Another way of privatisation is *contracting.* Governments may contract out services they have planned and specified to other organisations that produce and deliver them.

Franchising—authorising the delivery of certain services in designated geographical areas—is common in utilities and urban transport. Contracting is common in public works, defence and many specialised services. Where suppliers compete for contracts and there is no loss of economies of scale, contracting is efficient. But there is scope for corruption in contracting, and long-term contracts tend to encourage monopolistic behaviour by the private supplier. Contracts for road construction and maintenance are common in countries such as Brazil, Colombia, India, and Kenya. In agriculture and urban development in the Philippines and in water supply in the Ivory Coast, private contracts have played an important role.[10]

Another option for the government is to *withdraw* from the provision of certain goods and services leaving them wholly or partly to the private sector.

Privatisation may also take the form *of privatisation of management,* using *leases* and *management contracts.*

Government can shed the burden also by *liquidation* which can be either formal or informal. Formal liquidation involves the closure of an enterprise and the sale of its assets. Under informal liquidation, a firm retains its legal status even though some or all of its operations may be suspended.

Obstacles

When compared to the industrial countries, the progress of privatisation has been slow in the developing countries. As the World Bank points out, governments confront several obstacles, like those mentioned below, when they decide to divest SOEs.[11]

(i) Governments usually want to sell the least profitable enterprises, those that the private sector is not willing to buy at a price acceptable to the Government.

(ii) Divestiture tends to arouse political opposition from employees who may lose their jobs; from politicians who fear short-term unemployment as a consequences of liquidation or of cost reduction by private owners; from bureaucrats who stand to lose patronage; and from those sections of the public that fear that national assets are being cornered by foreigners, the rich, or a particular ethnic group. Sometimes the opposition of employees is due to the fact that they will have to bid good by to the 'easy going' culture in the public sector and produce result if the enterprise is privatised.

(iii) Relatively undeveloped capital markets sometimes make it difficult for governments to float shares and for individual buyers to finance large purchases.

Conditions for Success of Privatisation

Professor Samuel Paul points out that if privatisation is to succeed, in the sense of raising efficiency or effectiveness in the production or delivery of goods and services, the following seven conditions must be met.[12]

First, privatization cannot be sustained unless the political leadership is committed to it, and unless it reflects a shift in the preferences of the public arising out of dissatisfaction with the performance of other alternatives. Privatization has in the past worked best when a government was strongly committed to a change, or when a new government vowed to reverse the actions of its predecessors, as has happened in Chile and the United Kingdom. Some governments that had faced

severe economic crises, with massive budgetary deficits, had turned to privatization and divestiture as a part of their adjustment strategy.

Second, any alternative institutional arrangements chosen should not stifle competition among suppliers. Replacement of a government monopoly by a private monopoly may not increase public welfare—there must be a multiplicity of private suppliers. This can be a difficult problem where there are few competent suppliers. Though government may wish to contract out a service, if there are only one or two qualified contractors, the benefits of competition are unlikely to follow.

In this context, most developing countries' systems of regulation need major review and reform. Overregulation of industry discourages private initiative; overregulation of urban land use of building construction retards urban development; and unduly low ceilings on the prices of industrial products and utilities, such as bus transport and electricity, inflate demand and depress the incentives for production.

The third, related, condition is freedom of entry to provide goods and services. Long term contracts and franchises limit competition and consumers' choice. In some services that are capital intensive, freedom of entry is difficult to achieve. But in others, such as refuse collection or health services, the public will be better served by several private suppliers competing than by one agency monopolizing the market through a long-term contract.

Fourth, public services to be provided by the private sector must be specific or have measurable outcome. Physical construction or utility services, *for example,* can be measured, but most educational services and police protection are not easy to quantify, even though their inputs can be measured. Lack of specificity makes it more difficult to control services provided by the private sector, especially if the public served is illiterate, unorganized, and unassertive. Service delivery by non-governmental organisational or local governments may be more appropriate under these conditions.

Fifth, consumers should be able to link the benefits they receive from a service to the costs they pay for it, since they will then shop more wisely for different services. User charges are one way of establishing this link. The importance of educating consumers and disseminating information to the public cannot be overemphasized here.

Sixth, privately provided services should be less susceptible to fraud than government services if they are to be effective. Services provided through collective or cooperative action at the community level are probably the least susceptible to fraud.

Seventh, equity is an important consideration in the delivery of public services. Broadly speaking, the benefits of privatisation can accrue to the capital owner who supplies the service; to the consumer, who receives a more efficient service; and to the public at large, through a reduction in the public sector deficit, and hence in taxes or the rate of inflation, or both. Privatisation will be counter-productive if the ability of the public to pay, determined by the prevailing income distribution, becomes the sole guide for the delivery of services. And, if the benefits of privatization are likely to be reaped solely by local elites, expatriate groups, or multinational corporations, political resistance to reform is likely to increase.

Benefits of Privatisation

Privatisation benefits the society in several ways. The fact that privatisation is an important strategy of economic rejuvenation of even the 'communist' nations is a testimony to the economic role of privatisation.

Countries like the U.K. have shown how it could help solve the fiscal crisis of the State and to usher in a new industrial democracy. The benefits of privatisation may be listed down as follows.

1. It reduces the fiscal burden of the State by relieving it of the losses of the SOEs and reducing the size of the bureaucracy.
2. Privatisation of SOEs enables the government to mop up funds. Government of India's Budget for 2000-2001 proposed to raise Rs. 10,000 crore during the year through privatisation. (The achievement, however, was dismal as the privatisation plan could not be carried out in real earnest due to various reasons).
3. Privatisation helps the State to trim the size of the administrative machinery.
4. It enables the government to concentrate more on the essential State functions.
5. Privatisation helps accelerate the pace of economic development as it attracts more resources from the private sector for development.
6. It may result in better management of the enterprises.
7. Privatisation may also encourage entrepreneurship.
8. Privatisation may increase the number of workers and common man who are shareholders. This could make the enterprises subject to more public vigilance.

Arguments Against Privatisation

There is strong opposition to privatisation from different corners, based on economic, political, social and management rational and on vested interests. Some of the important argument against privatisation are as follows :

1. The public sector has been developed with certain noble objectives and privatisation means discarding them in one stroke.
2. Privatisation will encourage concentration of economic power to the common detriment.
3. If privatisation results in the substitution of the monopoly power of the public enterprises by the monopoly power of private enterprises it will be very dangerous.
4. Privatisation many a time results in the acquisition of national firms by foreign firms.
5. Privatisation of profitable enterprises, including potentially profitable, means foregoing future streams of income for the government.
6. Privatisation of strategic and vital sectors is against national interests.
7. There are well managed and ill managed firms both in the public and private sectors. It is not the sector that matters, but the quality and commitment of the management.
8. The capital markets of developing countries are not developed enough for efficiently carrying out privatisation.
9. Privatisation in many instances is a half-hearted measures and therefore it is not properly carried out, with the result that the expected results may not be achieved.
10. In many instance, there are vested interests behind privatisation and it amounts : deceiving the nation. The UNDP's *Human Development Report 1993* observes that in many countries privatisation often has been a 'garage sale' to favoured individuals and groups.

Sins and Pitfalls of Privatisation

Privatisation does not guarantee unconditional success. Privatisation in many countries has been found to be often fraught with many sins and pitfalls. Dubious objectives, tainted privatisation process etc. may lead to failure of privatisation.

The commonly observed flaws of privatisation are the following :

1. **Lack of Proper Strategy:** An important reason for failure of privatisation is absence of a proper strategy or norms regarding the industries/units to be privatised, the method of privatisation, extent of divestment, selection of buyer/investor etc.
2. **Ambiguity of Objectives:** The real objective of privatisation is another problem. Is it for raising revenue? Is it for making the enterprise competitive? If there are multiple objectives, what is the priority list?
3. **Connivance:** Some times politicians have hidden objective behind privatisation. The UNDP Report cited above points out that in too many cases it has taken place for the wrong reason, under the wrong conditions and in the wrong way.
4. **Wrong Timing:** Many privatisation schemes could not get a good price because of the wrong timing. A good price can be obtained if privatisation is done when the performance, market capitalisation and the industry prospects are good. It is pointed out the *Maruti* could have got a good price had it been privatised when the goings were good.
5. **Lack of Political Consensus:** Privatisation is a political process too. As there are opposing views regarding privatisation, there are likely to have some opposition of privatisation. The privatisation BALCO is a case in point. The government shall try to make clear the need for and objectives of privatisation and shall bring about as broad a consensus is possible.
6. **Wrong Labour Strategies:** Most public enterprise have surplus labour, getting rid of which is essential for success of the enterprise. But, to overcome labour resistance to privatisation, often unrealistic promises are given that the labour will not be affected by privatisation. A more open and realistic handling of the labour is needed for making privatisation meaningful. Prospects of retraining and redeployment of the labour are yet to be properly explored in countries like India.
7. **Lack of Political Will:** Privatisation is not carried out in real earnest and properly because of lack of political will and/or vested interests. *For example,* some ministers oppose privatisation of enterprises under their ministry and some politicians oppose privatisation of undertakings in their Constituencies or States.
8. **Poor Financial Strategies:** Many privatisations are carried out with out a good financial strategy.
9. **Wrong Environment:** Mere transfer of ownership does not help improve the performance of an enterprise. Where the market functions poorly and enterprises are still vulnerable to arbitrary government edicts, transferring ownership to the private sector is unlikely to achieve much.
10. **Prevalence of Monopoly Elements:** If privatisation results in the conversion of a public sector monopoly to a private sector monopoly, privatisation may not produce much beneficial effects, it could even worsen the situation.
11. **Problem of Cultural Change:** Improvement of performance of an enterprise after the privatisation will depends, inter alia, on bringing about a change in the work culture and the total enterprise culture. This is no easy task.

