2.1 Introduction

The financial system of India refers to the system of borrowing and lending of funds or the demand for and the supply of funds of all individuals, institutions, companies and of the Government. Commonly, the financial system is classified into:

(a) Industrial finance: Funds required for the conduct of industry and trade;

(b) Agricultural finance: Funds needed and supplied for the conduct of agriculture and allied activity;

(c) Development finance: Funds needed for development; actually it includes both industrial finance and agricultural finance; and

(d) Government finance: relates to the demand for and supply of funds to meet Government expenditure.
2.1.1 Indian Economy of India

India’s economy has been one of the stars of global economics in recent years, growing 9.2% in 2007 and 9.6% in 2006. Growth had been supported by markets reforms, huge inflows of FDI, rising foreign exchange reserves, both an IT and real estate boom, and a flourishing capital market.

Like most of the world, however, India is facing testing economic times in 2008. The Reserve Bank of India had set an inflation target of 4%, but by the middle of the year it was running at 11%, the highest level seen for a decade. The rising costs of oil, food and the resources needed for India’s construction boom are all playing a part.

India has to compete ever harder in the energy market place in particular and has not been as adept at securing new fossil fuel sources as the Chinese. The Indian Government is looking at alternatives, and has signed a wide-ranging nuclear treaty with the US, in part to gain access to nuclear power plant technology that can reduce its oil thirst. This has proved contentious though, leading to leftist members of the ruling coalition pulling out of the government.
As part of the fight against inflation a tighter monetary policy is expected, but this will help slow the growth of the Indian economy still further, as domestic demand will be dampened. External demand is also slowing, further adding to the downside risks.

The Indian stock market has fallen more than 40% in six months from its January 2008 high. $6b of foreign funds have flowed out of the country in that period, reacting both to slowing economic growth and perceptions that the market was over-valued.

It is not all doom and gloom, however. A growing number of investors feel that the market may now be undervalued and are seeing this as a buying opportunity. If their optimism about the long term health of the Indian economy is correct, then this will be a needed correction rather than a downtrend.

The Indian government certainly hopes that is the case. It views investment in the creaking infrastructure of the country as being a key requirement, and has ear-marked 23.8 trillion rupees, approximately $559 billion, for infrastructure upgrades during the 11th five year plan. It expects to fund 70% of project costs, with the other 30% being supplied by the private sector. Ports, airports, roads and railways are all seen as vital for the Indian Economy and have been targeted for investment.
Further hope comes from the confidence of India's home bred companies. As well as taking over the domestic reins, where they now account for most of the economic activity, they are also increasingly expanding abroad. India has contributed more new members to the Forbes Global 2000 than any other country in the last four years.

2.1.2. Recent Growth Trends in Indian Economy

India's Economy has grown by more than 9% for three years running, and has seen a decade of 7%+ growth. This has reduced poverty by 10%, but with 60% of India's 1.1 billion population living off agriculture and with droughts and floods increasing, poverty alleviation is still a major challenge.

The structural transformation that has been adopted by the national government in recent times has reduced growth constraints and contributed greatly to the overall growth and prosperity of the country. However there are still major issues around federal vs state bureaucracy, corruption and tariffs that require addressing. India's public debt is 58% of GDP according to the CIA World Fact book, and this represents another challenge.
During this period of stable growth, the performance of the Indian service sector has been particularly significant. The growth rate of the service sector was 11.18% in 2007 and now contributes 53% of GDP. The industrial sector grew 10.63% in the same period and is now 29% of GDP. Agriculture is 17% of the Indian economy.

Growth in the manufacturing sector has also complemented the country's excellent growth momentum. The growth rate of the manufacturing sector rose steadily from 8.98% in 2005, to 12% in 2006. The storage and communication sector also registered a significant growth rate of 16.64% in the same year.

Additional factors that have contributed to this robust environment are sustained in investment and high savings rates. As far as the percentage of gross capital formation in GDP is concerned, there has been a significant rise from 22.8% in the fiscal year 2001, to 35.9% in the fiscal year 2006. Further, the gross rate of savings as a proportion to GDP registered solid growth from 23.5% to 34.8% for the same period.
2.1.3 Basic Characteristics of the Indian Economy as Developing Economy

i. Low per capita income. Developing economies are marked by the existence of low per capita income. The per capita income of an Indian in 2005 was $720. Barring a few countries, the per capita income of the Indian people is the lowest in the world.

ii. Occupational pattern. From the point of view of occupational pattern, the Indian economy is primary producing because agriculture contributes 21 percent of national income while 58 percent of the labour force is engaged in agriculture.

iii. Heavy population pressure. The main problem in India is the high level of birth rates coupled with a falling level of death rates. The rate of growth of population which was about 1.31 per cent per annum during 1941-50 has risen to 1.93 per cent during 1991-2001. The annual average rate of growth of population during 2000-05 has further declined to 1.5 percent.

