(ABSTRACT)

Financial sector reforms have their ultimate impact on banking sector especially development banking in India. The last decade of the 21st century witnessed the maturity of India's financial markets. Since 1991, all the governments; both state and central, took major steps in reforming the financial sector of the country. The last few years witnessed a consecutive decrease in the sanctions and disbursements of the development banks and in case of performance they are still going ahead due to diversification and other strategies. Since liberalisation, the pattern and trends towards sanctions and disbursement is continuously changing. The backward areas are found to be neglected by these primary sources of their development funds.

As a result of the financial sector reforms and follow up activities, the development banks in India are now converting themselves towards pure commercial banks, which are already in later stage of development in India. The changing trends of these institutions have not happened by a single incident but it was the result of the policies initiated by the government from time to time to safeguard the interest of public without any forward looking to the future. The various committees, such as, Narasimham Committee (1991 and 1997), set up for the revival of banking sector and financial institutions in India recommended strongly to convert all these financial institutions into NBFCs or commercial banks to avail the cheap sources of funds, which are already available in the market, and also to enable them for the survival in the future.

However these banks have now entered into a new era of business forte, which enabled them to be more competitive, and to dominate in the financial market with their strong capital base, which has already been developed by them through their sound institutional set up and framework. But the modus
operandi of these banks is now continuously changing towards class banking, targeting only a particular class. However the current pattern and trends in the business dimensions of these development banks are now going to achieve high growth rate through their high degree of operational efficiency and strong marketability and efficiency.

These aspects of problems regarding their operational highlights and contributions to the institutional development of Indian economy, changes in their policy matters due to the reformist movement of the total economy, achievements in institutional building are going ahead to the mark-up. Therefore, it is necessary to recheck the activities of these development banks in the new era of third generation reforms, which seem to be more reliable for further development for both the economy without omitting the concept of welfare state.

The Indian financial system of the pre-reform period essentially catered to the needs of planned development in a mixed-economy framework where the Government sector had a predominant role in the economic activity. As part of planned development, the macro-economic policy in India moved from fiscal neutrality to fiscal activism. Such activism meant large developmental expenditures, much of it to finance long-gestation projects requiring long-term finance. The sovereign was also expected to raise funds at fine rates, and understandably at below the market rates for private sector.

Financial sector reforms, as a matter of fact, are at the center stage of the economic liberalization that was initiated in India in mid 1991. This is partly because the economic reform process itself took place amidst two serious crises involving the financial sector: at the first instance, the balance of payments crisis that threatened the international credibility of the country and pushed it to the brink of default. At the second stance, large-scale pre-emption of resources from the banking system by the government to finance its fiscal deficit, besides, excessive structural and micro regulation also inhibited financial innovation and increased transaction costs. Relatively inadequate level of prudential regulation in the financial sector; poorly developed debt and money
markets; and outdated technological and institutional structures. It made the capital markets and the rest of the financial system highly inefficient, buffeted the crisis deepen further to feint the economy at a critical juncture.

It was only in July 1991 that the paradigm shift in the economy took place with introduction of New Economic Policies (NEPs) focusing on financial sector reforms to create an efficient competitive and stable financial sector, which could then contribute in greater measure to stimulate growth. Concomitantly, the monetary policy framework made a phased shift from direct instruments of monetary management to an increasing reliance on indirect instruments. Since the initiation of reforms the Indian economy has achieved high growth in an enabling environment of macroeconomic and financial stability.

The post-reform period has been marked by broad-based economic reform that has touched every segment of the economy. These reforms were designed essentially to promote greater efficiency in the economy through promotion of greater competition. The one and a half decades of the post reforms have seen major improvements in the working of various financial market participants. The government and the regulatory authorities have followed a step-by-step approach, although not a big bang one. The entry of foreign players has assisted in the introduction of international practices and systems. Technology developments have improved customer service. Some gaps however still remain. On the whole, the cumulative effect of the developments since 1991 has been quite encouraging. An indication of the strength of the reformed Indian financial system can be seen from the way India has been growing incredibly achieving approximately 9.4 percent growth in GDP. The projection of GDP growth in the 11th plan is 10 percent on an average; no mean achievement by any standard for any individual economy.

