Opening stocks.

Source: Balance sheet of the respective company.

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STATEMENT -

Statement showing changes in current
the sources of their financing of pu
of which exceeded their current asse

Industrial Sub-Group	No.of compa-nies	Incr-ease or de-crease (-) in stocks & sto-res	Incr-ease or de-crease (-) in book debts	Incr-ease or decrease (-) in other current assets	Increase decrease(in other non-currei assets: Inve-stme-nts (unquo-ted)	Loar & Ac ance								
(1)	(2)	(3)	(4)	(5)	(6)	(7								
I) Agriculture & Allied Activities														
1. Tea	30	27	45	7	- 21	25				62	77	62	25	
2. Sugar	15	-197	10	8	6	- 28			444	2	494	118	174	
II) Mining & Quarrying														
3. Coal Mining	18	124	418	- 5	- 20	227	1168	95	605	173	295	245	461	333
III) Processing & Manufacture of food stuffs, textiles, leather and products thereof														
4. Edible vegetable oils	1	127	29	3	3	38	154	77	46	17	14	97	95	22
5. Tobacco	1	7	-	1	- 1	4	8	1	4	-	3	3	10	1
6. Cotton Textiles	103	2563	981	- 44	10	645	9810	514	3810	3132	2354	2924	1703	1882
7. Jute Textiles	16	824	476	41	- 23	303	1939	14	1095	331	527	1124	958	66
8. Miscellaneous	6	101	88	17	52	-	252	24	86	56	86	68	77	199
IV) Processing & Manufacturing Metals, Chemicals & Products thereof														
9. Transport equipment	3	783	108	- 2	162	102	634	300	195	81	58	736	346	129
10. Electrical Machinery, appliances, etc.	4	152	119	11	2	48	230	83	87	19	41	174	122	77
11. Machinery (other than transport & electrical)	7	242	109	46	34	134	614	237	243	79	55	258	147	265
12. Foundries & Engineering workshops	5	808	196	47	14	68	1285	288	434	310	253	818	501	67
13. Ferrous/non-ferrous metal products	3	239	71	20	- 8	58	481	226	106	87	62	158	124	160
14. Other metal products	1	95	12	- 6	-	4	167	59	26	67	15	67	19	34
15. Basic Industrial Chemicals	10	834	486	- 92	140	208	2868	610	1549	474	235	623	379	809
16. Medicines & Pharmaceuticals	3	150	96	23	-	77	215	51	90	61	13	174	54	131

Contd..... 2/-

Statement VII contd.

Industrial Sub-Group	No.of companies	Increase or decrease (-) in stocks & stores	Increase or decrease (-) in book debts	Increase or decrease (-) in other current assets	Increase or decrease(-) in other non-current assets: Investments (unquoted)	Loans & Advances	Increase or decrease (-) in fixed assets	Increase or decrease (-) in net worth	Increase in provision for depreciation	Increase or decrease (-) in deferred liabilities@	Fixed assets formation financed by short-term liabilities [8-(9+10+11)]	Increase or decrease (-) in short-term bank borrowings	Increase or decrease (-) in sundry creditors	Increase or decrease(-) in other current liabilities
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
V) Processing & Manufacturing - Not classified elsewhere														
17. Cement	1	219	110	7	- 5	- 75	876	350	251	161	114	219	90	61
18. Glass-works	2	19	14	7	-	1	65	5	40	6	14	23	25	7
19. Rubber & Rubber products	2	218	63	20	5	25	361	134	88	104	35	144	43	179
20. Paper and Paper products	13	689	177	- 90	16	- 13	4045	735	972	1560	778	941	234	382
VI) Other Industries														
21. Electricity generation & supply	8	45	40	24	- 68	22	499	60	153	165	121	48	41	95
22. Hotels, Restaurants, etc.	3	30	37	2	- 29	165	567	163	51	129	224	116	40	273
Total:-	255	8099	3685	44	270	2088	27467	4019	10504	7076	5868	9140	5666	5248

@ Includes term loans, debentures, mortgage loans and deferred payments on machinery etc.

