

PATTERN OF INDIA'S INDUSTRIALISATION

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INTRODUCTION

Business Environment, as already pointed out in the introductory chapters, affects different industrial segments differently, leading to different rates of growth in various sub-groups. In addition to the environmental factors, market conditions including state of demand, technological development, cost conditions and internal management, greatly affect the growth of individual industries and segments. The pattern of industrialisation that so emerges changes dynamically as the determinants of the pattern change. One important implication of the changing pattern is that in some segments that lag behind, domestic supply falls below the domestic demand levels while the others that surge ahead produce output levels exceeding domestic demand and make exports possible. The shift of investment from one segment to the other bring, in subsequent rounds, corresponding changes in the pattern of demand for technical skills demand has definite employment implications. Shifts in the domestic industrial pattern also affects the sectoral flows of foreign investment and technology and hence the comparative competitive position of individual segments. These factors are important as they affect the overall rate of industrial growth and hence.

DETERMINANTS OF INDUSTRIALISATION PATTERN

Factors affecting country's industrial pattern are both internal and external. External factors, as already pointed out, relate to the business environment, both national and international, whereas internal factors are related to the operational aspect of firms, covering productivity efficiency and profitability. The various factors affecting industrial composition and pattern may be broadly grouped under the following heads.

INDUSTRIAL POLICY

Industrial policy, among other things, identifies certain sectors of national importance on the basis of employment potential, linkages with other industries, export potential, nature of production and overall welfare of the society. It offers special incentives and concessions in the areas of finance, marketing, entrepreneurship and training. *With policy support, the identified priority segments may grow faster relative to others and thus may alter the production structure over time. The policy may invite foreign investment in selected areas on the basis of special facilities and incentives and it may accelerate the growth of these sectors.*

COMPETITIVE CONDITIONS

Competitive conditions widely vary across different industrial segments depending upon a number of factors. These conditions affect efficiency, productivity, costs and prices of the various firms in an industrial segment. Firms of comparable size tend to become more efficient under competitive conditions and the respective segments grow faster with the entry of new firms. State of competition in a particular industrial segment depends mainly on the following main factors:

- Total number of firms in the segment;
- The nature or form of the market;

- Barriers to the entry of new firms in the segment;
- Availability of alternative technologies;
- Stage of the product life cycle of the segment;
- Intellectual property protection;
- Competition from imports;
- Pattern and overall level of demand;
- Entrepreneurial culture; and
- Business legislation affecting competition.

Competition between firms of contrasting size and market power often leads to the marginalisation of a large number of small firms and the total output in a particular segment may shrink as monopoly power of firms increases. The price-raising and output-reducing effects of monopolistic tendencies are well-known in business theory.

GOVERNMENT REGULATION

Government regulation can be legislation-based or policy-based without a corresponding business law. The regulation can also be classed as macro-level and sectoral. National level regulation applies equally to all the industrial segments though the severity impact may vary across different industrial segments depending upon their vulnerability or other characteristics; sectoral-level regulation affects particular or individual segments directly. Government regulation may take such forms as price controls, limits (lower or upper) on wage or salary payments, conditions or restrictions on industrial locations, pollution norms, rates of interest, conditions or restrictions on raising capital and other areas affecting production, supply, distribution and demand. *Segments under a more restrictive government control generally tend to have slower growth rate of investment and output as compared to other segments which have greater degree of freedom in operations.* Similarly, sectors receiving assistance and incentives from the government tend to enjoy a better competitive edge over others.

INVESTMENT-RELATED FACTORS

Growth of a particular sector depends directly on the level and rate of investment. Investment largely follows demand and profitability conditions though government policy and regulation plays an important role. Other key factors behind new investment are entrepreneurship, availability of skilled workforce and technology and the flow of credit from financial institutions. Availability of skilled workforce is determined by the output of technical education and training institutions. Flow of credit to particular industrial segments depends upon the fund base, lending priorities criteria and the rate of interest charged by financial institutions. New domestic investment tends to be depressed in the segments which are less competitive and where imports are freely allowed at competitive or even lower prices. Such conditions also affect foreign direct investment in such segments.

CONTINGENT FACTORS

Such factors encompass, unforeseen or situational factors which can't be anticipated in advance, like earthquakes, social unrest, floods, ethnic strife and war, monsoon failure or sudden changes in domestic or international business environment. The sectors which are more vulnerable to such factors are prone to slower average growth and sharper fluctuations in performance. Import-dependent segments, for example, are more prone to sudden changes in import policy. Food processing industry depends critically on the supply conditions in agriculture which themselves depend heavily on monsoon and other geographical factors. Investment has the general tendency to gravitate more towards segments which are less affected by the vagaries of nature, economic policies or of business environment.

FISCAL FACTORS

Taxation and public expenditure are among the significant determinants of industrial pattern. These policies are operationalised through the budgetary mechanism. Depending upon the significance of industries and products from the point of view of national development and consumers welfare, different products and industry groups are subjected to different rates of excise and value added tax. In a federal set up like India, there are further differences in sales tax and other taxes which account for, to some extent, inter-state differences in the rate and level of investment and hence the structure of industrial production. Entrepreneurs generally prefer areas in where tax burden is comparatively less.

Pattern of public expenditure also affects the pattern of industrial production. *Capital expenditure on infrastructure and direct investment projects in specific locations may encourage specific industries through forward and backward linkages. Similarly, public expenditure on subsidies and other assistance or promotional measures may encourage faster, growth of industries of national importance and affect the industrialisation pattern.* The assistance or promotional measures may be in such areas as finance, technology, marketing, training or entrepreneurship.

EXPORT-IMPORT POLICY

Export-import policy particularly in a globalising economy can have significant influence on the pattern of industrialisation. On the export side, the policy, in addition to a general package, offers different industry or product-related packages. *The products in which the country enjoys comparative or competitive advantage over other lines of products, generally, attract greater state support for exports. Given other favourable conditions, investment tends to be larger in such areas.* The export incentives are generally in the form of duty drawback, concessional pre-shipment and post-shipment finance, excise exemptions and procedural simplification. Other promotional assistance measures may include R&D support, technological upgradation, market development assistance and facilities of canalised trade.

On the import side, selected products and industries may be given the benefit of concessional import duties on capital goods, raw materials and intermediate products. Industries which receive liberal import entitlements, foreign exchange facilities, concessional credit and import duty benefits often attract investment on a larger scale particularly in cases where domestic input supplies are inferior in quality or higher in price.

TECHNOLOGICAL CONDITIONS

Changing pattern of industrial growth is partly attributed to technological factors and conditions. Availability of modern or latest technology in a dynamic competitive environment is a necessary condition for the growth of business. In order to maintain or enhance competitiveness, firms frequently need to upgrade their technologies. Investment tends to be higher in industries where new technologies are available. Major sources of technology are domestic R&D, capital goods imports, foreign technical collaboration, international licensing and franchising. For the transfer and acquisition of technology, the government must have a flexible and enabling technology policy with suitable safeguards for intellectual property protection.

HUMAN RESOURCES

Different industries have different human resource environments. Human resources are a key factor that determine the growth of an industry. Availability of professional or skilled workforce, good industrial relations, rational compensation structures, motivating internal environment, rational and flexible labour laws greatly affect productivity, efficiency and growth of individual industries. Industries which have a good reward system and have a motivating work environment and culture can perform better than others and occupy a larger industrial space. Availability of skilled workforce basically depends upon the quality and quantum of the output of educational and training institutions. Productivity of workers depends not only on their own education and skills but also on the technological standard of the capital equipment on which they work. Job design, work processes and the overall quality environment of the organisation in which the workers work, also impact productivity. The industrial segments which enjoy such advantages tend to grow faster.

DEMAND FACTORS

Pattern of demand determines pattern of growth of industries. Demand for the products of an industrial segment is the result of a number of factors including product prices, consumers' income, taxes, product quality, consumer tastes and preferences, prices of substitutes of the products and, eventually, the delivered value to the consumers. Advertising, promotional measures and the efficiency and quality of the distribution network also significantly influence demand. In case of consumer durables, the cost and availability of consumer credit and hire-purchase facilities are important factors that can support demand. Industries facing buoyant demand conditions in both domestic and foreign markets have favourable conditions for growth.

The above factors can be easily classified into demand-related, supply-related and environmental factors. Together, these factors determine the profitability conditions which attract new investment. While making the investment decision, each firm, depending upon its management, has its own perception of risk and return factors which may or may not be in line with the actual prevailing scenario.

RECENT GROWTH TRENDS IN MAJOR INDUSTRIAL SEGMENTS

In India's industrial sector, manufacturing sector is the largest followed by electricity and mining and quarrying. It is interesting to find that since 1995-96, there has been a general decline in the

growth rate of each of these segments which bears a testimony to the fact that the industrial economy of the country is in the grip of recession over the last seven years (1995-2002) or so. The decline has been more dramatic in the mining and quarrying sector. *A major part of demand for mining products is derived demand as these products are used as raw materials for industries producing a large variety of other goods and services. It is, therefore, expected that the declining trend in manufacturing would be associated with matching trend in mining and quarrying.* Since the year 1996-97 production in the sector has been faltering markedly, fluctuating between marginally positive and negative rates of growth (Table 26.1). Falling trend in mining output is partly a manifestation of long run resource exhaustion. *The decline in the growth rate in the power sector is attributed both to the technical constraints and the failure of new investment in the sector to cope up with rising demand from manufacturing, household and agricultural sectors.* The resultant of the growth rate in the three sectors is that the growth rate in the **General Index of Industrial Production** has been declining.

Table 26.1 Annual Growth Rates of Industrial Production in Major Sectors of Industry Since 1994-95

(Growth rate in %)

| ↓ Year | Mining and quarrying | Manufacturing | Electricity | General |
|-----------------------|----------------------|---------------|-------------|---------|
| Weight ¹ → | 10.5 | 79.4 | 10.2 | 100 |
| 1994-95 | 9.8 | 9.1 | 8.5 | 9.1 |
| 1995-96 | 9.7 | 14.1 | 8.1 | 13.0 |
| 1996-97 | -1.9 | 7.3 | 4.0 | 6.3 |
| 1997-98 | 6.9 | 6.7 | 6.6 | 6.7 |
| 1998-99 | -0.8 | 4.4 | 6.5 | 4.1 |
| 1999-00 | 1.0 | 7.1 | 7.3 | 6.7 |
| 2000-01 | 2.8 | 5.3 | 4.0 | 5.0 |
| 2001-02 | 1.2 | 2.9 | 3.1 | 2.7 |

Notes: ¹Based on Index of Industrial Production with base 1993-94 = 100. The weights pertain to the base year.

Source: Govt. of India, *Economic Survey*, various issues.

The country's industrialisation pattern can also be seen in terms of **use-based classification of industries**. (Table 26.2) Basic goods, which support production in other industry groups, commanded the heaviest weight (35.5 per cent), followed by consumer goods (28.7 per cent), intermediate goods (26.5 per cent) and capital goods (9.3 per cent) in 1993-94. As before, the production of basic, capital and intermediate goods depends upon the final demand for consumer goods. During 1995-98, the output of consumer goods grew at a decelerating pace due largely to the lack of demand. The demand bottomed out at 2.2 per cent in 1998-99 and rose marginally in subsequent years but the growth rate has remained well below 10 per cent per annum.

The production of basic goods, which remained buoyant around 10 per cent during 1994-96, dipped to 3.0 per cent in 1996-97 and bottomed out at 1.6 per cent in 1998-99. During the last three years, the production growth rate, on the average, has remained below 5 per cent. The production of capital goods has widely fluctuated between 5-13 per cent during 1994-2000. During the period 1999-2000, the capital goods sector growth rate declined sharply, turning negative

in 2001-02. During 2000-03, the growth rate is expected to rise significantly. *It must be observed that the correlation between consumer goods and capital goods growth rate is relatively weak.* This could be basically due to the following reasons:

- Consumer goods production might have increased through reduction in excess or idle capacity.
- Part of the increased capital goods production might have found way to inventories in the face of weak demand.
- Part of the increased capital goods production might have been exported without causing corresponding increase in consumer goods production at home.
- Additional output in the consumer goods industries might have been produced from imported capital goods.

Table 26.2 Growth Rate of Industrial Production by Use-based Classification Since 1994-95

(Growth rate in %)

| ↓Year | Basic goods | Capital goods | Intermediate goods | Consumer goods | IIP |
|----------------------|-------------|---------------|--------------------|----------------------------|------|
| Weight' → | 35.5 | 9.3 | 26.5 | 28.7 (5.4) ² | 100 |
| 1994-95 | 9.6 | 9.2 | 5.3 | 12.1 (16.2) | 9.1 |
| 1995-96 | 10.8 | 5.3 | 19.4 | 12.8 (25.8) | 13.0 |
| 1996-97 | 3.0 | 11.5 | 8.1 | 6.2 (4.6) | 6.1 |
| 1997-98 | 6.9 | 5.8 | 8.0 | 5.5 (7.8) | 6.7 |
| 1998-99 | 1.6 | 12.6 | 6.1 | 2.2 (5.6) | 4.1 |
| 1999-00 | 5.5 | 6.9 | 8.8 | 5.7 (14.1) | 6.7 |
| 2000-01 | 3.7 | 1.8 | 4.7 | 8.0 (14.5) | 5.0 |
| 2001-02 | 2.6 | -3.4 | 1.5 | 6.0 (11.5) | 2.7 |
| 2002-03 ³ | 4.7 | 9.9 | 2.6 | 7.3 (-6.0) | 5.3 |

Notes: ¹Index of industrial production, base 1993-94 = 100. Weights pertain to the base year.

² Figures within brackets refer to consumer durables.

³ Estimated values, based on 8 month data (April – November)

Source: Govt. of India, *Economic Survey* Various issues.

The correlation between intermediate goods and consumer goods growth rate is relatively strong. The growth rate fell consistently in both the segments during 1995-99. During 2000-03, the growth rates have been modest reflecting conditions of recession. In the consumer goods segment, recessionary conditions are quite evident during 1996-03. However, within this segment,

except the year 1996-97, growth rate of consumer durables segment has remained far above that in the non-durable segment during 1995-03. The comparative trend is attributed to mainly two factors:

- The price trends in the consumer durables segment have been far more modest as compared to that in the non-durables segment.
- In the vast middle class segment of consumers, **income elasticity of demand** for consumer durables is generally found to be higher as compared to non-durables.

Table 26.3 Growth Rates (base 1993-94=100) of Major Manufacturing Groups (each having Weight of 5 Per Cent or More in 2001-02 in the IIP), Since 1999-2000

| Manufacturing Group | Weight (1993-94) | Growth rate (%) | | |
|--|------------------|-----------------|---------|---------|
| | | 1999-2000 | 2000-01 | 2001-02 |
| 1. Chemical products ¹ | 14.0 | 10.0 | 7.1 | 4.8 |
| 2. Mining & quarrying | 10.5 | 1.0 | 2.8 | 1.2 |
| 3. Electricity | 10.2 | 7.3 | 4.0 | 3.1 |
| 4. Machinery & equipment | 9.6 | 17.7 | 7.3 | 1.3 |
| 5. Food products | 9.1 | 4.2 | 10.1 | -1.6 |
| 6. Basic metals & alloys | 7.5 | 5.0 | 1.8 | 4.3 |
| 7. Rubber, plastic, Petroleum & coal products | 5.7 | -1.1 | 11.8 | 11.1 |
| 8. Cotton textiles | 5.5 | 6.7 | 2.9 | -2.2 |
| General overall index | 100 | 6.7 | 5.0 | 2.7 |

Note: ¹ Including basic chemicals but excluding petroleum products and coal.

Source: Compiled from Govt. of India, *Economic Survey*, Various issues.

Table 26.3 gives the industrial pattern according to the major groups of industries. Each of the industry specified has a weight exceeding 5 per cent in the overall **Index of Industrial Production**. In 2001-02, the largest industrial group was chemical products (including basic chemicals but excluding petrochemicals); followed by mining and quarrying; electricity, machinery and equipment; food products; basic metals and alloys; rubber, plastic, petroleum and coal products; and cotton textiles. During 1999-2002, annual growth rate has fallen in case of chemical products, electricity, machinery and equipment, basic metals and alloys and cotton textiles. Though each segment has its own reasons for the decline but among the environmental factors, the major ones are the industrial slowdown and import competition in the wake of increasing import liberalisation. During this period, the annual growth rate of only one broad sector viz. rubber, plastic, petroleum and coal products picked up.

Table 26.4 Different Industry Segments Classified on the Basis of Relative Growth in Production, 1994-95 to 2001-02

| Change in production (2001-02 over 1994-95) | Industry segments |
|---|---|
| 1. Absolute fall in production | Jute, hump and mesta products; wood and wood products, furniture and fixtures. |
| 2. Increase in production, 0-50% | Mining and quarrying; cotton textiles; and metal products and parts. |
| 3. Increase in production, 50-100% | Food products; textile products and apparels; paper, paper products and printing; basic chemicals and chemical products; rubber, plastic, petroleum and coal products; non-electric machinery and machine tools; and electricity. |
| 4. Increase in production, above 100% | Beverages; tobacco and tobacco products; wool, silk and man-made fibre textiles; non-metallic mineral products; and transport equipment (including parts). |

Note: Based on Index of Industrial Production of respective industrial segments, with base 1993-94 = 100.
Source: CSO data.

A more comprehensive picture is provided in Table 26.4 which classifies different industry segments on the basis of relative growth the production. Industry groups (3) and (4) have withstood recessionary conditions better than others due to comparative and competitive advantages possessed by them. These segments have proved to be the growth drivers of the country's industrialisation since the year 1994-95. These segments deserve better attention and encouragement from the government. The conditions of recession in recent years are well evidenced in Table 26.5. During 1999-2002, the total number of fresh industrial proposals through **Industrial Entrepreneurship Memorandum (IEM)** and **Letter of Intent (LOI)** has been almost stagnant and the total value of proposed investment has been on the decline.

Table 26.5 Industrial Investment Intentions through Industrial Entrepreneur Memorandum (IEM) and Letters of Intent (LOI), 1999-2002

| Year | No. of proposals | | | Proposed investment (Rs. '000 cr) | | |
|-------|------------------|-----|--------|-----------------------------------|-----|-------|
| | IEMs | LOI | Total | IEM | LOI | Total |
| 1999 | 2,948 | 132 | 3,080 | 128.9 | 0.8 | 129.7 |
| 2000 | 3,058 | 203 | 3,261 | 72.3 | 1.0 | 73.3 |
| 2001 | 2,981 | 117 | 3,098 | 91.3 | 1.3 | 92.6 |
| 2002 | 3,172 | 89 | 3,261 | 91.3 | 0.4 | 91.7 |
| Total | 12,159 | 541 | 12,700 | 383.8 | 3.5 | 387.3 |

Source: SIA (Data Unit), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, quoted in Govt. of India, *Economic Survey*, 2002-03, Table 7.4, p.132.

It is a sad commentary on the industrialisation front that during 1991-2000 hardly about 10 per cent of the investment proposals were implemented. This is inspite of liberalisation of the industrial policy and the overall economic reforms. Not only that, the geographical pattern of the intended investment has been highly skewed of the total investment proposals under IEM during the period, the largest share is claimed by Gujarat (18.8 per cent), followed by Maharashtra (16.2), Tamil Nadu (7.9), UP (7.6), Andhra Pradesh (7.1), Haryana (6.8), Rajasthan (6.2), MP (6.1) and Punjab (5.2). It appears that though economic reforms have been implemented, the broad bureaucratic culture is still intact impeding private investment.

