Introduction & Design of the Study
CHAPTER I

INTRODUCTION AND DESIGN OF THE STUDY

1.1 INTRODUCTION

India has made considerable economic progress since its Independence. Most noticeable are the expansion and diversification of production both in industry and agriculture. New technologies were introduced in many industries. Industrial investment took place in a large variety of new industries. Modern management techniques were introduced. An entirely new class of entrepreneurs has come up with the support system from the Government, and a large number of new industrial centers have developed in almost all parts of the country.

Over the years, the Government has built the infrastructure required by the industry and made massive investments to provide the much-needed facilities of power, communications, roads etc. A good number of institutions were promoted to help entrepreneurship development, provide finance for industry and to facilitate development of a variety of skills required by the industry as well as agriculture. The Government also followed a policy of encouraging indigenous industries and provides them all facilities and encouragement. As a result, we have now a widely diversified base of industry and an increased domestic production of a wide range of goods and services. The index of industrial production has gone up from 7.9 in 1950-51 to 154.7 in 1999-2000. Electricity generation went up from 5.1 billion Kwh to 480.7 billion Kwh in the same period.

The financial institutions which supply long and medium term resources may be classified into investing institutions and development banks on the basis of the nature of their activities and the financial mechanism adopted by them.
Industrial Policy and Incentives Since 1947

India is probably one of the few countries in the world which used its import policy for the healthy development of local industries. Barring the first few years after Independence, the country was facing a shortage of foreign exchange, and because of this shortage, imports had to be restricted. Imports of consumer goods were, therefore, disallowed. A good number of restrictions were put on the import of industrial goods, and the effort of the Government was to encourage the production of these goods indigenously. Local industries were encouraged to have foreign collaborations and to import the technical know-how needed to produce what was being imported into the country.

During the Second and Third plans, the emphasis was on the development of capital goods industries. India wanted to make machines that might help to produce other machines. Therefore, greater emphasis was given to the development of machine tools, textile machinery, and power equipment and so on. We were importing these mother machines, and the new effort was to produce them in India, to achieve self-sufficiency.

Financial Infrastructure

To provide the financial infrastructure necessary for industry, the Government set up a number of development banks. The principal function of a development bank is to provide medium and long term investments. They have to also play a major role in promoting the growth of enterprise. With this objective, the Government of India established the Industrial Finance Corporation of India (IFCI) (1948), Industrial Credit and Investment Corporation of India (ICICI) (1955), Industrial Development Bank of India (IDBI) (1964), Industrial Reconstruction Corporation of India (1971), Unit Trust of India (UTI) (1963), and the Life Insurance Corporation of India (LIC) (1956). For financial assistance to small entrepreneurs, Finance Corporations were established in all states on the basis of an Act that was passed by Parliament in 1951. In addition to this, the National Small Industries Corporation was also established at the Centre and a Small Industries Development Bank of India was established in 1989.
Encouragement to Small Industries

Though some of the policies of the Government resulted in inhibiting the growth of large-scale industries, they gave encouragement to small-scale industries by providing a number of support measures for growth. Policy measures undertaken by the Central and State Governments addressed the basic requirements of the SSI like credit, marketing, technology, entrepreneurship development, and fiscal, financial and infrastructural support.

Introduction to Development Banks

The term development bank was first used by Prof. William to refer to the specified financial institutions meant for providing long-term capital for financing economic development. Development banks includes those financial institutions, which provide the sinews of development, that is capital, enterprise and Technical knowhow to business enterprise so as to foster industrial growth. A development bank is a multipurpose institution with a broad development outlook rather than the conservative and short term outlook that used to be generally associated with commercial banks.

Finance from these agencies is supporting a variety of activities including agriculture, fisheries, tea, irrigation, water, sanitation housing and research in pharmaceuticals, vaccines and microfinance. What these institutions have done is provide long-term credit to cash strapped states to fast-track their economies – something they couldn’t have achieved solely on tax revenues and Central handouts. The investment scenario in India is also much improved by these agencies though indirectly. These agencies force the borrowing governments to make essential changes to their policy before lending: this ensures that most if not all funding reaches the right people. Vast changes have taken place over the years, all thanks to the development banks. Initiating a business is a lot easier than it was fifteen years ago.

Hence, development banking is service oriented and it is not meant for commercial for business profit. It is known fact that in earlier phase of the development of industrially advanced countries, the governments played a dominant role in providing necessary long-term finance to industries by starting development banks.
Historical Background

Development banks are often considered to be of relatively recent origin but it is not true. A development bank Viz. Societe Generale de Belgique existed as early as in 1822 in Belgaum for the specific task of financing Belgian industries. A similar institution was established in 1852 in France with the name “Credit Mobiliser”. The Industrial Bank of Japan came into being in 1902. The first phase of institutional development was witnessed on the European continent in the period following the First World War.

Every country in Europe saw the creation of specialized financial institutions to provide industrial finance for the reconstruction, modernization and development of war shattered industries. Among them the most important banks were the Industrial Mortgage Institute Limited the Provisional Mortgage Bank of Saxony and National Economic Bank of Poland.

Financial institutions which emerged in the period after World War II showed a remarkable preference for underwriting and direct investment activity, besides mortgage and lending business. The Industrial Development Bank of Canada (1944), the Finance Corporation of Industry Limited and the Industrial and Commercial Finance Corporation Limited of Great Britain and Industrial Finance Department of the Commonwealth Bank of Australia (1946) are the important examples. These institutions are primarily engaged in financing the establishment of industries in developed countries.

Development banks are international, national or provincial depending on the geographical area of their operations. The International Bank for Reconstruction and Development (IBRD), more commonly known as World Bank was established in 1946 with the active support of President Roosevelt of the U.S.A to assist in the construction and development of the territories of its members. In 1956 and in 1960, the World Bank set up its two affiliated institutions called International Finance Corporation (IFC), and International Development Association (IDA) respectively. In 1967, the Asian Development Bank (ADB) was started to finance its member countries.
Development banking in India

The concept of development banking rose only after Second World War, successive of the Great Depression in 1930s. The demand for reconstruction funds for the affected nations compelled in setting up a worldwide institution for reconstructions. As a result the IBRD was set up in 1945 as a worldwide institution for development and reconstruction. This concept has been widened all over the world and resulted in setting up of large number of banks around the world which coordinating the developmental activities of different nations with different objectives among the world. The Narashimam committee had recommended to give up its direct financing functions and to perform only the promotional and refinancing role. However it is the S.H.Khan committee appointed by RBI has recommended transforming the DFI (development finance institution) into universal banking institutions.

The course of development of financial institutions and markets during the post-Independence period was largely guided by the process of planned development pursued in India with emphasis on mobilization of savings and channelizing investment to meet Plan priorities. At the time of Independence in 1947, India had a fairly well-developed banking system. The adoption of bank dominated financial development strategy was aimed at meeting the sectoral credit needs, particularly of agriculture and industry. Towards this end, the Reserve Bank concentrated on regulating and developing mechanisms for institution building. The commercial banking network was expanded to cater to the requirements of general banking and for meeting the short-term working capital requirements of industry and agriculture. Specialized development financial institutions (DFIs) such as the IDBI, NABARD, NHB and SIDBI, etc., with majority ownership of the Reserve Bank were set up to meet the long-term financing requirements of industry and agriculture. To facilitate the growth of these institutions, a mechanism to provide concessional finance to these institutions was also put in place by the Reserve Bank.

The first development bank in India incorporated immediately after independence in 1948 under the Industrial Finance Corporation Act as a statutory corporation to pioneer institutional credit to medium and large-scale. Then after in regular intervals the government started new and different development financial institutions to attain the different objectives and helpful to five-year plans. The early history of Indian banking and finance was marked by strong
governmental regulation and control. The roots of the national system were in the *State Bank of India Act* of 1955, which nationalized the former Imperial Bank of India and its seven associate banks. In the early days, this national system operated alongside of a large private banking system. Banks were limited in their operational flexibility by the government's desire to maintain employment in the banking system and were often drawn into troublesome loans in order to further the government's social goals.

The financial institutions in India were set up under the strong control of both central and state Governments, and the Government utilized these institutions for the achievements in planning and development of the nation as a whole. The all India financial institutions can be classified under four heads according to their economic importance that are All-India Development Banks, Specialized Financial Institutions, Investment Institutions, State-level institutions and Other institutions.

**Genesis of IDBI**

The Industrial Development Bank of India (IDBI) was established on July 1, 1964 under an Act of Parliament as a wholly owned subsidiary of the Reserve Bank of India. In 16th February 1976, the ownership of IDBI was transferred to the Government of India and it was made the principal financial institution for coordinating the activities of institutions engaged in financing, promoting and developing industry in the country. Although Government shareholding in the Bank came down below 100% following IDBI's public issue in July 1995, the former continues to be the major shareholder (current shareholding: 52.3%). During the four decades of its existence, IDBI has been instrumental not only in establishing a well-developed, diversified and efficient industrial and institutional structure but also adding a qualitative dimension to the process of industrial development in the country. IDBI has played a pioneering role in fulfilling its mission of promoting industrial growth through financing of medium and long-term projects, in consonance with national plans and priorities. Over the years, IDBI has enlarged its basket of products and services, covering almost the entire spectrum of industrial activities, including manufacturing and services. IDBI provides financial assistance, both in rupee and foreign currencies, for green-field projects as also for expansion, modernization and diversification purposes. In the wake of financial sector reforms unveiled by the government
since 1992, IDBI evolved an array of fund and fee-based services with a view to providing an integrated solution to meet the entire demand of financial and corporate advisory requirements of its clients. IDBI also provides indirect financial assistance by way of refinancing of loans extended by State-level financial institutions and banks and by way of rediscounting of bills of exchange arising out of sale of indigenous machinery on deferred payment terms.

IDBI is vested with the responsibility of co-coordinating the working of institutions engaged in financing, promoting and developing industries. It has evolved an appropriate mechanism for this purpose. IDBI also undertakes/supports wide-ranging promotional activities including entrepreneurship development programmes for new entrepreneurs, provision of consultancy services for small and medium enterprises, up gradation of technology and programmes for economic upliftment of the underprivileged.

Genesis of SIDBI

Small Industries Development Bank of India (SIDBI) was established in April 1990 under an Act of Indian Parliament as the principal financial institution for the promotion, financing and development of industry in the small scale sector Co-coordinating the functions of other institutions engaged in similar activities Since its inception, SIDBI has been assisting the entire spectrum of SSI Sector including the tiny, village and cottage industries through suitable schemes tailored to meet the requirement of setting up of new projects, expansion, diversification, modernization and rehabilitation of existing units. SIDBI is committed to developing a strong, vibrant and responsive small scale sector. This commitment is to be achieved through a variety of means. Principal amongst them is finance. Alongside finance, SIDBI provides appropriate support in the form of promotional and developmental services. SIDBI has been built up as a financially sound, vibrant, forward looking and technically oriented institution and, it intends to sustain this orientation in future. The activities of SIDBI, as they have evolved over the period of time, now meet almost all the requirements of SMEs which fall into a wide spectrum constituting modern and technologically superior units at one end and traditional units at the other.
Introduction to State Financial Corporation

In pursuance of the SFCs Act, 1951, SFCs were set up mainly to finance small and medium scale units. Their area of operation is generally restricted to the concerned States. SFCs also assist small scale units for their modernization and technology upgradation programmes by providing soft loans, restructuring the sick small scale units through rehabilitation schemes and through equity type assistance under SIDBI's seed capital scheme. At present, there are 18 SFCs (including TIIC which was set up as a company) in existence for more than 40 years and operate as Regional Development Banks. The SFCs have played an important role in the evolution and growth of small and medium scale industries in their respective states. They provide financial assistance to industrial units by way of term loans, direct subscription to equity, guarantees, etc. Over the years SFCs have expanded their activities and coverage of assistance. One-Man Committee set up by RBI under the Chairmanship of former Secretary, SSI&ARI, to look into various problems regarding credit flow to SSI sector and support appropriate measures for their redressal has given the recommendations in its report submitted to RBI.

The main objectives of State Financial Corporation are to finance and promote small and medium enterprises in their own States for achieving balanced growth, catalyze investment, generate employment and widen the ownership base of industry. The SFC's mostly follow the types of assistance rendered by the Industrial Finance Corporations of India such as granting loans and advances or subscribing to debentures of Industrial concerns repayable within twenty years, guaranteeing industrial loans, underwriting the stocks, shares, bonds and debentures which have to be disposed within seven years. The funds of the Government and IDBI are mostly handled in these corporations.

List of State Financial Corporations (SFCs)
1. Andhra Pradesh State Financial Corporation (APSFC) Andhra Pradesh
2. Assam Financial Corporation (AFC) Assam
3. Bihar State Financial Corporation (BSFC) Bihar
4. Delhi Financial Corporation (DFC) Delhi (National Capital Territory)
5. Gujarat State Financial Corporation (GSFC) Gujarat
6. Haryana Financial Corporation (HFC) Haryana
7. Himachal Pradesh Financial Corporation (HPFC) Himachal Pradesh
9. Karnataka State Financial Corporation (KSFC) Karnataka
10. Kerala Financial Corporation (KFC) Kerala
11. Madhya Pradesh Financial Corporation (MPFC) Madhya Pradesh
12. Maharashtra State Financial Corporation (MSFC) Maharashtra, Goa, Daman & Diu
13. Orissa State Financial Corporation (OSFC) Orissa
14. Punjab Financial Corporation (PFC) Punjab
15. Rajasthan Financial Corporation (RFC) Rajasthan
16. The Tamil Nadu Industrial Investment Corporation Ltd. (TIIC) Tamil Nadu
17. Uttar Pradesh Financial Corporation (UPFC) Uttar Pradesh
18. West Bengal Financial Corporation (WBFC) West Bengal

1.2 STATEMENT OF THE PROBLEM

The Small Scale Industry today constitutes a very important segment of the Indian economy. The development of this sector came about primarily due to the vision of our late Prime Minister Jawaharlal Nehru who sought to develop core industry and have a supporting sector in the form of small scale enterprises. Small Scale Sector has emerged as a dynamic and vibrant sector of the economy. Today, it accounts for nearly 35% of the gross value of output in the manufacturing sector and over 40% of the total exports from the country. In terms of value added this sector accounts for about 40% of the value added in the manufacturing sector. The sector's contribution to employment is next only to agriculture in India. It is therefore an excellent sector of economy for investment.

State Financial Corporations were established in the States under the Central Act, viz.. The State Financial Corporations Act, 1951, with the basic objective of promoting and developing small scale industries in the respective states with a special focus on spreading industrial culture in the rural, semi-urban and backward areas of the States. These corporations
are owned by the respective state governments jointly with IDBI and they are functioning under the administrative control of the state governments. SFCs provide term loan to small and medium scale industries for creation of assets, viz., land, building and machinery. They also provide working capital term-loan to the industrial units on competitive terms. Various non fund based services like merchant banking, under-writing of public issues, project counseling, bill discounting, leasing and hire purchase are also been undertaken by them. They are operating a number of financial assistance schemes for the benefit of the entrepreneurs such as assistance for marketing activities, equipment finance, special schemes for assistance to ex-servicemen, single window scheme, etc. Since the State Financial Corporations played a vital role in promoting and developing the Small scale industries, they are contributing a major share in the overall industrial growth of our country, the researcher has taken this title for her study.

1.3 OBJECTIVES OF THE STUDY

- To study the origin and growth of State Financial Corporations of South India.
- To know the resource mobilization of State Financial Corporations.
- To analyze the lending performance of State Financial Corporations.
- To assess the recovery performance of State Financial Corporations.
- To know the profitability of State Financial Corporations.

1.4 METHODOLOGY AND FRAME WORK OF ANALYSIS

The study is based on secondary data. A convenient sample of four state financial corporations of South India has been taken for the purpose of the study. The required data were collected from the annual reports, operational statistics of state financial corporations and other relevant data were collected from journals, magazines, articles and websites. The sample consists of the following four financial Corporations.

1. Andhra Pradesh State Financial Corporation, Andhra Pradesh.
2. Karnataka State Financial Corporation, Karnataka.
4. Tamil Nadu Industrial Investment Corporation Ltd.,
For the purpose of the analysis various accounting and statistical techniques had been used. To analyze the profitability of the corporations, it makes use of ratio analysis. The statistical techniques used are arithmetic mean, co-efficient of variation, standard deviation, and compound annual growth rate and trend analysis. Correlation and multiple regression analysis were used to measure the relationship between the variables and to identify the factors influencing the profitability. Anova is an important technique used to examine the significant mean differences between more than one group. It will show whether or not the means of various groups are significantly different from one another as indicated by F statistic.

The study period covers the performance of state financial corporations for 10 years from 1996-97 to 2005-06.

1.5 SCOPE AND LIMITATIONS OF THE STUDY

The State Finance Corporations of South India showed poor and moderate performance over the years and the scope of the present study is to evaluate the performance of state finance corporations in terms of lending, recovery, outstanding and profitability. The limitations of the present study are,

1. The study covers only 10 years ranging from 1996-97 to 2005-06 and it does not include data before independence.
2. The study covers only 4 State Financial Corporations and a larger sample consisting of all State Financial Corporations could not be adopted due to resource constraints.
3. In this study primary data are not used.
4. It depends only on secondary data.
5. Time factor is also considered to be a constraint.
1.6 CHAPTER SCHEME

The present study has six chapters.

- The first chapter includes the Introduction, Statement of the problem, Objectives of the study, Methodology, Scope and Limitations of the study.

- The second chapter covers Review of literature and it contains excerpts from articles, journals from Indian and Foreign Journals.

- The third chapter deals with growth and development of State Financial Corporations in India and Profile of selected state financial corporations.

- The fourth chapter discloses the resource mobilization and growth of total funds raised by the sample State Financial Corporations.

- The fifth chapter contains the financial analysis of lending and recovery performance and the profitability of the sample State Financial Corporations.

- The sixth chapter presents Findings, Conclusions and provides suitable Suggestions for the study.