To maintain a rapidly growing population, the requirements of food, clothing, shelter, medicine, schooling, etc. all rise. Thus, a rising population imposes greater economic burdens and, consequently, society has to make a much greater effort to initiate the process of growth.
iv. Prevalence of chronic unemployment and underemployment. In India unemployment is structural and is the result of a deficiency of capital. The Indian economy does not find sufficient capital to expand its industries to such an extent that the entire labour force is absorbed. The Third Five Year Plan stated “In the rural areas both unemployment and underemployment exist side by side; the distinction between them is by no means sharp. In the villages unemployment ordinarily takes the form of underemployment. Urban and rural unemployment in fact constitute an indivisible problem.”¹

v. Low rate of capital formation. Another basic characteristic of the Indian economy is the existence of capital deficiency which is reflected in two ways – firstly, the amount of capital per head available is low; and secondly, the current rate of capital formation is also low. An important indicator of low capital per head available in underdeveloped countries is the consumption of energy. Gross capital formation in India was less than that of developed countries. Professor Colin Clark has estimated that in order to maintain the same level of living a country requires an additional investment of 4 per cent per annum.

vi. Maldistribution of Wealth / Assets. The situation in urban areas was much worse. 50.7 per cent of the urban households owning less than Rs.50,000 worth of assets accounted for barely 5.3 per cent of total assets.
vii. Poor Quality of Human Capital. Most of the underdeveloped countries suffer from mass illiteracy. Illiteracy retards growth. A minimum level of education is necessary to acquire skills as also in comprehend social problems. Rural areas where illiteracy is a rule, are the back-waters of civilization and the centres of superstition, social taboos and conservatism. The Indian public expenditure on primary to higher education and research and development in 2002-04 was a 3.3 per cent of GDP.

viii. Prevalence of low level of technology. In a developing economy like India, the most modern technique exists side by side with the most primitive in the same industry, but there is no gainsaying the fact that the majority of the productive units and a major part of the output is produced with the help of techniques which can be described as inferior judged by modern scientific standards.

ix. Low level of living of the average Indian. Nearly 28 per cent of the population in India lived below the poverty line in 2004-05, it is very doubtful whether the poor get a minimum intake of even 2,100 calories. The Working Group on Housing for the Tenth Plan has observed that around 90 per cent of the housing shortage pertains to weaker sections. The Working Group of the Tenth Plan on Housing has estimated a shortage of 22.44 million houses during the Tenth Plan period, out of which 8.89 million is the shortage of urban housing and 13.55 million of rural housing. This appears to be an under-estimate if we
consider 34.8 million temporary houses, especially 12.7 million temporary unserviceable houses to be built afresh.

x. **Demographic characteristics of an underdeveloped country.** The density of population in India in 2005 was 368 per sq. km. As compared with this the average density of population in the world is 50 per sq. km. Even in China, density imposes greater burdens on land and other natural resources.

xi. **The Socio-economic indicators of consumption are characteristic of underdeveloped economy in India.** As a developing economy, during the last over five decades of development, India has been able to improve its GDP growth rate which was only 3.5 per cent during 1950-51 to 1970-71 to a level of nearly 7 per cent during 2000-01 to 2004-05.

"But these fundamentals do not tell the entire story. In most of these economies; in one form or another, the government intervened – systematically and through multiple channels – to foster development and in some cases the development of specific industries."²
2.1.4 Indian Economy on the Eve of Independence

The Indian economy in the pre-British period consisted of isolated and self-sustaining villages on the one hand, and towns, which were the seats of administration, pilgrimage, commerce and handicrafts, on the other. Means of transport and communication were highly underdeveloped and so the size of the market was very small. To understand pre-British India, it is essential to study the structure of the village community, the character of towns, the character of internal and foreign trade, the state of the means of transport and communications.3
2.2 Indian Financial System – I: Commercial Banking System

"The resources of the financial system are held by financial institutions in trust and have to be deployed for the maximum benefit of their owners – viz., depositors and investors. The safety of their funds should be the primary concern of banks and regulatory authorities and ensuring solvency, health and efficiency of the institutions should, therefore, be central to effective financial reform."