Rangarajan Committee on Disinvestment

The Committee on Disinvestment in Public Sector Enterprises set up by Government of India, under the chairmanship of C. Rangarajan, in 1993 has in its Report made a number of recommendations. Important recommendations of the Committee include the following :

1. The best method for disinvestment is offering shares to the general public at a fixed price through a general prospecting. However, since these shares have not been traded so far on the stock markets, it would be difficult to decide the 'fixed rate' at which they should be offered to the public. Once a reasonable time had elapsed and a normal trading atmosphere established in the market, this indeed would be the best method. Till then, the auction method with wide participation may be adopted.
2. The target level of disinvestment should be decided on the basis of the desirable level of public ownership in an activity or unit consistent with industrial policy. In all those units which are reserved for the public sector, the percentage of equity disinvested should be 49 per cent so that the government, by holding majority of the shares, retains control over the management. In other cases, the percentage of equity to be disinvested should be 74 per cent.
3. Instead of year-wise targets of disinvestment, a clear action plan should be evolved.
4. Disinvestment shall be in stages and sales shall be staggered so as to get the best possible price.
5. A number of steps need to be undertaken for efficiently carrying out privatisation. These may include corporatisation of the public enterprises, restructuring of finance with a proper debt-equity gearing and on independent Regulatory Commission for the concerned sector, if necessary.
6. A Scheme of preferential offer of shares to workers and employees may be devised.
7. Ten percent of the proceeds of the privatisation may be set apart for lending to the public enterprises on concessional terms for meeting their expansion and rationalization needs.

Privatisation in India

In India, although there were some isolated cases of privatisation, no definite policy decision was taken until the new economic policy was been ushered in.

In India, the public sector, both the Central as well as State, expanded indiscriminately and it was extended to non-priority sectors and sectors where the private sector would perform better. Populist political appeal and vested interests of politicians and bureaucrats contributed to this State governments set up public corporations after corporations to expand the empire of the political parties and to give berths to political leaders.

The accumulated losses of many SOEs, including some state transport corporations, are larger than the capital invested in them. These public sector deficits compel governments to increase taxation and curtail development expenditures. There is no justification for imposing such burden on the public by the state carrying out activities which the private sector can do more efficiently. Privatisation of certain sectors and enterprises are, therefore, necessary to reduce the budgetary burden on the public, to make available more resources for the development activities, to enable the government to concentrate more on the essential government functions and priority areas and to relieve the consumers from the indifferent and arrogant attitude of the public sector.

The government should withdraw from areas where private enterprises will be more efficient. Now that the nation has achieved a certain level of industrial development and private entrepreneurship is plenty, the State should curtail its entrepreneurial role and concentrate its resources on the promotional and regulatory role (here regulation means regulation of the conduct of the business, and not the type of growth defeating hassles we have had).

The society may benefit from privatisation in several ways. It would help reduce the fiscal burden of the State by relieving it of the losses of the SOEs and reducing the size of the bureaucracy; enable the government to mop up funds; result in better management of the enterprises; encourage entrepreneurship; and, help accelerate the pace of economic development as it attracts more resources from the private sector for development. Privatisation may increase the number of workers and common man who are shareholders and this could make the enterprises subject to more public vigilance. Privatisation enables the government to concentrate more on the essential State functions.

In the latter part of the fifties, the change reflected in defining an SSI unit was mainly a shift from a workforce criterion to an investment criterion. In 1966, the original value in plant and machinery was adopted as the sole norm for defining a unit as small scale or otherwise.

Similarly, the concepts of ancillary and tiny units were introduced in 1960 and 1977, respectively.

Small Scale Service Establishments (SSSEs) were first classified in 1985 and later re-defined, in 1991, as Small Scale Service and Business Enterprises (SSSBEs). The definition of Women Entrepreneurs' Enterprise was brought out in 1988 and modified in 1991.

The periodic revisions in the definition of SSI, as made by the Government of India, are summarised in Table 15.1.

TABLE 15.1 : DEFINITION OF SMALL AND MEDIUM ENTERPRISES

Country	Category of Industry	Criteria
China	SMEs	Depends on product group; investment ceiling 30 million Yuan (US$ [illegible] million).
Germany	SMEs	No size definition. Craft firms are members of Craft Chambers and are defined by types of business and the qualifications of master craftsman. About 95 per cent of small firms have an employment of less than 20 workers.
[illegible]	[illegible]	Less than [illegible] employees and capitalisation less than [illegible] million Yen
	[illegible]	Less than [illegible] employees and capitalisation less than [illegible] million Yen
	Retailing and Services	Less than 50 employees and capitalisation less than 10 million Yen
Mexico	Micro	Less than 15 employees and gross income/Sales less than US $ 1,75,000
	Small	16-99 employees and gross income/Sales less than $ 1,75,000
	Medium	100-250 employees and gross income/Sales less than [illegible]
Malaysia	SMI	Employment less than 75 full-time workers or with a shareholder fund of less than RM 2.5 million (US $ 1.0 million)
	SIS	Manufacturing establishments employing between 5 and 50 employees or with a shareholders fund upto RM 500,000
	MIS	Manufacturing establishments employing between 50 and 75 full time employees or with a shareholders fund between RM 500,000 to RM 2.5 million
Taiwan	SMEs	In manufacturing, paid up capital less than NT$ 60 million or number of regular employees not to exceed 200.
	SSEs	In manufacturing, regular employees not to increase 20.
South Korea	Small	Less than 20 Employees
	Medium	20-300 employees. In some categories upto 200 employees with assets of upto US$ 7,00,000 (80 bn Won)

Source : SIDBI Report on Small Scale Industries Sector, 1999.

The term Small Scale Industry evokes different meanings for different agencies.

The Planning Commission, Government of India, views the entire Village and Small Industries (VSI) Sector as a part of the SSI sector. The National Sample Survey Organisation under the Central Statistical Organisation (CSO), Government of India, defines the entire industry sector in terms of organised and unorganised segments, as well as in terms of industrial enterprises run by households and non-households. The Central excise Department, on the other hand, distinguishes SSIs on the basis of the annual turn over of the units (up to a maximum limit of Rs. 30 million). The Reserve Bank of India (RBI) adopts an expanded definition of SSIs which includes traditional industries as well. The industrial policy planners in the Small Scale Industries Board define SSI on the basis of investment in plant and machinery (an upper limit of Rs. 30 million) and cover residual units which do not fall under the assistance programmes of any of the Statutory Boards.

Different segments of SSI have been defined as given below.

***Small Scale Industrial Undertaking*:** An industrial undertaking in which the investment in plant and machinery, whether held on ownership terms or on lease/hire-purchase basis does not exceed Rs.10 million is graded as small scale industrial undertaking.

(The investment ceiling has been revised from time to time. It was Rs. 7.5 lakh in 1966 and Rs. 30 million in 1997. An analysis of the quantitative increase in investment ceiling in plant and machinery from the year 1966 to 1997 by segregating the inflation component from the increase in current prices so as to calculate the effective enhancement in real terms shows that: (1) The ceiling of investment in plant and machinery for SSI, in real terms, has remained relatively unchanged from 1966 to 1991. For subsequent years from 1991 to 1996, it would further come down in real terms before increase in the ceiling in 1997. (2) For the most part of the seventies and early eighties, in fact, the upper threshold of investment in plant and machinery for both SSI and ancillary units was below 1970-71 level, in real terms. (3) The revision of the ceiling in 1991 also did not make much of a difference in real terms. (4) It was only the revision in 1997 (to Rs. 30 million) that had provided opportunities for small units to undertake higher investment for technology upgradation, product standardisation, R&D facilities and build competitiveness. However, in 1999 the Government decided to lower the investment ceiling from Rs. 30 million to Rs. 10 million).

Ancillary Industrial Undertaking: An industrial undertaking which is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling or intermediates, or the rendering of services is termed as ancillary undertaking. The ancillary undertaking has to supply or render or propose to supply or render not less than 50 per cent of its production or services, as the case may be, to one or more other industrial undertakings. The investment in plant and machinery, whether held on ownership terms or on lease or on hire purchase, should not exceed Rs.10 million.

***Tinny Enterprise*:** A unit is treated as tiny enterprise where investment in plant and machinery does not exceed Rs. 0.5 million, irrespective of the location of the unit.

Women Entrepreneurs Enterprise: An SSI unit/industry related service or business enterprise, managed by one or more women entrepreneurs in Proprietary concerns, or in which she/they individually or jointly have a share capital of not less than 51 per cent as Partners/Share Holders/ Directors of Private Ltd. Company/Members of Co-operative Society is treated as Women Entrepreneurs' Enterprise.

Small Scale (Industry related) Service and Business Enterprises (SSSBEs): Enterprises rendering industry-related service/business with investment up to Rs. 0.5 million in fixed assets, excluding land and building, are called SSSBEs.