The thesis in question would seek to go into the nitty-gritty of the aspects pertaining to the financial sector reforms vis-à-vis the modus operandi and their performance appraisal in the post economic reforms era.
From the comprehensive literature reviews it peters out that the studies made on the areas of both financial sector reforms and their impact on banking and development banking are very few. Most of the studies deal with the varied dimensions of banking sector with less emphasis on the special case of development banks. No study has been found to make according to the new era of financial sector reforms and their impact on Indian development banking. The current scenario of development banking in India has on the one hand witnessed a high degree of operational efficiency due to the overall financial liberalisation resulted in cross border flow of investments and multidimensional business forte but on the other hand the basic objective of development banking has been dismantled. Thus the study makes an earnest attempt to trace out the major impacts of the financial sector reforms on various activities of All India Development Banks (hereafter AIDBs) since liberalisation for globalisation. Therefore the present study is a bit different from all the previous research analyses that emphasized on the varied dimensions of overall reforms agenda.

The study on financial sector reforms and their impact on development banking has covered a span of two and a half decades, i.e. from 1981 to 2006. This span of period is more than sufficient to find out the trends in performance related aspects of development banking vis-à-vis the financial sector reforms particularly, banking sector reforms, insurance sector reforms, capital market reforms. The Researcher is fully aware about the fact that the whole sale reforms have affected the banking sector, insurance sector and capital market. Keeping this in mind the present study has focused mainly on these three sectors to find out the impact of the total reforms. The study is mainly focusing on the All India Financial Institutions (hereafter AIFIs) in general and Industrial Development Bank of India (hereafter IDBI) in particular. The Researcher is of a strong opinion that the analyses on the total DFIs as a whole and IDBI in particular is able to represent the performance of total Development Financial Institutions especially All India Development Banks.
The specific objectives of the study are to find out the major impact of financial sector reforms in the working of All India Development Banks (AIDBs), to find out the impact of reforms in the total sanctions and disbursement of the Development Banks and Development Financial Institutions, to analyze the pattern and trends in assistance sanctioned and disbursed by all India development banks region specific, purpose wise, component wise sector specific and industry specific; to evaluate the performance of all India development banks in the new regime of financial liberalization for globalisation, to analyze the degree of changes in the business of financial institutions after the reforms, to investigate into the reasons of difference between the pre and post reforms performance of both banking and non banking businesses, To identify the qualitative and quantitative contributions of these all India development banks in post and pre reforms regime and differentiate the major changes due to policy reforms And to make suggestions and recommendations for further improvement in the policy reforms for future performance.

The study is an empirical work based on the secondary data and primary data collected from various sources for the fulfilment of veracity and truthfulness of analysis to ensure the quality of research. The secondary data for the study have been collected from various secondary sources of information, such as, Published Reports, of Various Ministries, Financial Institutions and Various Authorities, Books, Journals and periodicals, Research Papers, Published Theses, Articles, Business Dailies, Financial Dailies and Websites. For the analysis purpose the primary sources of secondary information have been used which are published by the All India Development Banks (AIDBs). The various reports, such as, annual reports of Industrial Credit and Investment Corporation of India (hereafter ICICI), IDBI, Industrial Financial Corporation of India (hereafter IFCI), Small Industries Development Bank of India (hereafter SIDBI), Industrial Investment Bank of India (hereafter IIBI), and several Reports on Indian Development Banking published by IDBI up to 2004 are the major sources of materials for analysis.
The statistical tools have been used for the analysis and interpretations, such as, Mean, Maxima, Minima, Range, Standard Deviation and Coefficient of Variance, Coefficient of Variance Percentage, CAGR, Stepwise univariate and multivariate regression. Both classical and log-linear regression functions have also been applied. For test of significance F-test and t-test have been done depending upon the nature of cases.

The financial sector reforms have been studied under four separate subsections, namely reforms in banking, insurance, capital market and others. Reforms in these sectors have an ultimate impact on Indian financial system, which witnessed a high degree of market efficiency and strong form of broad-based institutional building in recent years.

The review of financial sector reforms and monetary policy has documented the calibrated and coordinated reforms that have been undertaken in India since the 1990s. In terms of outcomes, this strategy has achieved the broad objectives of price stability along with reduced medium and long term inflation expectations; the installation of an institutional framework and policy reform promoting relatively efficient price discovery of interest rates and the exchange rate; phased introduction of competition in banking along with corresponding improvements in regulation and supervision approaching international best practice, which has led to notable improvement in banking performance and financials. The implementation of financial sector reforms was characterized with setting up of various committees, to recommend the economic system to survive in the modern world of core competence.