- Report of the Committee on Financial Reform, 1991 (Narasimham Committee)

Commercial Banks have been in existence for many decades. They mobilize savings in urban areas and make them available to large and small industrial and trading units mainly for working capital requirements. After 1969 commercial banks are broadly classified into nationalized or public sector banks and private sector banks. The State Bank of India and its associate banks along with another 20 banks are the public sector banks. The private sector banks include a small number of Indian scheduled banks which have not been nationalized and branches of foreign banks operating in India – commonly known as foreign exchange banks.
The Regional Rural Banks (RRBs) came into existence since the middle of 1970s with the specific objective of providing credit and deposit facilities particularly to the small and marginal farmers, agricultural labourers and artisans and small entrepreneurs. The Regional Rural Banks have the responsibility to develop agriculture, trade, commerce and industry in the rural areas. The RRBs are essentially commercial banks but their area of operation is generally limited to a district.

M. Gopalakrishnan, a professional banker states: "The single striking feature of the post-nationalisation banking scene is the rapidity with which the branch network has multiplied itself. The rate of branch expansion has been unparalleled anywhere else in the world." 4

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<td>State Bank Group (8)</td>
<td>244</td>
<td>280</td>
<td>356</td>
<td>793</td>
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<td>Nationalised Banks (19)</td>
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<td>-3648</td>
<td>-4779</td>
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<td>573</td>
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A money market is not a market for money but it is a market for "near money"; or it is the market for lending and borrowing of short-term funds. It is the market where the short-term surplus investible funds of banks and other financial institutions are demanded by borrowers comprising individuals, companies and the Government. Commercial banks are both suppliers of funds in the money market and borrowers. The composition of the Indian money market.

The Indian money market consists of two parts: the unorganized and the organized sectors. The unorganized sector consists of indigenous bankers who pursue the banking business on traditional lines and non-banking financial companies (NBFCs). The organized sector comprises the Reserve Bank, the State Bank of India and its associate banks, the 20 nationalised banks and private sector banks, both Indian and foreign.

The organized money market in India has a number of sub-markets such as the treasury bills market, the commercial bills market and the inter-bank call money market.
The Indian money market is not a single homogeneous market but is composed of several sub-markets, each one of which deals in a particular type of short term credit.

2.3.2 Call Money Market

One important sub-market of the Indian money market is the Call Money Market, which is the market for very short-term funds. This market is also known as money at call and short notice. The market has actually two segments, viz. (a) the call market or overnight market, and (b) short notice market. The rate at which funds are borrowed and lent in this market is called the call money rate.

Call money rates are market determined, i.e., by demand for and supply of short term funds. The public sector banks account for about 80 per cent of the demand (that is, borrowings) and foreign banks and Indian private sector banks account for the balance of 20 per cent of borrowings. Non-banking financial institutions such as IDBI, LIC, GIC, etc. enter the call money market as lenders and supply up to 80 per cent of the short-term funds. The balance of 20 per cent of the funds is supplied by the banking system. While some banks operate both as lenders and borrowers, others are either only borrowers or only tenders in the call money market.
2.3.3 Bill Market in India

The bill market or the discount market is the most important part of the money market where short term bills – normally up to 90 days – are bought and sold. The bill market is further subdivided into commercial bill market and treasury bill market.

The market for commercial bills has not become popular in India, unlike in London and other international money markets where commercial bills are extensively bought and sold (i.e., discounted).

The 91-day treasury bills are the most common way the Government of India raises funds for the short period. Some years ago, the government had introduced the 182-day treasury bills which were later converted into 364-day treasury bills. In 1997, the Government introduced the 14-day intermediate treasury bills.

<table>
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<tr>
<th>Year</th>
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<th>Lowest</th>
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<tr>
<td>1990-91</td>
<td>70.00</td>
<td>4.00</td>
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<tr>
<td>1993-94</td>
<td>17.00</td>
<td>0.25</td>
</tr>
<tr>
<td>2000-01</td>
<td>14.00</td>
<td>4.00</td>
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<tr>
<td>2005-06</td>
<td>8.25</td>
<td>3.00</td>
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<tr>
<td>2006-07</td>
<td>80.00</td>
<td>6.00</td>
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2.3.4 The Indian Capital Market

The Indian capital market is the market for long-term capital; it refers to all the facilities and institutional arrangements for borrowing and lending "term funds" – medium-term and long-term funds.

Since independence and particularly after 1951, the Indian capital market has been broadening significantly and the volume of saving and investment has shown steady improvement. All types of encouragement and tax relief exist in the country to promote savings. Besides, many steps have been taken to protect the interests of investors. A very important indicator of the growth of the capital market is the growth of joint stock companies or corporate enterprises. In 1951 there were about 28,500 companies both public limited and private limited companies with a paid-up capital of Rs.775 crores; in 2000, there were over 70,000 companies with a paid-up capital of over Rs.200,000 crores.