COMPARATIVE PATTERN OF INVESTMENT

It is analytically useful to compare the growth patterns of major manufacturing and service sectors in terms of private gross **capital formation**. Private investment in major industrial and service segments is largely governed by the demand conditions, infrastructural availability, cost of finance and future business prospects. Private investment in a particular industrial segment in a particular period determines the flow of output in the subsequent time periods so that there is always a time lag between time of investment and the time of production. **Table 26.6** provides the comparative pattern of investment in major industrial and service segments as reflected in the figures of gross **capital formation**. The relative differences in the growth rate of investment reflect and explain the changing pattern of production as explained in the previous sections.

Table 26.6 Comparative Private Investment in Major Industrial and Service Segments, 1997-2001

| | Sector | Capital formation (Rs.' 000 cr) | | | |
|----|---|---------------------------------|---------|---------|---------|
| | | 1997-98 | 1998-99 | 1999-00 | 2000-01 |
| 1. | Manufacturing | 105.7 | 91.2 | 101.1 | 85.7 |
| 2. | Finance, insurance, real estate and business services | 28.4 | 27.9 | 28.2 | 28.8 |
| 3. | Transport, storage and communication | 10.6 | 11.3 | 13.0 | 15.6 |
| 4. | Agriculture, forestry | 13.8 | 13.0 | 15.3 | 15.2 |
| 5. | Community, social and personal services | 5.4 | 7.9 | 8.5 | 7.9 |
| 6. | Trade, hotels and restaurants | 11.0 | 3.1 | 8.3 | 7.9 |
| 7. | Construction | 4.9 | 5.2 | 1.4 | 4.9 |
| 8. | Electricity, gas and water supply | 3.9 | 5.6 | 3.1 | 4.6 |
| 9. | Mining and quarrying | 0.4 | 0.8 | 0.2 | 0.5 |

Source: Rajya Sabha Unstarred Question # 1301 quoted in *The Tribune* dated March 7, 2003.

At constant prices (1993-94 = 100), investment in the manufacturing sector took a substantial dip in 1998-99 compared to 1997-98 and made a quick recovery in the year 1999-2000. The latest available estimates for the year 2000-2001 again indicate a slump in investment showing the overall conditions of recession over the period 1997-2001. An almost opposite trend is witnessed in the mining and quarrying sector. Compared to 1997-98, investment almost doubled in 1998-99 but nose-dived in 1999-2000. In the year 2000-01, it made a quick recovery with investment getting doubled as compared to the previous year. Similarly, in electricity, gas and water supply segment, investment has fluctuated rising from Rs. 3861 crore in 1997-98 to Rs. 5615 crore in 1998-99, falling to Rs. 3146 crore in 1999-2000 and further to Rs. 4601 crore in 2000-2001.

Compared to the above pattern of industrial investment, **capital formation** in agricultural and allied sectors was almost stagnant around Rs. 13,000 crore during 1997-99, jumping to about Rs. 15,000 crore in the subsequent two-year period. In the services sector, annual rate of investment in finance, insurance, **real estate** and business services has been stagnant around Rs. 28,000 crore. The transport, storage and communication segment has been relatively buoyant with investment rising consistently from about Rs. 10,600 crore in 1997-98 to Rs. 15,600 crore in 2000-01. Similar trend is witnessed in community, social and personal services where investment rose from about Rs. 5,400 crore in 1997-98 to Rs. 8,500 crore in 1999-2000. The investment, however, is estimated to have declined marginally to about Rs. 8000 crore in 2000-01. Detailed trends in the services sector are discussed in Chapter 30.

GROWTH PROFILES OF LEADING INDUSTRIAL SEGMENTS

The pattern of India's industrialisation, as discussed in the preceding sections, is in terms of broad industrial groups which consist of a number of heterogeneous sub segments having different weights within their respective groups. It is useful to have a look on the nature and performance of the engines of the country's industrialisation process. These leading industrial segments possess comparative advantage and competitiveness and have tremendous potential for further growth.

These segments, in fact, need focused assistance and policy support from the government so that these are able to withstand the challenges of growing international competition.

TEXTILE INDUSTRY

The textile industry, consisting basically of the mill sector, powerloom sector and handloom sector, is the oldest and the largest industry in the country. The powerloom and the handloom sectors consist of manufacturing units which are highly decentralised and dispersed. It is interesting to find that the share of the mill sector in the total fabric production in 2001-02 was only 3.7 per cent. The share was 38 per cent in 1980-81 and 76 per cent in 1950-51. This shows the overriding growth of the decentralised sector which has been driven largely by the powerloom sector. In 2001-02, the total production of fabrics was about 42 billion square metres of which powerloom sector accounted for 76.8 per cent and handloom segment 18 per cent. In 2003, there were about 14 lakh looms in the country providing employment to about 16 million workers. Of this, powerloom complexes concentrated mostly in Maharashtra, Gujarat and parts of Uttar Pradesh absorb nearly 13 million workers. *Textile industry as a whole contributes about 3.8 per cent of gross domestic*

product, accounts for about one-sixth of total industrial output and provides employment to about 22 million people. In the recent years, readymade garments has emerged as a fast-growth segment of the industry. The activities covered in the decentralised segment, in addition to handloom and powerloom, covers sericulture, handicrafts and wool. In 2002-03, government adopted cluster-based approach in the implementation of development programmes in these segments.

The industry, however, faces a number of formidable problems. The industry is predominantly cotton based, cotton being more than 60 per cent of the raw-material consumed. The industry faces the problem of sufficient availability and good quality of cotton. As a major part of the industry is old, there is a widespread problem of outdated plant and machinery and modernisation, which involves huge capital investment as a big challenge. The cost structure of the industry is much higher as compared to that in China, Pakistan and a number of East-Asian countries. The industry now faces challenges from import liberalisation under the new WTO regime. The new **National Textile Policy 2000** provides for gradual phasing out of **quantitative restrictions (QRS)** on imports by the year 2005 and integrating it with the world textile market.

CEMENT INDUSTRY

Cement is a heavy and basic industry which derives its demand largely from housing and construction sector. Before 1991, the industry was heavily controlled and regulated by the government and the controls covered entry of new firms, production, prices, distribution and end use. The industry was delicensed in 1991 and has undergone substantial growth since then. The total production of cement in 2001-02 was about 107 million tonnes compared to 76 million tonnes in 1996-97 and only 19 million tonnes in 1980-81. Today, Indian cement industry is the fourth largest in the world. After the decontrol of price and distribution in March 1989, the industry has made rapid strides both in terms of production capacity and technological upgradation. As on April 30, 2002, there were 124 large cement plants with installed capacity of 137 million tonnes per year and additional 300 mini cement plants having installed capacity of about 11 million tonnes per year. In 2001-02, total cement production was 107 million tonnes showing capacity utilisation rate of 73 per cent.

The industry produces a variety of cement like **Ordinary Portland Cement (OPC)**, **Portland Pozzolona Cement (PPC)**, **Portland Blast Furnace Slag Cement (PBFS)**, **Oil Well Cement (OWC)** and white cement. The quality of all the varieties of cement produced conforms to world standards. Due to the high quality of cement, it also has export markets in Bangladesh, Indonesia, Malaysia, Nepal, Myanmar and a number of countries in the Middle East, Africa and South-east Asian region. In 2001-02, the export of cement was about 5 million tonnes which however, is a small share of total production. The major problems faced by the industry include high burden of taxation, poor quality of coal as an input (high ash content), power shortage, high incidence of transportation cost and financial problems. The supply side problems coupled with demand constraints have resulted in under-utilisation of capacity which in itself raises per unit cost and squeezes profit margin.

IRON AND STEEL INDUSTRY

India is rated as the tenth largest steel producing country in the world. Iron and steel industry has a total capital employed at about Rs. 90,000 crore and provides direct employment to

more than 5 lakh people. In 2001-02 the total production of pig iron and finished steel (by main and secondary producers) was four million tonnes and 31 million tonnes respectively. **India is also the second largest producer of sponge iron in the world.** The sponge iron industry has been given special promotion in order to provide an alternative to steel melting scrap which is increasingly getting scarce. The production of sponge iron in 2000-01 was about 5.5 million tons.

Under the present EXIM policy, import and export of all items of iron and steel are freely allowed. Export of high grade iron ore, chrome ore and manganese ore is canalised and controlled by the government. India imports about 1 to 1.5 million tons of finished steel annually mainly in the form of hot and cold rolled coils and semis. In 2001-02, India's export of finished steel was about 2.7 million tonnes consisting mainly of plates, structurals colour-coated sheets and GO-GC sheets. Small quantities of pig iron and sponge iron are also exported.

India has competitive advantage in this sector as it is rich in iron ore and has a vast reserve of technical manpower and low labour cost. Currently, there is focus on modernisation and upgradation of existing steel plants with the induction of modern technology. However, it faces formidable challenges like shortage of coal and power, inefficiency in the public sector and demand constraints resulting in depressed capacity utilisation. *In the late 1990's, the growth rate in the industry decelerated due mainly to weak domestic demand and competition from imports. However, in recent years, the increase in world steel prices and strengthening of domestic demand for steel, emanating mainly from infrastructural projects, are expected to boost the growth of the industry.*

SUGAR INDUSTRY

It is the second largest agro-based industry in the country, a predominant part of which is located in rural areas. As on March 31, 2002 there were 527 sugar industries in the country, compared to only 138 in 1950-51. **India is among the top producers of sugar in the world** and most of the producing units are located in Uttar Pradesh, Maharashtra, Andhra Pradesh, Karnataka, Bihar and Tamil Nadu. Sugar being the item of mass consumption and an essential product, the industry remained highly controlled by the government for a long time and was delicensed as late as in 1998. Since 1979, the government has been following dual pricing policy under which a specified proportion of total production of each sugar mill is procured as levy sugar at predetermined official prices for distribution through the public distribution system, the rest being free sale sugar to be sold in the open market. *The ratio of levy sugar during 1992-99 was 40 per cent which was reduced to 30 per cent in January 2000, 15 per cent in February 2001 and further to 10 per cent in March 2002.* The dilution of the levy obligation of the sugar mills has been done primarily to enable the industry to sell more sugar under free sale quota in the open market and obtain better price realisation.

Under gradual liberalisation of the industry, production has been steadily on the increase in recent years. The total sugar production has risen from 129 lakh tonnes in 1996-97 to 183 lakh tonnes in 2001-02. The government maintains comfortable buffer stocks of sugar and has been exporting the product from year to year, depending upon availability and foreign demand. However, in certain years, India has been net importer of sugar due to high level of internal consumption - 1997-98 (5.3 lakh tonnes), 1998-99 (8.2 lakh tons) and 1999-2000 (4.5 lakh tonnes).

The industry continues to face the perennial problems of outdated technology, finance and power shortage. More recently, low sugar recovery from the canes and fixation of high sugarcane prices under the Statutory Minimum Price (SMP) system have eroded profit margins and even caused losses to a number of marginal units. Cane prices are estimated to account for about 60 per cent of the total cost of production. The resulting poor financial position has led to the inability of a number of sugar mills to make cash payments to cane farmers, leading to mounting cane arrears. More recently, the industry has been facing import competition under trade liberalisation. In 2002-03, the industry was protected by the government with a custom duty of 60 per cent along with a countervailing duty of Rs. 850 per tonne.

CHEMICAL INDUSTRY

It is a highly diversified industry covering more than 70,000 products. At the global level, chemical industry is valued at US \$1.5 trillion constituting about 6 per cent of the global GDP. *India's share in global chemical market is about 1.3 per cent of the world trade in chemicals. By production volumes, Indian chemical industry ranks 12th in the world with the current turnover being about \$30 billion. It accounts for about 14 per cent of the country's total manufactured output.* In the year 2000, India's export of chemicals was \$4.5 billion which constituted 14 per cent of the country's manufactured exports and about 11 per cent of total export. The quality of Indian chemical products in a number of areas is among the best in the world and its export destinations include USA, Europe and a number of other developed countries.

India has strong supply capabilities in basic chemicals which are used in a number of consumer and industrial products like paints, dyes, soaps, medicines, toiletries, cosmetics, food additives, pigments, polymer additives and antioxidants. Within the chemical industry, dyestuff sector occupies an important place and its output is used in many industries including textiles, leather, paper, plastic, printing and food stuff. Other important chemical products include soda ash, caustic soda, carbon black, calcium carbide, phenol, methanol and pesticides. India now produces a large variety of agro chemicals which are exported to the USA, UK, France, Belgium, Spain, South Africa, Singapore and many other countries.

Petrochemicals is another significant segment of the chemical industry. In 2001-02, India's total production of major petrochemicals (including synthetic fibre, polymers, elastomers and surfactant intermediate-LAB) was about 6 million tonnes representing capacity utilisation rate exceeding 90 per cent. Plastic processing industry is another important segment with more than 20,000 units engaged in the manufacture of various plastic products and having a turnover of about Rs. 25,000 crore. The industry has the investment of Rs. 15,000 crore with annual installed capacity of 6-7 million tons. India's pharmaceutical industry produces a number of bulk drugs and a wide variety of formulations.

ENGINEERING INDUSTRY

India's engineering industry is highly diversified and manufactures a wide range of consumer and industrial products. The industry can be broadly classified into the following segments:

- **Mechanical engineering industry** manufacturing products like machine tools, textile machinery, sugar mill machinery, cement machinery, automobiles, diesel engines, earth moving equipment, power driven pumps, tractors, bicycles and sewing machines.

- **Electrical engineering industry** manufacturing such products as power transformers, electric motors, fans and lamps, radio receivers and metal conductors.

The industry can also be classified as light engineering industry, heavy equipment and machinery, heavy electrical industry, machine tools, transport equipment and other miscellaneous industries. Light engineering industry products range from low-tech items like castings, forgings and fasteners to highly sophisticated microprocessors, control equipment and medical diagnostic equipments. A large part of the products of this industry is used as input for the **capital goods** industry and, therefore, the demand for light engineering products is **derived demand**.

Heavy equipment industry produces equipment and machinery for mining, transport, fertilizer, chemical, petroleum and other mechanical industries. There is substantial presence of public sector and foreign collaboration in this segment. Some of the major industrial units are Heavy Engineering Corporation, Mining and Allied Machinery Corporation, Bharat Heavy Plate and Vessels Limited, Braithwaites and Jessop and Company, Burn Standard Company Limited and Bharat Wagon and Engineering Company Limited.

The main products of the heavy electrical industry include equipment and machinery for generation, transmission, distribution and utilisation of power. The main items of production include turbo generators, boilers, turbines, transformers, motors, switch gears and related items. The industry has attained high degree of technological competence and a number of items produced are exported as well.

Table 26.7 provides growth trends in a few leading engineering industries in the country. The industry has shown impressive growth in machine tools, automobiles, two wheelers and power driven pumps. The segments which have been hit by recession in recent years include automobiles, power driven pumps, diesel engines, sewing machines, agricultural tractors and a number of consumer electrical items. India's engineering industry has made substantial improvement in technology due largely to foreign collaborations. The impact is widely seen in such areas as watches, razor blades, refrigerators, storage batteries, dry cells and consumer electricals.

Table 26.7 Growth Trends in Selected Engineering Industries, 1990-91, 1996-97 and 2001-02

| | Industry | Unit | Production | | |
|----|--------------------|-------------|------------|---------|---------|
| | | | 1990-91 | 1996-97 | 2001-02 |
| 1. | Machine tools | Rs. cr | 773 | 1322 | 1451 |
| 2. | Automobiles | thousand | 366 | 788 | 748 |
| 3. | Two-wheelers | -do- | 1843 | 2979 | 3932 |
| 4. | Power driven pumps | -do- | 419 | 680 | 431 |
| 5. | Bicycles | -do- | 7084 | 10895 | 10834 |
| 6. | Tractors | -do- | 142 | 245 | 205 |
| 7. | Power transformers | million KVA | 37 | 37 | 63 |
| 8. | Electric lamps | million | 274 | 395 | 393 |

Source: Govt. of India, *Economic Survey* 2002-03, pp. S-31,32

ELECTRONICS AND COMPUTER INDUSTRY

This industry has been of relatively recent origin and had made rapid strides over the last few years. During 1996-2002, the industry has grown by over three times. The industry is highly competitive with private enterprise and has high export orientation. Software exports, over the last five years, have grown at a compound growth rate of over 50 per cent and is enhancing India's image in foreign markets. The export of electronics hardware has risen from about Rs. 2,600 crore in 1996-97 to about Rs. 6000 crore in 2001-02. The country's software exports in 2001-02 crossed \$1 billion mark. Leading IT firms all over the world are now outsourcing into India and are utilising Indian talents in high-end research and development.

The production of consumer electronics, over the last five years, has risen consistently from Rs. 6,500 crore in 1996-97 to Rs. 12,700 crore in 2001-02. The total electronics production including computers, communication and broadcasting equipment, computers and components, strategic electronics and other consumer and industrial electronics was about Rs. 20,000 crore in 1996-97 which rose to about Rs. 33,000 crore in 2001-02. In order to encourage the growth of the industry, the government has been gradually reducing **custom duty** on a large number of computer and electronic items in recent years. The government has set up a number of **Electronic Hardware Technology Parks (EHTPs)** and **Software Technology Parks (STPs)** with latest infrastructure and other facilities to make such industries internationally competitive. India produces high quality software which is low-priced and user-friendly by world standards. However, large scale computerisation is required both in the public and private sectors to provide demand support for the growth of the industry.

CONCLUSION

The rate and pattern of industrialisation is an important determinant of the overall business environment. Industry has significant linkages with the other two major sectors of the economy viz. the agricultural and service sectors from where it buys its inputs and sells its output. The changes in the pattern of industrialisation are produced by a multitude of factors – both domestic and international. The changing pattern reflects, to a good extent, shifts in the demand pattern and opportunities for profitable investment. These shifts have important implications for a firm's investment and diversification decisions.

Key Terms

| | | |
|--------------------------------------|------------------------|---------------------------------|
| Derived demand | Letter of Intent (LOI) | Gross Domestic Product (GDP) |
| Use-based classification of industry | Memorandum (IEM) | Quantitative restrictions (QRS) |
| Industrial Entrepreneurship | Capital formation | Capital goods |
| | Real estate | |

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Long Questions

1. Discuss the major changes that have taken place in the trend and pattern of India's industrialisation in the post-reform period.
2. Bring out the major factors that have brought changes in India's industrialisation pattern over the last decade. What has been the impact of economic reforms on the industrialisation process?
3. How has India's industrialisation responded to reform measures? What steps in your opinion are required to accelerate the pace of industrialisation in the country?
4. Have economic reforms increased the overall competitiveness of Indian industry? What has been the impact of globalisation?

Short Questions

1. How do the following affect the pattern of industrialization:
 - a. Fiscal Policy
 - b. Industrial Policy
 - c. Import-export policy

2. Distinguish between basic goods, capital goods, intermediate goods and consumer goods, giving two example in each case.
3. Explain the following:
 - a. Industrial Entrepreneurship Memorandum
 - b. Letter of Intent
4. Give three major factors of low implementation rate of proposed investments in India in the post-reform period.
5. What are the major driving sectors of India's industrialisation?
6. How are industrialisation growth and pattern affected by changes in agricultural sector and the services sector?