Development of VISs under the Plans

All our Five Year Plans and Industrial Policy resolutions/statements have stressed the need to accelerate the development of village and small industries to create large scale employment opportunities, promote decentralisation and dispersal of industries, achieve diffusion of ownership and prevention of concentration of economic power, promote entrepreneurship, develop agro- based and ancillary industries, improve the skills of artisans and quality of their products, reduce the role of subsidies and to step up the productions of essential articles and those having potential for exports.

The Government, Central and States, have taken a number of measures to help solve the age-old problems of these industries, such as lack of credit facilities, outmoded methods and techniques, absence of organised marketing, unsatisfactory raw material supply and competition from large-scale units.

The Governments, central and state, have taken a number of steps, including the establishment of a number of agencies to foster the development of the VSI.

Objectives

The main objectives of the development of village and small industries have been the following.

1. To assist in the growth and widespread dispersal of industries.
2. To increase the levels of earnings of artisans.
3. To sustain and create avenues of self-employment.
4. To ensure regular supply of goods and services through use of local skills and resources.
5. To develop entrepreneurship in combination with improved methods of production through appropriate training and package of incentives.
6. To preserve craftsmanship and art heritage of the country.

It is estimated that the number of small-scale units (excluding khadi and village units) increased from about 4 lakh in 1973-74 to about 35.7 lakh in 2002-2003; employment increased from less than 40 lakh to about 199.65 lakh and value of output increased from about Rs. 7,200 crore to Rs. 742,021 crore at current prices. The small-scale units contribute about 40 per cent of the total industrial output and about 35 per cent of the total export earnings.

The performance of the small scale sector should be evaluated in the light of the fact that the Plan allocation for this sector has come down from 2 to 4 per cent in the earlier Five Year Plans to about 1.5 per cent.

PROMOTIONAL MEASURES

A number of measures have been taken by the governments, central and state, to protect this sector from the onslaught of the large sector and to promote its growth.

Measures taken by the Government, from time to time, include reservations, upward revision of investment ceilings in the definition, reservation of products for the SSIs, increasing credit flows, preference in Government purchases, modernisation, technology upgradation and improving export performance.

In the post-reform period, a number of new steps have been initiated by the Government with regard to foreign direct investment, development of infrastructural facilities, establishment of growth centres, export promotion, marketing, etc.

The important protective and promotional measures include the following

1. Reservation of products: Protection has ben provided to the small-scale units by the reservation of items for exclusive production in the small scale sector. Over the years there had been an increase in the number of items so reserved, but has significantly reduced it recently.

2. Reservation and Preference in Government Procurement: SSIs have been given protection from competition in the matter of purchases of different products by the DGS&D. A large number of items have been reserved for exclusive purchase from the VSI sector while a number of items have been provided price preference up to 15 per cent over units in the large scale sector.

3. Infrastructural and Institutional Support: Infrastructural and institutional supports are provided through industrial estates, district industries centres (DICs), Small Industries Service Institute, Khadi and Village Industries Commission (KVIC) and other specialised institutions which provide technical assistance, testing facilities, etc.

4. Machinery on Hire Purchase: The National Small Industries Corporation (CNSIC) arranges supply of machines on hire purchase to small scale units.

5. Marketing Assistance: Marketing assistances including export promotion assistance are provided by institutions such as the NSIC, the Small Industries Development Organisation (SIDO), Handicrafts and Handlooms Export Promotion Corporation, KVIC etc.

6. Financial Assistance: Financial assistance is provided at concessional terms by commercial banks, state level financial institutions, etc.

In order to step up the flow of assistance to the small sector and to provide a focal point to coordinate at the apex level the availability of both financial and non-financial inputs required for the orderly growth of this sector, the Small Industries Development Bank of India (SIDBI) was established in 1990.

7. Training: Training for existing and potential entrepreneurs and others associated with the working of the small units are offered by Entrepreneurship Development Institute of India (EDII), Technical Consultancy Organisations (TCOs), financial institutions and commercial banks, management institute, NSIC etc.

8. Supply of Raw Materials: Arrangements have also been made for the supply of raw materials, particularly of scarce items, to the small scale units.

9. Promotion of Ancillarisation: The Industrial policy also gives importance to ancillarisation. This has been recognised as one of the objective of the public sector industry. One of the factors considered by the government while evaluating application from the private sector for industrial licence was the scope for ancillarisation by the proposed project.

A more detailed account of some of the promotional aspects is given below.

Industrial Estates (IE) Programme

With a view to encouraging entrepreneurs to set up small industries and to expand existing units, a programme for the establishment of industrial estates was started in the year 1955. This programme envisaged the following facilities for entrepreneurs: *(i)* the acquisition of suitable land and its development; *(ii)* the construction of factory sheds; *(iii)* the provision of infrastructure like water, electricity, transport, banks, canteens, watch and ward, all-weather approach roads.

- Access to Internet for world-wide trade information.
- Research & Training Wing.
- R&D Centres.
- Provision for procuring and storing inputs in bulk for each group of units.
- Liaison Department to interact with traders, exporters and government agencies.
- A wing for the organisation of Trade Fairs, Exhibitions, group advertisements and the common branding of cluster products.

Industrial Growth Centres Schemes

For the promotion of industries in the backward areas, the scheme of establishing Growth Centres was envisaged in 1988 for the establishment of 100 Growth Centres around the country. The criteria for location of centres are as follows: *(i)* Outside 50 Kms. of Cities with a population above 2.5 million; *(ii)* Outside 30 kms of cities with a population of above 1.5 million but below 2.5 million; *(iii)* Outside 15 kms of cities with a population of 0.75 million but below 1.5 million.

The objective of the scheme has been to provide the best of the infrastructure facilities in these Growth Centres nation wide. The other criteria for the establishment of Growth Centres were the proximity to rail heads, National or State highway, access to adequate and dependable sources of water, power, telecommunication facilities, educational and health facilities and sufficient land for the development of housing and for the promotion of tertiary activities. Growth Centres should not lie located in ecologically sensitive areas.

The important pre-requisite for the identification of a Growth Centre has been that its sphere of influence should cover an area of 400 to 800 hectares.

INSTITUTIONAL SUPPORT STRUCTURE

There is a network of organizations to support the development of the VSIs.

The Small Scale Industries Board is an apex advisory body constituted by the Government of India to render advice on all the issues pertaining to the SSI sector. The Board was constituted in 1954 to facilitate co-ordination and provide Inter-institutional linkages for the development of the sector. The Union Industries Minister is the Chairman of the Board which consists of State Industries Ministers, select members of Parliament, Secretaries of various departments of Central Government. Heads of financial institutions, industries associations and eminent experts in the SSI field.

The Department of SSI and Agro & Rural Industries (SSI and A & ARI) was created under the Union Ministry of Industry to formulate policy framework and initiate appropriate programmes and schemes for the promotion of SSIs in the country.

The range of functions of the department include the setting up of a network of institutions to render services of a varied nature like, techno-economic and managerial aspects, training, testing facilities, marketing assistance, etc. These activities are supported by a host of other Central / State Departments. Agencies, and Autonomous Institutions all over the country.

The office of the Development (Commissioner Small Scale Industries), known as the Small Industries Development Organisation (SIDO) was set up in 1951 is the nodal agency for

implementation of Central Government policies and plays a constructive role in the strengthening of the SSI sector.

The SIDO functions through a network of Small Industry Service Institutes (SISIs) and a host of other field centres, The major SSI-related activities of SIDO include evolving all India policies and programmes, co-ordinating policies and programmes of State Governments, liaisoning with different State and Central Ministries, Planning Commission, RBI and Financial Institutions. SIDO also provides a comprehensive range of extension services through allied institutions and monitors Government-sponsored programmes.

At the State level, the Commissioner/Directorate of Industries implement policies for the promotion and development of small scale, cottage, medium and large-scale industries. The Central policies for the SSI sector serve as the guidelines, but each State evolves its own policy and package of incentives.

The State departments also oversee activities of the field offices, viz, District Industries Centres (DICs), etc. In addition, State Financial Corporations, State Small Industries Development Corporations (SIDCs), and Technical Consultancy Organisations (TCOs) operate at the State level to assist the promotion and development of SSIs. Other regional level agencies include State Infrastructure Development Corporations, State Co-operative Banks, Regional Rural Banks, State Export Corporations, Agro Industries Corporation and Handloom and Handicrafts Corporations. For the purpose of human resources development, there is a network of specialised institutes associated with SIDO. At grassroot level, NGOs play important role for the development of tiny units.

Industry Associations provide support to the SSI sector and offer with a common platform to raise industry-related issues. Government policies, in recent years, have stressed the increasing role of Industry Associations in the setting up of common facilities and other ventures in the area of technology, marketing and other support services.

Women Entrepreneurs

The importance of the economic development of women takes on an added dimension in India when considered in the context of the prevailing social, legal and economic norms. The Government has, therefore, taken several steps to promote women entrepreneurship.

In view of the initiative shown by women in various economic activities, promotional organisations have been organising special programmes for them. This trend indicates a shift towards a gender-specific approach to such programmes in order to enhance the competence of women in the establishment and management of SSIs.

The 1991 Industrial Policy has envisaged special training programmes to support women entrepreneurs. Accordingly, women entrepreneurs are receiving training through Entrepreneurship Development Programmes (EDPs) conducted by various institutions and organisations both at the Central and State levels.

The SIDO, with its field offices all over the country, has been carrying out development programmes for women entrepreneurs and is providing technical schemes for the setting up of SSI units. In view of changing outlook for the promotion of women enterprises, the SSI Board in 1991 revised the definition of women enterprises by omitting the condition of employing 50 per cent of women workers. This provided a boost to women entrepreneurs to take up businesses and avail of facilities/concessions as are applicable to all SSIs.