The rate of growth of investment has been phenomenal in recent years, in keeping with the accelerated tempo of development of the Indian economy under the impetus of the Five Year Plans. The growth of public borrowings for investment purposes is also an indicator of the growth of the capital market. But 2003-04, there were 250 non-departmental public enterprises of the Central Government alone with capital investment of Rs.150,000 crores.
In the last two decades alone, the capital market in India has witnessed rapid growth. The volume of capital market transactions has increased sharply; its functioning has been diversified. New financial instruments, such as fully and partly paid convertible debentures (FCDs and PCDs) 364-day treasury bills, commercial paper, CDs have appeared. These reflect the growing diversifications and a measure of sophistication of the financial services in the capital and money markets. The volume of new issues was Rs.31,800 crores during 1994-95, though it declined in the subsequent years (Rs.12,900 crores during 1996-97). The number of shareholders runs into several million, indicating the growth of the cult of equity.

2.3.5 Special Financial Institutions and the Capital Market

Soon after independence, the Government of India set up a series of financial institutions to be of special help to the private sector industries in the matter of finance. IFCI was the first of these institutions (1948). It was followed by SFCs (set up by State Governments with cooperation of RBI and other banks) to provide long term finance to small and medium industrial units. ICICI (1955), IDBI (1964) and UTI (1964) followed soon after; LIC was set up in 1956 to mobilize individual savings and to invest part of the savings in the capital market. Many
more specialized financial institutions were set up and are commonly called public sector financial institutions. These institutions have been doing very useful work in subscribing to the shares and debentures of new and old companies, in giving loan assistance, in underwriting new issues, and so on. At present, many of them have become powerful shareholders in many prominent companies. LIC and UTI mobilize resources from the public and place them at the disposal of the capital market. On the other hand, the development financial institutions (DFIs) are engaged in providing funds to the private sector enterprises. The total assistance sanctioned by the term-lending institutions had increased from Rs.230 crores in 1970-71 to Rs.2,550 crores in 1980-81 and over Rs.1,21,350 crores in 2000-01. Since then, the loans sanctioned and disbursed by these institutions have declined steeply. Leading DFIs such as IDBI and ICICI are no more development banks; they are now universal banks.

2.3.6 Mutual Funds

In recent years, mutual funds are the most important among the newer capital market institutions. Several public sector banks and financial institutions have set up mutual funds on a tax-exempt basis, virtually on the same footing as Unit Trust of India (UTI). Their main function is to mobilize the saving of the general public and invest them in stock market securities. Accordingly, they attracted strong investor support and showed significant progress. There was
even diversion of savings of the middle classes from banks to mutual funds. The Government threw the field open to the private sector and joint sector mutual funds.

**Regulation of Mutual Funds by SEBI**

SEBI has the authority to lay guidelines and supervise and regulate the working of mutual funds. The guidelines, issued by SEBI relate to advertisements and disclosures and reporting requirements. The investors have to be informed about the status of their investments in equity, debentures and government securities. SEBI has introduced a uniform set of regulations governing the mutual funds in the country, known as SEBI (Mutual Fund) Regulations, 1993, under which:

(a) mutual funds have to be formed as trusts and managed by a separate asset management company (AMC) and supervised by a board of trustees;

(b) the AMC must have a minimum net worth of Rs.6 crores, of which the sponsors must contribute at least 40 per cent;
(c) SEBI should approve the offer documents of schemes of mutual funds;

(d) SEBI prescribes the minimum amounts to be raised by each scheme – a close-ended scheme should raise a minimum of Rs.20 crores and open-ended scheme should raise a minimum of Rs.50 crores. In case, the amount collected falls short by the prescribed minimum, the subscription amount must be refunded within a period of six weeks;

(e) the advertisement code prescribes norms for fair and truthful disclosure by the mutual funds in advertisements and publicity materials.

**Growth of Mutual Funds**

In the 1990s, MFs found it hard to attract investors. The competition for funds was hotting up from banks and the Government. With the Government offering interest rates of nearly 14 per cent for medium term securities – the Government of India proposed to offer 10-year paper on tap with a coupon rate of 14% - and banks pegging short term rates at 12 per cent, investors were focusing on debt instruments which were gaining popularly over equity. HDFC,
leading housing finance company was offering 14% interest on fixed deposits; IDBI had decided on a 15.75% for a twin-bond issue.

Under these conditions, it was difficult for mutual funds to rival such high yields on debt instruments. They also found it hard to meet the high expectations of investors who were yet to break out of the get-rich-quick syndrome. Accordingly, the first wave of mutual funds failed.