Practical Assignments

1. You are the project manager of a multinational company intending to have its presence in India through foreign direct investment. Keeping in view the recent trends in the industrialisation pattern, which industrial segments do you think have high growth potential. Make a reference to the country's industrial policy as well. Discuss the observations in a small focussed group.
2. Make a list of factors responsible for slow rate of industrialisation. Hold a group discussion on these factors and make an attempt to rank them in order of importance. Also suggest measures to revive the industrial sector.
3. Identify the industrial segments which are not well developed at present but have high growth potential in future. Hold a debate on identified segments.

INDUSTRIAL POLICY ENVIRONMENT

Chapter Outline :

- Introduction: Significance of Industrial Policy
- General Objectives of Industrial Policy
- What Does An Industrial Policy Contain?
- Present Industrial Policy
 - Objectives
 - Comparative Roles of Public and Private Sectors
 - Abolition of Industrial Licensing
 - Basic Licensing Provisions
 - Thawing of the Rigours of Licensing before the New Policy
 - Industrial Dispersal
 - Abolition of Phased Manufacturing Programme
 - Removal of the Mandatory Convertibility Clause
 - Liberalization of Foreign Investment and Technology Inflow
 - Foreign Direct Investment
 - Technical Collaborations
 - Public Sector Refocusing
 - Priority Areas
 - Public Sector Policy
 - Removal of size limit on Large Companies
- Conclusion

INTRODUCTION: SIGNIFICANCE OF INDUSTRIAL POLICY

Industrial sector is an important part of Indian economy and consists of a wide spectrum of industrial enterprises with greatly varying size. In India, **Central Statistical Organization (CSO)** takes into account mining and quarrying, manufacturing and electricity while computing the **Index of Industrial Production (IIP)** and industrial growth rate. The sector includes millions of enterprises contributing substantially to **gross national product**, exports, employment, product development and industrial research. The sector has huge **backward linkages** with agriculture and raw material producing sector and forward linkage with the services sector so that there is close link between the growth of the industrial sector and other sectors having transactions with it. Within the industrial sector too, the various industrial units have forward, backward, **vertical and horizontal integration** with one another.

Industrial policy, broadly speaking, seeks to provide a framework for the promotion and regulation of the sector in consonance with the broader macroeconomic or planning objectives as laid down by the government from time to time. The policy is a reflection of economic philosophy and mindset of the government and it provide a suitable direction for future growth. The policy is neither a moral commitment nor a contractual obligation rather it is a statement of intention which is specified in broad terms and which the government seeks to implement within the limitations of its resources and the circumscribing influence of actual economic or business conditions.

Industrial policy has wide-reaching effects, both direct and indirect. The policy creates a broad environment in which the different segments of industry live and adjust. It affects the conditions of industrial investment, operations, growth and management. It impacts competitive environment, foreign investment, **capital formation**, labour and employment conditions, and flow of indirect tax revenue, exports and imports. Within the constraints of available financial technological and entrepreneurial resources, it has the capacity to redirect the flow of productive investment to priority areas of national importance. *The policy is designed in view of the constitutional obligations, resource availability, past trade trends in industrial growth, future projections and current industrial challenges and opportunities.*

GENERAL OBJECTIVES OF INDUSTRIAL POLICY

As already pointed out, the objectives of industrial policy are attuned to or derived from the broad macroeconomic objectives which are generally specified in the plan documents. In addition, there can be specific objectives which are set in the light to configuration of circumstances or problems prevailing in the industrial sector. The broad objectives of industrial policy are the following:

- Accelerating the overall rate of growth through industrialization;
- Expanding the industrial base in relation to industrialization needs of the country.
- Generating employment and reducing poverty;
- Reducing regional disparities in industrial development;

- Preventing monopolies and concentration of industrial power;
- Creating competitive conditions and encouraging the growth of entrepreneurship;
- Promoting balanced industrial development;
- Promoting linkages with other sectors of the economy;
- Assisting small enterprises; and
- Encouraging the growth of industrial research and development.

These objectives, with different emphasis or priorities, were laid in the various industrial policy resolutions, statements and amendments made from time to time. These objectives are often reviewed to check consistency or fulfillment and sometimes changed, diluted or even dropped, as will be seen in the succeeding sections.

WHAT DOES AN INDUSTRIAL POLICY CONTAIN?

There are no standard contents of an industrial policy. The coverage of the policy depends upon how comprehensively it is formulated. A well-developed industrial policy specifies the following:

- Comparative roles of public, private, joint and cooperative sectors in the economy.
- Categorization of industries from the point of view of assistance, market entry, control or regulation.
- Jurisdiction (geographical, functional or product) of the state monopoly.
- Structure of control for the private sector.
- Role, attitude and policy towards foreign investment and companies.
- Thrust or priority areas of industrialization.
- Incentive and institutional structure for the promotion of industrialization.
- Role of cottage and small industries vis-à-vis large industries.
- Policy towards geographical distribution of industries.
- Procedures for establishment, operation, expansion, modernization and diversification of industries.
- Policy towards monopolies, market concentration and competition.

Governments often provide legislative support for the implementation of some of the major provisions of the policy. For example, some of the industrial policy provisions are backed by Competition Act (2002), Companies Act (1956), and **Industries (Development and Regulation) Act, 1951**.

THE PRESENT INDUSTRIAL POLICY

The present industrial policy environment is based on the industry policy announced on July 24, 1991. It is regarded as a landmark policy, which makes radical departure from the earlier Industrial Policy of 1956, which in its amended versions, ruled the industrial economy of the country for about 35 years. The 1991 policy was drafted in the background of the economic crisis which assumed threatening proportions in 1991 and in the context of economic reforms programme launched in the same year. The industrial policy of 1991 can also be visualized as a part of the economic reforms programme. Though the policy is a bold departure from the earlier policy of 1956 as amended from time to time, still it retains the spirit of the latter in many aspects. The following sections discuss the major aspects of the present policy drawing comparison with the earlier policy wherever found useful.

OBJECTIVES

The major objectives of the policy, as announced at the time of the policy in 1991, are:

- To deregulate the economy in a substantial manner;
- to remove the weaknesses or distortions of the earlier policies;
- to maintain sustained growth in productivity and employment;
- to encourage the growth of entrepreneurship; and
- to upgrade technology to match the standards of international competitiveness.

Key provisions of the present industrial policy are discussed in the following sections.

COMPARATIVE ROLES OF PUBLIC AND PRIVATE SECTORS

One of the landmark developments of the new industrial policy is that it opens up a number of industries earlier reserved for public sector operation to the private enterprise. Under the Industry Policy Resolution of 1956, as many as 17 industries were reserved for the public sector; in the 1991 policy, the number of reserved industries was brought down to only 8 (Table 27.1). The new policy provides that the focus of the public sector would only be on strategic and high technology industries and essential infrastructure. The policy with regard to the public sector is flexible and provides for periodic review of public sector investment to maintain the focus. *The policy, further lays down that there would be no bar for areas of exclusivity to be opened up to the private enterprise on a selective basis.* Making use of this provision, out of the reservation list (Table 27.1) declared in 1991 items (5) and (6) were de-reserved in 1993, item (1) was opened up to private sector in 2001 so that at present only the three remaining items stand reserved for the public sector. The policy for the public sector further provides for the following:

- Chronically sick public sector units (PSUs) will be referred to institutions created for financial and industrial reconstruction of such enterprises.
- To raise resources and to secure wider participation, a part of the government's shareholding in PSUs will be offered to mutual funds, financial institutions, general public as well as workers. This provision has led to gradual disinvestment of the public sector.

Table 27.1: Comparative Industrial Reservation Position of Public Sector in 1991 and 1956 Industrial Policies

| Industries reserved in 1956 policy | Reservation position in the 1991 policy |
|--|---|
| 1. Arms, ammunition and allied defense equipment. | Reserved (de-reserved in 2001). |
| 2. Atomic energy. | Reserved |
| 3. Iron and Steel | De-reserved |
| 4. Heavy iron & steel castings and forgings. | De-reserved |
| 5. Heavy plant and machinery | De-reserved |
| 6. Heavy electrical plants. | De-reserved |
| 7. Coal and lignite. | Reserved (de-reserved in 1999) |
| 8. Mineral oils | Reserved (de-reserved in 1999) |
| 9. Mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond. | Reserved (de-reserved in 1993) |
| 10. Mining and processing of copper, lead, zinc, tin molybdenum and wolfram. | Reserved (de-reserved in 1993) |
| 11. Minerals specified in the schedule to Atomic Energy (Control of Production and Use) Order, 1953. | Reserved |
| 12. Aircraft. | De-reserved |
| 13. Railway transport. | Reserved |
| 14. Air transport. | De-reserved |
| 15. Ship-building. | De-reserved |
| 16. Telephone, cables, telegraph and wireless apparatus. | De-reserved |
| 17. Generation and distribution of electricity. | De-reserved |

There would be greater thrust on improvement of performance which will be achieved through the system of **Memorandum of Understanding (MoU)**. Under the system, managements of PSUs will be given greater autonomy as well as accountability. The MoU signed between a PSU and the government will be placed before the Parliament highlighting major management issues and aspects of day-to-day operations. *The public sector policy thus is built upon the considerations of performance, privatization, wider participation and competition.* From 1991-92 to 2000-03, the aggregate of the PSU disinvestments amounted to Rs. 78,300 crore of which about Rs. 30,000 crore was realized. There have been a number of factors behind the under-achievement, which are discussed in **Chapter 28**.

It is interesting to compare the relative roles of the public and private sectors under the present policy with that provided in the earlier 1956 policy. The 17 industries given in Table 27.1, as provided in Schedule A to the Industry Policy Resolution, were state monopolies the development of which was exclusive responsibility of the state. Except arms and ammunition, atomic energy, railway and air transport, existing private sector units (already operating in the state monopoly list) were allowed to subsist but all future investment in these industries was to be made in the public sector only. Then there was a set of another 12 industries appended as Schedule B to the policy

resolution in which the state would 'increasingly establish new units but would not deny opportunities to the private sector to establish and expand'. The pro-PSU bias in the policy led to massive expansion of the public sector to its present gigantic proportions. Industries outside the ambit of Schedule A and B were left to the private enterprise with government taking up only a promotional and regulatory role. One of the major arguments of the time was that the private investment was shy and the role of the government was vital to establish the industrial base within the framework of a socialistic pattern of society. Nevertheless, it explicitly recognized interdependence between public and private sectors and highlighted the need for control over the latter in national interest and for social justice.

Towards partial liberalization, the **Industrial Policy Statement of 1973** floated the concept of 'joint sector' in which both public and private sectors would join hands to organize industrial activity. The concept did not take off, as it was not spelt out clearly. Appendix-I of the policy contained a list of 19 core industries of national importance which were opened up on a selective basis to large MRTP and FERA companies (i.e. companies falling within the purview of the erstwhile Foreign Exchange Regulation Act, 1973) provided the concerned items were not reserved for the public and small-scale sector. The list was later expanded, as expected investment was not forthcoming.

During 1980s, a spate of measures was initiated to enlarge the participation of private enterprise. Some of the main measures included increase in the investment limits of MRTP Companies from Rs. 20 crores to Rs. 100 crore and permission to such companies to expand capacity in areas of national importance or high import, substitution potential, unrestricted entry of large industrial houses falling under the purview of FERA (1973) in 21 high-technology areas covering more than 80 product lines, regularization of excess capacity and re-endorsement of capacity to large MRTP and FERA companies operating in industrially backward areas.

Under the present industrial policy, the increasing role of the private sector can be seen as the escalation of measures to encourage private enterprise undertaken cautiously during in 1970s and more liberally during the 1980s. Similarly, performance-focus and shrinking role of the public sector can be seen in the light of the unsustainably large size of the public sector and its low level of efficiency due largely to lack of competition and professionalism.

ABOLITION OF INDUSTRIAL LICENSING

Another important landmark of the new industrial policy is the abolition of industrial licensing for all industries except a select list of industries specified in Annexure-II of the Policy (Box 27.1). The industries on which the licensing requirement was retained related to:

- Security and strategic concerns.
- Social reasons.
- Environmental factors.
- Hazardous effects.
- Elitist consumption.

Out of the list of industries with compulsory licensing, those having security and strategic implications were reserved for the public sector as discussed above. *The primary motive for the*

abolition of licensing is to unshackle the private initiative and enterprise from bureaucratic chains and demolish the entry barriers. A number of industries as specified in the **Box 27.1** were delicensed in later years. These included such areas as alcohol, cigarettes, hazardous chemicals, aerospace and defense equipment, drugs and pharmaceuticals, industrial explosives and electric products. At present, only six industries require compulsory licensing. In delicensed areas, firms can produce any product according to market demand conditions.

BOX 27.1

List of Industries in which licensing requirements remained after the abolition of industrial licensing in New Industrial Policy

1. Coal and lignite
2. Petroleum (other than crude) and its distillation products
3. Distillation and brewing of alcoholic drinks
4. Sugar
5. Animal fats and oils.
6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes
7. Asbestos and asbestos-based products
8. Plywood, decorative veneers and other wood-based products
9. Tanned or dressed fur skins
10. Paper and newsprint (except bagasse-based units)
11. Electronic aerospace and defense equipment
12. Industrial explosives and allied products
13. Hazardous chemicals
14. Drugs and pharmaceuticals
15. Entertainment electronics.

Under the new policy, all existing registration schemes, viz. De-licensed Registration, Exempted Industries Registration and Director-General of Technical Development (DGTD) Registration are abolished. Entrepreneurs are now only required to file an Information Memorandum on new projects and substantial expansions. The policy provides for notification of various categories of industries in the **Indian Trade Classification (Harmonized System)**. The original 1991 policy provided for continuation of reservation of items for small-scale industries, though in later years a number of items reserved for the sector were de-reserved on the ground that either these were not actually produced by the sector or there was lack of competition in such areas.

The 1991 policy provides for automatic clearance of projects involving capital imports provided the foreign exchange expenditures are covered through foreign equity. Automatic clearance is also available in cases where CIF (cost, insurance and freight) value of imported capital goods required is less than 25 per cent (net of taxes) of plant and equipment up to a maximum value of Rs. two crore. In other cases, clearance is required in the **Secretariat of Industrial Approvals (SIA)** in the **Department of Industrial Development** of the central government.

Basic Licensing Provisions: Industrial licensing in the country is presently regulated by **Industries (Development and Regulation) Act, 1951** as amended from time to time. The Act applies to the whole of India and covers all industrial undertakings as defined in the Act. The Act

empowers the government to grant exemption to certain industries from the Act. It also provides for the registration of scheduled industries (i.e. the industries listed in the First Schedule to the Act) with comprehensive details of the industries to be registered. Before the present industrial policy, no person or authority (except the central government or other governments with permission of the central government) could establish an industrial undertaking without a license. In the present industrial policy, the government has been granted the power of exemption from the licensing provision of the Act. In addition to licensing, the Act provides for a number of other regulatory and development measures including laying down norms of efficiency and capacity utilization, promoting arrangements for better marketing and distribution, labour training, research and development, standardization of accounting and costing methods, productivity growth, takeovers and investigations.

Thawing of the Rigours of Licensing Before the New Policy: Prior to the delicensing of industries under the present policy, industries were required to seek license for the manufacture of a new item, addition to existing capacity change in industrial location and even for continuation of production in specific cases. The Act also empowered the government to revoke, amend or change the conditions for issue of license under the constitutional obligation. To establish a socialistic pattern of society, the licensing policy was used as an instrument to promote industrial decentralization and diversification, prevent concentration of industrial power, control demand supply imbalances, promote import substituting and export promoting industrialization, control pollution and promote industrialization of backward areas. In effect, however, the policy restricted the flow of investment and created bureaucratic obstacles to industrialization.

Delicensing under the present policy removes barriers to the entry of new firms and expansion of capacity by the existing firms. Pressure towards de-licensing was witnessed during seventies and eighties when the government relaxed, though selectively, the rigorous application of licensing. During this period licensing was also the instrument for reservation of industries for the public sector and the small-scale sector. In other words licensing was the mechanism through which certain identified sectors were opened to the private enterprise. **Box 27.2** shows thawing of the rigors of licensing during the seventies and the eighties.

Industrial Dispersal: In spite of liberalization, the licensing policy continues to address social concerns. The policy continues to take care of the concerns of balanced regional industrialization. The policy provides that there is no need to obtain industrial approvals from the government if a new industrial unit is proposed to be established in locations other than those with population of one million or more. In such locations, units other than those of a non-polluting nature (such as printing, electronics and essential operations) can be established outside the 25 km periphery of such areas. This condition does not apply to units in designated industrial areas. For the industrial regeneration of industrially backward locations with population of one million or more, the policy provides for a flexible industrial location. The policy seeks to promote industrial dispersal to rural and backward areas through suitable incentives and investment design in infrastructure development. However, industrial zoning, land use norms and environment legislation continue to be the instruments of regulation of industrial locations.

Abolition of Phased Manufacturing Programme: Another hallmark of the present industrial policy is that the phased manufacturing programme has been abolished. Under this programme, a number of industries particularly engaged in engineering and electronic segments, were required to attain a specified percentage of local or indigenous raw materials and components

in their total consumption of raw material and components in a phased manner over a period of time. This programme which existed till 1991 was intended to reduce foreign exchange outflow on account of import of industrial inputs and promote the demand for locally produced raw materials, intermediates and components. Such a programme became contradictory to trade liberalization in the era of economic reforms under which a large number of industrial inputs were made freely importable. Further, the programme was under the purview of **TRIMS (Trade-related Investment Measures)**, which was in conflict with GATT/WTO norms. **The local content requirement** was one of the major obstacles in the inward flow of foreign direct investment. The obstacle was particularly serious in areas where the quality of local raw materials did not match with the product standards of a number of Indian and foreign companies. The abolition of the local content requirements under the programme has given greater freedom to the firms in managing costs, input quality and final product standards.

BOX 27.2

Thawing of the Rigour of Industrial Licensing During 1970s and 80s

The abolition of industrial licensing in 1991 was not really a big bang. The process of dilution and relaxation of industrial licensing provisions started in 1970 with the announcement of a new **Industrial Licensing Policy**. Since then, the process of relaxation had been proceeding though at a marginally increasing pace. The following points highlight the trend towards licensing liberalization during the period preceding the present policy:

- The Industrial Licensing policy of 1970 identified core sector consisting of nine industrial segments, viz., (1) agricultural inputs, (2) iron and steel, (3) non-ferrous metals, (4) petroleum, (5) cooking coal, (6) specified heavy industrial machinery, (7) ship-building and building of dredgers, (8) newsprint and (9) electronics (selected components) and those not reserved for the public sector, were opened to large industrial houses and MNCs through licensing. Similarly, heavy investment sector identified as consisting of units with total investment at that time exceeding Rs. 5 crore was opened (except the reserved industries) to large industrial houses through licensing. Earlier, no licenses were issuable to private units in these areas. The industries with investment of Rs. 1-5 crore were labelled middle sector and licensing policies and procedures were simplified for this segment. The Policy raised the exemption limit for licensing from Rs. 25 lakh to Rs. one crore.
- The **Industrial Licensing Policy of 1973** identified 'large houses' as industrial houses with assets exceeding Rs. 20 crore (same as the MRTP definition at that time) as against Rs. 35 crore adopted in the 1970 policy. With this change, the number of industrial units eligible for licenses expanded considerably. Further, the number of core industries was raised from nine (in 1970) to 19.
- The exemption limit was raised to Rs. 3 crore in 1978, Rs. 5 crore in 1983 and to Rs. 15 crore for non-backward areas and Rs. 50 crore for backward areas in 1988-89. A large number of industries were then exempted from the licensing requirement.
- In 1985, the exemption limit for MRTP Companies was raised five times from Rs. 20 crore to Rs. 100 crore and such companies became eligible to obtain licenses for capacity expansion. Similarly, FERA companies (covered under the then Foreign Exchange Regulation Act) were allowed entry to 21 high-tech areas of manufacture. In all, additional 83 unreserved product areas were opened to such large companies.
- Towards the late eighties, about 34 non-FERA and non-MRTP companies in about 30 broad industry groups (unreserved) were de-licensed. These included about 90 drugs and their formulations.
- Other liberalization measures undertaken during the eighties included re-endorsement of capacity, broad-banding, capacity expansion on the ground of economies of scale (about 110 industries covered during 1986-89) and liberal norms for industrial units working for exports or in backward areas.