Industries coming under the purview of Village Industries include : (1) Bee keeping; (2) Cottage Match, manufacture of fireworks and Agarbatties; (3) Cottage Pottery; (4) Cottage Soap; (5) Flaying, curing and tanning of hides and skins and ancillary industries connected with the same and cottage leather industry; (6) Ghani Oil; (7) Handmade paper; (8) Manufacture of cane-gur and khandasari; (9) Palmgur making and other palm products; (10) Processing, packing and marketing of cereals, pulses, spices, condiments, massalas, etc.; (11) Manufacture and use of manure and methane gas from cowdung and other waste products (such as flesh of dead animals, night soil, etc.;) (12) Lime stone, lime shell and other lime products; (13) Manufacture of shellac; (14) Collection of forest plants and fruits for medicinal purposes; (15) Fruit and vegetable processing, preservation and canning, including pickles; (16) Bamboo and cane-work; (17) Blacksmithy; (18) Carpentry; (19) Fibre other than coir; (20) Manufacture of household utensils in aluminium; (21) Manufacture of Katha; (22) Manufacture of gums and resins; (23) Manufacture of Lokvastra; (24) Manufacture of Polyvastra; (25) Processing of maize and ragi.

KVIC

The Khadi and Village Industries Commission (KVIC) is a statutory organization engaged in the task of promoting and developing khadi and village industries with a view to creating employment opportunities in the rural areas and thereby strengthening the rural economy. It was established in 1975 by an Act of Parliament. It is an autonomous body which took over from its predecessor, the All-India Khadi and Village Industries Board, set up in 1953.

The broad objectives that the KVIC has set before it are :

1. the social objective of providing employment;
2. the economic objective of producing saleable articles; and
3. the wider objective of creating self-reliance amongst the people and building up a strong rural community spirit.

The functions of the KVIC are generally to plan, organise and implement programmes for the promotion and development of khadi and village industries. In particular they include:

1. training of persons engaged in production of khadi and village industries;
2. building up reserve of raw materials and implements and supplying them to persons engaged in the production of KVIs at economical rates;
3. to provide for sale and marketing of khadi and products of village industries and handicrafts;
4. to encourage and promote research in the technique of production of khadi and in the development of village industries, and to provide facilities for study of problems relating to KVIs;
5. to maintain or assist in the maintenance of institutions for the development of KVIs;
6. to undertake, assist or encourage production of khadi or development of village industries;
7. to promote and encourage co-operative efforts among manufactures of khadi and persons engaged in village industries; and
8. for ensuring the genuineness of and for granting certificates to producers of or dealers in, khadi or the products of any village industry.

The KVIC have created an organisational base for further development with many State KVI Boards, a large number of registered institutions and industrial co-operatives. KVIC has a very large

number of sales outlets in the country. This is a unique national organisation in the country which has its roots in the villages and has wide organisational linkages. Its activities cover numerous villages in the country. A substantial number beneficiaries belong to the scheduled caste and scheduled tribes and inhabitants in hill and border areas. The participation of women in the activities is also very high.

ANCILLARY INDUSTRIES

Integration of small and large industries through ancillarisation is an important feature of industrial development of countries like U.S.A. and Japan. In India, the government policy has been one of encouraging ancillarisation.

Though all industries are not amenable to ancillarisation, there are a number of industries with scope for considerable ancillarisation. Large industries may benefit from ancillarisation in different ways. One benefit of ancillarisation is the realisation of economies of scale. If the requirement of any item is less than the economic size of production, it stands to gain by purchasing the item from an outside unit of economic size. Further, a large company can relieve itself from the problem of tying up of capital, managerial time, etc., on minor items which can be efficiently produced by ancillaries. The society also benefits from the economies of scale and other efficiencies associated with ancillarisation. As the impact of energy crisis and credit squeeze is comparatively less on small-scale units, ancillarisation offers further advantages to large units in an era of power shortage and financial problems.

Ancillarisation and sub-contracting, however, have some problems also. The parts or components supplied by these units may not sometimes be of satisfactory quality. The small units usually do not have the resources for carrying out research and development. Hence, parent units will have to help them to update technology and enforce strict quality control.

Industrial machinery, agricultural and earth moving machinery; machine tools; industrial; scientific and mathematical instruments; locomotives and rolling stock; ships; aircrafts; bicycles; boilers; steam generating plants; steam engine; automotive parts; turbine; internal combusion engine; commercial, office and household equipment; telecommunication equipment; electronics; electrical equipment; packaging items for use in chemicals; some iron and steel industry items are but some fields where there is good scope for ancillarisation.

According to a study conducted some time ago, the extent of ancillarisation possible in different fields in India is as high as 60 to 90 per cent in transportation industry; 50 to 75 per cent in communications industry and 30 to 50 per cent in prime movers and power based industry. It is 20 to 40 per cent in industrial machinery and machine tools; 15 to 30 per cent in chemicals and pharmaceuticals industry; 10 to 30 per cent in consumption and consumer durable goods industry; and 5 to 10 per cent in basic industry, such as metals, minerals, cement and petroleum. The lowest range is 2 to 10 per cent in wood, paper fibres, glass, ceramics, leather, rubber, etc.[3]

DRAWBACKS AND PROBLEMS

The number of VSI units have increased remarkably. The role of this sector in the Indian economy cannot be underestimated. However, as the Planning Commission observes, some of the important objectives set for the village and small industries sector are yet to be fully achieved.

industrial sectors, restricted exports and has done little for the promotion of small scale industries...

It has been found that in the case of many items currently reserved for small scale industries the manufacture of these items at appropriate quality and efficiency levels requires investments in plant and machinery at a level much higher than the existing investment limits. The existing investment limit on these items, therefore, precludes the quality production of such items in India.

Since the changes in the trade policy instituted since 1991 almost all items except for consumer goods are now freely importable. A careful examination of the import policy has shown that more than 550 items on the list of reserved products are now (In 1996-QR restrictions, were almost completely done away with by April 2001, making almost all the reserved items importable), freely importable. This means that, whereas foreign companies which produce these products could sell them freely in India, large domestic companies are not free to manufacture such items. Some protection however, is provided by the applicable customs tariff. These facts give credence to the view that the government has allowed free competition between the Indian small scale sector and the multinationals but not with the large Indian companies.

Several labor-intensive industries such as garments, shoes, leather goods, sports goods, hand tools, and the like that have flourished in East Asian economies but have not done so in India due to the exclusion of large companies. The toy industry has prospered in other Asian countries but its growth in India has been unremarkable. Similarly, the light engineering industry, e.g. hand tools, is among the larger industries in East Asia but have not achieved significant progress in India. The food processing industry in India is a potential giant but its growth has been arrested by the reservation policy.

The reservation of products for the small scale sector has proved to be a barrier to growth of exports in a number of these industries. It is true that despite severe odds, some of these industries such as garments and shoes have contributed tremendously to the country's export effort. These are the sectors where the country exhibits significant comparative advantage. But various studies conducted by the Export Import Bank of India and others show that our export of items such as garments and shoes are limited to a narrow range of goods and exhibit low unit values. They are also not able to supply branded goods in large quantities with consistent quality to large buyers like trading houses and department stores. In the case of garments, *for example,* our record of exporting to non-quota countries is poor since we are not able to compete. The dismantling of the Multiple Fibre Agreement (MFA) will mean the existing quota markets will also become increasingly competitive over the next 8 years. It is, therefore, imperative for future export growth to remove such small scale industry reservations so that adequate new investment and technology upgradation take place in these industries and that existing units are allowed to upgrade. It should be understood that existing units are unlikely to be hurt as they could continue exporting their current composition of products, instead they would be enabled to grow. The experience in South East and East Asian countries suggests that these industries would grow quite spectacularly if they are freed in such a manner. Whereas many large units could come up in sectors such as garments, toys, and shoes, a great amount of outsourcing and subcontracting would take place so that, in fact, even greater growth would take place in the small scale sector with the attendant employment growth.

An additional consideration that has a bearing on exports is speedy delivery. The clearest example of this can be found in the garments industry where the exporters need to use computer-aided cutting machines to be able to match the delivery schedules of their competitors. Consequently, large scale investments are required.

Similarly, the poor quality of inputs manufactured in the small scale sector has its deleterious influence on the end products. This is, *for example,* evident in the automobile

sector markets and bicycles. The final product suffers because low quality components over the final quality of the assembled product. The result is that for export of items such as bicycles many components have to be imported.

We have also been made aware of some of the impacts of reserved items on the large industries which are the suppliers of intermediate goods to the final manufactures of the finished goods which are reserved for small scale industries. *For example,* in the case of the textile industry, where fibre or fabric producers supply to garment producers in the small scale sectors, domestic industry is handicapped because they do not have large scale buyers. Large industries would become more competitive if they had more demanding buyers. They would then upgrade in quality as well.

The experience with reservation tells a story of love's labour lost. Good intentions of the government have manifestly not registered in the business calculations of small enterprises. The second census of small scale industries provides persuasive evidence of the misplaced importance given the policy of reservation. Out of a total of 200 products leading in value of output produced by the small scale sector, it was found that reserved products accounted for only 21 per cent. Only 210,000 small scale sector units, less than half out of a total of 5,82,000 units, manufactured the reserved products *at* all. No less than 233 reserved items out of a total of *1,076* (when expanded at a lower level of aggregation in the NIC code) were found not be manufactured at all according to the census. Although further inquiries have revealed that many of these products are found to be manufactured by some units, the fact remains that their production is in negligible quantities.