Source: Data have been compiled from the balance sheets of the companies covered in the study of 1501 medium and large non-Government non-financial public limited companies by Reserve Bank. The assets of the 255 companies covered in this statement formed about 25 per cent of the total assets of 1333 companies.

STATEMENT - VIII

Statement showing changes in current, non-current and fixed assets and the sources of their financing of public companies which enjoy credit facilities with a major bank for amounts of Rs.50 lakhs and over and had witnessed a deterioration in the current ratio during the period 1961-62 to 1966-67

(Rupees in lakhs)

Industrial Sub-Group	No.of compa-nies	Incre-ase or decrea-se (-) in sto-cks & stores	Incr-ease or de-crease (-) in book debts	Incr-ease or de-crease (-) in current assets	Increase or decrease(-) in other non-current assets: Inve-stme-nts (unquo-ted)	Increase or decrease(-) in other non-current assets: Loans & Adv-ances	Increase or dec-rease(-) in fixed assets	Incr-ease or de-crease (-) in net worth	Incr-ease in pro-vision for de-precia-tion	Incr-ease or de-crease (-) in defe-rred liabi-lities@	Fixed assets forma-tion finan-ced by short-term liabili-ties /8-(9+10+11)/	Incr-ease or de-crease (-) in short-term bank borrow-ings	Increase or de-crease (-) in sundry credi-tors	Increase or de-crease (-) in other current liabili-ties	Non-current assets fina-nced by short-term liabilities /(3+4+5)-(13+14+15)/
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
I) Agriculture and Allied Activities															
1. Tea	1	- 5	22	21	39	- 75	50	- 36	24	-	62	13	13	40	26
2. Sugar	24	-927	1	- 35	14	408	1091	246	543	20	282	-358	- 81	182	704
II) Mining & Quarrying															
1. Coal Mining	1	- 7	167	- 10	- 7	93	328	63	202	22	41	77	117	83	127
2. Metal Mining	1	147	8	31	- 1	271	428	480	61	- 82	- 31	-	88	337	239
III) Processing & Manufacturing of food stuff, textiles, leather & Products thereof															
5. Tobacco	1	324	109	1	-	243	218	227	68	49	-126	229	61	261	117
6. Cotton Textiles	30	2460	785	22	44	1027	6938	1297	3532	1509	600	2233	999	1706	1671
7. Jute Textiles	23	1513	711	94	- 46	417	3869	472	2092	620	685	1987	1318	69	1056
8. Miscellaneous	3	209	12	1	17	154	464	87	189	47	141	303	235	- 4	312
IV) Processing & Manufacturing Metals, Chemicals and Products thereof															
9. Automobile and Transport Equipments	3	851	173	- 2	159	91	726	429	171	180	- 54	749	264	205	196
10. Electrical Machinery, Appliances, etc.	3	761	163	32	14	288	2169	938	567	828	-164	809	210	75	138
11. Machinery (other than Transport & Electrical)	8	2253	1180	66	111	1373	2398	1214	828	728	-372	1993	1895	723	1112
12. Basic Metal Industries	1	31	- 1	- 1	-	3	117	14	19	61	23	39	17	- 1	26
13. Ferrous & Non-ferrous Metal Products	3	431	44	- 31	- 10	70	689	356	195	102	36	259	164	117	96
14. Paints	1	57	25	9	-	106	16	31	- 6	21	- 30	15	25	127	76
15. Chemical Products	4	572	411	56	182	462	2043	700	967	604	-228	682	390	383	416
V) Processing & Manufacturing - Not classified elsewhere															
16. Cement	1	173	16	-102	- 7	17	107	33	52	-	22	84	54	- 19	32
17. Paper & Paper Products	2	435	36	- 41	-	13	2518	146	816	1346	210	487	218	- 52	223
VI) Other Industries															
18. Builders, Engineers etc	4	432	25	- 80	130	389	569	585	293	18	-327	80	157	332	192
	114	9710	3887	31	639	5350	24738	7282	10613	6073	770	9680	6143	4564	6759

@ Include term loans debentures, mortgage loans and deferred payments on machinery etc.