REMOVAL OF THE MANDATORY CONVERTIBILITY CLAUSE

Commercial banks and other financial institutions engaged in industrial finance followed a mandatory practice of including a convertibility clause in their loan agreements with clients. Under this clause, the lending institutions reserved the right to convert loans into equity of the borrowing industrial unit if their managements felt it necessary. *Though this provision had been rarely exercised but this clause meets a continuous threat of takeover of the borrowing company by the lending institution through the exercise of convertibility option.*

Removal of the mandatory convertibility clause under the present policy has removed the takeover threat and the companies are now in a better position to plan their future operations in the absence of such a threat. It also removes an obstacle in the free flow of credit from financial institutions to industry. The removal of the clause has also improved the environment for foreign direct investment and MNCs in the country. This step has been in consonance with the general spirit of economic reforms.

LIBERALIZATION OF FOREIGN INVESTMENT AND TECHNOLOGY INFLOW

Recognizing the significance of foreign investment and technology in bringing in foreign exchange, technological upgradation, filling domestic saving-investment gap and accelerating the overall pace of industrialization, the present industrial policy seeks to open a wider gate to foreign companies. The policy particularly recognizes the contribution of foreign investment in technology transfer, marketing expertise, induction of modern management techniques and export promotion. The policy regards freer flow of foreign investment necessary in the global scenario of industrial and economic cooperation and welcomes it in the interest of country's industrialization and development.

Foreign Direct Investment

The thrust of the industrial policy of 1991 has been to invite foreign investment in high priority areas requiring large investment and sophisticated technology. Initially, the policy provided for foreign equity up to 51 per cent in such industries but the limit has been substantially raised in a number of cases in subsequent years. This group of industries is popularly known as **Appendix-I Industries** and consists of areas in which (the then) FERA companies were already allowed to operate. Such industries are listed in **Box 27.3**. The selection of these industries was motivated by the considerations of transparency and creation of a level playing field for foreign enterprises. The policy provides for automatic approval to foreign direct investment subject to the ceiling of foreign shareholding. In later years, the basic policy with regard to foreign investment has developed in the following directions:

- Expansion in the list of industries where foreign investment qualifies for automatic approval.
- Expansion in the list of industries where foreign majority holding has been allowed.
- Increase in the number of areas in which 100 per cent foreign equity is permissible (**Box 27.4**).
- Simplification of foreign investment entry procedures and speedy disposal of foreign investment proposals.

- Increase in the range of technology transferable services and investments.

Specific measures to promote the inflow of foreign direct investment are more fully discussed in chapter 35.

List of Industries for Automatic Approval of Technology Agreements and for 51 per cent Foreign Equity (1991)

Such industries as specified in Annexure B of the Industrial Policy, 1991 are as follows:

| | |
|---------------------------------------|--|
| • Metallurgical industries | • Cranes |
| • Boilers and steam generation plants | • Cement and products |
| • Prime movers | • Remodelling and replacement equipment |
| • Electrical equipment | • Cast iron and castings |
| • Transport trucks | • Weld pipes |
| • Industrial machinery | • Rubber machinery |
| • Machine tools | • Printing machinery |
| • Agricultural machinery | • Welding electrodes |
| • Earth moving machinery | • Industrial sulphur compounds |
| • Industrial instruments | • Miscellaneous products |
| • Scientific and lab equipment | • Minor oils |
| • Fertilizers | • Pre-fabricated building material |
| • Chemicals | • Soya products |
| • Drugs and pharmaceuticals | • Seeds and planters |
| • Paper (and products) and plastics | • Food processing industries |
| • Rubber and plastic products | • Packaging for food processing industry |
| • Plate glass | • Hotels and tourism related industry |

The above industry groups do not cover all the inorganic products but only those specified in the policy.

The policy explicitly recognizes the need for foreign investment for export development which requires, apart from domestic capabilities, systematic exploration of world markets through intensive and highly professional international marketing efforts. This kind of expertise is not well developed in the country. The policy provides for encouragement to foreign trading companies for developing Indian exports and lays emphasis on collaboration with world's large manufacturers and trading companies.

Technical Collaborations

The present policy accord high priority to the acquisition of technological capability through foreign collaborations. The 1991 Policy provides for automatic approval for technical collaborations within specified parameters. The policy gives freedom to Indian companies to negotiate terms of technology transfer with foreign companies according to their own commercial wisdom, subject to the condition that no foreign exchange drain is caused. The basic intention behind this provision is to motivate Indian firms to develop capability to absorb foreign technology in their productive

processes and invest more in industrial research and development. This is also the requirement of a competitive environment under the policy. No prior government clearance (which was required before the new policy) is needed for hiring foreign technicians and for foreign testing of indigenously developed technologies. In such cases, payment can be made from blanket permits or free foreign exchange subject to RBI guidelines.

BOX 27.4

Some Major Areas in Which 100 per cent FDI is Permissible under the Present Industrial Policy

Before the Industrial Policy of 1991, the policy towards foreign direct investment was restrictive. Since the announcement of the policy, there has been gradual expansion in the list of areas in which 100 per cent foreign equity ownership is permitted. These are generally the areas where domestic enterprise is weak, technology requirements are complex or sophisticated, infrastructure development is involved or where restriction on foreign ownership is likely to weaken the FDI inflow. Till Jan. 2003, some of the major areas in which 100 per cent foreign equity ownership is allowed are the following:

- B to B (Business-to-business) commerce.
- Oil refining
- Special economic zones
- Films
- Telecommunications (selected areas)
- Airport development
- Power plants
- NRI investment in export/trading houses, health care, sick units etc.
- Courier services
- Integrated Township Development
- Mass Rapid Transport Systems
- Hotel and tourism
- Drugs and pharmaceuticals
- Tea industry (including plantation)
- Non-bank financial companies

Source: Compiled from Govt. of India, *Economic Survey*, various years.

Under the present policy, automatic approval is available to Indian companies seeking foreign technical collaboration (without foreign investment) in the following cases:

- Lump sum payment of technical know-how fee involved is up to \$2 million.
- Rate of royalty is up to five per cent on domestic sales and eight per cent on export over a period of seven years from the date of commencement of production or 10 years from the date of agreement, whichever is earlier.

The components of foreign technology collaboration which are subject to government approval or automatic route include payments for drawings, designs and engineering services as well, in addition to technical know-how fees and royalty. The payments that are not covered under the foreign technology collaboration approval (i.e. are decided separately) are:

- Hiring of foreign technicians
- Deputation of Indian technicians abroad
- Testing of indigenous raw materials, products and indigenously developed technologies in foreign countries
- Import of plant, machinery and raw materials involved

PUBLIC SECTOR REFOCUSING

The new industrial policy imparts a new and strategic focus to the problem-ridden public sector. The leading problems of the public sector, identified by the 1991 policy statement are:

- Insufficient growth of productivity
- Poor project management
- Poor manpower planning and over staffing
- Lack of continuous technological up-gradation
- Inadequate attention to R&D and HRD
- Very low rate of return on capital

In 1991, about one-third of the losses were due to the **takeover** of sick units in the private sector by the government. The re-focus was necessitated not only due to the fact that a number of units were a liability rather than asset to the government but also due to the fact that it was losing its status as being the commanding heights of the economy. The erosion of status was largely due to the fact that the public sector was entering consumer goods and service sectors at a significant pace.

Priority Areas

The new industrial policy seeks to impart dynamism to the gigantic sector and make it growth-oriented. It lays emphasis on the restructuring of the sector and lays down the following priority areas for its growth:

- Essential infrastructure goods and services
- Exploration and exploitation of oil and mineral resources
- Technological development
- Building of manufacturing capabilities in areas, which are crucial in the long-run development of the economy and where private sector investment is inadequate
- Manufacture of products of strategic importance such as defense equipment

While the above are the priority areas for public sector participation, the policy does not debar the units from entering other areas. At the same time, the policy calls for a review (which connotes discouragement) of the public sector units (PSUs) engaged in the areas characterized by any of the following:

- Low technology base
- Small-scale operations
- Non-strategic product lines
- Inefficient or unproductive areas
- Low or little social consideration or public purpose
- Adequacy of the private enterprise and resources

NEW INDUSTRIAL POLICY

The new policy provides for the strengthening of the public sector in high-priority as well as essential areas of production so that reasonable profits are generated. *At present, the declared intention of the state policy is to run the sector on commercial lines. The policy gives greater autonomy to the units through the system of memoranda of understanding (MoU).* Autonomy is a fact essential for an enterprise to run on commercial lines. Under the MoU system greater autonomy is granted along with accountability. In order to make negotiation and implementation of MoU more effective, the policy recommends up-gradation of technical expertise on the part of the government. There is further provision for placing the MoUs between the government and the PSUs before the Parliament so that fuller discussion on their performance could be held.

The policy lays special emphasis on competition. Lack of competition generally makes organizations fat and lazy. Recognizing this, the policy seeks to introduce competition for the public sector by inviting public sector participation. *As another landmark development, the policy provides for disinvestments of government equity in order to introduce more professionalism in the running of the enterprises and to introduce market discipline. The policy calls for attention to the PSUs, which are chronically sick, loss making, uncompetitive or having little or no social or public purpose.* The policy provides for reference of the units difficult to turnaround, to Board of Industrial and Financial Reconstruction (BIFR) to similar other high-level institutions created for the purpose. At present, Companies (Second Amendment) Act, 2002 provides for the establishment of National Company Law Tribunal (NCLT). Among other functions, the functions, which are handled by BIFR, will now be handled by NCLT, once the Sick Industrial Companies (Special Provisions) Act (SICA) is repealed. The policy provides for the creation of a social security mechanism for workers, which might be adversely affected by the rehabilitation packages.

REMOVAL OF SIZE-LIMIT ON LARGE COMPANIES

The new industrial policy provides more freedom to large companies to enable them to attain greater competitiveness particularly in foreign markets. In 1985, the asset limit of the MRTP companies was raised to Rs. 100 crore and such firms had to obtain prior approval from the government on a case-by case basis to enter certain categories of industries or to expand their existing production capacity. This provision was kept to prevent or control their monopolistic or dominating influence on the market. There was thus a tendency on the part of a number of large firms to restrict their further growth so that their assets remained below Rs. 100 crore and that they could avoid the control and scrutiny of the government on their operations. This not only had a restrictive influence on industrialization but also denied **economies of scale** and cost reduction opportunities thereby circumscribing their competitiveness.

Recognizing the negative effects of size limitation of companies on industrial expansion, the new policy has abolished the system of pre-entry scrutiny of investment decisions by the so-called MRTP companies. More specifically the 1991 Policy provided for the following:

- ✦ Restructuring of the MRTP Act (now repealed) by eliminating the legal requirement for prior government approval for expansion of present undertakings and establishment of new undertakings.

- Repeal of provisions relating to merger, amalgamation and takeover
- Incorporation of provisions relating to restrictions on acquisition of and transfer of shares in the Companies Act.

The new policy has scrapped the threshold limit on assets of the MNCs and dominant companies so that these are now at par with others. Now these companies do not require prior approval from the government to enter, operate or expand in different industries.

CONCLUSION

The New Industrial Policy 1991 made a radical departure from the earlier industrial policies. The various policy reforms undertaken in the subsequent years have broadly followed the spirit of the 1991 Policy. The basic thrust of the policy has been in the direction of raising productivity and efficiency and to make industrial organisations more competitive. The industrial policy is an important instrument of industrialisation but the policy alone is not enough. Industrialisation requires the supporting force of demand, new technology, financial institutions and, above all, an entrepreneurial culture. With the progress towards globalisation, international influences on domestic industry have increased. In this scenario, the basic purpose of industrial policy is to maintain an enabling environment for industrial growth and spread. The policy also requires coordinated support from other macroeconomic policies particularly fiscal and monetary policies.

Key Terms

| | | |
|-------------------------------------|---------------------------------|-----------------------------------|
| Gross National Product (GNP) | Joint sector | Amalgamation |
| Horizontal and vertical integration | TRIMS | Merger |
| Forward and backward linkages | Local Content Requirement (LCR) | Memorandum of Understanding (MOU) |
| Capital formation | Technology transfer | Takeover |

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Long Questions

1. Discuss the design and strategy of India's present industrial policy. Highlight its weak areas.
2. Discuss the effectiveness of new industrial policy in the light of industrial performance of the country in the post-reform years.
3. Discuss the comparative roles of public and private sectors under the present industrial policy. What more needs to be done to develop a symbiotic relationship between the two sectors?
4. In the light of FDI inflow trends, comment on the provisions of the present industrial policy concerning foreign investment and technology. What improvements in policy would you suggest in this regard?

Short Questions

1. How is industrial policy relevant for industrial growth?
2. What are the broad objectives that an industrial policy seeks to achieve particularly in a less developed country like India?
3. What does an industry policy generally specify or lay down?
4. Briefly explain the following under the New Industrial Policy?
 - a. Role of the public sector
 - b. The provisions concerning industrial licensing
 - c. The provisions concerning industrial dispersal
 - d. Provisions concerning foreign investment and technology.
5. Explain and illustrate the following:
 - a. Mandatory Convertibility Clause
 - b. Phased manufacturing programme
 - c. Broadbanding.
6. List five major segments of the industry where 100 per cent FDI is permitted under the present policy. What is logic for 100 per cent FDI?

Practical Assignments

1. Hold a group discussion on 'new investment opportunities under the new industrial policy'.
2. 'In what directions does the present industrial policy need to be reformed further?'
Hold a symposium on the above topic and discuss the outcome with a selected panel of industry managers. Present a synthesised report to the class.

PUBLIC SECTOR REFORMS AND THE DISINVESTMENT PROGRAMME

Chapter Outline :

- Introduction
- What is Public Sector?
- The Four Standard Routes of Establishing a Public Sector Unit
- The Logic of Public Sector in the Present Context
- Growing Pressure Against the Public Sector
- Public Sector Reforms
 - PSU Refocussing
 - Memorandum of Understanding (MOU) System of Public Enterprise Management
 - Financial and Operational Autonomy
 - Restructuring and Revival of Sick Units
 - Privatisation through Disinvestment
 - Protection of PSU Workers' Interest
- Post-reform Performance of Central PSUs
- The Disinvestment Programme
 - Disinvestment Trends Since 1991
 - Present Disinvestment Policy
- Basic Issues Concerning Disinvestment Programme
 - Valuation of Public Sector Units
 - Method of Disinvestment
 - Extent of Disinvestment
 - Utilisation of Disinvestment Proceeds
 - Issues Concerning Labour
- Conclusion

INTRODUCTION

With the commencement of the process of economic reforms and the announcement of the new industrial policy in 1991, the role of and expectations from the public sector have widely been debated. The controversy in fact is still raging and, in the process, the role of the public sector is being refocussed. The controversy has been largely in the context of the increasing role of the private enterprise, emerging competitive environment, public sector inefficiency and losses and the fiscal position of the government. The sector is already in the process of being downsized and the government has already implemented a number of reform measures to make the sector financially viable and competitive. This Chapter brings out the changing role and performance of the public sector in the backdrop of the reform measures and brings out the major issues that are involved in the current phase of the disinvestment programme as a part of privatisation.

WHAT IS PUBLIC SECTOR?

From the standpoint of national economic planning and national accounting, public sector in India includes all activities or institutions funded out of the government's budget whether at the centre or in the states. Defined thus, the scope of the public sector is large and includes the following:

- Government departments and government companies both in the central and state sectors;
- Irrigation and power projects;
- Railways, Post and Telegraphs, ordnance factories and other departmental undertakings; and
- Banking, insurance, financial and other services

Within this public sector, the focus of attention is generally on central public sector undertakings (PSUs) which have the following three broad organisational forms

- Departmental undertakings (like Railways and Post and Telegraphs)
- Joint stock companies registered under the Companies Act (like Hindustan Machine Tools, Bharat Heavy Electricals Limited and Steel Authority of India Ltd) and
- Statutory corporations like Air India, Damodar Valley Corporation, Food Corporation of India).

Joint stock companies and statutory corporations are **separate legal entities** and have separate commercial accounts. Unlike a departmental undertaking, their employees are not civil servants in the usual sense of the term. These enterprises are supervised by the **Bureau of Public Enterprises** though this form of control is, more loose as compared to the control exercised by the government on the departmental undertakings. *The state-level public sector undertakings are much more diversified and together outweigh central PSUs.*

A public sector undertaking has dominant ownership management or control of the government, a local authority or a government agency. Government plays a key role, directly or

indirectly, in key or critical functions like production, finance, marketing, distribution, pricing and future investment. *It may be run on commercial lines but there is always an underlying social purpose or national interest considerations. It is generally governed under a system of public accountability and the state exchequer is affected by its performance.*

THE FOUR STANDARD ROUTES OF ESTABLISHING A PUBLIC SECTOR UNIT

There are basically four standard ways through which PSUs have come to be established in the country:

- **Historical legacy**, in which the enterprises have been inherited from the British regime of the colonial period. Most of these are now departmental undertakings.
- **Government entrepreneurship**, through which government made new investment in areas permitted under the prevailing industrial policies and in accordance with national interests and priorities. This includes a large number of industries in diverse areas of production.
- **Nationalisation**, through which industries or services of national importance were brought under state ownership and control (e.g. commercial banks) or brought under government management (like coal mines)
- **Government Acquisition**, through which private sector units were acquired by the government *through normal market transaction or as a matter of deliberate policy* (like Andrew Yule, Hindustan Petroleum and Bharat Refineries). Government sometimes also acquires sick private sector units in the public interest.

The present PSUs have come to be established through the above routes. In a number of areas, PSUs have been established with the help of foreign collaborations. (like Maruti Udhog Ltd.)

THE LOGIC OF THE PUBLIC SECTOR IN THE PRESENT CONTEXT

The rationale of the public sector in the present age of private enterprise, deregulation, competition and *globalisation* is being actively debated. *The basic questions are: what should be extent and role of the public sector? Why should it exist when sufficient private enterprise is available? What are the specific objectives that public enterprises seek to achieve?*

The rationale of the public sector enterprises engaged in manufacturing, services, trade, commerce or other production activities is well documented in various five-year plans, industrial policy statements and other macroeconomic policy documents. Many points of rationale are still valid in the present-day context. As early as in the **1948 Industry Policy Resolution**, the need for the expansion of the state sector in existing and new areas was highlighted. In the **1956 Industrial Policy Statement**, 17 key industries were reserved for the public sector in addition to another set of 12 industries where the state would increasingly establish new units. The basic logic of entrusting basic and heavy industry development to the state was that these industries involved long gestation periods, complex technology, massive investment and high degree of coordination between various

sectors. *In the present times, this logic stands discredited as the private sector commands huge financial and technological resources and private investment is no longer shy in such areas. There are immense possibilities of collaboration with multinational companies some of which are so large that the annual sales or total assets of each exceeds the GNP of a number of low and middle income countries taken together.* The government under the *New Industrial Policy 1991* has already dereserved most of the public sector areas.