Conversely, very few of the reserved products attracted significant levels of participation from small scale units. As many as 90 products were found to be manufactured by just one company each. The sum total of the value of production of all small scale companies in as many as 692 items was a low of Rs. 10 crore or less. Just 68 reserved items accounted for 81 per cent of the total value of production of reserved products and 83 per cent of the units.

In general, small scale units do not need protection by reservation and can survive in free markets. Analysis of Korean data showed that small scale companies (defined as employing between I to 100 employees) accounted for between 17 to 39 per cent of the employment in as many as 373 industries." They survive due to product differentiation. This can take the form of small companies specialising for consumption in different markets. Or small companies survive in niche markets requiring custom designed products. They also do well in new markets where large companies have not made their presence felt. Thus existence of product differentiation means that many SSI firms co-exists with large firms and cater to different consumption needs. In some cases small firms supply low priced products for mass consumption in local markets where larger firms cannot compete. In other cases they supply high priced products for the elite market. As the markets grow, small companies also grow in size and retain their dominant petition.

The removal of reservation will also pave the way for greater equity participation from large Indian companies and foreign investors along with greater sub-contracting. Large companies will then have an incentive to establish long-term relationships and transfer proprietary technology for improving the quality of products supplied by small scale companies. It would then be much easier to establish interdependent relationships between large, medium and small industries as subcontractors, ancillaries, and suppliers of parts and components. The establishment of mother units would then spawn large numbers of small units in clusters.

has become a *doubtful advance* as defined by the Reserve Bank of India, *i.e.*, principal or interest in respect of any of its borrowal accounts has remained overdue for a period exceeding two and a half years and there is an erosion in the networth due to accumulated cash losses to the extent of 50 per cent or more of its peak networth in the preceding two accounting years."

Common symptoms of industrial sickness include failure to pay statutory liabilities like Provident Funds and E.S.I. contributions, failure to pay timely installment of capital and interest on loans taken from financial institutions and through public deposits, increase in inventories with a large number of slow or non-moving items, high rate of rejection of goods manufactured, low capacity utilisation and frequent industrial disputes.

Weak Units

It is important to detect sickness at the incipient stage and take necessary remedial measures. The Reserve Bank has, therefore, advised the commercial banks to take remedial measures in respective units at the stage of 50 per cent erosion of their networth. Such units are termed as weak units to distinguish them from sick industrial companies as defined in the Sick Industrial Companies Act.

An Industrial unit is termed as weak if at the end of any accounting year it has: (i) accumulated losses equal to or exceeding 50 per cent of its peak networth in the immediately preceding five accounting years; (ii) a current debt-equity ratio of less than 1:1, and (iii) suffers a cash loss in the immediately preceding accounting year.

Magnitude

There is a large number of sick units in the small scale sector (SSI sick units) and the non-SSI sector. There was a substantial increase in the magnitude of sickness during the pre-liberalization period. The number of SSI sick units increased from 58,551 in 1982 to about 2.21 lakh at the end of March 1991 and 2.46 lakh at the end of March 1992. At the end of March 1998, there were 2.24 lakhs sick and weak units in the SSI sector. The number of sick and weak SSI units was about 2.5 lakhs at the end of March 2001. (These statistics cover only those units which enjoy commercial bank credit).

There were 1622 non-SSI sick units in 1982. There were 2337 non-SSI weak/sick units in 1991 and this fell to 2149 in1992. Their number jumped from 2476 in 1998 to 3317 in 2001, spread over the private, public, joint and cooperative sectors. There has also been a significant increase in the bank credit locked up in the sick industrial units.

Many of the sick units are non-viable, *i.e.*, they cannot be brought back to healthy existence.

CAUSES OF SICKNESS

Industrial units may become sick at different stages and due to different reasons. Indeed, some industrial units "are born sick, some achieve sickness and some have sickness thrust upon them."[3]

Born Sick: Industrial units born sick are those which are destined for disaster right from their conception due to various causes. A study conducted by the Institute of Economics, Hyderabad, found that 50 per cent of the dead units closed within three years of opening. This proves that these units never had any reasonable survival prospect right from birth.[4]

Any one or more of the following factors may cause the birth of sick units.

1. Lack of experience of the promoters, wrong selection of the project, faulty project planning, etc., may give birth to sick units. The mushroom growth of the so-called consultancy firms has been regarded as a factor contributing to these sorts of problems because the primary interest of such consultancy firms is to make money by selling some ideas or project reports to the aspirants who may, thus, be misguided or made over-enthusiastic. We must also think that the rosy hopes generated by the high-sounding promises and schemes including the self-employment schemes of the financial institutions and other promotional agencies of the Governments also contribute to this unfortunate situation.

2. Paucity of funds and faulty financial management may also cause the birth of sick units. Many new units have been found to be underutilised and the strains of undercapitalisation become evident when the unit becomes operational. In case of some companies, the heavy investment in non-productive capital assets like staff housing projects even before they commence production distorts the liquidity and causes a lot of problems. Problems also crop up due to inadequate provisions for contingencies, faulty fund flow and cash flow estimate etc.

3. Time and cost overruns some times prove to be very disastrous. Particularly in case of large projects, delays in project commissioning due to delay in supply of equipment, both indigenous and imported, slippage in the schedule of civil works, creation of equipment, etc., are not uncommon. Such delays cause cost escalations leading to capital shortage, liquidity problems, hike in the production costs and break-even point etc.

4. Sickness may arise from locational problems also. It has been observed that "high-technology based units are established in areas without skilled labour or supporting infrastructure; industries based on imported raw materials are founded in regions without adequate transport and communication system."[5]

5. Technological factors like selection of obsolete or improper technology or the technology becoming outdated due to innovations while the project is being executed, sub-standard machinery, wrong collaboration, etc., also cause sickness.

According to the Tiwari Committee, 14 per cent of the large sick units suffered from technical factors and faulty initial planning.

6. Wrong assessment of the market potential or faulty demand forecasting, change in the market conditions, including the change in the consumer tastes and preferences and competitive situation, etc. can also cause birth of sick units.

Achieved Sickness: Industries which achieve sickness are those which fail after becoming operational due to internal causes. Such internal causes which are common are the following.

1. Bad management, which "covers a wide range from inexperience, inefficiency, lack of professional expertise, neglect and internal squabbles to delinquency and dishonesty"[5] is an important cause of industrial sickness. According to the Tiwari Committee Report, 1984, "the factor most often responsible for industrial sickness can be identified as 'management'. This may take the form of poor production management, poor labour management, poor resources management, lack of professionalism, dissensions within the management, or even dishonest management". The Committee found that 65 per cent of the large sick units were affected by this problem.

However in due course the government felt that it was a mistake to have gone on taking over sick units and that the government should not be burdened with the mounting losses of the sick units.

Some State Governments like the Government of Gujarat have introduced specific schemes for rehabilitation of sick SSI and non-BIFR sick viable units.

Sick Industrial Companies Act

An important piece of legislation dealing with industrial sickness was the Sick Industrial Companies (Special Provisions) Act, 1985. The objectives of the (SICA), were:

1. The timely detection of sick and potentially sick companies owning industrial undertaking.
2. The speedy determination by a Board of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies.
3. The expeditions enforcement of the measures so determined and for matters connected therewith or incidental thereto.

According to the SICA, amended in 1993, a sick industrial company meant an *industrial company (being a company registered for not less than five years) which had at the end of any financial year accumulated losses equal to or exceeding its entire networth.*

An industrial company was regarded as potentially sick, *if the accumulated losses of an industrial company as at the end of any financial year had resulted in the erosion of fifty per cent or more of its peak networth during the immediately preceding four financial years.*

Under the Central Government established a Board for Industrial and Financial Reconstruction (BIFR) to exercise the jurisdiction and powers and discharge the function and duties conferred or imposed on the Board by the Act.

The SICA required the Board of Directors of a sick industrial company to make a reference to the BIFR for determination of the measures to be adopted with respect to the company. The BIFR could direct any operating agency (like the financial institution to prepare the scheme for revival of the sick unit. The scheme could provide for any one or more of the following measures.

1. The financial reconstruction of the company.
2. The proper management of the sick industrial company by change in or takeover of management of the sick industrial company.
3. The amalgamation of the sick industrial company with any other company, or any other company with the sick industrial company.
4. The sale or lease of apart or whole of industrial undertaking of the sick industrial company.

Where the BIFR was of the opinion that the sick industrial company was not likely to make its networth exceed its accumulated losses within a reasonable time and that it was not likely to become viable in future and that it was just and equitable that the company should be wound up, it could imitate proceedings with the High Court, for winding up of the company.

There has been all round criticism against the SICA and the BIFR and it has been felt that they should be scrapped. In the Budget Speech for 2001-2002, the Finance Minister announced the decision to repeal the Act.

SUMMARY

Sickness is a serious problem that has afflicted the small, medium and large industries and it is a matter of serious national concern because besides affecting the owners, employees, creditors and suppliers, it causes wastage of national resources and social unrest.

Industrial units may become sick at different stages and due to different reasons. Indeed, some industrial units "are born sick, some achieve sickness and some have sickness thrust upon them."