The implementation of these reforms have also involved the setting up or improvement of key financial infrastructure, such as, payment and settlement systems, and clearing and settlement systems for debt and forex market functioning. All of this financial development has been achieved with the maintenance of a great degree of financial stability, along with overall movement of the economy towards a higher growth path.

The pre and post reforms regimes have been analytically divided into four phases according to the basic changes reflected in the development
banking business. The first phase is the post independence era of establishment of these financial institutions and its gradual development. This phase between 1948 and witnessed establishment of the major development banks, such as, IDBI, ICICI, and IFCI. The second phase has witnessed major transformations and subsidiary financial institutions from 1974 to 1991. The third phase between 1991-2001 is the first decade of post-liberalisation globalisation regime, in which most of the development banks flourished their diversified business forte and all the development banks entered into secondary market to secure the advantage of cheap sources of funds, and as a result the total market capitalization of these banks, especially development banks, were restructured. The fourth phase from 2001 onwards is the neo-liberal regime and the phase of second generation reforms that enabled the banks and Development Banks to corporatised them. Finally all the development banks converted in to full-fledged commercial banks that offered them high degree of operational flexibility.

All the above-mentioned phases in the evolution and functioning of the Development Banking in India have seen a number of committees being established for further suggestions to the survival of these all India development financial institutions which has a sound financial set up and strong capital base but structured with the boundaries of legal barriers which led them to continuous decline in financial highlights and huge losses of opportunity of profits.

The changes in the regulatory structure of these financial institutions by means of financial liberalization facilitated their survival and it could dominate in the commercial banking business with a high degree of operational flexibility and strong market efficiency. The ICICI and IDBI, which were the apex institutions of Indian financial system before liberalization, got a strong source of cheap funds for their institutional building. But ultimately these liberal financial policies affected the prime objectives of these financial institutions, which diverted their business to merchandised business
atmosphere. Altogether the case of IDBI has indicated the enhanced business dimension of development banks since liberalisation.

The study has analyzed Impact of financial sector reforms on the overall lending activities of development financial institutions through comparison of the sanctions, disbursements, and utilization rate. The study has also taken into consideration individual cases of selected development banks in India, such as: IDBI, ICICI, IFCI and other important development banks under the head ‘other DBs’. The overall lending activities have been analyzed through bifurcating the total span of 25 years into pre and post reforms regime.

The Researcher is of an opinion that to analyse the impact of financial liberalisation on Indian development banking, it is necessary to classify the post liberalisation period into two. The real form of reforms process has been seen only in the second decade of post reforms period.

However the analysis of impact of reforms cannot be quantified as one variable is qualitative and other is quantitative. Therefore the Researcher has assumed two dummy variables for the total period under the study to find out the impact of policies in pre and post reforms. The model-1 has been made to describe the impact of pre-liberalisation policy measures on the performance of later years. The Researcher has made the assumption that in model-1, d=1 if Y belongs to 1982-1991 and ‘0’ otherwise, and in model 2 where the real impact of reforms has been checked, d=1 if Y belongs to 1992-2001 and ‘0’ otherwise.

Model 1 has described the application of dummy variables for the case of sanctions of the development finance in pre and post reforms period. The dummy has been assigned by the Researcher for pre-liberalisation sanctions as ‘1’ whereas for the remaining it has been assigned as ‘0’. Time has been taken on the basis of years where 1 to 25 has been assigned for each year. The time and product dummy into time have been considered as independent variables where the sanctions amount is considered to be dependent on the year and policy reform process. The assumption behind the first dummy is that no major policy was announced before the liberalisation regime i.e. before 1991. The
real significance has been tested by the second dummy where the impact of the entire reforms process has taken place.

The sanctions and their coefficients have shown the impact of pre reforms period on the development banking in India. The t' static of time variable has been estimated significant at 0.03 percent where the impact of dummy variable is insignificant. As assumed in the first dummy that no major policy was announced in pre-liberalisation period. The impact has been estimated as significant due to the continuous increase in the total sanctions since the beginning of the period under consideration and it has continued up to the end of the first decade of post liberalisation.

On the other hand, the second dummy where the impact of financial sector reforms has been quantified by the application of the dummy variable along with the time variable has shown its significance.

The coefficient of determination (R^2) after adjustment stood at 0.88. This patently implies that whatever changes or decline in the lending activities of development banks have occurred in post reforms period is on account of the reform process. In other words, the reforms process is responsible up to 88 percent for the changes in the lending activities. The impact therefore is very much pronounced. Coefficients have indicated that the impact of time and policy reforms is significant at any level of significance.

To find out impact of financial sector reforms on the overall lending activities of development banks in pre and post liberalisation period it is necessary to take the case of disbursals too.

Result of application of dummy variables and time variable on the disbursal has come the same as in case of sanctions described in the model-1 and model-2. The model-1 has been developed for pre reforms period and the model-2 is about impact of reforms on development financing in India in post liberalisation period. t value is 3.537 which is significant at 0.2 percent in case of time variable. But in the case of policy measures it is not significant at any level which can be considered to be insignificant. t value of the same is -1.708. This implies that there is no impact of policy process.
It has further seen that the result of the post reforms period has witnessed that reforms process has an immediate effect on the overall lending activities of development banks in India during the referred time span. The model-2 on disbursals has left an impression that the impact of policy measures is highly significant like in the case of sanctions during post-liberalisation period.

The adjusted R-Squared is 0.92. The R-Square of 0.92 thus indicates that whatever changes or decline have happened in the overall disbursals in post reform period on account of the financial liberalisation. The R-squared of 92 percent is very much significant to demonstrate the overall impact of reforms. The coefficients of model-2 on disbursals have also illustrated the impact of reforms on development finance. The t value of time variable i.e. 8.506 and the policy reforms is 10.808 is significant at any point of level.

The analysis made on the basis of sanctions and disbursals of development banks has proved that the impact of reforms process in post liberalization period is significant which has ultimately resulted into the acceptance of alternative hypothesis of the study. The overall reforms movement has an ultimate impact on the overall lending activities of development banks since liberalization. The major impact of reforms on development banking in India is changing the basic objectives of the development banks in post independence period. The major reason for the decline in the overall lending activities may be attributed to the development of secondary market and availability of cheap sources of debt and equity funds for any business firm. The impact of financial sector reforms has their ultimate impact on the institutional development of Indian economy resulted in the establishment of well structured capital market administered and operated through electronic mode with high end technical support.

Most of private and public sector undertakings have raised funds from secondary market through Initial Public Offers (IPOs). The importance of development finance thus witnessed the continuous decline which could not grow according to the time. The development banks hence diversified their
business to various other financial services by their own establishments or by direct actions.

The impact of financial sector reforms has its exclusive approach for insurance as well as other realms, such as, pension, foreign exchange, and government securities market. Hence the development financial institutions took further steps in these sectors too which resulted in diverting their development funds to the needy and profitable segments.

The significant impact is discernible on the overall sanctions and disbursements of DFIs despite the decline in lending activities. This decline is attributed to the fact that other sources of financing, such as, Pension Fund, Asset Management Funds, Mutual Funds, Venture Capital Fund, Life Insurance Fund have appeared on the horizon of the financing arena. The policy packages and measures have therefore paramount impact on the overall development banking activities.

The study has also taken into consideration the impact of financial sector reforms on region wise lending activities of development banks in phased manner. The impact can be analyzed through a comparison of pre and post reforms trends in region wise lending activities. The descriptive statistics, such as, Compound Annual Growth Rate (CAGR) and Standard Deviation (SD), Coefficient of variation (CV percent) and mean throw light to the shift from one segment to another. The Researcher felt that to analyze the impact it is better to test the significance deference in mean of each independent region separately on their percentage shares. Therefore the study has relied upon the independent sample \( t \) test for test of significance in variation of mean of both the regime based on the percentage share of each region.

Among the five regions based on the per capita GDP of the country the shift of development funds from one region to other have been seen. \( T \) value is estimated to be significant at 5 percent level of significance in whole regions except the averagely developed region. The \( t \) static of each region where equal mean variance have been assumed which are highly forward: 2.701, forward: -3.664, average: -0.677, backward: 6.899 and very backward is of 7.567. All the
cases have been seen significant at 5 percent level which enlightened to the acceptance of alternative hypothesis except the averagely developed regions where alternative hypothesis is significant at 50 percent only. The impact is therefore much pronounced in case of disbursals of development banks where the t value is significant at any level except the aforementioned average developed regions. It can be said there is the same result as in case of sanctions. The cases of forward, highly forward, backward and highly backward are significant where the average is insignificant.

All the computed statistics of overall lending activities of industrial development bank of India have also supported the same trend which has been pronounced by the overall lending activities of development banks. In both sanctions and disbursals of IDBI the impact of reforms is more evident on development finance at its regional selection. The cases of both the sanctions and disbursals are very clear that shift of funding has happened anyway. The t-static of both has denoted the negative impact of one segment resulted in the positive impact on another. The overall lending activities have a negative impact on decline of development finance through out the post liberalisation especially after 2000. By the test of independent sample of development finance in both sanctions and disbursals for backward and forward regions it can be deduced that there is a shift of development finance from backward regions to forward regions which is basically a major alteration in the basic objectives of development banking in India.

As far as the t-static is concerned the impact is visible in regional attraction of development finance and therefore the Researcher failed to observe the acceptance of null hypothesis. The basic reason behind the regional imbalance is not only proliferated by the development banks themselves. The accumulated Non-performing Assets (NPAs) from those backward regions in the gloominess of government policies for the sake of regional imbalance as well as the instable political environment has compelled the banks to divert their funds from risky investments. As a matter of fact the total environmental changes in the financial sector have further influenced to utilize the funds for
more profitable manner. The development of well structured secondary market resulted in promotion of supplementary and other secondary application of funds as well.

The Researcher has observed in case of sector wise sanctions and disbursals of development banks that the overall lending activities of development banks witnessed a downward trend in post reforms period. Altogether the impact has materialized. Analysis of sectoral implication of development finance has shown the degree of changes in overall development finance for sector specific. It has been found that the impact is much evident in all the segments of sectoral classification. The cases of sectoral sanctions have been found to be significant at 5 percent level of significance in all the sectors except the private sector. The t-static of each segment is expectant enough to the approval of alternative hypothesis.

In case of sanctions the t-static (two-tail) of each segment i.e. public, joint and cooperative stood at -2.184, 3.685, and 4.849 are significant at 5 percent level of significance where as in the case of private sector a t-static of 855 is insignificant up to 25 percent level of significance. The same has been again approved by the independent sample test of disbursals where the private sector’s percentage share is insignificant up to 25 percent. The other cases test of equality of means of public, joint and cooperative sector is significant at 5 percent level of significance with t-static of -2.176, 3.571, and 6.304. As far as the independent sample test of significance is concerned the impact of financial sector reforms on sectoral selection of development finance has been approved and therefore the Researcher has failed to observe the acceptance of null hypothesis. The individual case of industrial development bank of India has also supported the sectoral impact of reforms on development financing in India. The basic reason behind the sectoral imbalances of development finance in post liberalisation regime is the changing business environment where the importance of priority sector has been redefined. The reforms initiated by the Narasimham Committee recommended to eliminate the existing priorities have influenced further lending activities of whole banking sector. The environment
became much friendly for public sector with high degree of operational efficiency with a strong support of capital market. The trends also indicate the impact of strengthened capital market where the debt and equity became much cheaper than the development finance. The total trends in lending activities of development banks envisaged a downward trend in post liberalisation regime where it was the last resort for sick and weak sectors influencing the sanctions and disbursements of development finance in the sectors.

In case of industry wise analysis it is discernible that basically the classification of the total industries has covered the whole industrial segment where the development banks have made their deployment of funds on the basis of priority. The simple statistics, such as, CAGR, Standard deviation, Coefficient of variance percentage, and means have pointed out that the impact is visible and pronounced. However the avoidance of agriculture and consumer goods are much pronounced by the analysis and the shift of total sanctions and disbursals is also visible. However to find out the degree of impact on the industrial attraction of development finance it has been tested through the test of significance of variation between the means of both periods.

The t-static of sanctions in each industrial segment is significant at 5 percent level of significance except the others which is insignificant up to 68 percent. The t-static (two-tailed) of sanctions i.e. 5.442, 2.025, -3.435, 4.971, -1.936, -2.321, of each industrial concern i.e. Agri-Food, Industrial goods, Infrastructure, Consumer goods, Health care and allied are significant at 5 percent level of significance where the others has a t-static of 0.409 which is significant only at level more than 68 percent. Among the segments the cases of all instable industries are having the negative impact where the case of infrastructure has shown the positive impact as compared to other industrial segments for the period under reference.

As regards the significance of equality of means among the industry wise disbursals, the analysis supports the acceptance of alternative hypothesis in which the impact of reforms on industrial lending activities is assumed. The individual case of IDBI is also having the same result where the acceptance of
alternative hypothesis is justified. As regards the independent sample test of significance of mean differences, the industry specific lending activities are found to be impacted and null hypothesis has been rejected. The basic reasons are the industrial imbalance of development finance especially the elimination of priority in case of agriculture and small scale industries.

Agriculture and food industries in India are considered to be a loss making sector but 1/3rd of employment is being generated by this industry. The banks and financial institutions always take care of agricultural finance where the maximum numbers of illiterates are the beneficiaries. The government policies regarding agricultural lending without any vision in pre-liberalisation period encouraged the farmers to avail the maximum credit from banks which consequently led to increase in high volume of NPAs. The government’s announcements of writing off the agricultural debts from time to time for temporary political benefits resulted in increment in banks assets without performance. The positive impact in case of infrastructure has been witnessed due to the emergence of new service sector and institutionalisation of infrastructure. The establishment of special infrastructure funds further increased the scope of infrastructure other than the five segments where the infrastructure development was the responsibility of government now transferred to the institutions. However the impact of financial sector reforms is significant in case of industry wise sanctions and disbursements.

The purpose and component wise assistance have also been analyzed by the Researcher. To test the significance of impact of financial liberalization on purpose wise as well as on the component wise sanctions independent sample test of significance of equality of means has been used. The test has assumed the equality of means of pre and post reform period in terms of purpose and component wise sanctions of development finance.

The results are case sensitive in terms of purpose wise sanctions of development finance where the t-statistic of new and start-ups, diversification, modernization and rehabilitation, supplementary and others are 5.392, 10.221, 2.459, -6.815 respectively. The assumption of impact is significant in all the
cases. In the case of other and miscellaneous the impact is much visible in positive manner. While on other hand, the case of component wise divided on the basis of components, such as, rupee loan, foreign currency loan, and underwriting and subscription of securities, financial sector reforms have major impact on institutional development of Indian economy especially after 1991. The major triumph of financial liberalisation is the well structured and strengthened capital and financial market. Among the components the underwriting and subscription was not important in pre-liberalisation period but that emerged as one of the important financial services in the wake of financial liberalisation. Component wise sanctions showed a shift from traditional funding to the modern format. The objective of component wise sanctions is to find how far the changes in format of financial services affected in the development financing in India since liberalisation.

The case of component wise sanctions of development financial institutions has a significant change in the pre and post reforms period. The t-statistic indicates the assumption of impact of reforms on the above said purpose wise sanctions.

The t-statistics in case of each purpose i.e. 3.781 and -5.118 of rupee loan and underwriting and subscription are significant at 5 percent level of significance whereas the case of foreign currency loan is insignificant up to 95 percent level with a t-value of 0.053. The individual case of Industrial development banks of India is also in support of alternative hypothesis where the impact of reforms has been assumed as significant.

The major reason for the positive impact of subscription related funding of development banks is changes in the format of financial services in which the development banks played the major role up to the setting up of their own subsidiaries with sector specific objectives. The overall lending activities of development banks have a diminishing trend. The purpose and component wise analysis of development banks throws a light on the reasons for the negative trend in overall lending activities. The post liberalisation globalization regime has witnessed a series of reforms in financial sector where all the development
banks seem to have diversified their business domain with high degree of efficiency. A large share of their funds have been diverted to the promotion of further institutional building to cater to the needs of institutionalizing the economic development and to survive in the competitive market without government support.

In fine, the Researcher has come out with the suggestions along with the strategies for overcoming existing problems of development banks, so that, they may play vital roll for overall economic development of the country. The major problems are regional imbalance, sectoral shifts, stage wise shift, increasing risk aversion which resulted in the changing basic objective of development banks in post liberalization period. The direction for future researches in the realm of development banking has also been identified by the Researcher in the study.