The logic of using public sector as an instrument of checking concentration of economic power is considerably weakened in the wake for forces of competition unleashed in the new economic policy based on **privatisation**, deregulation and **globalisation**. *The public sector disinvestment programme (discussed in subsequent sections) bears adequate testimony to the fact that the government is itself convinced that the present size of the public sector is operationally unsustainable or unnecessary.*

The traditionally held rationale that the public sector, through a subsidy-based price policy can make private investment more profitable and viable through its **forward and backward linkages** doesn't hold much ground in present times. *There are formidable obstacles to containing fiscal deficit of the central government which has for long been at unsustainably large levels.* In this situation of fiscal stress, subsidy-based pricing doesn't hold much ground. *The government has already declared that it will run public enterprises on commercial principles.*

GROWING PRESSURE AGAINST THE PUBLIC SECTOR

The diminishing logic and relevance of the public sector has been attended by a number of endemic problems and challenges faced by it. As a result, criticism against the sector has been mounting in recent years. Some of the leading and well-known problems faced by the sector are the following:

- Conflict between the financial and social objectives;
- Problem of losses or low rate of return on investment;
- Lack of professionalism in management;
- Time and cost overruns in new projects;
- Underutilisation of capacity;
- Bureaucratisation or political interferences;
- Lack of sensitivity to consumer needs and problems; and
- Operational inefficiency.

Several problems of the sector are interrelated. For example, lack of professionalism causes inefficiency which, in turn, reduces profitability. Nevertheless, the sector has, over decades been unsuccessful in liberating itself from these chronic challenges. There are of course certain aspects of problems relating to PSU performance for which the units are not responsible to the full extent. *Pricing policy of a number of enterprises has been based on the social objective of making*

the products (like pharmaceuticals to combat community diseases) and services (like life insurance) available to the widest range of population at most affordable prices. Such pricing policies have been one of the factors behind low rate of return on investment.

The building up of pressure of criticism against the public sector within the government circles, academic arena and the private industry has led to a series of reforms including disinvestment which are discussed in the following sections.

PUBLIC SECTOR REFORMS

The basic design of reforms for the PSUs is contained in the Industrial Policy Statement of 1991 which is discussed in chapter 27. The basic thrust of the reforms has been to attain sharper focus, improve efficiency and profitability and grant greater autonomy to the PSUs so that these units can function on commercial lines. The major aspects of public sector reforms are the following.

PSU REFOCUSING

One major aspects of PSU reforms is that it has been refocussed on selected priority areas. The new industrial policy of 1991 brought down the number of industries reserved for the public sector from 17 to 8 relating to strategic, high-technology and essential infrastructure areas (see Chapter 27). In 2001, the number of reserved industries was only three (atomic energy, minerals specified in the Schedule to the Atomic Energy [Control of Production and Use] Order, 1953 and rail transport). The new policy focussed the public sector on selected priority areas including infrastructure, mineral resource exploration and exploitation, technological development, building of manufacturing capability and products of strategic importance. *The policy, in its strategic refocus, discourages public sector units from entering areas with small scale operations, low-technology base, non-strategic, inefficient or unproductive product lines, little social relevance or where private enterprise was adequate and strong.*

MEMORANDUM-OF-UNDERSTANDING (MOU) SYSTEM OF PUBLIC ENTERPRISE MANAGEMENT

One of the important pillars of the structure of public enterprise reforms as enunciated in the Industrial Policy of 1991 is MOU-based system of operation of public sector undertakings. The government, under the new policy has the objective to bring all the operating public sector enterprises (PSEs) under the MOU system. The system provides for an **arm's length relationship** between public sector enterprises and their respective administrative ministries. Under this system, well-defined targets are given to individual enterprises and they are given operational or functional autonomy to achieve these targets. Box 28.1 describes the MOU system of public enterprise management in fuller details.

BOX 28.1**How Does MOU-based System of Public Enterprise Management Operate?**

The system of public enterprise operation and management based on Memorandum of Understanding (MOU) between a public sector enterprise (PSE) and the respective administrative ministry controlling it, was formally started in the country in 1988 with four PSEs signing it. The system is modelled on the pattern of *Contract De Programme of France* which basically is a system of performance contract. An MOU is a freely negotiated performance contract executed between a PSU and the government (through the concerned administrative machinery). After an MOU, is signed, the government doesn't interfere in the day-to-day operation and management of the enterprise which practically manages itself with full autonomy. At the end of a year, the government reviews the performance in the light of the predetermined and negotiated targets. For all practical purposes, the enterprise gets freedom from bureaucratic controls and procedures and can run on efficient and professional lines. There are basically two types of MOUs viz. the **French contract system** (as described above) and the '**signalling system**'. Under the signalling system, performance is rated on a five-point scale ranging from 1 (excellent) to 5 (poor). Performance is assessed on the basis of a comprehensive set of parameters and procedures relating to *performance evaluation system* and *performance incentive system*. An MOU is analogous to a business plan which lays down targets, strategy and the operational mechanism. The progress of the MOU during a year is constantly monitored by the Department of Public Enterprises. In the year-end review, the department rates the performance as excellent/very good/ good/ fair/ poor on a five-point scale. The MOU system has been successful in a number of countries like France, Korea and Pakistan. The system has been working fairly well in India. It is expected that if the system gets more effective, it might reduce the pressure for privatisation or disinvestment.

The MOU system was formally introduced in the country in 1988 when four public sector enterprises signed it with the government. In the year 2002-03, the total number of public sector enterprises that had signed MOU with the government was 100. During the year 2001-02, of the total 105 enterprises under the MOU system, 50 were rated excellent, 28 very good, 9 good, 14 fair and 5 rated as poor (*Govt. of India, 2003, p. 541*). The financial performance of PSUs operating under the MOU system has been distinctly better. *The aggregate gross margin of PSUs under the MOU system for the year 2001-02 was about 25 per cent higher as compared to the previous year.*

FINANCIAL AND OPERATIONAL AUTONOMY

The 1991 industrial policy provided that the boards of the public enterprises will be made professional and made more powerful and independent. In 1997, the government identified 11 PSUs as *Navratnas* and decided to give increased powers to their board of directors so that these enterprises could run more independently and professionally to gain competitiveness in the domestic and foreign markets. These enterprises were BHEL, BPCL, GAIL, HPCL, IOC, IPCL, MTNL, NTIC, ONGC, SAIL and VSNL. In August 2002, only 9 *Navratnas* remained in the list after the privatisation of IPCL and VSNL. The boards of *Navratna* enterprises have been professionalised with the induction of independent, non-official part-time directors. These enterprises have been granted substantial autonomy in a number of functional areas including capital expenditure, **joint ventures**, organisational restructuring, human resource rationalisation, raising fresh capital from domestic and international sources and to establish financial **joint ventures** within certain limits. The aggregate **net profit** of the enterprises stood at about Rs 18,000 crore in 2000-01.

Financial and operational autonomy has also been given to a number of other profit-making PSUs subject to certain conditions. From the point of view of granting such autonomy, the government has identified two categories of PSUs, called **Miniratna-I** and **Miniratna-II**. **Miniratna-I** category of enterprises are those which, at a particular point of time, fulfil the following conditions:

- Earning of profit from the last three years continuously, and earning of a *net profit* of Rs 30 crore or more in one of the three years; and
- Existence of positive net worth

An enterprise in **Miniratna-I** category enjoys autonomy in the form of freedom to make capital expenditure without government approval upto Rs 300 crore or an amount equal to its **net worth**, whichever is lower. **Miniratna-II** enterprises are those which have:

- Made profits for the last 3 years continuously, and
- Have a positive *net worth*.

These enterprises have the autonomy to make capital expenditure upto Rs 150 crore or 50 per cent of net worth whichever is lower. Miniratna enterprises also have autonomy with respect to such areas entering joint ventures, setting up subsidiaries and overseas offices and entering into technical collaborations. As on March 31, 2002, 41 PSUs existed as *Miniratnas*. The performance of such enterprises is reviewed through an institutional mechanism. *Enterprises with unsatisfactory performance can be stripped off their navratna status and other enterprises can be granted such a status on the basis of good performance.*

RESTRUCTURING AND REVIVAL OF SICK UNITS

As already pointed out in **Chapter 27**, the new industrial policy for the public sector gives special attention to enterprises which are chronically sick, loss-making, uncompetitive or have lost social relevance or purpose. Under the reform measures undertaken, it is the endeavour of the government to restructure and revive the PSUs to improve their performance, **productivity** and **profitability**. Major thrust of such measures is on loss-making and sick enterprises which are capable of being revived. Such units are referred to the **Bureau of Industrial and Financial Reconstruction (BIFR)** under the provisions of **Sick Industrial Companies (special provisions) Act, 1985** for recommendation of rehabilitation and revival packages. In other cases, concerned administrative ministries or departments, together with management, worker representatives and other experts and consultants hammer out the revival plans and strategies through restructuring.

PRIVATISATION THROUGH DISINVESTMENT

The government policy recognises **privatisation** as an instrument of improving **efficiency** and **productivity** of PSUs. Privatisation, as discussed in **Chapter 15**, is an important pillar of the structure of economic reforms in the country. Privatisation in the country has been attempted predominantly through disinvestment of government equity in PSUs. As on March 31, 2003, the total balance sheet assets of PSUs was estimated at Rs 22 lakh crore (Rs 20,000 billion) and even a small improvement in efficiency can produce a substantial increase in total profits. To handle the

task, the government now has a separate **Ministry of Disinvestment** and a **Disinvestment Commission**. Since the year 1991-92, the government has been fixing yearly disinvestment targets though these have been missed by wide margins in most of the years. The disinvestments programme is separately discussed in the subsequent sections of the Chapter. The programme and its implementation have been mired in a wide-ranging controversy and the major issues involved are separately discussed below.

PROTECTION OF PSU WORKERS' INTEREST

The new public sector policy and reforms take special notice of PSU employees whose employment and interests might have been adversely affected in the process of restructuring, revival strategies, privatisation through disinvestments, outright sale of PSUs or rationalisation and optimisation of human resources. *The government, at present, has the policy of inserting a worker protection clause in the shareholder agreement in privatisation or disinvestments cases under which no retrenchment of employees can take place atleast for a period of one year after privatisation. After such a period, retrenchment is possible only under the liberalised voluntary retirement scheme (VRS) as applicable under the guidelines of the Department of Public Enterprises or the Voluntary Separation Scheme (VSS) in the company prior to disinvestments, whichever is more beneficial to the employees.*

The Public Sector Enterprise (PSE) Survey, 2000-01, reveals that the unemployment concerns of public sector reforms have been blown out of proportion. Over the decade 1991-2001, workforce in PSUs has contracted only by 20 per cent. From October 1988 to March 2001, 3.69 lakh central PSU employees have availed VRS involving an expenditure of Rs 6930 crore for the purpose. The post-disinvestment retrenchment of employees has been marginal. In a large number of cases, employees availing VRS obtained re-employment in other organisations.

POST-REFORM PERFORMANCE OF CENTRAL PSUS

In order to have an assessment of the impact of public enterprise reforms, it is necessary to have a look at the public enterprise performance in post-reform years. **Table 28.1** summarises the performance in terms of turnover, profits, contribution to exchequer and resource generation.

In 1990, the total number of central PSUs was 244 (compared to just 5 in 1951, 47 in 1961 and 179 in 1980). Due to the sell-off, **restructuring** and disinvestments, the number came down to 236 in 1998 but marginally rose to 242 as on March 31, 2002. As is evident from **Table 28.1** there has been sustained increase in turnover or operating income which during the decade rose 3.42 times. Similarly, there has been sustained increase in profits before interest and taxes and net profits which rose 3.57 times and 6.64 times respectively over the decade. There has been equally impressive increase of 3.17 times in contribution to central exchequer by way of **dividend**, interest, corporate taxes excise duty etc. The sustained increase in internal resource generation has reduced the burden on the central budget.

Table 28.1: Performance of central public sector undertakings, 1991-2001

(Rs.'000 cr)

| Year | Turnover/ Operating income | PBIT ¹ | Net profits | Contribution to central exchequer | Gross internal resource generation |
|--|----------------------------------|-------------------|----------------|---|--|
| 1991-92 | 133.9 | 13.7 | 2.4 | 19.3 | 12.9 |
| 1992-93 | 147.2 | 16.0 | 3.3 | 21.7 | 14.8 |
| 1993-94 | 158.0 | 18.6 | 4.5 | 22.0 | 16.7 |
| 1994-95 | 187.4 | 22.6 | 7.2 | 26.0 | 20.0 |
| 1995-96 | 226.9 | 27.6 | 9.6 | 28.7 | 24.2 |
| 1996-97 | 260.7 | 30.9 | 10.2 | 39.0 | 25.6 |
| 1997-98 | 276.0 | 37.2 | 13.6 | 42.3 | 31.2 |
| 1998-99 | 310.2 | 39.7 | 13.2 | 46.9 | 31.3 |
| 1999-00 | 389.1 | 42.3 | 14.3 | 56.2 | 35.9 |
| 2000-01 | 458.2 | 48.8 | 15.7 | 61.0 | 37.8 |
| Growth in 2000-01 over 1991-92 (%) | 342 | 357 | 664 | 317 | 292 |

Note: ¹ Profit before interest and taxes

Source: Extracted from Government of India (2003), *India 2003: A Reference Annual* (New Delhi: Govt of India), Table 20.1, p.339

Here, however, it must be commented that all central PSUs have not been making profits. The overall profit position is the resultant of negative and positive financial performance of individual enterprises and this performance has been varying over years. In the post-reform years, the overall performance has also improved in terms of standard financial ratios. For example, the return on investment (ROI) measured as ratio of profit before interest and taxes to capital employed increased from 11.6 per cent in 1991-92 to 14.7 per cent in 2001-02. Similarly, dividend payout ratio increased from 29.2 per cent to 52.8 per cent during the same period.

The performance of central PSUs should not be appraised in terms of financial parameters alone. These enterprises today provide employment to more than 2 million persons, as referred to in the preceding sections. In addition, the enterprises are instrumental in administering and developing industrial townships and incur substantial expenditure on social overheads.

THE DISINVESTMENT PROGRAMME

DISINVESTMENT TRENDS SINCE 1991

The disinvestment programme towards greater *privatisation* of the economy was launched in the year 1991-92 with the announcement of the new industrial policy in August 1991 and is an on-going process even today. It has generated a lot of debate and attracted much criticism on various

grounds. Under the programme, the government has been setting disinvestment targets (in terms of disinvestment of government equity) from year to year and has been resorting to different methods and strategies to attract private investors. *Table 28.2* gives year-wise position of targets and achievement. Since 1991-92, achievement exceeded targets only for the years 1991-92, 1994-95 and 1998-99; for all the remaining years, achievement has remained far below targets. From April 1991 to Jan 2003, the aggregate of annual disinvestments targets was Rs 78,300 crore of which only 38 per cent has been achieved.

Table 28.2: Disinvestment Targets and Achievement in Central Public Sector Undertakings, 1991-2003

| Year | Disinvestment | |
|----------------------|---------------|------------------------|
| | Target | Achievement |
| 1991-92 | 2500 | 3038 (47) ² |
| 1992-93 | 2500 | 1913 (35) |
| 1993-94 | 3500 | n..a. (-) |
| 1994-95 | 4000 | 4843 (13) |
| 1995-96 | 7000 | 362 (5) |
| 1996-97 | 5000 | 380 (1) |
| 1997-98 | 4800 | 902 (1) |
| 1998-99 | 5000 | 5,371 (5) |
| 1999-00 | 10,000 | 1,829 (2) |
| 2000-01 | 10,000 | 1,869 (4) |
| 2001-02 | 12,000 | 5,632 (10) |
| 2002-03 ¹ | 12,000 | 3,342 (6) |

Note:¹ Upto Jan 31, 2003

² Figures in brackets show the number of companies in which at least a part of the equity was sold during the year.

Source: Govt of India (2003), *Economic Survey, 2002-03* (New Delhi: Govt of India)

In the initial years, investment involved the sale of minority stake in a few PSUs. In the later years the focus has shifted to **strategic sales**. In addition to strategic sales, the other route to disinvestments has been **initial public offering (IPO)** and **rights offer** renunciation and control premium. *Table 28.3* gives the list of PSUs that have undergone disinvestments during the period 2001-03. In 2002, the government intended to disinvest in Hindustan Petroleum Corporation Ltd (HPCL) and Bharat Petroleum Corporation Ltd (BPCL) but it had to suspend the programme in view of sharp criticism both from within and outside the government. *Between August 1991 and March 2003, in all 48 companies underwent the disinvestments process.*

Table 28.3: Major Central PSUs That Have Undergone Disinvestment in Recent Years

| 2001-02 | | 2002-03 | |
|---|-------------------------|--------------------------------------|-------------------------|
| PSU | % of equity disinvested | PSU | % of equity disinvested |
| Hotel Corporation of India Ltd (3 hotels) | 100 | ITDC (10 hotels) | 100 |
| HTL Ltd | 74 | Hotel Corporation of India (1 hotel) | 100 |
| CMC Ltd | 51 | Hindustan Zinc Ltd | 26 |
| IBP Ltd | 34 | Modern Food Industries (India) Ltd | 26 |
| VSNL | 25 | IPCL | 26 |

Source: Govt of India, *Economic Survey*, 2001-02 and 2002-03 issues

PRESENT DISINVESTMENT POLICY

One of the major criticism against the disinvestment programme has been that the government does not have a clear-cut and transparent policy in this regard. *The programme has often been considered as erratic, adhoc and without any meaningful perception. The government adopted multiple and varying criteria for the selection of PSUs for disinvestment and its extent was also arbitrarily determined.* Dogged by fierce controversy and criticism, the government came out with a Disinvestment Policy on December 9, 2002. The contents and direction of the privatisation policy are broadly indicated in its following aims:

- Modernisation and upgradation of public sector enterprises;
- Creation of new assets;
- Generation of employment;
- Ensuring that disinvestment does not lead to the alienation of national assets;
- Setting up of **Disinvestment Proceeds Funds (DPF)**;
- Formulation of guidelines for disinvestment of national asset companies; and
- Preparation of a paper on the feasibility and modalities of setting up an Asset Management Company to hold, manage and dispose the residual holding of the government in the companies in which government equity has been disinvested to a strategic partner.

The policy statement which came at the end of the year 2002, after a temporary suspension of the programme, was partly aimed at cooling down the controversy which reached a vortex in August 2002 and was also an attempt to make a public revelation of the basic objectives and purposes of the programme. The objectives, however, are in general and broad terms and the policy is not specified in concrete form.

BASIC ISSUES CONCERNING THE DISINVESTMENT PROGRAMME

In spite of the announcement of the disinvestment objectives and policy, the controversy concerning the extent, objectives and methods of the programme continues to rage. The central issue involved continues to be public interest. The following issues highlight the major concerns.