Lack of experience of the promoters; wrong selection of the project; faulty project planning; paucity of funds and faulty financial management; time and cost overruns; wrong location of the project; technological factors like selection of obsolete or improper technology or the technology becoming outdated due to innovations while the project is being executed; sub-standard machinery; wrong collaboration; wrong assessment of the market potential or faulty demand forecasting; change in the market conditions; including the change in the consumer tastes and preferences and competitive situation, etc. can cause birth of sick units.

Firms become sick after becoming operational due to internal causes such as bad management; unwarranted expansion or diversion of resources; poor inventory management in respect of finished goods as well as inputs; failure to modernise the productive apparatus, change the product mix and other elements of the marketing mix to suit the changing environment; and poor labour-management relationship and the associated problems.

Sickness may be caused also due to external factors, *i.e.*, factors beyond the control of an industrial unit, such as energy crisis arising out of power cuts or shortage of coal, and oil; failure to achieve optimum capacity due to shortage of raw materials due to production set-backs in the supply industries, poor agricultural output due to natural reasons, changes in the import conditions etc; infrastructural problems like transport bottlenecks; credit squeeze; Government controls on the product mix and impossibility to automate or rationalize due to unfavourable government policy or labour attitude.

Absence of an appropriate exit policy has significantly contributed to the problem of industrial sickness in India.

In the past, the Government took over a large number of sick units, particularly in the textiles industry. Overburdened with their huge financial burden, Government has given up the policy of taking over sick units.

The Sick Industrial Companies (Special Provisions) Act, was passed in 1985 with the main objectives of timely detection of sick and potentially sick and the speedy determination by a Board of experts (BIFR) of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies. The SICA and the BIFR miserably failed to achieve their objectives. Government has announced the decision to repeal this Act.

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17 PRICE AND DISTRIBUTION CONTROLS

PART 3

Control over price and distribution has been regarded as one of the important means of achieving the socio-economic goals in many planned, especially developing, economies. Even market economies have price and distribution controls.

The important factors that call for price and distribution controls in countries like India are short supply of goods and services; an unreasonable level of prices in the free market and the very low levels of income of a large number of people.

Objectives of Price and Distribution Controls

The objectives of price and distribution controls, in general, are to supplement the efforts of other instruments of planning. The specific objectives of the control over price and distribution may be listed as follows.

1. Equity or Distributive Justice: Growth with social justice has been accepted as a major objective of development. This implies that the fruits of development should be distributed equitably. But it has been generally accepted that inflation distorts income distribution against the poor. Many a time, the scarcity of "wage goods"—the essential consumer items—leads to black marketing, making the life of the poor more miserable. One of the prime objectives of price and distribution controls, therefore, is to protect the vulnerable sections against inflation and shortages, and ensure a reasonable level of consumption for them.

2. Maintain Quality of Goods and Services: Price and distribution controls aim at ensuring the quality of goods and services. For instance, the Industries (Development and Regulation) Act, 1951, the Essential Commodities Act, 1955, etc. empower the Government of India to control the quality of various goods and services.

3. Prevention of Monopolistic, Restrictive and Unfair Trade Practices: Prevention of certain trade practices that are detrimental to the common interest is another major objective of price and distribution controls. In India, the MRTP Act, 1969, seeks to prevent the monopolistic, restrictive and unfair trade practices that are prejudicial to the public interest. This Act, apart from trying to remove certain imperfections in supply, also aims at ensuring that capital investment and technical development are not hampered by such trade practices.

4. Augmentation of Supply: Increasing the supply of goods and services is of paramount importance to reduce the hardships of the people by making goods available at reasonable prices. And this is one of the objectives of the price and distribution controls. Laws like the Industries

(Development and Regulation) Act and the Essential Commodities Act contain provisions to prevent unjustifiable reduction in production by industrial undertakings. The public distribution system of the Government of India envisages a comprehensive production-cum-distribution scheme.

5. ***Enlargement and Smoothening of the Supply System:*** To remove the imperfections in the supply system in order to ensure the availability of essential goods at reasonable prices to the vulnerable sections in all areas, it is essential to enlarge and strengthen the distribution channels to cover all areas. It is one of the aims of our public distribution system to provide the benefits of its services even to the remote areas and thereby assure social justice.

6. ***Supply of Inputs to Priority Sectors:*** Ensuring supply of essential inputs to the priority sectors at reasonable prices is an important objective of the price and distribution controls. For instance, in India, certain industries are accorded priority in the allocation of certain raw materials and intermediate goods which are in short supply. Small scale industries, export industries, agriculture and other priority sectors have been given credit at concessional terms.

7. ***Resource Allocation:*** Control over prices and distribution enables the planning authorities to achieve the desired pattern of resource allocation more easily. Apart from distributing the productive resources as mentioned above, the price and distribution controls can be made use of in other ways also to achieve the objective of resource allocation. To encourage investment in a particular field, it is essential to ensure a remunerative price for the output. For this purpose sometimes price support schemes will have to be adopted. Considerable supply response to prices is noticed in case of certain agricultural commodities. In such cases deliberate variations in relative prices may be effected to redistribute the area under different crops to obtain a desirable output mix.

8. ***Prevention of Hoarding and Blackmarketing:*** Hoarding and blackmarketing have almost become by-products of shortage economy. An effective system of control should prevent the creation of artificial scarcity by the unscrupulous businessmen for profiteering. Laws like the Prevention of Blackmarketing and Maintenance of Supplies of Essential Commodities, and Essential Commodities Act, are designed to serve this purpose.

9. ***Control of Inflation and Deflation:*** As it is abundantly clear from the objectives mentioned above, control of inflation is a principal objective of price and distribution controls. In certain cases, however, prevention of fall in the prices is also the task of these controls. As there is a close inter relationship between supply and prices, price and distribution policies should mutually support each other to achieve the desired objective.

PRICE POLICY IN INDIA

The price system can be used as a steering mechanism to secure the desired allocation of consumption and production, and thereby the interpersonal and inter-sectoral distribution of income. Hence, it is essential to have a price policy that is comprehensive enough to help achieve the various socio-economic aims. Today, the price polices of various nations aim, in general, at avoiding wide fluctuations in the price behaviour, mobilisation and optimum utilisation of resources by bringing about their rational allocation, providing price incentives for increasing production and redistribution of income in favour of the poor. The nature of price policy a nation should adopt, however, depends on the nature of the economy, objectives of development, the institutional framework, trade and commercial practices and the overall market behaviour.

When the First Five-Year Plan of India was formulated, the planners did not appear to have bothered much about the prices. As the First Plan experienced comparative price stability, the issue of prices was not a major concern while formulating the Second Plan also. But, during the Second Plan period, prices exhibited a disturbing trend and this became a matter of major concern. Hence, a separate chapter on Price Policy was incorporated, for the first time, in the Third Plan document.

The chapter on Price Policy for the Third Plan mainly dealt with the scope and limitations of price policy and the constituents of the price policy. It stated that the price policy in a developing economy should concentrate on two main objectives: *(a)* it must ensure that the movements of relative prices accorded with priorities and targets that had been set in the Plan; and *(b)* it must prevent any considerable rise in prices of essential goods that entered into the consumption of low income groups.

Fiscal and monetary discipline was conceived as the major constituent of price policy. It pointed out that fiscal policy must be directed to mopping up the excess purchasing power which tended to push up demands above the level of available supplies. The quantum of taxation must, in other words, be adequate to keep down consumption to the limits provided for in the Plan. The requirements of public sector investment programme must be met by the transfer of real resources from the public rather than by creation of fresh purchasing power. In other words, fiscal policy in all its aspects must aim at restraining consumption and mobilising savings more effectively.

It was stressed that monetary policy should go hand in hand with fiscal policy. Just as the latter should avoid the creation of excess purchasing power through government operations, the former should regulate the pace of credit creation through banks.

The policy also recognised the scope and limitations of the commercial policy in imparting stability to the economy.

While stressing that without adequate fiscal and monetary discipline, other regulatory measures would not have the desired effect, the policy recognised that fiscal and monetary policies by themselves might also not suffice to secure the right relationship between various prices or to prevent undue hardship to low and fixed income groups. "It may be necessary, then, to have physical allocations and direct controls in certain sectors. It will be agreed, for instance, that so long as steel is scarce, it should be distributed between competing uses on the basis of agreed priorities. It may, of course, be essential to raise the price of any commodity that is scarce; but it may not be desirable from an overall point of view to get the highest bidder to get the bulk of the available supplies, leaving the rest to their own devices. If, similarly, there is a shortage of an essential drug, control of prices and distribution at a fair price to genuine users would be the appropriate course of action to adopt. The same reasoning applies to essentials of life like food or cloth. The prices of what may be called basic essentials must be held reasonably stable, in regard to commodities that are less essential, or may be classed as comforts or luxuries, a rise in prices may have to be tolerated. In the case of comfort and luxuries, in fact, an important factor in policy is the need to raise more resources, a rise in their prices does not affect the common man. The techniques of price regulation may vary from commodity to commodity; in some cases an increase in production may be the only way to secure a reasonable level of prices. In other cases, buffer stocks, reorganisation of distribution arrangements and some direct controls may be inescapable."[1]

Thus, the Price Policy recognised the importance of fiscal and monetary policies, commercial policy, physical controls, enhancement of supply, etc., in achieving its objectives.