The performance of mutual funds was not encouraging for many years. Investor confidence in mutual funds was low. This could be attributed partly to lack of confidence and partly to stock market conditions which had affected the perception of investors.

The revival of the MF market since 1995-96 was due to the entry of corporate majors – the Tatas, Birlas, Reliance and SBI. Many others followed with products designed for investor specific needs. They also offered improved liquidity, easy exit routes and regular income flows. All these changes coincided with the revival of the stock market. Sensex, for instance, crossed 6,000 mark in February 2000. Investors left the banking system and flocked to the mutual funds. This period of booming stock exchanges and mutual funds was, however, short lived.
After Ketan Parekh incident, the stock market crashed with sensex touching 2,600 (with 1974-75=100) during 2001-02. This led to a two-year period of recession in the MF market. In the mean time, the Unit Trust of India (UTI), the public sector mutual fund went through a crisis and had to be restructured. As a result, the share of the private sector MP companies increased considerably.

The overall assets under management (AUM) declined from 1,02,830 crores to Rs.89,240 crores between April 2002 and 2003. By March 2004, AUM grew to Rs.1,43,690 crores, and to Rs.3,26,290 crores by March, 2007. The Mutual Fund industry is now mobilizing about Rs.90,000 crores annually.

2.3.7 Security Market

One of the most important decisions which must be made by an economy is the allocation of its scarce capital resources among competing uses. In a mixed economy like ours, the securities market plays a vital role in the allocation of capital resource in the private sector. It facilitates transfer of investible funds from their owners to the entrepreneurs seeking to establish new enterprises or to expand the existing ones. By providing liquidity to the corporate securities, the securities market helps long-term investments to be financed by funds provided by individuals, many of whom wish to commit the funds only for a limited period or to be able to withdraw them at will.
The securities market can be divided into two parts. The one is the market for the existing securities and the other is the new issue market. From the standpoint of economic growth, the new issue market is more strategic than the market for existing securities. Although organizationally the new issue market is distinct from the market for old securities, it is important to recognize that economically both old and new securities are integral parts of a single market. The two parts of the market are susceptible to common influence, and they act and react upon one another. That is why price movements on the stock exchange (the market for existing securities) and the volume of activity of the new issue market are directly and closely related: new issues tend to increase when stock prices are rising, and tend to decrease when stock prices are declining. The stock exchange are usually the first to feel the impact of a change in economic outlook, but the effect is quickly transmitted to the new issues section of the market. Apart from the extreme sensitivity of stock exchanges to changes in the economic climate, the quantitative predominance of old securities in the market usually ensures that it is these which set the tone of the market as a whole, and govern the prices and acceptability of new securities. Thus, the flow of new savings into new securities is profoundly influenced by conditions prevailing in the securities market.

In India, the new issue market consisting of debentures, preference shares and equity shares, plays a crucial role in providing finance for industry. This is reflected in the increasing number and amount of capital issues in recent
years. The early eighties have been a spectacular spurt in the convertible debentures and a significant rise in the public response to them. During the period, there is a healthy emergence of convertible debentures as a popular form of financial assets floated on the capital market by the private corporate sector in India.

As a means of raising finance from the public, convertible debentures are not new to the Indian capital market. But they have become popular during the early eighties. While convertible debentures have appeared on the scene of capital market many times in the recent past, little empirical or analytical work seems to have been done in this area. This present chapter aims at bridging the gap.

2.3.8 Stock Exchange in India

In a modern capitalist economy, almost all commodities, even the smallest, are produced on a large scale; and large-scale production implies large amounts of capital. The joint stock company or the corporate form of organization is ideally suited to secure large amounts of capital from all those who have surplus funds and who are willing to take risks in investing in companies. It issues stocks and bonds and enables those with surplus funds to invest them profitably in either of them, according to their convenience and temperament. An
investor who puts his savings in a company by buying its securities cannot get the amount back from the company directly. The only way the capital invested in stocks and shares of a joint stock company may be realized by its owner is through the sale of those stocks and shares to others. The stock market or exchange is a place where stocks and shares and other long-term commitments or investments are bought and sold. For the existence of the capitalist system of economy and for the smooth functioning of the corporate form of organization, the stock exchange is, therefore, an essential institution.