VALUATION OF PUBLIC SECTOR UNITS

One of the major points of criticism against the programme is that the PSU stocks are undervalued and sold at below the market or current price. The valuation basically depends upon the method applied. There are various methods available like discounted cash flow, the historical cost method, the balance sheet method and comparable transaction method, each of which gives a different result. Within each method, there are different costing standards and conventions. So the basic problem is the appropriateness of the method applied. *An undervaluation of PSU stock is a loss of public property and a setback to national interest.*

METHOD OF DISINVESTMENT

The government has been applying different methods of disinvestment to different PSUs. Table 28.4 shows how different methods have been adopted for different PSUs since 1991-92. The lack of uniform practice in this regard has been one of the major causes of controversy and criticism. Till 2002-03, the number of companies in which government equity has been sold in varying degrees has been 48. Till 1998-99, the stake was sold off in small tranchers. Since 1999-2000, there has been a greater stress on *strategic sale*. *The method of strategic sale involves an effective transfer of control and management from government to a private entity with the expectation that the surrender of management control would fetch a better price from the private party in a matching proportion.*

The private party is called the strategic partner which generally has experience in related lines of business. This method of sale has been resorted to in the case of disinvestment of BALCO, CMC, VSNL, IBP, ITDC Hotels, Maruti and HZL. Strategic sales are far more convenient and cheaper as compared to public offering of shares which is a slow, expensive and uncertain process. At the world level, however, strategic sale is not a popular method of disinvestment as in this method the probability of undervaluation and corruption is large.

THE EXTENT OF DISINVESTMENT

Though the government has been setting annual targets for disinvestment, there is no target as such for the overall or total disinvestment programme. There is, in fact, no declared terminal year of the programme nor is there any policy in this regard. Where will the government stop? There is no clear-cut answer to this question. Further, no policy exists with regard to the choice of a PSU for disinvestment. The government has so far been picking both loss-making and profit-making enterprises for the purpose. There appears to be a large element of ahocism and arbitrariness in this regard.

Table 28.4: Methods of Disinvestment Actually Followed for PSUs in India during 1991-2003

| Year | No. of Cos ¹ | Method of Disinvestment |
|--------|-------------------------|--|
| '91-92 | 47 | Minority shares sold by auction method in bundles of "very good", "good" and "average" companies. |
| '92-93 | 35 | Bundling of shares abandoned. Shares sold separately for each company by auction method. |
| '93-94 | – | Equity of 7 companies sold by open auction but proceeds received in '94-95. |
| '94-95 | 13 | Sale through auction method, in which NRIs and other persons legally permitted to buy, hold or sell equity, allowed to participate. |
| '95-96 | 5 | Equities of 4 companies auctioned and government rode piggy back on the IDBI fixed price offering for the fifth company. |
| '96-97 | 1 | GDR (VSNL) in international market. |
| '97-98 | 1 | GDR (MTNL) in international market. |
| '98-99 | 5 | GDR (VSNL)/ Domestic offerings with the participation of FIIs (CONCOR, GAIL). Cross purchase by 3 oil sector companies i.e. GAIL, ONGC & Indian Oil Corporation. |
| '99-00 | 2 | GDR (GAIL), Domestic Issue (VSNL), Restructuring (BALCO), MFIL's strategic sale and others. |
| '00-01 | 4 | Strategic sale of BALCO, LIMC; Takeover-KRL (CRL), CPCL (MRL), BRPL. |
| '01-02 | 10 | Strategic sale of CMC (51%), HTL (74%), VSNL (25%), IBP (33.58%), PPL (74%), and sale by other modes (TTDC & HCL); surplus reserves: STC and MMTC. |
| '02-03 | 6 | Strategic sale of JESSOP (72%), HZI (26%), MFIL (26%), IPCL (25%) and other modes (HCL, Maruti). |

Note:¹ Number of companies in which atleast a part of the equity was sold during the year. From '91-92 to '02-03, disinvestment has taken place in 48 companies.

Source: Ministry of Disinvestment, quoted in the Economic Times, March 21, 2003

UTILISATION OF DISINVESTMENT PROCEEDS

PSUs are built with public resources and there is a widespread opinion that the disinvestment proceeds must not be used up in government consumption or meeting the fiscal deficits. Again, the government has no declared policy in this regard. There is a widely held opinion that the disinvestment proceeds must be utilised in making new investment which serves the widest interest of the public. It is often alleged that the government has been using the disinvestment proceeds in meeting fiscal deficits. The money can be well utilised if it is spent for any one or more of the following ways in the present-day context:

- Retiring huge public debt which would reduce interest payment burden of the government in the subsequent years.

- Increasing social welfare through such expenditures as on public health, education or employment generation.
- Building social and economic overheads.
- Increasing capital formation in agriculture.
- Retraining of workers affected in the process of privatization.
- Building safety net for workers adversely affected by public sector restructuring.

Transparency in the utilisation of investment proceeds can greatly enhance the acceptability of the programme in the public.

ISSUES CONCERNING LABOUR

As discussed in the preceding sections, though the new public sector policy provides for the protection of workers' interest adversely affected by privatisation or PSU restructuring, still labour concerns are widely debated. The policy provides such schemes as liberal voluntary retirement scheme, insertion of labour protection clauses in privatisation agreements and workers safety nets. The level of employment in PSUs has been steadily falling and new employment generation is insignificant. There is hardly any facility for retraining of workers for suitable employment in private sector organisations. In the process of economic reforms, the government is yet to come out with a clear labour policy. Till such time, labour concerns will continue to dog the privatisation programme.

CONCLUSION

It is important for the government to develop a comprehensive, well-defined and transparent privatisation programme. Simultaneously, national level efforts are required to enhance public acceptability of the programme. Such measures would also help the government in obtaining a better price for the PSUs. If the MOU-based system of public enterprise management is strengthened, the need of PSU sell-off can be reduced or atleast postponed and the public enterprises will emerge as a strength rather than weakness of the economy.

Key Terms

| | | |
|-----------------------------------|-------------------------|-------------------------------|
| Statutory corporation | Productivity | Initial Public Offering (IPO) |
| Nationalisation | Subsidiary | Dividend |
| Globalisation | Efficiency | Rights offer |
| Privatization | Technical Collaboration | Dividend payout ratio |
| Forward and backward linkages | Restructuring | Capital formation |
| Arm's length | Profitability | Strategic sale |
| Memorandum of understanding (MOU) | Return of investment | Public debt |
| Joint venture | Turnover | Safety net |

Supplementary Readings

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Long Questions

1. Discuss the salient characteristics of public sector reforms in India. Do you think privatisation is the effective answer to all public sector problems?
2. Do you agree with the view that public sector disinvestment is unnecessary after the introduction of MoU-based system of public enterprise management?
3. What are the standard methods of public sector disinvestment? What are the main issues concerning public sector disinvestment in India?
4. Why has disinvestment remained mostly below target in India since 1991? How can the disinvestment programme be made more effective?
5. Give an overview of the post-reform performance of central PSUs. In the light of the performance, will you recommend further disinvestment? Give reasons.

Short Questions

1. Is disinvestment the same thing as privatisation?
2. Write three major points on public sector reforms in India.
3. What are *Navratna* and *Mininavratna* PSUs?
4. What are the main constituents of the public sector?
5. Mention three ways in which public sector helps the private sector.
6. What are the standard routes to establishing PSUs?
7. Write three major reasons for public sector disinvestment.
8. Give three major reasons as to why public sector should continues to exist.
9. Why is the rate of return on most PSU investment low?
10. What is MOU-based system of public enterprise management?

11. Draw three major conclusions from the data given in Table 28.1?
12. What is the concept of strategic sale in public sector disinvestment?
13. List three major labour issues concerning PSU disinvestment.

Practical Assignments

1. Hold a group discussion on '*Effectiveness of MOU-Based System of Public Enterprise Management*'. Prepare a report on the outcome of the discussion and present it to the class. Obtain suggestions to make the system more effective.
2. Select a PSU that has recently undergone disinvestment. Make a visit to the undertaking to find out:
 - i. Why was the disinvestment considered necessary?
 - ii. What method was adopted for the disinvestment?
 - iii. Compare the performance statistics of the enterprise in the pre-and post-disinvestment period.
3. '*Disinvestment as a method to solve the public sector problems is like killing the patient to get rid of the disease*'.
Hold a debate on the above topic and discuss alternatives to public sector disinvestment.
4. Make a visit to a loss-making PSU and analyse the reasons for its financial position. Prepare a revival plan and present it to the class for further discussion.
5. Suggest alternatives (in declining order of importance) for the utilisation of the proceeds from public sector disinvestment.

THE SMALL SCALE INDUSTRY: CURRENT STATUS AND PROSPECTS

Chapter Outline :

- Structure and Definition of SSI
 - Significance of the SSI Definition
 - Dangers of Too High and Too Low Investment Limits
- The Logic of the Small Scale Industry
- Contribution and the Role of the SSI
 - Growth and Spread
 - Production
 - Employment Generation
 - Export Contribution
- Incidence of Sickness in the SSI sector
 - What is Industrial Sickness?
 - Warning Signals of Sickness
 - Extent of SSI Sickness
- General Problems of the SSI
 - Problems at the Project Planning Stage
 - Problems at the Implementation Stage
 - Problems during the Operational Stage
 - Financial Problems
 - Marketing Problems
 - Production Problems
 - Managerial Problems
 - Exogenous Factors
 - Current Challenges
 - Declining Share in Bank Credit
 - Growing Competition with Large Industry
 - Threats from Imports and WTO
 - Delayed Payments
 - High Burden of Taxation
 - Quality Problems
- The Present SSI Support System
 - The Institutional Support Network
 - Recent Incentives and Facilities
- Conclusion

The small scale industry (SSI) is an important segment of the country's industrial economy. The industry is widely scattered all over the country and produces a large number of consumer and industrial goods and services. A major segment of the SSI is unregistered and lies in the *unorganised sector* so that a sizeable portion of its output goes unrecorded.

STRUCTURE AND DEFINITION OF SSI

The SSI sector is not internally homogenous. A large number of differentiations exist within the sector depending upon the location of production, type of output, size of central investment, nature of inputs and linkages with other categories of industries. Further, different institutions like commercial and development banks and the government apply different criteria or use different definitions and terms to denote the SSI. Broadly speaking, the different segments (often overlapping) within the SSI sector are the following.

- **Handicrafts Industry.** It uses traditional skills and techniques and selective goods like wood carvings, jewellery and artistic products are produced which require high-skill, labour-intensive workmanship. The products are unique and individualistic and have aesthetic appeal which attract tourists and people in higher-income brackets. Most of the producing units fall within the purview of the **All India Handicrafts Board**.
- **Village and Household Industries.** It also uses traditional skills and techniques but produces common consumer products of mass consumption like hand-woven fabrics, pottery and simple furniture using mostly locally available raw materials. Production is highly labour intensive and the use of family labour is common. Most of the producing units in this category fall within the purview of the **Khadi and Village Industries Commission (KVIC)**. Handloom units fall within the purview of the **All India Handloom Board**.
- **Modern Small Scale Industry.** It uses modern technology based on power and includes units producing a variety of good and services such as repair and maintenance, slimming and beauty centres, veterinary clinics, entertainment, advertising etc.

Depending upon size, there exists the category of '*tiny units*' which are defined on the basis of capital investment. On the basis of linkage with other industries, SSI units can be classified into *independent or stand-alone units* and *ancillary units*. **Ancillary units** are those which supply a part of their production consisting of components, sub-assemblies, tooling, intermediates or services to other units for production of other kinds of goods or services. Such units in India are distinguished from the small scale industry units and have separate definition in terms of size (**Table 29.1**). The official definition of SSI units (including its subcategories) has changed from time to time and is provided in various industrial policy statements. *Industries (Development and Regulation) Act, 1951* empowers the central government to defines SSIs and ancillary units. *While defining an SSI unit, the government can take into account such criteria or factors as investment in plant and machinery (as well as buildings), number of workers, nature, cost and quality of product, foreign exchange requirements or other relevant criteria. The government has, however, used predominantly the criteria of investment in plant and machinery for defining SSI and ancillary units.* **Table 29.1** gives the various definitions of SSI, ancillary and tiny units revised and adapted from time to time.

Table 29.1: Changes in the Definition of the Small Scale Industry, Ancillary Units and Tiny Units, from Time to Time.

| Year | Investment limit in plant and machinery (Rs. lakhs) | | |
|---------------|---|-----------------|------------|
| | Small scale Industry | Ancillary units | Tiny units |
| (Up to) 1974 | 7.5 | 10.0 | – |
| 1975 | 10.0 | 15.0 | – |
| 1980 | 20.0 | 25.0 | – |
| 1985 | 35.0 | 45.0 | – |
| 1991 | 60.0 | 75.0 | 5.0 |
| 1997 | 300.0 | 300.0 | 25.0 |
| 1999 | 100.0 | 100.0 | 25.0 |

Source: Govt of India, *Economic Survey*, various years

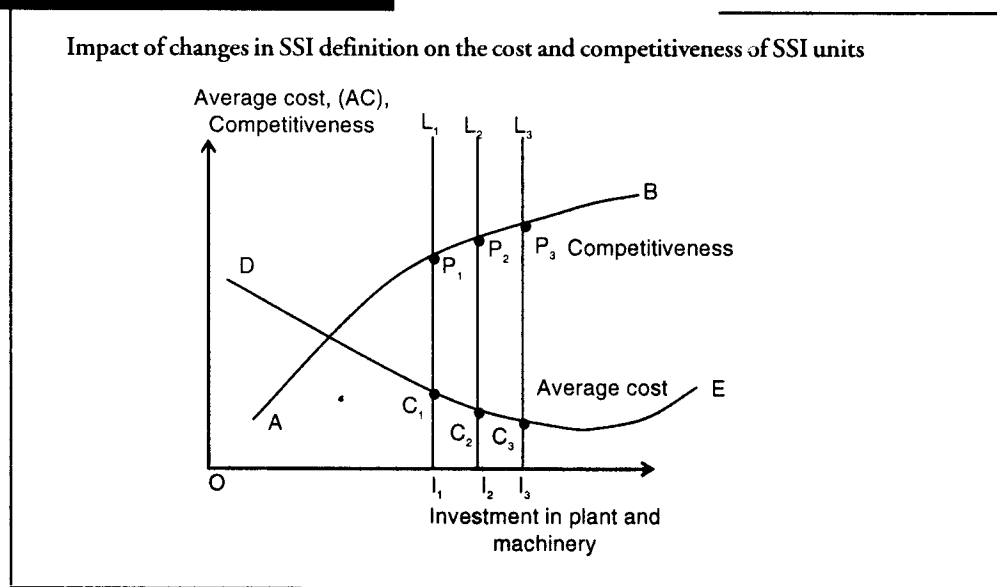
SIGNIFICANCE OF THE SSI DEFINITION

The definition of the SSI is important from the point of view of production, **economies of scale** and competition. Changes in the size definition of SSIs are widely commented upon. The investment limit of SSI units has been periodically revised upwards keeping in view various economic considerations. The significance of the SSI definition is brought out in the following points.

- It specifies the units in terms of size (or other criteria) which are eligible to receive various facilities, benefits, concessions, subsidies, direct assistance and exemptions from the government.
- Low level of investment limits reduces the number of SSIs in the category and higher level of limit increases the number. In the former case, competition within the SSI sector is reduced and in the latter case increased.
- When investment limit is too high, larger SSI units can dominate the SSI sector marginalising many smaller units in the competitive process.
- When investment limit is too low, SSIs would find it difficult to acquire new technology which could be expensive. This can force SSIs to remain within the domain of technological backwardness and low competitiveness.
- Low investment limits incapacitate units to produce more from with limited machinery. As a result, they would be unable to reap *economies of scale*. At the national level, it amounts to wastage of resources. The case is illustrated in Figure 29.1. *AB is the curve of competitiveness that a firm tends to be more competitive as its size and resources increase. DE represents the usual merge cost curve which is U-shaped.* When an SSI has the investment of I_2 , average

cost is C_2I_2 and competitiveness at P_2I_2 . If investment limit is raised to I_3 , the firm enjoys economies of scale which reduce the average cost from C_2I_2 to C_3I_3 thereby raising its competitiveness from I_2P_2 to I_3P_3 . Conversely, if investment limit is lowered to I_1 , average cost increases and competitiveness level falls. The increase in investment limit, however, has to be in real (rather than nominal) terms so that it represents enhanced capacity of the firm to produce.

FIGURE 29.1



DANGERS OF TOO HIGH OR TOO LOW INVESTMENT LIMITS

Investment limit as a criterion of definition of an SSI, is a sensitive matter. Changes in the limit often raise controversies as it has the potential to impact SSI performance. As already pointed out in the explanation to **Figure 29.1**, a too low investment limit would confine a firm to a small level of output which will deny the firm the economies of scale. Moreover, the firm would be driven to serve a small local market and may confront capital constraints to growth. A high investment limit would include a number of medium or larger firms and make the SSI sector so defined a heterogeneous one. *This would create an unfair competition between firms of small and large size within the SSI sector and might eventually lead to the marginalisation or exit of smaller, uncompetitive firms. The larger firms are expected to gain a sharper competitive edge as the benefits available to firms in the legally defined SSI sector grow in proportion to the size of output. SSI limits therefore have to be carefully demarcated keeping in view the following:*

- The objectives of the SSI policy;
- competitiveness and efficiency of the industrial segment;

- factors relating to economies of scale;
- overall requirements of industrial growth; and
- employment and other social implications.

THE LOGIC OF THE SMALL SCALE INDUSTRY

The five-year plan documents, industrial policy, union budgets and various other policy documents of the government lay special emphasis on the development of the SSI. These industries already occupy an important place in the country's industrial economy as is discussed in the subsequent sections. Though the SSI sector is suffering from a number of serious business problems, still there exists a strong economic logic for strengthening and developing this segment of the industrial sector. The following brief points bring out the logic.

- **Capital Light.** SSI units are easy to establish as these require relatively small amount of investment. As the investment can be afforded even at the individual level, these are capable of being set up under sole proprietorship and partnership forms of business. Because of low investment requirement, banks and other financial institutions are easily willing to extend financial support.
- **Skill Light.** The skill requirement for operating SSI units are not much sophisticated. Small machinery in most lines of production is easily available in the open market and the skills are also commonly known and available. A large number of technical institutions like polytechnics are available which impart technical and professional training on a large-scale basis. Easy availability of skilled workforce provides a good ground for the growth of entrepreneurship in the SSI sector.
- **Industrialisation and Growth.** As SSI units are easy to establish, their number is usually large. These firms promote industrialisation and contribute to economic growth through the production of a wide variety of goods and services. Because of this contribution, most governments maintain elaborate institutional arrangements and facilities and incentives in the areas of finance, infrastructure, production and marketing for their growth.
- **Low Gestation Period.** SSI projects take much less time in their completion as compared to large enterprises. The period is low basically due to easy availability of capital and labour as pointed out above. Government assistance, facilities and incentives further help in keeping the period length low. *The advantage of low gestation period is that the chances of cost and time overruns are low and the projects involve a low degree of risk.*
- **Employment Effects.** SSIs, by virtue of their large number with geographical dispersion, create huge employment particularly at the local level. *The sector absorbs excess labour from agricultural sector reducing the problem of rural or agricultural disguised employment and raises overall productivity. Further, it reduces the burden of providing employment in the government sector and the large-scale industry. Labour-capital ratios in SSI units is generally higher as compared to large-scale industries so that one unit of capital generates more employment in the former than in the latter. This point has been established in a recent study (SIDBI 1999).*

- **Distributive Effects.** SSI units being widely different and large in number, create a more equitable structure of wealth and income in the various strata of society. *More equitable distribution of income is important from the point of view of social welfare and justice. Balanced income distribution supports demand, reduces social tensions and promotes peace.*
- **Fuller Utilisation of Local Resources.** Most SSI units have local area of operation. These firms provide demand for locally produced raw materials which are both cheap and easily available. A large number of industries (like food processing) choose their location according to the local availability of inputs. *To the extent that local materials are used as inputs, the problems of excess supply, low price and wastage are reduced. This backward linkage promotes production of local materials.*
- **Industrial Diversification.** SSI units serve to broaden the industrial production structure as the units produce a large number of diverse items catering to the variegated requirements of the population. *The diversification comes with decentralisation and the two factors together help in reducing both product and regional imbalances.*
- **Forward Linkages:** SSI units not only have *backward linkages* causing development of the raw material supplying activities but have substantial *forward linkages*. A large number of small enterprises exist as ancillary units of large-scale industries producing a range of raw materials, intermediates or components for them. That way, the small units acquire acute specialisation in selected areas and support large scale industries. Industries like automobiles, bicycles and textiles depend heavily upon a number of small units for the supply of components and intermediates.
- **Better Industrial Relations.** As SSI units employ a limited number of persons, the employer-employee contact is close, often leading to better understanding of professional and interpersonal relations. This promotes industrial peace and reduces man-days lost in **strikes** or **lockouts**. Good industrial relations are important for steady flow of output and efficiency in production.