Successive Plans have emphasised the need for achieving price stability and distributive justice. However, the basic objectives and approach enunciated the Price Policy formulated in the Third Plan continued in the successive plans without any remarkable change and more and more measures were taken by the government to realise the objectives. Decontrol of prices and distribution has been a part of the economic reforms ushered in 1991. Price and distribution controls would, however, continue in certain vital areas.

PRICE CONTROLS

A number of measures have been taken to control the prices. These measures include both indirect and direct controls.

INDIRECT CONTROLS

Indirect controls are exercised mainly through the monetary policy, fiscal policy and commercial (foreign trade) policy.

The term monetary policy refers to the policy of the Central Bank of the country in respect of the cost and availability of credit. The rationale of using the monetary policy to control prices is that there is a very strong direct relationship between money supply and prices. *Ceteris paribus*, an increase in money supply results in an increase in prices and vice versa. Hence, a price rise is sought to be arrested by monetary contraction and a fall in prices is dealt with by monetary expansion.

The Reserve Bank of India (RBI) has been employing the Bank (Discount) Rate Policy, Open Market Operations and Variable Reserve Ratio Requirements and various methods of Selective (Qualitative) Credit Control. (See the chapter on *Monetary and Fiscal Policies* for details).

A policy that should go hand in hand with the monetary policy to make it effective is the fiscal policy. Fiscal policy refers to the policy of the government in respect of public revenue and public expenditure. Fiscal policy can influence the price level by increasing or reducing the purchasing power of the public. Further, it can affect prices by imposing or removing or varying taxes on commodities or services, and by subsidies. Taxes, like excise duties, sales tax and customs duty, can have a profound impact on the prices of commodities.

Commercial policy has also been used to a certain extent to stabilise the domestic economy. Prices can be kept under control by increasing the supply by importing goods which are in short supply. This has been done for such commodities as edible oils. Further, the government bans the export of certain items the supply position of which is not comfortable within the economy.

To prevent an unwarranted fall in the prices, the government may sometimes resort to the deliberate export of certain items.

There are also some other measures such as buffer stock operations which can help avoid wide fluctuations in prices.

DIRECT CONTROLS

The Central and State Governments in India have armed themselves with a number of Acts to exercise direct control over the functioning of the economy. Laws like the Industries (Development and Regulation) Act, the Essential Commodities Act, the MRTP Act, the Foreign Trade Development

and Regulation Act [earlier the Imports and Exports (Control) Act], etc., empower the Central Government to control production, supply, distribution and price in a large number of cases.

Administered Prices

Administered price, a term coined by Lord Keynes, refers to the price which is set consciously by a single decision making body—like a monopoly firm, a cartel, or a government agency — rather than being determined by the free play or market forces. However, the term administered price often refers to the government determined price.

When the market forces of supply and demand are free to interact, the price of a product rises when the supply falls short of the demand and declines when the supply exceeds demand. But under the administered price system, as the price is fixed at a particular level, fluctuations in demand and supply do not cause any price fluctuation. In other words, the administered price is not an equilibrium price. Not only that, the administered price may not reflect the demand and supply conditions; sometimes it may not even absorb the full cost of production.

In India, the price of a number of key commodities were administered by the government. Some key commodities and services such as steel, coal, fertilizers, aluminium and electricity, whose prices were administered, account for about one-fifth of the total weight in the wholesale price index. Thus, in the past the administered price was an important factor affecting the general price level in India. At one time over 70 per cent of the goods and services sold by the public sector enterprises were subject to administered prices. This indicates the importance the administered price had in the Indian economy.

Administered prices were generally fixed on the recommendations of an expert body like the Bureau of Industrial Costs and Prices (BICP) or, in the case of certain public enterprises, on those of specially constituted Inter-Ministerial Committee or Groups. The BICP was later replaced by Tariff Commission.

While recommending prices, the recommendatory body normally goes by the guidelines for price fixation prescribed by the government and, inter alia, takes into account the cost of most efficient firms which account for a large percentage of the total output (to ensure a certain level of efficiency in production), the optimal norms of consumption of raw materials and energy as well as capacity utilisation, and provides a fair rate of return which has generally ranged between 10 and 14 per cent on net worth, depending on the differences with respect to factors such as risk, priority, growth prospects, etc. In order to reconcile the interests of consumers as well as producers, a system of retention prices for different producers on the basis of cost of production on the one hand and uniform sale prices for consumers on the other had been recommended, and had been in operation in several cases such as steel, fertilizers, cement, etc. Price adjustments had been allowed for changes in major cost components from time to time, and a review in depth is undertaken after suitable intervals.

The principle of fair return is relevant to public enterprises as well. However, these enterprises are generally engaged in the provision of infrastructural services or in the manufacture and supply of basic industrial materials such as coal, steel and POL, or agricultural inputs, such as fertilisers; and an increase in their prices generally has a cascading effect. Hence, an attempt had been made to keep down their prices. This, together with managerial deficiencies and other factors, had resulted in inadequate resource generation by the public enterprises, losses in some of them, and a heavy draft on the public exchequer. It also meant the supply of goods and services produced in the public

sector at subsidised prices even for non-priority uses, which had the effect of accentuating the imbalances between demand and supply. There was, therefore, a growing realisation that, in the context of continued inflationary pressure at home and abroad, administered prices should not be kept out of tune with other prices without heavy economic cost to the nation.

The principal aim of the administered price system is the protection of the interests of both the producers and consumers. But, in India, in many an instance, the system miserably failed to safeguard the interests of the producer as well as the consumer. Price controls retarded the growth of the concerned industries and increased market imperfections, resulting in persistent commodity shortages and rampant and flourishing blackmarkets.

Industry circles argued that many a time the price was fixed on unrealistic capacity utilisation norms, and that there was a delay in granting price increases to cover cost escalations.

Take the case of the cement industry, for instance. The unrealistic price policy has retarded the growth of the cement industry and the resultant widening of the demand supply gap "has raised the price of cement in the blackmarket to about four times the official price. Government must also recognise that even imported cement costs twice as much as the indigenous product".

In short, the unrealistic price control policy in India, administered by inefficient and corrupt men at various administrative levels, has resulted in growing shortages and rampant blackmarketing, generating enormous black money.

With the advent of the economic reforms, there has been a phasing out of the administered prices.

Dual Pricing

Some commodities like sugar, cotton textiles, paper and aluminium were subject to dual pricing in India in the past.

The system of dual pricing has been designed to allow the weaker sections of the people or the privileged buyers like the government to get the commodity at a lower price. Under dual pricing, a part of the output of an industry may be acquired by the government at a price fixed by it, which is usually lower than the market price, and the remaining part of the output may be sold by the industry at the market price. For instance, under the dual pricing policy for sugar, a part of the total production of sugar was to be sold to the government as levy at the price fixed by the government. The non-levy sugar (the remaining part) was allowed to be sold at the free market price. Sometimes the free market price went up to three times, the levy price.

The dual pricing system in our country was severely criticised. It was argued that such controls affected capital formation and production in such industries. It is said that the dual pricing system does not always permit the industry to make up for the loss on the levy sales by sales in the free market.

Another criticism is that the system encourages malpractices, blackmarketing, tax evasion, corruption and the generation of black money.

Subsidisation

Prices of certain commodities are directly affected by the policy of subsidisation. Important commodities the prices of which were deliberately kept low by the government subsidies were foodgrains, fertilisers and controlled cloth. Certain export goods also enjoyed the benefit of subsidies.

In August 1976, the Department of Civil Supplies and Co-operation was converted into a separate Ministry. The functions of the Ministry of Civil Supplies and Co-operation are two-fold:

(i) Those relating to civil supplies and allied matters, which include: *(a)* monitoring prices, the public distribution system, consumer protection, integrated management of the supply, prices and distribution of certain essential commodities; *(b)* regulating weights and measures; and *(c)* control of forward trading.

(ii) Those pertaining to co-operation. These include general policy in the field of co-operation, matters relating to national co-operative organisations, co-operative training, education, marketing, processing and consumer co-operation.

On July 1, 1979, the Union Government inaugurated the production-cum-distribution system. The main features of this system are:

(i) Every village or a group of villages having a population of 2,000 and above will have a fair price shop. In remote areas, the population coverage would be even less – about 1,000.

(ii) Commodity coverage will be extended with a view to strengthening the system.

(iii) For the successful implementation of the scheme, effective arrangement will be made for the procurement, including import wherever necessary, and buffer-stocking of the commodities for distribution.

(iv) In regard to certain manufactured articles, the Central Government would assist in establishing direct links between the manufacturers and the States and their approved agencies, including co-operatives, for the distribution of such items.

(v) Special care will be taken in the production and distribution of the items of basic consumption by the vulnerable sections of society.

In early 1980, the government decided to make the PDS a permanent features of the economy and an integral part of its price stabilisation policy.

The cooperative sector is assigned an important role in the PDS in India. Besides consumer co-operatives in urban areas, there are very large number of village co-operative societies. At the secondary level, in semi-urban areas, there are several thousands of Agricultural Marketing Societies. Most of these, are engaged in the distribution of consumer articles. At the central level, the National Agricultural Co-operative Marketing Federation (NAFED) and the National Co-operative Consumers' Federation (NCCF) carry out support price operations, maintenance of reasonable prices of essential items, creation of buffer-stocks of surplus production, etc. Thus, the co-operatives have a large base and a great potential to contribute to the successful running of the PDS. But, the co-operatives, too, have their own organisational weaknesses. They have to streamline and strengthen the existing consumer co-operative structure to take up the gigantic task of supplying essential commodities to masses in rural, semi-urban and hilly and tribal areas.

Several states have also established State Civil Supplies Corporations to handle the distribution of essential commodities under the Public Distribution System.

The Indian Public Distribution System (PDS) is probably the largest distribution network of its type in the world. The system is designed to help both the producers and consumers of foodgrains by linking procurement to support prices and ensuring their distribution along with other essential commodities at affordable prices throughout the country. PDS continues to be a major instrument of Government's economic policy for ensuring food security for the poor.

The network of fair-price shops has been expanding over the years. In April 1999 there were about 4.52 lakh ration shops in the country.

Under the PDS the Central government has assumed responsibility for procurement and supply of essential commodities, *viz.*, wheat, rice, levy sugar, imported edible oils and kerosene, to the State governments and the Union Territories for distribution at affordable prices to the public. These commodities are made available to the States/UTs at fixed Central Issue Prices (CIP) which are determined by the Central government and which generally involve subsidies borne by the Central government. The Central Issue Prices of foodgrains are fixed by the Ministry of Food after taking into account the Minimum Support Price of foodgrains, statutory charges/taxes payable on the Minimum Support Prices and interest charged at the prescribed rate of interest. In the case of other items like sugar, kerosene and imported edible oils, the cost of procurement/production, margins to dealers, transportation incidentals, etc., are included while working out the Central Issue Prices. Some States/UTs also distribute additional items of mass consumption through the PDS outlets.

Targeted Public Distribution System: In June 1997 the Government launched the Targeted Public Distribution System (TPDS) by streamlining the PDS by issuing special cards to the families below the poverty-line (BPL) and selling essential articles under PDS to them at specially subsidised prices. The thrust is to include only the really poor and vulnerable sections of the society such as landless agricultural labourers, marginal farmers, rural artisans/craftsmen such as potters, tappers, weavers, blacksmiths, carpenters, etc., in the rural areas, and slum-dwellers and persons earning their livelihood on a daily basis in the informal sector, like porters, rickshawpullers and hand-cart pullers, fruit and flower-sellers on the pavements, etc., in urban areas.

The TPDS is now in operation in all States/UTs except in Delhi and Lakshadweep.

The PDS, as it operates in our country, has been severely criticised. The major criticism is that the system is inefficient, the supply is not smooth, prompt and sufficient, and the quality of goods supplied is poor. There is a serious allegation that some of the goods of good quality are sold secretly to private traders and low quality goods are sold to the public by the PDS. This needs to be probed into by a competent authority.

BOX 17.1 : PERFORMANCE APPRAISAL OF PDS

In the Performance Appraisal Report (Civil), the Comptroller and Auditor General of India (CAG), has disclosed that the benefits of the public distribution system (PDS) in terms of food availability, income transfer, coverage of the needy and nutrition support did not accrue to the intended sections of society.

The report has pointed out several shortcomings relating to targeting of the beneficiaries, adequacy of food and nutritional security, meagre income transfer to the targeted group, high cost of operations, higher prices charged from the consumers, poor quality and non-existent vigilance system, which adversely affected fulfilment of the envisaged objectives of the PDS.

According to the CAG report, while the objective of remunerative minimum support prices every year for sustained foodgrains production had been achieved to a large extent, the other objectives of supply and distribution to the consumers, particularly to the weaker sections at subsidised rates had not been achieved.

The report noted that inefficient targeting had affected even targeted PDS, under which 10 kg foodgrains per month per family was to be provided to the households below the poverty line (BPL) at about half the normal PDS price.

18 INDIAN COMPANY LAW

Brief History of Company Law in India*

Indian Company Law has a long history. The Companies Act, 1956, is the successor to the Indian Companies Act of 1913 and is a consolidation of many successive Amendment Acts, statutory rules and principles laid down in decisions of the courts in India and in England. Several Acts were passed from 1850 onwards. The first Act, passed in 1850, was known as the Joint Stock Companies Act. This was followed by two Acts of 1857 and 1860; but the Act of 1866, which followed soon after, repealed all the previous enactments; and this Act itself was repealed in turn by the Act of, 1882. This last mentioned Act remained on the statute book up to 1913, though, in the meantime, it was amended several times to meet the demands of the commercial world. The Indian Companies Act of 1913 was passed with the object of consolidating and amending the law relating to trading companies, and was mainly based upon the English Companies Act of 1908, with certain additional provisions to meet the peculiar business conditions obtaining in this country. Since the Indian Act closely followed the English Company Law, the decisions of the English courts under the latter were also generally followed by the courts in India. This Act of 1913, however, did not provide for certain peculiarities of the Indian commercial world, such as the managing agency, and was, therefore, found to be highly unsatisfactory in several respects in the course of its working. Eventually, extensive amendments were introduced in the Act by the Indian Companies (Amendment) Act of 1935, which came into operation on 15th January 1937. The vast number of amendments introduced by this Act of 1937, however, involved a few omissions; but they were sought to be removed by frequent amendments in the subsequent years.

The Act of 1913 was, however, repealed by the present Companies Act (I of 1956) which was brought into force from 1st April 1956. This followed the acceptance by the Government of the recommendations of what is known as the Bhabha Committee which consisted of some Members of Parliament. This Committee submitted a detailed report in 1952, and a Bill incorporating the amendments suggested by it was introduced in the Lok Sabha in 1953 and became subsequently Act I of 1956. This Act, while adopting the scheme and most of the provisions of the UK Companies Act of 1948, marked a distinct improvement on the Act of 1913 in several respects and sought to ensure an efficient and honest management of companies governed by the Act.

The Companies Act, 1956, was amended several times. The most significant amendment so far was effected by the Companies (Amendment) Act, 2000.

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* Adapted from the *Report of High-Powered Expert Committee on Companies and MRTP Acts.*

The Companies Act is a very lengthy piece of legislation. Presenting a comprehensive picture of the Companies Act is beyond the scope of this book. What is given in this chapter is salient features of *only some* of the important aspects of the Companies Act.

Objectives of the Companies Act

The Companies Act, 1956, for the first time also provided for a greater measure of Governmental control over the formation and management of joint stock companies. This was considered desirable in the public interest and in order to prevent the diversion of company's funds for purpose which thwarted national economic policies or approved economic objectives.

The basic objectives underlying the law were to provide:

1. A minimum standard of good behaviour and business honesty in company promotion and management.
2. Due recognition of the legitimate interest of shareholders and creditors and of the duty of managements not to prejudice to jeoparadise those interests.
3. Provision for greater and effective control over and voice in the management for shareholders.
4. A fair and true disclosure of the affairs of companies in their annual published balance sheet and profit and loss accounts.
5. Proper standard of accounting and auditing.
6. Recognition of the rights of shareholders to receive reasonable information and facilities for exercising an intelligent judgment with reference to the management.
7. A ceiling on the share of profits payable to managements as remuneration for services rendered.
8. A check on their transactions where there was a possibility of conflict of duty and interest.
9. A provision for investigation into the affairs of any company managed in a manner oppressive to minority of the shareholders or prejudicial to the interest of the company as a whole.
10. Enforcement of the performance of their duties by those engaged in the management of public companies or of private companies which are subsidiaries of public companies by providing sanctions in the case of breach and subjecting the latter also to the more restrictive provisions of law applicable to public companies.

CLASSIFICATION OF COMPANIES

In the words of Lord Justice Lindley, "a company is an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted". According to Chief Justice Marshall, "a corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the

charter of its creation confers upon it, either expressly or as incidental to its very existence." Hahlo's *Case Book on Company Law* says that "like any juristic person, a company is legally an entity apart from its members, capable of rights and duties of its own, and endowed with the potential of perpetual succession."

Section 3 (l)(i) of the Companies Act says that "a company means a company formed and registered under this Act or an existing company" (An existing company is a company formed and registered under any of the previous company laws, before the Companies Act, 1956, came in to effect.)

The Companies Act deals with the following classes of companies.

- Companies limited by shares (sub-divided into public, deemed public and private companies)
- Companies limited by guarantee (either with or without share capital)
- Companies with unlimited liability (either with or without share capital)

The Companies Act also refers to certain special types of companies such as:

- Holding and subsidiary companies
- Government companies
- Foreign companies

Unlimited Companies

A company not having any limit on the liability of its members is termed as unlimited company. The members of an unlimited company are liable, like the partners of a firm, for all its trade debts without any limit.

An unlimited company must have Articles of Association, stating the number of members with which the company is to be registered. An unlimited company may or may not have share capital.

The Articles of Association of an unlimited company shall state the number of members with which the company is to be registered and, if the company has a share capital, the amount of share capital with which the company is to be registered.

The High-Powered Expert Committee on Companies and MRTP Act, popularly known as the Sachar Committee, observed that "although the present Act provides for the formation of unlimited companies, the latter have hardly had any useful career in the growth and development of the corporate sector. We feel that the concept of a company with unlimited liability of its members does not conform to the corporate concept which necessarily postulates a limited liability. We, therefore, suggest that this type of companies should be abolished from the statue book....It is also suggested that the existing unlimited companies should be compulsorily required to convert themselves into limited companies." However, even after the significant Amendment Act of 2000, unlimited company continues to have its place in the Indian Companies Act.

As on 30th November 2000, there were 458 companies in India with unlimited liabilities.

Guarantee Companies

The liability of the members of a guarantee company is limited by a fixed sum which is specified in the memorandum and beyond which they cannot be called upon to contribute. The memorandum