2.3.9 Objectives of the Study

This chapter has the following objectives:

1. To examine the financial arrangements available to corporate sector and the effect of capital market condition on corporate policies for financing patterns and to present the overall role of, and trends in, funds raised from the new issue market;

2. To identify the various characteristics of companies (according to size, growth and profitability) issuing convertible debentures;
3. To study the important motivations lying behind management's decisions to issue this type of security and to ascertain the appropriateness of the use of convertible debentures from the viewpoint of the corporate issues; and

4. To point out the decision areas from the investor's point of view for investment in convertible debenture.

2.4 Indian Financial System – III: Development Financial Institution

It identifies trends in growth in assistance sanctioned and disturbed by the financial institutions. The qualitative dimensions of financing operations of their institutions are examined. In every country financial institutions are structured with the political, social, economic fabric of that country.5

With the end of the Second World War, there was great urge for speedy industrial expansion. At the same time, there was also a great need for modernization and replacement of absolute machinery in already established industries. The usual agencies meant to provide finance for large-scale industries were either apathetic or were found inadequate and hence the Government of India set-up a series of financial institutions to provide funds to the large industrial sector – the Industrial Finance Corporation of India (IFCI) in 1948, the
Industrial Credit and Investment Corporation of India (ICICI) in 1955, the Industrial Reconstruction Bank of India (IRBI) in 1971, now called IIBI, the Export and Import Bank of India (EXIM BANK) in 1982 and so on. At the state level, the State Financial Corporation (SIDCs) were set up. All these institutions or term lending institutions. The Narasimham Committee (1991) called them Development Financial Institutions (DFIs).

![Diagram of financial institutions]

Note: * Industrial Credit and Investment Corporation of India (ICICI) was merged with ICICI Bank in 2002 and ceased to be a development finance institution.
** The Industrial Reconstruction Bank of India (IRBI) was set-up in 1985 but was renamed as Industrial Investment Bank of India in 1997.
*** NABARD took over the refinance functions performed earlier by Agriculture Refinance Development Corporation.
**State Financial Corporations**

The Government of India passed the State Financial Corporations Act in 1951 and made it applicable to all the States. The authorized capital of a State Financial Corporation is fixed by the State Government within the minimum and maximum limits of Rs.50 lakhs and Rs.5 crores and is divided into shares of capital value which are taken by the respective State Governments, the Reserve Bank of India, scheduled banks, co-operative banks, other financial institutions such as insurance companies and investment trusts and private parties. The shares are guaranteed by the State Government. A State Financial Corporation can augment its funds through issue and sale of bonds and debentures, which should not exceed five times the capital and reserves at Rs.10 lakhs. But the management in the case of the State Corporation is similar to that of the IFCI. It has a Board of Directors, a Managing Director and an Executive Committee. The first step towards building up a structure of development finance institution was taken with the establishment in 1948 of IFCI for providing medium and long-term credit to units of corporate sector and industrial cooperatives.

**State Industrial Development Corporations (SIDCs)**

Besides, SFCs, there are 28 State Industrial Development Corporations (SIDCs) which promote industrial development in their respective
states and also provide financial assistance to small entrepreneurs and help backward regions.

**Industrial Credit and Investment Corporation of India (ICICI)**

The Industrial Credit and Investment Corporation was sponsored by a mission from the World Bank for the purpose of developing small and medium industries in the private sector. It was registered in January, 1955 under the Indian Companies Act. Its issued capital was subscribed by Indian banks, insurance companies and individuals and corporations of the United States, the British eastern exchange banks and other companies and the general public in India.

The aim of ICICI was to stimulate the promotion of new industries, to assist the expansion and modernization of existing industries and to furnish technical and managerial aid so as to increase production and afford employment opportunities.

**The Industrial Development Bank of India (IDBI)**

The Industrial Development Bank of India is another in the series of specialized institutions set up since 1947 to provide long-term finance in industry. IFCI, the SFCs, ICICI, NIDC and the Refinance Corporation of India were
functioning for several years provide direct plans, subscribe to shares and bounds and to guarantee of loans and deferred payments. The volume of long-term finance provided by these institutions were substantial and were steadily increasing too, but it was found inadequate to meet the requirements of new and growing industrial enterprises.

_Functions of IDBI_

The main function of IDBI, as its name suggests, is to finance industrial enterprises such as manufacturing, mining, processing, shipping, and other transport industries and hotel industry.6

_Small Industries Development Bank of India (SIDBI)_

The Small Industries Development Bank of India (SIDBI) was set up by the Government of India under a special Act of the Parliament in April 1990 as a wholly-owned subsidiary of IDBI. SIDBI took over the outstanding portfolio of IDBI relating to the small scale sector worth over Rs.4,000 crores. The authorized capital of SIDBI is Rs.250 crores which could be increased to Rs.1,000 crores.
Role of SIDBI

SIDBI is now the principal financial institution for promotion, financing and development of small scale industries in the country. It coordinates the functions of existing institutions engaged in similar activities. Accordingly, SIDBI has taken over the responsibility of administering Small Industries Development Fund and National Equity Fund which were earlier administered by IDBI.