The above points highlight the need for developing the sector on a priority basis. In a large number of countries, small industry receives get priority attention and is encouraged by the government through a variety of support measures to enable it to stand in competition with large domestic and foreign enterprises. In India, this segment occupies an important place and is a priority area of the government. As will be seen in the subsequent sections, the government maintains an elaborate system of institutions, facilities and incentives for the growth of the sector.

CONTRIBUTION AND THE ROLE OF THE SSI

The small scale sector occupies an important place in the economy and its contribution in terms of production, employment and exports has been increasing. The growth and performance of the SSI sector in recent years is explained through the following sections.

GROWTH AND SPREAD

SSI units are both registered and unregistered, the former far outnumbering the latter. Registration is done by the *Directorate of Industries* of the states or union territories in which the units are located. This entitles them to various facilities and concessions of the government. The total number of SSI units rose from about 28 lakh in 1996-97 to 34.6 lakh in 2001-02 (Table 29.2). Of the 34.6 lakh units, 27.5 lakh units were registered and the rest unregistered. The proportion of registered units has, however, increased marginally from 76.8 per cent to 79.5 per cent over the period. Annual growth rate (year to year) over the period 1996-02 has varied within the narrow range of 4 to 5 per cent.

Table 29.2: Growth and performance of the small scale industry, 1996-2002

| Year | No. of units (lakhs) | Value of production (Rs '000 cr) | | Employment (lakhs) | Exports (Rs '000 cr) | | |
|---------|----------------------|----------------------------------|--------------------------|--------------------|----------------------|--------------------|---------------------|
| | | At constant prices (1993-94) | As % of GNP ¹ | | At current prices | % of total exports | % of SSI production |
| 1996-97 | 28.0 | 411.9 | 34.4 | 160.0 | 39.2 | 33.0 | 9.5 |
| 1997-98 | 29.4 | 462.6 | 35.6 | 167.2 | 44.4 | 34.2 | 9.6 |
| 1998-99 | 30.8 | 520.7 | 36.0 | 171.6 | 49.0 | 35.0 | 9.4 |
| 1999-00 | 32.1 | 572.9 | 36.7 | 178.5 | 54.2 | 34.0 | 9.5 |
| 2000-01 | 33.7 | 639.0 | 38.1 | 185.6 | 60.0 | 29.8 | 9.4 |
| 2001-02 | 34.6 | 690.5 | - | 192.2 | - | - | - |

Note: ¹ At factor cost

Source: Prepared from (a) Govt of India (2003), *India 2003; A Reference Annual* (New Delhi: Govt of India); and (b) Govt of India (2002-03), *Economic Survey 2002-03* (New Delhi: Govt. of India)

The geographical distribution of the SSI units is highly skewed (Table 29.3). In 2000-01, only three states viz. Uttar Pradesh, Tamil Nadu and Madhya Pradesh accounted for more than 10 per cent each in the total number of SSI units granted permanent registration by the Directorate of Industries of various states and union territories. Seven states (viz. Andhra Pradesh, Bihar, Gujarat, Kerala, Maharashtra, Punjab and West Bengal) had the share ranging between 5-10 per cent and the rest less than 5 per cent. *The number of registered SSI units in various states are observed to be directly proportional to the degree of industrialisation and geographical size. It is interesting to observe that the top three states account for about 38 per cent and top five states account for about 53 per cent of the total number of units registered in the country.*

PRODUCTION

SSI production accounts for a sizeable part of the country's total output. In 1996-97, SSI production was 34.4 per cent of the country's *gross national product* (at factor cost) which steadily rose to 38.1 per cent in 2000-01. Over this period, the production rose by 68 per cent (at current prices) and by about 45 per cent at constant (1993-94) prices. *SSI production at present accounts for about one-half of the total value added in manufacturing in the country.*

Table 29.3: States with registered SSI units exceeding 5 per cent of total registered SSI units in India 2001

| State | Registered units | | |
|-------------|------------------|--------------------------|----------------------|
| | No (lakh) | Share in total units (%) | Cumulative share (%) |
| UP | 4.03 | 15.1 | 15.1 |
| TN | 3.32 | 12.4 | 27.5 |
| MP | 2.89 | 10.8 | 38.3 |
| Kerala | 2.14 | 8.0 | 46.3 |
| Gujarat | 1.85 | 6.9 | 53.2 |
| Punjab | 1.61 | 6.0 | 59.2 |
| W. Bengal | 1.60 | 6.0 | 65.2 |
| Maharashtra | 1.52 | 5.7 | 70.9 |
| AP | 1.36 | 5.1 | 76.0 |

Source: SIDO Data

During 1996-2002, the year-to-year rate of growth has been above 11 per cent at current prices and above 8 per cent at constant prices. The production figures are, at best, under-estimates as a large number of village and tiny industries and small service units in the unregistered category do not maintain adequate or reliable records. Even among registered units, under-reporting of production to evade taxes, is quite common.

EMPLOYMENT GENERATION

The SSI sector has been a major generator of employment in the country. The employment generation is widespread and decentralised according to the geographical distribution pattern of the sector. *Most of the SSI units, as already pointed out, generate employment locally so that the employment benefits are distributed more equitably. During 1996-2002, SSI sector generated employment at the compound annual growth rate of 4 per cent compared to just 0.98 per cent in the overall economy. SSI segment offers tremendous opportunities for self-employment.* Actual employment in the sector could be larger as a large number of enterprises and service units exist in informal sectors like retailing and automobile repair and maintenance where no formal employment records are maintained.

EXPORTS CONTRIBUTION

SSI sector makes significant contribution to exports. Its export basket is considerably diversified and includes such products as handicrafts, food products, leather products, spices woolen garments, textile products, gem and jewellery, sports goods, metalware and a large number of other consumer and industrial-use items. *SSI exports, as a proportion of SSI production, remained within a narrow range of 9-10 per cent during 1996-2001. The share of SSI exports in the total exports of the country was 33 per cent in 1996-97 and 35 per cent in 1998-99. However, it fell significantly to 29.8*

per cent in 2000-01. During 1997-2001 the annual growth rate of SSI exports in rupee terms and at current prices remained above 10 per cent. The relative decline in the export performance of the SSIs is attributed largely to increased competition from the large scale sector, foreign companies and imported goods and recessionary conditions in major foreign markets. At present, the sector faces major challenges from import liberalisation, privatisation and the new WTO regime. De-reservation of a number of items, earlier meant for exclusive production in the SSI sector, has added new dimension to the competitive challenges faced by the sector.

INCIDENCE OF SICKNESS IN THE SSI SECTOR

SSI sector suffers from a number of endemic problems which are built into their small size and resource constraints. The challenges before the sector have multiplied in the wake of increased competition flowing from economic reforms. The level of protection granted to the sector has gradually gone down resulting in the larger incidence of sickness, both actual and potential.

WHAT IS INDUSTRIAL SICKNESS?

According to *Sick Industrial Companies (Special Provisions) Amendment Act, 1993* (being phased out), an industrial company (being a company registered for not less than five years) which has, at the end of any financial year, accumulated losses equal to or exceeding its entire *net worth* is a **sick company**. A company is defined as **potentially sick** if its accumulated cash losses (i.e., losses without providing for depreciation) as at the end of any financial year result in the erosion of 50 per cent or more of its peak net worth during the immediately preceding four financial years. The sickness is the resultant of a large number of problems and constraints and owners generally have a tendency to hide this as it adversely affects their reputation or standing in the market. Banks, financial institutions and other creditors have their own parameters to identify and assess sickness and include a number of balance sheet ratios in their assessment methods.

WARNING SIGNALS OF SICKNESS

Industrial sickness has a number of direct and indirect symptoms which show the presence or intensity of the problem of sickness. Some of the indicators are quantifiable and may be used to measure the extent or incidence of the problem. Common symptoms which may be read as warning signals by all the stakeholders of an industrial unit, are:

- Frequent or continuous irregularities in the **cash-credit or overdraft accounts**.
- High level of outstanding balances in the cash-credit accounts.
- Failure to make timely repayment of loans.
- Delay or non-payment of salary and other bills.
- Incomplete, delayed or non-submission of stock statements and other statistical returns to creditors, government and other agencies and attempts to conceal or workup data.
- Diversion of sale proceeds to other uses.

- Bouncing of cheques and other bills.
- Decline in the volume of production, sale and profits and unusual rise in *inventory* levels.
- Reduction in workforce and deterioration in employer-employee relations.
- Failure to meet statutory liabilities and obligations (like taxes and bonus).
- Offer of unreasonably large discounts and unusually liberal terms of supplier's credit.

Industrial sickness may not show all these symptoms and these may not even be unambiguous. These indicators, require close examination to assess the problem. The problem, if not treated at an early stage, may degenerate into full-blown illness leading to wind-up or closure of the unit.

EXTENT OF SSI SICKNESS

As per RBI statistics, as on March 31, 2001, there were about 2.53 lakh sick units (both SSI and non-SSI) in the country, of which about 2.50 lakh units (98.8 per cent of the total) were in the SSI sector. By number, therefore, industrial sickness problem is basically the SSI problem. The proportion would be close to 100 per cent if unregistered small units in the informal sector are also included. Interestingly, the picture is reversed if the problem is looked at from the angle of bank credit blocked in sick units. As on March 31, 2002, the total bank funds blocked in sick units was of the order of Rs 25,775 crore of which only 17.5 per cent was blocked in the SSI units and the rest 82.2 per cent in the medium and large units. The situation is basically due to the fact that SSI units are small borrowers. Large units are small in number but large as borrowers. The proportion of sick SSI units in total SSI units greatly varies from state to state. In terms of the number of sick units, the top eight states (in declining order) each having more than 10,000 sick SSI units in the year 2000 were West Bengal, Bihar, Maharashtra, Assam, Rajasthan, UP, Tamil Nadu and Andhra Pradesh.

GENERAL PROBLEMS OF THE SSI

As already pointed out, the major problems of the small scale units are built into their small size and resource constraints which limit their competitiveness and growth capabilities. The leading problems of the sector are both **internal** relating to the planning, operation and management of the enterprises and **external** relating to the business environment the units face. There is a broad set of problems which almost all the small enterprises face in different degrees; then there are product-specific, location-specific or ownership-specific factors which affect different enterprises differently. Further, different sub-segments within the SSI sector have their own specific problems and issues. The following problems are general and common to all the SSI units and the individual management of the units play a major role in reducing of the problems and constraints.

PROBLEMS AT THE PROJECT PLANNING STAGE

Like any industrial unit, an SSI unit requires careful project planning. It requires both economic and technical feasibility studies and market potential survey. *Most of the individual SSI promoters have inadequate technical expertise and knowhow but are not financially sound enough to engage*

specialised technical consulting firms which are often expensive by SSI standards. Further, as SSI units have local orientation, the geographical location may not necessarily be favourable. Cottage and tiny units are least mobile geographically.

At the initial planning stage, self-assessment of the financial requirements may be widely off the mark. *In the middle of the project implementation stage, discovery of inadequacy of project outlay or cost overruns may force the promoters to compromise on other items of expenditure which may sow the seeds of sickness right in the embryonic stage.* Shortage of resources may also compel the promoters to settle for low-technology capital equipment which may confine the competitiveness of the enterprise in the operational stage. In the same fashion, inability to conduct scientific or reliable market potential survey may cause unrealistically high level of demand estimation. Such limitations are most common in individual proprietorships or partnerships where one or few people take decisions on the basis of their own limited expertise. Mistakes made at the project planning stage often prove very costly later at the implementation or operational stage.

PROBLEMS AT THE IMPLEMENTATION STAGE

The efficiency and effectiveness with which an SSI project is implemented determine the *sunk costs* and the *gestation period* of the project. Faulty implementation often leads to *cost and time overruns* which increase the project cost and the gestation period. In most SSI units, project implementation is in the hands of the owner-promoters which sometimes due to lack of professional expertise, may not be able to complete the project in time. Further, project planning mistakes made at the implementation stage adversely affect the effectiveness and competitiveness of the enterprise in the operational stage. This is the stage where funds are mobilised and plant and equipment installed. Shortfalls in fund mobilisation may make the unit uneconomic and raise its costs. Similarly, delay in the availability of technical manpower may prolong the implementation stage. Time overruns also involve financial burden as the overheads, right from the time of establishment, start imposing fixed costs which may strain the financial position of the enterprise in the later stages.

PROBLEMS DURING THE OPERATIONAL STAGE

During the operational stage, SSI units face a larger variety of problems. These problems relate to the diverse aspects of the functioning of the enterprise including management, finance, marketing, manpower, technology and related areas. Quality and effectiveness of management generally plays a great role in preventing or reducing a number of problems. These problems cause sickness in the SSI units which may eventually lead to their closure and wind-up. A large number of SSI units are known to have closed down within a few years of their establishment. Operational units, as already discussed in the preceding sections, suffer from widespread sickness in different measures or degrees. Major problems of the small sector may be grouped under the following heads.

Financial Problems

Small units have a weak capital base which obstructs their efforts to upgrade technology, introduce innovative products or even expand existing production. *An equally serious problem is that of working capital which gets aggravated as the working capital cycle lengthens. Small firms generally have weak bargaining power vis-à-vis distributors or bulk buyers (like industrial firms) which are*

not only able to dictate supplier credit terms in their favour but also often default on timely payment. This seriously hampers the subsequent production runs or forces the unit to raise additional working capital. This raises costs, reduces competitiveness and squeezes profits.

A number of financial institutions like state financial corporations, state industrial development banks, Small Industries Development Bank of India and scheduled commercial banks exist which cater to the financial requirements of the small industries on a priority basis. However, procedures are bureaucratic, sanction time is long, amount disbursed is often less than the requirement and, above all, the effective rate of interest is high. Moreover the repayment conditions are generally rigid.

Public sector banks treat SSI units as part of the priority sector. **Table 29.4** shows that though, in absolute terms, the flow of credit to the SSI sector has increased but its share in the net bank credit has gone down significantly from 15.6 per cent in 1999-2000 to 12.5 per cent in 2001-02 and is expected to go down further if the present downtrend continues. *Even the growth in the absolute amount of credit would be insignificant if it is taken in real terms after discounting it by the rate of inflation in the respective years. This is an unwelcome trend as the share of SSI credit is falling at a time when the sector needs greater financial support in the wake of increased competition from imports and the large-scale sector in a growing number of product areas.* Banks have been getting increasingly reluctant to lend to the small sector in view of the widespread sickness, erosion in viability and their own problems regarding *non-performing assets (NPAs)*.

Table 29.4: Flow of Credit from public sector banks to the SSI in recent years

| Year | Amount of credit (Rs cr) | Credit amount as % of net bank credit |
|------------------------|--------------------------|---------------------------------------|
| 1999-2000 | 45,788 | 15.6 |
| 2000-01 | 48,445 | 14.2 |
| 2001-02 | 49,743 | 12.5 |
| 2002-03 (Projected) | 48,718 | 11.5 |

Source: Development Commissioner, Small Scale Industry

Financial problems of the small sector are not merely confined to credit availability. Even the cost of credit has been quite high. It has been estimated that the effective rate of interest of SSI credit is 16-17 per cent while larger non-SSI units are able to get credit at prime lending rate (PLR) of the banks and sometimes even 1-2 per cent below PLR. Often SSI units have to avail credit from the unorganised financial market at exorbitant rates when they are unable to satisfy the lending criteria of institutions in the organised sector.

Internally too, most SSI units are unable to have proper financial planning due to lack of professional expertise. As a result, degree of financial indiscipline is high. Dishonesty or mistrust between partners inhibits new investment and sometimes leads to fraudulent practices which drain away the limited financial resources of the enterprise. The intensity of the financial problems is commonly observed to be inversely proportional to the size of the SSI unit.

Marketing Problems

Another problem emanating from the resource limitation of the SSIs is manifested in the marketing constraints and handicaps. *Most SSI units do not have separate marketing divisions as a result of which their marketing effort is weak. These units are generally not in a position to afford modern advertising, consumer research, market potential surveys, product adaptations and measures for channel development.* The weakness of the marketing function causes the following types of problems.

- Lack of product awareness among the consumers.
- Weak bargaining position of SSI producers vis-à-vis distributors which are able to dictate terms of sale.
- Offer of products unmatched to consumer needs or requirements.
- Recurrent stock-out position or excess-supply situation.
- High proportion of unbranded products leading to loss of market power.

These problems lead to weak demand and unremunerative prices to producers. Most of the profit margins are eaten away by the members of distribution channels. Marketing problems are worse where the products are seasonal. As most SSI units have a local market, heavy selling pressure and local competition keep prices down. Because of the financial limitations, the units are unable to build buffer or inventory stocks. It is for this reason that a number of government institutions provide marketing support to SSI units in various product areas. These institutions and support measures are taken up in the subsequent sections.

Production Problems

Small units face a number of production problems due to which the supply flow is interrupted. Production setbacks also cause wastage and raise per unit costs. These problems arise from a variety of sources. Some of the main sources of production problem are the following.

- As these units depend upon local sources of raw material supply, the *availability of materials in sufficient quantity* is not sometimes forthcoming. These units, being small buyers, are often *unable to negotiate regular supply contracts* with raw material suppliers. Raw material availability as a problem often gets worse when the supplies come from the government or are imported. Due to financial problems, the units are not in a position to build sufficient inventories.
- *Lack of availability of skilled labour force*, particularly in remote local areas, creates production problems. Quite often workers leave the unit without prior notice leading to disruption in production.
- Small units commonly use traditional or obsolete technology. As a result, *the repair and maintenance problems* are common. Frequent plant breakdowns cause interruption in the flow of production.
- Chronic power shortage in the country affects small units in a larger measure. These units are generally not able to afford captive power generation systems. Frequent power cuts lead to production stoppages.

These problems affect market supplies, cause more wastage and increase per unit costs. These also lead to under utilisation of productive capacity and deprive the units of economies of scale. These factors together make the units still more uncompetitive. According to the *Report of the Informal Group of the Planning Commission (1987)*, capacity utilisation in the SSI sector was an abysmal 30 per cent.

Labour Problems

The employee-employee relations in a small organisation are expected to be close, yet these units are prone to greater labours troubles. *Labour problems spoil work environment, reduce productivity and cause disruption to production. These problems also account for fall in quality and increase in production costs.* Such problems are mainly caused by:

- Seasonal migration of workers to rural areas.
- Tactless handling of worker problems.
- Lack of worker facilities and safety devices at the workplace.
- Low or delayed payment to workers.
- Inter-personal problems and disputes.
- Low educational status of workers and lack of training.

Static labour skills often deter the units to modernise or upgrade technology. The level of compliance of the small units to various labour laws is quite low and in tiny and cottage unit, there are hardly any labour records. Modern SSI units are also afflicted by the problems of trade unionism. Skilled and competent workers in small units are commonly observed to seek work in larger organisations which offer better wages, facilities and career prospects.

Managerial Problems

A vast majority of small scale units are individual proprietorship or partnerships with little skills in professional management. Relatively fewer private limited companies with the SSI tag are also closely-held and family-run enterprises with little better managerial skills. Poor management is, in fact, responsible for most of the internal problems as discussed above. *Organisational mission, vision, planning and strategy are hardly reflected in the operational or functional aspects. Absence or lack of managerial perspective is like sailing without oars and the enterprise is most vulnerable to the vagaries of changing market conditions.*

Exogenous Factors

There exist a large number of external factors which are beyond the control of the SSI owners or managers and which create many problems for the enterprises. These factors are related to business environment – both internal and external. Main adverse factors beyond the control of the small units are the following:

- Infrastructural bottlenecks;
- Stringent lending policies of financial institutions;

- Government control on prices and distribution;
- Burdensome taxation;
- Swings in government policy towards SSI;
- Bureaucratic and procedural problems;
- Competition from large enterprises; and
- Liberal imports.

Some of these problems affect non-SSI units as well but SSI units because of their resource limitations, are more vulnerable to these factors and have limited capacity to withstand such shocks.

CURRENT CHALLENGES

In addition to the above general problems SSI units at present face unprecedented challenges. Some of the challenges threaten the very existence of the small and vulnerable units. The government has been responding, though slowly, to the emerging challenges before the SSI through a series of compensatory measures which are discussed in the next section. Some of the major challenges facing the SSI units are the following:

Declining Share in Bank Credit

As pointed out in the preceding sections, the share of SSI sector in total bank segment shrunk from 15.6 per cent in 1999-2000 to 11.5 per cent in 2002-03. SSI units now face unprecedented challenges of competition both from imports and domestic large units. Under the present phase of *privatisation, liberalisation and globalisation*, competition is bound to increase and SSI units will have to reposition themselves with better technology and new capital equipment. It will require additional funds. The current trend in bank credit has to be reversed in favour of the SSI. Banks will have to be more flexible, liberal and rational. This, however, may not be an easy task. Now that the banks are highly conscious of their NPA position, they have to ensure that they are not lending to a weak or potentially sick enterprise. The flow of credit to the SSI is intimately linked to the productivity and overall viability of the enterprises.

Growing competition with the Large Industry

In the process of economic reforms, small industry is facing growing competition from large enterprises. *Competition is more intense for stand-alone enterprises which are not in ancillary or sub-contracting relationship with the large enterprises. Dereservation of items, earlier reserved for exclusive production by the SSI, have also contributed to some extent to the increased competition.* Upto 1996, the total number of items reserved for the SSI was 836. Following the recommendation of the Abid Hussain Committee, 24 items were dereserved. Fourteen more items were dereserved in the Union Budget 2001-02. *In the year 2002, about 800 items were still reserved but any large scale unit can produce these items provided it exports 50 per cent of the*

production over a period of three years. Further, units located in *special economic zones* are permitted to manufacture any of the reserved items without a licence. The exemption is available even if the foreign equity component in these units exceeds 24 per cent. *It points to the anti-SSI bias of the export policy.*

Threat from Imports and WTO

SSI units are seriously threatened by import liberalisation following the emergence of the WTO regime in the country. *At present, more than 550 items reserved for the SSI are freely importable under the export-import policy. Even in other areas, SSI units face serious threat of import competition particularly from China and East Asian countries. Competition from imports is gradually intensifying with declining import duties and dismantling of quantitative restriction of imports.* SSI is also being dislodged in foreign markets by countries like China in such products as garments, shoes, leather goods, sports goods and even toys. *SSI is gradually losing its competitiveness in exports due to quality problems, high input costs, inability to reap economies of scale, marketing constraints and high taxation burden.* There have been a few other challenges emanating from the WTO regime. While SSI units engaged in the production of such items as food, clothing, electronic goods, household appliances, auto-parts, chinaware and glassware are already suffering heavily on account of import liberalisation, sanitary and phytosanitary norms and removal of the obligation of the MNCs to buy from local units may affect SSI units still more seriously. Under WTO norm provisions concerning reduction in protectionism and technical barriers may eventually lead to elimination or reduction in price and purchase preference given to SSI units in public sector purchases.

Delayed Payments

This is one of the major problems facing SSI today. It lengthens **working capital cycle** and creates financial problems. In ancillary production, **buyback** and **sub-contracting** arrangements with large units, it is well known that payments are *not* made in time for the goods or services delivered. Even in case of consumer products, wholesalers and retailers withhold payments for unreasonably long time causing severe problems to the vulnerable small units. *The payment problems are largely due to their weak bargaining position vis-à-vis industrial buyers and merchants and their dire need to keep working capital in circulation.* The government is already considering introducing a legislation on delayed payments which might bring much-needed relief to the sector.

High Burden of Taxation

The burden of taxation on SSI is quite high in relation to its vulnerability and importance in the national economy. This is in spite of the increase in the excise exemption limit from Rs 50 lakh to Rs one crore made in the new industrial policy for the SSI (see later) announced in the year 2000. SSI units have no relative advantage vis-à-vis large units in case raw materials are imported or exempted from payment of excise. Under the present policy, SSI units pay excise at the rate of 9.6 per cent (60% of 16, the CENVAT rate) *ad valorem* on total clearances upto sales of Rs one crore. Before the new policy, the units availing CENVAT credit paid excise duty at the rate of

9.6 per cent (60% of 16) *ad valorem* on clearances upto Rs 50 lakh and at the rate of 12.8 per cent (80% of 16) on clearances in respect of sales between Rs 50 lakh- 1crore. **On a total sale of Rs one crore, the total relief under the new policy is only Rs 1.60 lakh** (i.e. 1.6 per cent). As the large units are also covered by CENVAT, there is no relative price advantage to ancillary units as a result of increase in excise exemption. *In sum, SSI units now have no significant tax advantage vis-à-vis other non-priority industrial segments.*

Quality Problems

SSI faces unprecedented quality challenges at the present time. *While there is a quality wave among the large units to gain entry in the foreign markets and to respond to the quality expectations of the domestic consumers, technological obsolescence and resource constraints are dogging most of the SSI units, particularly in the tiny sector.* At present, **Bureau of Indian Standards (BIS)** has about 150 products for which compliance with ISI certification norms is mandatory. Some of the popular product groups are LPG cylinders, food colouring agents, galvanised iron pipes, oil pressure stoves, GLS lamps, electrical accessories, pressure cookers and batteries. Due to non-compliance with quality standards, a large number of SSI units are losing their market to larger units in these areas both at home and abroad. Quality standardisation requires quality awareness, professionalism and increased investment in new processes and products. BIS assists SSI units in pre-certification training and trial assessment but the managements of a large number of units are generally not able to make a proper benefit-cost-analysis of quality certification.

THE PRESENT SSI SUPPORT SYSTEM

The support system for SSI is largely state-sponsored. The basic support system consists of two parts, viz. **the institutional support system** which comprises a large network of institutions engaged in providing assistance to SSI units in various areas of their activity, and **the policy support system** which consists of a range of incentives and measures for the promotion of the small enterprise. The overall support system has evolved over a number of decades and has been an integral part of the industrial policy announced from time to time. The magnitude and direction of evolution has been driven by the problems and issues faced by the segment from time to time. SSI has received special attention in the various five-year plans and government budgets.

THE INSTITUTIONAL SUPPORT NETWORK

There exists a wide network of institutions supporting the growth of the SSI. There is a separate full-fledged *Ministry of Small Scale Industries and Agro and Rural Industries*. Under the Ministry, *Small Industries Development Organisation (SIDO)* exists as an apex institution. Established in 1954, SIDO is involved in the formulation of policies and coordination of institutional activities both at the centre and in the states for the sustained growth of the sector. It provides a wide range of facilities and services through a network of 30 Small Industry Service Institutes (SISIs), 28 branch SISIs, four *Regional Testing Centres (RTCs)*, seven *Field Testing Stations (FTSs)*, six

Process-Cum-Product Development Centres (PPDCs), 11 *Tool Rooms* and three *specialised training institutes*. The various schemes operated by the SIDO relate to credit, technology upgradation, employment, creation, infrastructure development, quality certification, marketing development, product testing, entrepreneurship development and sub-contracting. **Box 29.1** gives the schemes operated by the SIDO. In the area of training and entrepreneurship development, the following national-level institutions play an important role:

- National Institute of Small Industries Extension Training (NISIET), Hyderabad
- National Institute for Entrepreneurship and Small Business Development (NIESBD), New Delhi.
- Centre for Tool Resources and Training Centre (CTRTCs) at Calcutta and Ludhiana.

BOX 29.1

Small Industry Development Schemes Run by the SIDO

SIDO, as the apex institution for the development of small industries, operates a number of schemes which seek to promote the enterprises in the various aspects of their activities. The organisation operates the following schemes:

- Credit Guarantee Scheme
- Credit-linked Capital Subsidy Scheme for Technology Upgradation.
- Prime Minister's Rozgar Yojana (under Ministry of Agro Rural Industries)
- Integrated Infrastructure Development Scheme
- ISO 9000 Certification Reimbursement Scheme
- Small Enterprises Information and Resource Centre Network (SENET)
- Technology Upgradation and Modernisation Programme (UPTECH)
- Marketing Development Scheme (SSI-MDA)
- Testing Centres by Industry Associations
- Assistance for Entrepreneurship Development Institutes
- Sub-contracting Exchanges.

Source: Govt of India (2003), *India 2003: A Reference Annual* (New Delhi: Govt of India), p567.

An equally wide network of institutions exists in the area of SSI finance. Commercial banks provide working capital to the SSI as a priority area and term loans are provided by State Finance Corporations. The institutions provide **composite finance** (including both term loans and working capital) to tiny units. Refinance to these institutions is provided by **Small Industries Development Bank of India (SIDBI)** as the apex institution in the area of finance. In addition to refinance, SIDBI also offers a wide range of financial assistance through direct finance, bill finance, equity finance and other schemes of assistance in addition to support services. The various types of assistance provided by SIDBI are given in **Box 29.2**.

Box 29.2**How Does SIDBI Assist the Development of the SSI?**

Small Industries Development Bank of India (SIDBI) was established in April 1990 under an Act of Parliament as a wholly-owned subsidiary of the Industrial Development Bank of India, the premier development bank of the country. At present, it operates independently as an apex institution for SSI finance. Its resources come from borrowings from the RBI, the government and other sources in addition to its own capital. It contributes towards the development of the SSI in the following ways:

- Term loans to SSI units including ancillary and sub-contracting units for expansion, diversification, modernisation and acquisition of ISO 9000 series certification.
- Term loans to specialised marketing agencies engaged in developing marketing outlets for SSI products.
- Term loans to infrastructure development agencies for developing industrial areas for SSI units.
- Foreign currency loans for the import of capital equipment by export-oriented SSI units and for executing confirmed export orders by way of pre-shipment credit.
- Lines of credit to **State Small Industries Development Corporations (SIDCs)** (for supplying raw materials and providing marketing support to SSI units), **factoring companies** (to factor SSI debt), **commercial banks** (to cover their pre-shipment credit in foreign currency to SSI exporters) and **merchant banks** for supporting equity issues of SSIs on **Over-the-Counter Exchange of India (OTCEI)**.
- Equity assistance to well-run SSI units for expansion, modernisation and diversification and to new export-oriented or high-tech units.
- Equity-type **soft loans** to women entrepreneurs and ex-servicemen for setting up small units and to new projects and potentially viable sick units under **National Equity Fund Scheme (NEFS)**.
- Refinance support to banks and state level institutions for financing new SSI projects and expansion, modernisation, quality promotion, diversification and rehabilitation of SSI units.
- Direct discounting of short-term bills covering sale of equipment on deferred credit and short-term bills for supply of SSI products/ components.
- Rediscounting of long-term usance bills covering the sale of equipment by SSI units and short-term bills discounted by banks.
- Providing **venture capital** to small scale entrepreneurs using innovative indigenous technology and expertise.
- Extending development and support services for technological upgradation, **technology transfer**, entrepreneurship development, environment management and skill upgradation.

In order to provide a single window to the SSI units for facilitating credit, raw materials, training, marketing and other supports, **District Industries Centres (DICs)** were introduced in the 1977 Industrial Policy statement. At present, there are more than 425 DICs all over the country providing information and facilitation to the SSI.

RECENT INCENTIVES AND FACILITIES

The structure of various incentives and facilities to the SSI has evolved over decades and has been varied from time to time depending upon the type and magnitude of the problems faced by the sector. Preferential treatment to the sector has been provided in the various industrial policy statements, five-year plan documents and union budgets. A number of committees have been constituted from time to time to look into the specific problems of the sector and suggest measures to solve them. More recently, **Abid Hussain Committee** and **Kapoor Committee (1998)** have

given wide ranging recommendations for the development of the sector. In the year 2000, a comprehensive policy package was announced for the sector which revised the earlier small enterprise policy of 1991. The major concessions and facilities provided by the government to the SSI under the present policy are as follows:

- Preferential treatment in levy of **excise duty**;
- Provision of credit at **concessional rates of interest** by commercial banks and other financial institutions;
- **Higher investment limits** to make more SSI units eligible for various concessions and facilities;
- Technology development, marketing, training and information support from a number of public sector institutions;
- **Purchase preference** given by various government departments and public sector institutions;
- Assistance in the acquisition of **quality certification**;
- **Price preference** to the extent of 10 per cent;
- Provision for acquisition of equity in SSI units by large scale industry and foreign companies to the extent of 24 per cent;
- **Reservation of a large number of items** for exclusive production by SSI units;
- **Priority treatment for supply of vital raw materials** and import of capital equipment; and
- **Infrastructural support** through State Small Industry Development Corporations (SIDCs).

Box 29.3 summarise the specific provisions of the comprehensive policy package announced by the government in the year 2000 and a few additional measures undertaken during 2001-02.

BOX 29.3

Specific SSI Assistance Measures Undertaken Since the Year 2000

Measures Announced in the Comprehensive Policy Package of 2000

Increase in the excise exemption limit from Rs 50 lakh to Rs 1 crore w.e.f. September 1, 2000.

- Provision of **credit-linked capital subsidy** of 12% against loans for technological upgradation in specified industries.
 - Increase in the limit of investment in industry-related service and business enterprises from Rs 5 lakh to Rs 10 lakh.
 - Capital grant of 50% to SSI associations for developing and operating testing laboratories. Increase in the limit of composite loans from Rs 10 lakh to Rs 25 lakh.
 - Increase in the coverage of the ongoing **Integrated Infrastructure Development (IID)** Scheme to progressively cover all areas of the country with 50% reservation for rural areas and 50% plots reserved for the tiny sector.
 - **Credit Guarantee Fund Scheme** to provide guarantee for loans upto Rs 25 lakh extended by commercial banks and other selected financial institutions without any **collateral** including **third party guarantee**.
 - Dereservation of readymade garments.
- Measures Taken During 2001-02**
- Increase in investment limit in units in hosiery and hand-tool units from Rs 1 crore to Rs 5 crore.
 - Increase in the corpus fund of the **Credit Guarantee Fund Scheme** from Rs 125 crore to Rs 150 crore. Fourteen more items including leather goods, shoes and toys dereserved.
 - Launch of the new **Market Development Assistance Scheme** exclusively for the SSI

Source: Compiled from Govt of India, *Economic Survey*, 2000-01 and 2001-02 issues.

CONCLUSION

The threats to the small scale industry have multiplied in the post-reform period. The new threats are emerging mainly from import liberalisation, increased competition from the large industry and inability of the small industry to keep pace with advancing technology and rising consumer expectations. Apart from the endemic challenges of the small scale sector, the managerial challenges are also increasing with the changing industrial scenario. *Most of the SSI support programmes and incentives are becoming less and less relevant and most of such facilities go unutilised. The state support system must be simplified to make it relevant and convenient, to the SSI. SSI units on their part have to re-strategise and seek new relationships with the medium and large industry. A growing number of small enterprise are already discovering the advantages of ancillarisation and sub-contracting arrangements.*

Key Terms

| | | |
|------------------------------|------------------------------|----------------------------------|
| Ancillary units | Net worth | Venture capital |
| Economics of scale | Sick company | Buyback |
| Gestation period | Cash-credit account | Soft loan |
| Labour capital ratio | Inventory | CENVAT |
| Strike | Sunk cost | Merchant bank |
| Lockout | Cost overrun | Factoring |
| Backward linkages | Time overrun | Over-the-counter exchange (OTCE) |
| Forward linkages | Non-performing assets (NPAs) | Excise duty |
| Gross National Product (GNP) | Economic liberalization | Collateral |
| Value-added | Sub contracting | Third party guarantee |
| Privatisation | Working capital cycle | |
| Globalisation | | |

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Long Questions

1. Discuss the major challenges facing small scale industry. Do you think that economic reforms have hit the segment the most?
2. Discuss the view that most of the problems of the SSI are linked to their small size and resource constraints. Appraise the various measures taken by the government to promote the SSI.
3. Build a case for the development of SSI. How can the sector respond to the challenges of competition from the large scale industry?
4. What are the leading factors of widespread sickness among the SSI units? How can sickness be identified? Suggest measures to enhance economic viability of the segment.
5. Critically appraise the recent measures undertaken by the government to promote the SSI. What more, in your opinion, needs to be done?
6. Discuss the major aspects of competition between the small scale and the large scale industry. Build a strategy for the sustained and independent growth of the SSI in future.

Short Questions

1. What is the significance of the definition of an SSI unit?
2. Should an SSI unit be defined in terms of investment, production or employment?
3. What are the different segments within the SSI?
4. What is the implication of an increase in investment limit in the definition of an SSI unit?
5. Are SSI units a burden on society?
6. In view of widespread sickness among the SSI units, should the government stop promoting this sector?
7. Distinguish between sick and potentially sick units.
8. Does dereservation of items mean increased competition for small scale industry?
9. Explain the logic of industrialisation through the small scale industry.
10. Why is industrial sickness in India most concentrated in the SSI segment?
11. Explain three leading and general problems of the SSI in (a) Marketing (b) Finance (c) Labour.
12. Do you think ancillarisation will solve most of the problems of the SSIs?
13. List five major initiatives of the government for the promotion of SSIs in recent years.

Practical Assignments

1. Prepare a list of firms in the small scale sector the items of which have been recently dereserved. Determine the impact of dereservation on selected firms and discuss the results in the class.
2. Hold a group discussion on the **Impact of the last Union Budget on the Small Scale Industry**.
3. Search a small scale firm in your region which has recently been shut down after operations for a number of years. Identify the causes of its failure and discuss the causes in a focussed group with a view to develop a revival plan.
4. Hold a panel discussion on **'Are small industries less competitive than the medium and large industries?'**
5. Hold a session on the pros and cons of **'ancillarisation as a strategy to safeguard the interests of the SSI'**.