Industrial Investment Bank of India (IIIBI)

To lookable special problems of sick unit and provide assistance for their speedy reconstruction and rehabilitation, if necessary by undertaking the management of the units and developing infrastructure facilities like those of transport and marketing etc.

The Unit Trust of India

The Unit Trust of India was a formally established in February 1964. The initial capital of the Trust was Rs.5 crores which was subscribed fully by the Reserve Bank of India, the Life Insurance Corporation, the State Bank of India and the scheduled banks and other financial institutions. The general
superintendence, direction and management of the affairs and business of the Trust is vested in a Board of Trustees.

The primary objective of the Unit Trust is two-fold: (a) stimulate and pool the savings of the middle and low-income groups, and (b) to enable them to share the benefits and prosperity of the rapidly growing industrialization in the country. These two-fold objectives would be achieved through a three-fold approach: (i) by selling Units of the Trust among as many investors as possible in different parts of the country; (ii) by investing the sale proceeds of the Units and also the initial capital fund of Rs.5 crores in industrial and corporate securities; and (iii) by paying dividends to those who have bought the units of the Trust.

LIC & GIC

Apart from the Unit Trust of India which mobilizes the savings of the public to specifically invest in the industrial securities, there are two other, investment institutions in the country – the Life Insurance Corporation of India (LIC) and the General Insurance Corporation of India (GIC). These two institutions collect large amounts of funds from the general public to provide insurance cover but they use part of their funds to give long-term loans to the corporate sector or to acquire industrial securities (shares and debentures) from the market. Because of the
large funds they are able to mobilize, these two institutions have become powerful operators in the stock exchange.

Table – 2.1
Growth Rate in Assistance Sanctioned and Disbursed

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Assistance</th>
<th>Percentage Change over the previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sanctions 'S'</td>
<td>Disbursement 'D'</td>
</tr>
<tr>
<td>1997-98</td>
<td>77091.6</td>
<td>53647.9</td>
</tr>
<tr>
<td>1998-99</td>
<td>83695.6</td>
<td>58329.5</td>
</tr>
<tr>
<td>1999-00</td>
<td>101917.8</td>
<td>68594.2</td>
</tr>
<tr>
<td>2000-01</td>
<td>120548.1</td>
<td>75363.6</td>
</tr>
<tr>
<td>2001-02</td>
<td>75088.5</td>
<td>58734.7</td>
</tr>
<tr>
<td>2002-03</td>
<td>28310.9</td>
<td>26704.6</td>
</tr>
<tr>
<td>2003-04</td>
<td>40758.6</td>
<td>30172.7</td>
</tr>
<tr>
<td>2004-05</td>
<td>30403.9</td>
<td>21505.8</td>
</tr>
<tr>
<td>2005-06</td>
<td>27665.4</td>
<td>21145.5</td>
</tr>
<tr>
<td>2006-07</td>
<td>31259.4</td>
<td>38652.6</td>
</tr>
</tbody>
</table>

Source: Appendix - I

![Growth Rate in Assistance Sanctioned and Disbursement by all Financial Institutions](image-url)
Financial institutions have to be accepted as a prerequisite for promoting faster and more balanced growth of industrial sector. During the last thirteen years, these institutions operating at the rational and regional level have emerged as a significant source of term finance to industry. There has been a rapid growth in the volume of assistance given by financial institutions in recent years so as to keep pace with the requirements of growing industrial economy.

In absolute terms, the assistance sanctioned by the financial institutions in India marked declined from Rs.77091.6 crores in 1997-98 to 31,259.4 crores in 2006-07. Similarly, disbursement of assistance by these institutions declined from Rs.53,647.9 crores in 1996-97 to Rs.38,652.6 crore in 2006-07. Responding to the emerging requirements of industrial and economic growth, they have coordinated approach towards industrial financing.

Over the years, the level of Small Industries Development Bank of India (SIDBI) assistance has grown at a rapid pace. The total assistance sanctioned by SIDBI increased from Rs.6485.3 crores in 1997-98 to Rs.11102.3 crores in 2006-07. Correspondingly, the disbursements also recorded a comparable rise from Rs.4584.7 crores to Rs.10225.4 crores during this period. With the growth and diversification taking place in the industrial structure, the needs of industry grew large as well as diverse. SIDBI endeavoured to evolve appropriate policies to
meet the changing needs and fulfill national priorities. Growth in operations may be regarded as natural in an institution like SIDBI from II India development Bank.

On the other hand, the performance of LIC (Life Insurance Corporation of India) has been creditable from the investment institutions. The growth rate in sanctions and disbursements of assistance was particularly noteworthy during 2007-08 i.e. more than double of 2006-07. Assistance sanctioned by LIC increased from Rs.2341.9 in 1997-98 crores to Rs.18,126.9 crores in 2006-07 with a significant record in the year 2003-04 as Rs.21974 crores. Correspondingly, the disbursement also increased from Rs.3909.9 crores in 1997-98 to Rs.27017.0 crores in 2006-07.

The IDBI (Industrial Development Bank of India) sanctioned Rs.23,982 crore in 1997-98 and Rs.3937.7 crores in 2003-04. Correspondingly, the disbursement also Rs.15170 and Rs.4986.4 crores from 1997-98 and 203-04 respectively.

As a operating financial institutions, the performance of IFCI (Industrial Finance Corporation of India) has been creditable. The growth rate in sanctions and disbursements declined from 7693 crores in 1997-98 to Rs.1050 crores in 2006-07. Correspondingly, the disbursement also records Rs.5650.4 in 1997-98 to Rs.550 crores in 2006-07.
The ICICI (Industrial Credit and Investment Corporation of India) was sponsored by a mission from the World Bank for the purpose of developing small and medium industries in the private sector. The aim of ICICI was to stimulate the promotion of new industries, to assist the expansion and modernization of existing industries and to furnish technical and management aid so as to increase production and afford employment opportunities.

This was to be accomplished by providing long-term and medium term loans in rupees and foreign currencies by equity securities and by guaranteeing loans from other private investment sources. ICICI operation’s got substantially stopped up last 6 years with sanction increasing from Rs.24717.5 crores in 1997-98 to Rs.55815.2 crores in 2001-02. Correspondingly, the disbursement increasing Rs.15806.9 in 1997-98 to Rs.25831.0 in 2001-02.

The financial assistance rendered by IRCI later renamed as IRBI and finally renamed as IIBI since 1997 is meager. Industry Investment Bank of India Ltd. sanctioned Rs.816 crores in 1997-98 and Rs.2252.2 crores in 2004-05 which is a significant record.

The Unit Trust of India (UTI) was formally established in February 1964. The initial capital of the Trust was Rs.5 crores. The primary objective of the Unit Trust is two fold (a) stimulate and pool the savings of the middle and low income group and (b) to enable them to share the benefits and prosperity of the rapidly
growing industrialization in the country. It sanctioned Rs.4537.8 crores and disbursed Rs.3557.9 in 1997-98. And it also sanctioned Rs.307.4 crores and disbursed Rs.414.7 crores in 2002-03.

GIC (General Insurance Corporation of India) sanctioned Rs.1172.8 cores and disbursed Rs.1143.8 crores in 1997-98. It also sanctioned Rs.734.5 crores and Rs.740 crore in 2006-07.

The SFS (State Financial Corporation) started with smaller amount of share capital between Rs.50 lakhs and Rs.5 crores. The Government of India passed the State Financial Corporation Act in 1951 and made it applicable to all the state. In 1997-98 it sanctioned Rs.2626.1 crores against Rs.1135.8 crores in 2003-04. Correspondingly, the disbursement records Rs.2110.2 crores in 1997-98 and Rs.1454.1 crore in 2003-04.

Over the years, the level of SIDC's and assistance has grown at rapid pace. The total assistance is sanctioned by SIDC increased from Rs.1795 crores in 1997-98 to 2080.1 in 2000-01. Correspondingly, the disbursements also recorded a comparable rise from Rs.1416.2 crore to Rs.1664.4 crore.

A notable feature that emerged from the working result of the financial institution was that their total sanctions were higher and recorded a steady rise. On the other hand, the magnitude of increase in disbursements was also more
pronounced. This in effect, was felt on the percentage share of disbursements in the total assistance sanctioned, which increased from Rs.69.58 per cent in 1997-98 to 78.71 per cent in 2006-07. In other words compared to the observed rise in assistance sanctioned, the level of sharp increase in utilization was commensurate and this led to the rise in disbursement sanction ratio.

By going a step further, the point may be highlighted by the data on annual average growth rate. The growth rates in sanctions as well as disbursements are marked out by wide fluctuations. Thus for instance, of the years with positive growth rate in sanctions in 2003-04 with 43.97 per cent showed the highest and 1998-99 with 7.89 per cent, the lowest. Similarly, with positive growth rate in disbursement in 2006-07 with 82.79 per cent showed the highest rate and 1998-99 with 9.32 per cent lowest. The average annual growth rate of disbursement with 46.06 per cent higher than average growth rate in sanctions with 0.28 per cent. Thus, it may be designated as the level of utilization was better than the level of sanction.
References:


