Chapter 1: Introduction

Financial institutions in India were operating under a covered and regulated environment since independence. The concept of marketing was non-existent in these financial institutions. They were simply engaged in providing traditional tailor-made products and served with little or no orientation towards profits. The working of these financial institutions was characterized by over staffing, low productivity, low levels of motivation, lack of specialized operations and low customer orientation. A large number of financial institutions instead of doing the jobs for which they were established could fall sick and could not come out of the sickness despite of varied efforts of the government whereas only few of them could survive due to their expanded activities.

Developments in the recent year's world wide as well in India have brought about fundamental revision in the approach of these financial institutions. The government has almost stopped providing free lunches to these financial institutions. In India up to 1980's the dominant fear of market failure supported the rationale of government intervention the financial institutions. Bhalla (2002) highlighted that the first five-year plan by and large ignored the role of financial institutions in the development process. The financial institutions were given a restricted role of allocating the resources and distributing it with greater accent towards socialism. Ray and Sengupta (2000) further emphasized the role of financial institutions in the era of globalization. Initially the Government of India was viewed as the primary entrepreneur in the economy and the financial institutions were provided the restricted role of channelising the resources from the saver to the allocated use of the government. The emphasis of the system was to
design a system with wide spread network not in terms of geographical spread but in terms of socioeconomic reach. This policy guideline resulted in the nationalization of banks in 1969 and consolidation and nationalization of private insurance companies in 1971. However the ninth five-year plan intensified the reforms in the financial sector by increasing the purview of performance of financial institution from a mere allocator of resources to an intermediary operating in various segments of the markets with different risk profiles. It resulted in the widening and deepening of financial markets. Subramanian (2002) indicates that the objective of financial institutions has changed from growth with profit to profit with growth, as mere growth in business does not lead to profitability. Today financial institutions are working hard to increase the profitability by increasing the demands and curtailing the cost by finding new sources of revenue. Qamar (2003) emphasized that the efficiency of financial institutions is simply not dependent on how well it is able to maintain its traditional sources, rather now it is dependent on fact that how well it is able to supplement its traditional sources of income with new sources of income. Taneja (2003) has highlighted the reinvestment pattern of LIC to emphasize on the growing awareness among financial institutions to find new sources of income. The investment made by life Insurance Corporation in various sector was 38406.62 crore in 1992-93 which increased to the tune of 175491 crore in 2001-02 registering a remarkable increase of 357 percent. Similarly the investment of general insurance companies increased from 7358.9 crore in 1991-92 to 23113 crore in Mar 2001 registering an increase of 265.67 percent.

Further more there is growing rationalization among the financial institutions that that the basic reason for their existence in a market is to meet the needs and expectations of consumers. The success of financial
institutions will depend on the closeness with which it is able to relate its products and services with the changing need of consumers. Chhottaraj (2005) indicated that mere satisfaction does not ensure loyalty in today's market. What guarantees loyalty, is customer delight. In reality the Indian financial institutions are merely trying to satisfy the consumers, which cannot guarantee repeat purchases. Today the performance of a product or service is tested at all levels beginning from core benefits it provides to the unexpected it can offer at the augmented level. Reserve Bank of India provided a performance code for banking institutions in India in 2006. The irony is that this code still focuses on basic service elements which were suggested way back by Parasuraman et. al in 1988. This fact highlights the low level of concern of policy makers to improve the efficiency of banks in India. They are busy making policy for survival even after long years of existence in the market. There is very little or no focus to become the leader in the market. The leader transcends the expectations of its customers by simply dropping benefits in the wallet of customers, which is unexpected. Thus industry in general and financial institutions in particular must focus on evolving new and innovative products and services which is unexpected by the consumers.

The significance of financial institutions has increased with the emergence of service-based economy. Restructuring of financial markets and institutions has become the prime need of Government. The establishment of high-level committee like the Narsimhan committee in Aug. 1990 to consider all aspects of structure, organization, functions and procedures of financial institutions has reestablished this fact. The key component of strategy suggested by the committee was to integrate Indian financial institutions with global financial markets by deregulation, liberalization and globalization. Interestingly the story of financial sector
reform is not a one-side chronicle of withdrawal of the state. It was based on two pillars. The first pillar was based on a move towards a market based system whereas the second pillar was based upon the measure for improving the health of financial system by regulatory and supervisory initiatives. Thilangya (2000) reflected that Indian financial systems always had a guided tour, not a sight seeing trip. They were always advised regarding whom to lend? How to lend? And when to lend, but they were not told how to make profit at the end of the day. Probably the policy makers felt that the pleasure was in traveling alone and not reaching at a destination. Thus when Dr. Manmohan Singh the then finance Minister of India announced the liberalization privatization and globalization policy the entire sector was exposed to new challenges. Further more the changing moral values, changing technology inputs, increased competition and changing policy guidelines for operations increased the challenges in front of the financial institutions. The financial institutions, which were a having a safe and pressures less style of operation needed to think about means to distinguish themselves from others to survive from the pressure of new entrants. Gupta (2003) expressed that Indian financial institutions used heritage and reputation to attract and maintain customers whereas the foreign financial institutions used technology as their distinguishing point. Banu (2004) rightly pointed out that LPG policy provided a new perspective to Indian Financial Institutions to operate in Global economy. Kumar (2003) expressed his concern over average and low customer satisfaction of Indian Public sector banks, falling renewal premiums of Nationalized Insurance companies and continuous scams in the stock markets. He emphasized on the need of customer retention as customer creation was a costly affair. Awasthi, Jinnah and Joshi (2004) presented similar views when the emphasized on after sales and during sales service. Root (2003) emphasized that product innovation in financial sector is short lived since it
is relatively easy to copy new products offered in financial service sector. So the financial service sector has to depend on customer satisfaction for repeat purchases and profits. Indian financial institutions had always taken the customers for granted and the emphasis on customer management practices made their operations tough.

1.1 Management of Finance

In any area of activity, good management is the sine-quo-non of success through efficiency and cost effectiveness. The objective of management may change but basically all aim at efficiency, productivity, and lowering of cost and raising of profits. If it is the area of services, the quality and cost effectiveness would still count as important prerequisite for its success. It is in this background that input availability and their efficient use for low output are necessary to promote competitive efficiency and economy.

The activity analysis of any economy, firm or company involves the technological relationship between inputs and outputs. It is the management function to see that this relationship of input and outputs is most up to date, modern, cost effective. This activity may be provision of services in case of financial services where efficiency is the land mark of success, management has role which is judged by the results in terms of cost, quality, profits etc.

The process of Financial Management takes place in the following manner:

1.1.1 Activity Analysis
1.1.2 Productivity Analysis
1.1.3 Role of Financial Institutions
1.1.1 Activity Analysis

The basis of all activities is man's desire. Thus desire plus purchasing power leads to demand. Desire is both physical and mental and is supported by the qualities of heart or mind. This would make supply of labour available along with management expertise, technology etc. which are the products of man. On the other hand purchasing power comes from his command on money, claims on money, finance, wealth etc.

In the financial markets desire can be classified under three motives:

1.1.1.a Transaction Motive
1.1.1.b Precautionary Motive
1.1.1.c Asset Management Motive

1.1.1.a Transaction Motive: Consumers require money to purchase goods and services. Exchange process in today's market is facilitated by money or variants of money like credit or debit cards. Banking services regulate the flow of money in the economy.

1.1.1.b Precautionary purposes: Money or variants of money is also used by consumers to safeguard themselves during some future risk also. Consumers invest money in Life insurance policies or general insurance policies to save themselves from risk related with uncertainty in future. These policies covers risk related with life and property.

1.1.1.c Asset Management Purposes: Consumers have the tendency to accumulate money for future needs. Investment and securities companies provide avenues to save money for future in the form of shares and bonds.
Thus the demand side of the activity which leads to supply may be set out as follows:

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<table>
<thead>
<tr>
<th>Supply of human resources</th>
<th>Availability of Financial Resources</th>
<th>Land Assets Plant &amp; Machinery etc.</th>
<th>Production of Goods &amp; Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour Enterprise</td>
<td>Money Finance and Capital</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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Figure 1.1: Demand and Supply Cycle

**Productive Process Involves**

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Inputs ➔ Technological Relation ➔ Output
Rent, Wages ➔ Finance as Input ➔ Goods & Services
Demand ➔ Relation of Demand/Supply ➔ Supply
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**Money/Finance**

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Transaction Purpose ➔ Precautionary Purpose ➔ Asset Purpose
Cash ➔ Cash / Credit ➔ Financial Assets
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Figure 1.2: Productive Process
1.1.2 Productive Activity

Management of productive activity thus involves:

(a) Cash Management
(b) Credit Management
(c) Asset Management both in macro and micro sense.

In macro sense these elements of management are part of the financial markets governed by the services rendered by them. They can be depicted as follows:

**Inputs Lead To Outputs And Are Classified As**

<table>
<thead>
<tr>
<th>Physical</th>
<th>Financial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corresponding to physical activity</td>
<td>these are Financial Service</td>
</tr>
<tr>
<td>Physical inputs: Land, Labour, Enterprise, Management</td>
<td>Financial Inputs: Cash Credit and Finance</td>
</tr>
<tr>
<td>(Converted Into Financial Form For Income Expenditure)</td>
<td></td>
</tr>
<tr>
<td>Financial Markets</td>
<td>Financial Services</td>
</tr>
<tr>
<td>Money / Securities/Financial Instruments, Financial Assets/Trading in them</td>
<td>Lending and borrowing / investments, discounting, sale/purchase of assets, hire purchase, lease financing, housing finance etc.</td>
</tr>
</tbody>
</table>

_Figure 1.3: Flow of Finance_

1.1.3 Role of Financial Institution

Further the operations of Financial System are based around the process of financial intermediation and the firms that undertake this function. The process of financial intermediation involves the channeling of
funds between those who wish to lend and those who wish to borrow; that is, between people and institutions with budget deficit. In fact, whenever an institution of individual channels fund between lenders and borrowers, than the process of financial intermediation occurs.

In the process of intermediation assets are created. Financial institution creates asset when funds are deposited at a risk on a precondition that it may be withdrawn after a period of notice. The intermediary uses this fund and, pays a periodical fee and creates a liability for itself. Similarly by paying insurance premium the consumer creates a liability for the financial institution to safe guard him/her against future risk. Tradable security is another form of asset that is created by financial intermediation. The establishment of security market allows the lender of capital to buy a contract which places a legal claim on the financial intermediary. The structure of financial industry has several intricacies, thus for accurate representation a functional approach is adopted to study the types of financial services.

1.2 Types of Financial Institutions

Thus existence of financial institutions is necessary to provide services to fulfill the various motives of consumers. Kotler (2005) opined that a service is any activity or performance that is essentially intangible and does not result in ownership of anything. Provision of service may or may not be tied to a physical product. Similarly financial services may be defined to consist of any activity or performance that is intangible in nature and is directed towards delivery of products and services for satisfaction of financial motives. According to Bhalla (2005) financial services include the
provision of financial service or sale of financial product. Bhalla has grouped the financial service and products under following category: Banking and credit, Insurance, Security and brokerage. Further Gupta and Agrawal (2006) defined the term financial service as activities benefits and satisfaction connected with the sale of money that offers the users and customer's financial related values. Khan (2003) mentioned that financial services can be broadly classified into two categories (i) asset based and (ii) advisory based. The financial institutions providing these services can be classified under three categories: (i) deposit taking firms (ii) Insurance providing firms (iii) securities and investment providing firms.

The analysis of financial services allows an analysis of the significantly different processes existing in each of these markets. It highlights the segmented structure of financial service market arising out of different needs and motives of customers in the market. The financial service market can be clearly categorized into three different segments satisfying financial requirements.

<table>
<thead>
<tr>
<th>Service/Product</th>
<th>Banking &amp; Credit</th>
<th>Insurance</th>
<th>Securities &amp; Brokerage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal</td>
<td>Deposit schemes</td>
<td>Life insurance</td>
<td>Equities &amp; Debt</td>
</tr>
<tr>
<td></td>
<td>Credit schemes</td>
<td>General Insurance</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insurance</td>
<td>Capital Management</td>
</tr>
<tr>
<td>Corporate</td>
<td>Merchant Banking</td>
<td>General</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Services</td>
<td>Insurance</td>
<td></td>
</tr>
</tbody>
</table>

Table 1.1: Scope of Financial Services
1.3 Types of Services provided by Financial Institutions

1.3.1 Deposit Taking Firms

Sayers (1999) highlighted that deposit taking firm is an institution whose debts are widely accepted in settlement of other people's debts to each other. Banking Regulation Act (1949) defined deposit taking firm as accepting for the purpose of lending or investment of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, and order or otherwise.

1.3.1.a. Deposit Schemes

The deposit taking firm provides following deposit schemes:

I. Saving Bank Deposit Scheme
II. Recurring Deposit Scheme
III. Fixed Deposit Scheme
IV. Current Account Scheme

I. Savings bank Deposit Scheme

The objective of this service is to inculcate the habit of savings among individuals. This facility allows individual to save small amount of money with banks for their future need. The rate of interest paid to customers is comparatively lower than Fixed Deposit and Recurring Deposit schemes. He is allowed to withdraw money as per his convenience.

II. Recurring Deposit Scheme

Customer deposits a fixed installment of money every month for a fixed time period. He is not allowed to withdraw money before that time period. If he withdraws money an interest penalty is charged on him.
III. Fixed Deposit Scheme

A fixed sum of money is deposited with the bank for a time period, which is predefined. The bank pays highest interest on this service.

IV. Current Account Schemes

This account is managed by businessmen to facilitate transaction with their creditors and debtors. Bank charges money on this account from businessmen. No interest is paid on this account. There is no limit to number of withdrawals from this account.

1.3.1.b Credit Schemes

The term consumer finance and consumer credit are used interchangeably in the common parlance. It refers to the arising of finance by individuals for meeting their personal expenditure or for the acquisition of durable consumer goods and for the purchase / creation of an asset. In a typical consumer finance transaction, the individual / consumer / buyer pays a fraction of the purchase price in cash at the time of the delivery of the asset and pays the balance with interest over a pre-determined period of time. Consumer finance is emerging as an important asset – based service in India with the objective of providing finance asset – based financial service in India with the objective of providing finance on easy terms and at the door steps of the consumer. Various banks, both public and private, and finance companies are in the field to provide not only the consumer goods such as TVs, refrigerators, washing machines, personal computers (PCs), cooking ranges but also for the construction/ purchase renovation of a house education in India and abroad, and for the purchase of cars scooter etc. Finance in generally extended for a period of two a five years. Usually consumer finance transactions may be structured in any of the following ways.
I. Hire Purchase

II. Installment System

III. Overdraft / Demand Loans

IV. Credit Cards

V. Retail Loans

I. **Hire Purchase**: Hire purchase means a transaction where goods are purchased and sold on the terms (i) payment will be made in installment, (ii) the possession of the goods is given to the buyer immediately, (iii) the property (ownership) in the goods remains with the vendor till the last installment is paid, (iv) the seller can repossess the goods in case of default in payment of any installment, and (v) each installment is treated as hire charges till the last installment is paid.

II. **Installment System**: Under installment system, the seller/dealer of goods finance the asset purchased by the customer/borrower. The ownership and possession of an asset is transferred to the customer on payment of first installment. The balance amount of purchase price is paid in number of installments along with the rate of interest. Relation between the seller and buyer is of debtor and creditor.

Installment system may be two types:

(a) **Conditional Sale** - In conditional sale (hire purchase) the seller retains ownership of asset/goods and only possession of goods is transferred. Ownership gets transferred only when the buyer makes payment of last installment. This is done so as to avoid bad debts. In case the buyer makes a default in the payment, the seller can take possession of goods/assets back and may dispose off the same to realize his money.

(b) **Pledge or Hypothecation** - This mode of finance is very popular with banks that advance credit on the security of goods. Jewelry and government securities pledged or hypothecated with the bank. Once
the amount advanced as credit is returned. The hypothecation charge is vacated.

III. Overdraft / Demand Loans: Facilities are also made available to individuals to overdraw their accounts up to certain limits as laid down by the banks, commensurate with the value of security, margins and credit worthiness of the individual customer. Under an overdraft, interest is charged on the amount actually utilised by the life insurance policies, fixed deposit receipts, government securities such as NSCs, IVP/KVP, shares and debentures etc. of the individuals.

IV. Credit Cards: Many banks, both in public and private sector, have entered the credit card field. Credit card plans involve a three party arrangement. The cardholder the bank, and a merchant. The embossed plastic card issued to the consumers serves as evidence to merchants that a bank has granted a line of credit to the holder of the card. Retail merchants agree with the bank to accept the card for payment of goods and services. Merchants who have an account with a card for issuing bank may deposit their sales slips with the bank or with one of its real sense, the bank is financing the merchant’s accounts receivable and, in doing so, relieves them of the costs involved in operating a credit department if the merchant does not have an account with the bank but has a credit card clearing agreement with the bank, is required to make payment to the merchant by cheque for the sales drafts.

V. Retail Loans: As per a report published ‘Business India’ April 2002, the market size of consumers is as below:

The size of the consumer finance market is estimated at Rs. 50,000 crore including a credit card spend of Rs. 10,000 crore and housing occupying major share of 50%. The changing mind set of the Indian middle
class has resulted in banks and NBFCs aggressively lending to the household segment. As a result, Consumer finance is growing at a scoring pace. Between December 2001 and March, 2002 in banks such as SBI over 50% of the total credit growth came from retail finance, particularly from housing and personal loans segments.

**V.a Housing Finance**: Housing loan is a type of installment credit which forms the largest single source of housing finance. Under installment credit scheme, the customer repays the loan in equal periodic installment or equated monthly installment (EMI) as they are called, the housing loan can be availed for following purpose.

I. **Construction**: It means construction of a complete house comprising of bedroom, living first floor etc.

II. **Extension**: Purchase means construction of additional rooms, toilets etc, in an existing house.

III. **Purchase**: Purchase means purchase of complete house having basic requirements for a family to live in.

IV. **Combined loan for purchase of plot and construction**: It means loan is required for the purchase of plot and construction on that plot. These loans are given for specified ratios.

V. **Acquiring house/ flat through cooperative housing society**: The loan can also be availed for acquiring a house or flat through the cooperative housing societies.

**V.b Educational Loans**: There has been tremendous growth in the recent past in the education sector. Highly specialized, professional and technical education is now available in India. The number of students seeking admission to professional courses is multiplying every year. However, the cost of these courses is considerably high and the meritorious students look towards commercial banks for financial
assistance. The high cost of education in premier institutions need no longer stand in between the students and their career aspirations. If one has the ambition and drive, the banks will take care of finance involved. Most of the students, after completion of their respective courses, get good jobs and as such acquire the necessary repayment capacity to service these loans without default. The prime aim of education loans is to make careers happen.

V.c Automobile Finance: The changing paradigm of society and further in this era of fast life everyone wants to own a vehicle of his own. Thus, auto loans have become a need of the hour because the people who do not have sufficient funds prefer to buy today and pay tomorrow. Under the banks auto loan scheme there is a vehicle loan for every class i.e. 2 wheeler’s loan 2nd hand car loans, new car loan. The market for auto loans is large and lot of opportunity exists there for the banks and other finance companies who by adopting customer friendly policies and mass advertising can surely make auto loan schemes a success.

V.d Personal Loans: General-purpose loans are advance to the individual to meet personal expenses e.g. consumer durables, marriage / family function / medical / education expenses / travel etc. Thus, with such easy finance facility, a consumer can buy refrigerator, food processor, and cooking range or music system or wants to renovate his home or pay his children’s college fees or whether he wants to take a vacation abroad. It is possible now with the bank’s personal loan schemes.

V.e Holiday Finance: Consumers are offered tour packages with holiday now, pay later options. Today, consumer who finds himself unable to meet the cost of package gets ready to accept the option. For example, SOTCs European tour package in cities and beautiful locates of Europe in the 15 day package.
V.1 Finance For Medical Treatment: Banks provide financial assistance for specialised medical treatments, which involve heavy expenditure running into a few lacs of rupees. It is very difficult for individuals especially the salaried class to arrange funds at short exigencies. Loans are available to all such patients who are suffering from diseases where mortality probability is low and the patient emerges as a healthier person after treatment.

For examples; coronary by pass, hip and knee replacement surgery, cochlear implants (surgical) for the hearing impaired, angioplasty, congenital heart surgery etc. Payment is made direct to the hospitals.

1.3.2 Insurance Services

We all are exposed to various risks in our daily life. Even the wisest and cleverest person can not provide for or avoid all risk. Nobody can predict or foresee the calamity he may suffer in future. Everybody on the road, whether on foot or in a vehicle carries some risk of accident which may result into serious injury, loss of limb impairing ability to earn livelihood, or even death. One may take precautions against such risk, but the risk can not be eliminated. Similarly, there can be loss due to fire, flood, earthquakes, burglaries, illness etc. Every loss causes human suffering.

It is possible to take precautions against such events, but the possibility of such happenings can not be completely ruled out. One can also make provision for coping up with such events, but can not eliminate the chance of such happening. For example, security can be increased in a particular area in view of increased burglaries, however, burglary can still happen. One can increase life expectancy by proper health and medical care, however death will still happen. Efficient fire service can minimize the
loss due to fire cannot prevent the occurrence of fire. In short can be reduced but not eliminated.

A risk involves loss. Not all, but most of the losses can be expressed in terms of money. A person exposed to some risk may incur a loss. If loss is small he may bear it alone. If loss is huge he may not be able to bear it alone. Society may have to render help to enable the sufferer to cope up with the situation. Example, the help rendered to the victims of earthquake in Gujrat. However, it will be better if a device or system is developed to provide help to those who happen to suffer a loss. Such a device is 'insurance'. Insurance is a co-operative device which spreads, the loss caused by a particular risk to some persons, over a number of persons who are exposed to, same or similar risk and who agree to 'insure' against that risk. There can be two approaches for defining insurance. One is functional approach other is contractual approach.

The functional approach definitions discussed below are noteworthy. According to Encyclopaedia Britannica, "Insurance may be defined as a social device whereby a large group of individuals, through a system of equitable contributions, may reduce or eliminate measurable risk of economic loss common to all members of the group." In similar sense Disnadle (1999) has defined that, "Insurance is an instrument of distributing the loss of few among many." Allen (2000) Mayerson states that, "Insurance is device for the transfer to an insured of certain risks of economic loss that would otherwise be borne by the insured."

From the above definitions, it emerges clearly that the functional definition has the following features. (a) It is a co-operative device; (b) It spreads the risk over a large number of persons who are insured against the risk; (c) It provides security to the insured.
In contractual sense the following definitions are noteworthy. According to Justice Tindall, (1989) "Insurance is a contract in which a sum of money is paid to the assured in consideration of insurer’s incurring the risk of paying a large sum upon a given contingency." In the words of E.W. Patterson(2000), "Insurance is contract by which one party, for a consideration called premium assumes a particular risk of the other party and promises to pay to him or his nominee a certain or ascertainable sum of amount on a specified contingency. The contractual approach definitions highlight the following features:

(a) it is a contract; (b) Where by insurer assumes the risk of insured; (c) And promise to pay a specified or ascertainable amount; (d) On the happening of a specific event and (e) In consideration of the premium paid by the insured.

The person who seeks protection against a risk is known as 'insured'. The person who provides protection is 'insurer' (i.e. insurance company). The document containing terms and conditions of contract in called ‘policy’ or ‘insurance policy’. The consideration from the insured is called premium.

1.3.2.a Kinds of Insurance: Insurance can be mainly classified into two categories.

I. Life Insurance:

The subject matter of this type of insurance is human life. Most of the insurance policies are combination of savings and security. The insured is promised by the insurance company that during the tenure of insurance in case of his death, his nominee will be paid the insurance amount. According to section 2 (ii) of Insurance Act 1938, "Life insurance is the business of effecting contracts of insurance upon human life including
any contract, whereby the payment of money is assured on death except death by accident on the happening of any contingency dependent on human life and any contract which is subject to the payment of premium for a term dependent on human life. In case he survives the term of the policy, he will be paid an amount as per terms of the policy."

II. General Insurance

All other types of insurance are called general insurance or non-life insurance. The common type of general insurances are discussed below:

II.a  Marine Insurance - It is oldest type of insurance. It covers the sea or marine perils, peril is the cause of loss or hazard which is a condition that may increase the chance of the loss. Marine insurance is protection against marine perils like loss or sinking of the ship, sea piracy, capture by enemy etc. The loss could be of ship, cargo or freight Marine insurance will cover such risks.

II.b  Fire Insurance - It covers the loss due to fire to the property like houses, shops, goods factories or godown etc. It covers loss from fire and the consequent loss from such fire i.e. the loss of work due to stoppage of work due to fire.

II.c  Liability Insurance - This type of insurance covers the risk of liability against third parties, which an insurer might have to pay under certain circumstances. For example, injury to the property and/or person of a third person in road accident or employer’s liability for an injury or death of a worker while performing duty etc.

II.d  Social Insurance - This insurance is aimed at providing social security to the weaker sections of the society. It may take the shape of pension plans, disability or sickness benefits etc. The premium may come from Govt. or employee and may also be shared by beneficiary.

II.e  Other Insurances - All other type of general insurances can be placed under this category e.g. theft insurance, earthquake insurance,
flood insurance, crop insurance, personal accident insurance, cattle insurance or livestock insurance, guarantee insurance etc.

1.3.3 Securities And Brokerage Market

Finance is the integral part of modern business. Financial markets refer to the institutional arrangements for dealing in financial assets and credit instruments of different types, such as currency cheques, bank deposits bills, etc.

The main functions of the financial markets are:

I. To facilitate creation and allocation of credit and liquidity.
II. To serve as intermediaries for mobilisation of savings.
III. To assist the process of balanced economic growth.
IV. To provide financial convenience.
V. To cater to the various credit needs of the business houses.

On the basis of credit requirement for short-term and long-term purposes, financial markets are divided into two categories.

1.3.3.a Money Market.

1.3.3.b Capital Market.

1.3.3.a Money Market: The term money market is used in a composite sense to mean financial institutions which deal with short-term funds in the economy. It refers to the institutional arrangements facilitating borrowing and lending of short-term funds. The money market brings together the lenders who have surplus short term investible funds and the borrowers who are in need of short-term funds. In a money market, funds can be borrowed for a short period varying from a day, a week, a month, or 3 to 6 months and against different types of instruments, such as bill of exchange, bankers' acceptances, bonds, etc., called 'near money'. Thus money market has been defined by Crowther as, “the collective name given to the various firms and institutions that deal in the various grades of near money.”
The Reserve Bank of India describes the money market as, "the centre for dealings, mainly of a short term character, in monetary assets; it meets the short-term requirements of borrowers and provides liquidity or cash to the lenders." The borrowers in the money market are generally merchants, traders, manufacturers, business concerns, brokers and even government institutions. The lenders in the money market, on the other hand, include the Central Bank of the country, the commercial banks, insurance companies and financial concerns.

The organization of the money market is formed. There is no definite place or location where money is borrowed and lent by the parties concerned, it is not necessary for the borrowers and the lenders to have a personal contact with each other. Negotiations between the parties may be carried through telephone, telegraph or mail. Thus, money market is simply an arrangement that brings about a direct or indirect contact between the lender and the borrower.

The term money market should be distinguished from the capital market. Money market in essence, is a short-term credit market that deals only in short-term finance, the capital market, on the other hand, is the market for long terms funds. However, the two markets are closely related as the same institution may many a times deal in both types of funds. The money market is not a single homogeneous market but it is composed of several specialized sub-market, each one of which deals in different types of short-term credit. We shall describe here the following important components of money market.

I. **Call Money Market**: The call money market refers to the market for extremely short-period loans. Bill brokers and dealers in the stock exchange usually borrow money for short periods from commercial banks. The money is advanced by the commercial banks to bill broker and dealers in the stock exchange for a very short period of one day, overnight or
maximum seven days. Such short period loans are called "call loans" as these can be recalled by the lending bank at any time. There is no collateral security demanded against these loans and the borrower has to repay the loans immediately whenever called for.

Call loans are found useful by commercial banks as they are like cash and also bring some income for the banks. Inter-bank call money market is very common in India. The bank which has surplus money for a short period lends to the needy bank.

II. Collateral Loan Market: The market which deals with collateral loans, i.e., loans backed up by collateral securities like stock and bonds, etc., is called collateral loan market. The collateral loans are given for short-period generally lasting a few months. The borrowers in this market are generally brokers and dealers in stock and shares, and the lenders are commercial banks. Sometimes, even a smaller bank may raise collateral loans from a bigger bank. The collateral security is returned by the lender on the repayment of loan but if the loan is not repaid the collateral security may be retained by the lender.

III. Bill Market or Discount Market: The bill market or the discount market refers to the market in which short period papers or bills are bought and sold. The most important short period papers, which are dealt in the bill market, are commercial bills. There are two types of commercial bills, (I) bill of exchange, and (ii) treasury bills. The bill of exchange, popularly known as bill, is a written instrument containing an unconditional order, signed by the drawer, directing a certain person to pay a certain sum of money only to, or order of a certain person, or to the bearer of the instrument at a fixed time in future or on demand. Bill of exchange is a very important document in commercial transactions. When the buyer is unable to make the payment immediately the seller may draw a bill upon him.
payable after certain period. The buyer accepts the bill and returns to the seller. The seller may either retain the bill till the due date or get it discounted from some banker and get immediate cash. Discounting being the main process of exchange of credit, such market is also referred to as the discount market.

The treasury bill, on the other hand, is a short-term government security, usually of the duration of 91 days, sold by the central bank on behalf of the government. There is no fixed rate of interest payable on the treasury bills. These are sold by the central bank on the basis of competitive bidding. The treasury bills are allotted to the person who is satisfied with the lowest rate of interest on the security. As treasury bills are government papers having no risk, these are good papers commercial banks to invest short-term funds.

1.3.3.b Capital Market

A good capital market is an essential pre-requisite for industrial and commercial development of a country. Credit is generally, required and supplied on short-term and long-term basis. The money market caters to the short-term; needs only. The long term capital needs are met by the capital market. Capital market is a central coordinating and directing mechanism for free and balanced flow of financial resources into the economic system operating in a country.

The development of a good capital market in a country is dependent upon the availability of savings, proper organization of its constituent units and the entrepreneurship qualities of its people. Before independence, the capital market of India was ill-developed because of its certain defects. But in recent years since independence, the capital market of India has substantially changed and has been changing for the better. The term capital market refers to the institutional arrangements for facilitating the
borrowing and the lending of long-term funds. In the widest sense, it consists of a series of channels through which the savings of the community are made available for industrial and commercial enterprises and public authorities. It is concerned with those private savings, individuals as well as corporate, that are turned into investments through new capital issues and also new public loans floated by government and semi-government bodies.

A capital market may be defined as an organized mechanism for effective and efficient transfer of money-capital or financial resources from the investment parties, i.e., individuals or institutional savers to the entrepreneurs (individuals or institutions) engaged in industry or commerce in the business either be in the private of public sectors of an economy. The corporate securities, viz; bonds or debentures, preferred stock commonly called preference shares and common stock or equity shares, are traded in carefully regulated money markets. The markets for the three type of corporate securities include:

1. The Primary or New Issue Markets.
2. The Secondary Markets.
3. Over-The Counter Markets.

The primary or the new issue market deals with the offer and exchange of stocks or bonds that have never been previously issued. The securities that have been previously issued are traded in the secondary markets, which include the organized stock exchanges and over the counter market. The Over-the Counter Exchange of India (OTCEI) began its operations in the year 1992 as a second-tier bourse which permits smaller companies to raise funds. In addition to the market, the National Stock Exchange has also started on-line scripless trading in India in the year 1994.
1.4 Management of Financial Services

Any saver has some specific objectives or motives behind his savings. He may be providing for a future, or for large accumulation of wealth. His objectives may be set out as follows:

(a) Income at regular intervals; (b) Capital appreciation or gain in wealth; (c) Safety of his funds; (d) Marketability and liquidity of assets; and (e) Hedge against inflation or fall in value of money.

All of the above objectives are fulfilled by investments in stock and capital markets. The most important, objective, namely, to protect the value of his money requires planning for proper money management by the investors. The management of financial services involves following activities.

1.4.1 Money Management

1.4.2 Saving Allocation

1.4.3 Investment Activity

1.4.1 Money Management

Money management refers to use of money in such a way that his investments generate an appreciation much higher than the fall of money and investors net worth will continue to grow faster than the average rate of inflation. A saver has many alternative avenues for use of his finds and his choice among them would depend upon his own income, wealth, psychological preferences and his requirement for future

Investment means conversion of money into claims on money or use of funds for productive and income earning assets. Investment means
many things to many people. For a saver, investment is lending of funds for an income, capital appreciation or both. The investment may also be purchase of marketable securities or sometimes non marketable securities promissory notes. These promissory notes are claims on money payable at future date. Sometimes one’s investment may be disinvestment of other. The total available funds to the companies have not increased by this, but this process helps the flow of investment into new issues and new securities due to increase liquidity in the economy.

Figure 1.4: Money Management
1.4.2 Saving Allocation

Qamar (2000) highlighted that average Indian household distributes its saving in financial forms in such a manner that nearly 9% is in cash and 38% is in bank deposits. The return in cash is zero in nominal terms and negative in real terms due to fall in value of money. The return in bank deposit may vary from 4.5% to 10% and can offset the fall in value of money only partially. The real return on bank's fixed deposit is negligible as inflation has been running an average rate of 10% per annum and nominal rates on them vary from 12-15% which after minimum tax deduction at 20% will give a net return of only 10-12%. The investors are therefore not benefiting from keeping savings in cash or deposits which they do the extent of 47%.

Further the saving flowing into insurance, pension funds accounted for 29% which also yields a lower rate than inflation rate, but investments in these media is necessitated for providing for contingencies such as accident, death, retirement etc. Investment in P.O certificates, deposits, and government securities amounted to only 5% of their financial savings. The returns on these investments are higher than inflation rate, if available tax concessions are taken into consideration. These categories of investment account for nearly 80-90% of investment of the savings of household sectors. The holdings in UTI at 6% of the house hold savings and 3-4% of the same in shares and debentures of companies are the only revenues which yield higher return.

1.4.3 Investment Activity

Investment refers to conversion of money into claims on money or use of funds for productive and income earning assets. Investment means
many thing to many people. For a saver, investment is lending of funds for an income, capital appreciation or both. The investment may be purchase of marketable securities or sometimes non- marketable securities like promissory notes. Sometimes, one’s investment may be disinvestment of another, when the former buys the share or debenture of the others. The total available funds to the company do not increase by this, but this process helps the flow of funds into new issues and new securities due to increased liquidity in the economy.

1.5 Present Market Scenario of Financial Services

1.5.1 Market scenario of deposit taking firms

For years consumers lived life within their means. They planned their expenditure and created assets either out of savings or by inheritance. To be in debt, in short, was to mortgage one’s further or one of the worst curses one could invite. For mortgage one’s further or one or the worst curse one late or never happened, leaving them lounging wistfully for that dream home, that car ride, that home theatre system or study/ travel abroad.

All this has changed. Today’s consumer would rather stretch his legs beyond the blanket to live life king- size. Reports from banks reveal that lending to individuals has tripled in five years as consumers borrow and spend. Bank officials attribute the boom to “the cocktail of increase in disposable incomes blended with easy access to finance stirred by exposure to media” that has translated wants into needs. Nearly every third person in owing a house or towns in found shopping on credit.

The a few years back consumers were made to stand in line or sit for long hours in the waiting rooms of banks. Some even had to use influence and grease to get bank managers to expedite their loan papers.
But today one can get a car financed in a day and a home within 3 days without moving out of the home. Marketing executives and sales agents chase the consumer around his work place and home with e-mails, SMS and phone calls. It is not only the ease that a making more and more consumers to seek financial assistance from banks and but the credit itself has become extremely affordable in fact, interest rates have virtually halved in the past five years: rates for car loans have slipped from 16% in 1997-98 to less than 11% in 2003 and housing loan rates have slid much sharper, from 15.5% to 7.75% bringing the per lakh EMI (equated monthly installment) from over Rs. 1450 to an incredible Rs. 750 Plus. In other words, EMIs on housing loans today either equal or are less than the monthly rent paid. That is why it seems wiser option to borrow and buy rather than live on rent. Add the tax incentive to home-loan takers that provide for exemption on interest payments of up to Rs. 1.5 lakh and today the effective rate has reduced to less than 6%.

Today consumers are willing to alter the image to fit their needs and wants. They are more willing to take risks. Their approach to borrowing has changed, earlier they believed in saving and then buying assets. Now the attitude is to buy today and pay later.

1.5.2 Market Scenario of Insurance Services

The potential market is estimated at 312 million people. Some estimates suggest that only 25 percent insurable population has taken up the insurance policies. According to National Council for Applied Research, 50 million people have the capacity to pay an annual premium of Rs. 10,000, 100 million have the capacity to pay annual premium of Rs. 7000 and another 50 million have the capacity to pay Rs. 3500 per annum. Thus, there is a huge market to be tapped.
Insurance is a Rs 40,000 crore business industry in India. Together with banking services, it adds about 7% to India’s gross domestic product. Gross premium collection that has been growing between 15-20% per annum, accounts for around 2% of the gross domestic product. Total investible funds with Life Insurance corporation of India constitutes almost 8% of India’s, gross domestic product. India ia also credited with the highest number of life insurance policies in force in the world.

Yet more than three fourths of India’s, insurable cover. To be precise, it is reported that out of 312 million middle class consumers, only 25% have been able to get insurable cover. As against only 7% in India, life insurance premium as percentage of GDP is as high as 24% for USA, 41% in the UK, 32 % in Korea and 31% for Japan. Health insurance is negligible and other forms of non-life insurance are well below international standards. The following Table indicates India’s, poor insurance penetration ratio even when compared with some of the underdeveloped countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Premium/GDP</th>
<th>Country</th>
<th>Premium/GDP</th>
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</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>12.8</td>
<td>Kenya</td>
<td>2.4</td>
</tr>
<tr>
<td>South Korea</td>
<td>12.3</td>
<td>Philippines</td>
<td>2.3</td>
</tr>
<tr>
<td>USA</td>
<td>8.8</td>
<td>Venezuela</td>
<td>2.2</td>
</tr>
<tr>
<td>Japan</td>
<td>8.6</td>
<td>Morocco</td>
<td>2.1</td>
</tr>
<tr>
<td>Canada</td>
<td>7.0</td>
<td>Uruguay</td>
<td>2.0</td>
</tr>
<tr>
<td>Taiwan</td>
<td>4.8</td>
<td>Thailand</td>
<td>2.0</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>4.8</td>
<td>Colombia</td>
<td>1.8</td>
</tr>
<tr>
<td>Brazil</td>
<td>4.3</td>
<td>India</td>
<td>1.7</td>
</tr>
<tr>
<td>Malaysia</td>
<td>3.8</td>
<td>Tunisia</td>
<td>1.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>3.7</td>
<td>Argentina</td>
<td>1.6</td>
</tr>
</tbody>
</table>
Table 1.2: Insurance Penetration Inter Country Comparison (in %)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Panama</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>3.0</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>1.0</td>
<td></td>
</tr>
</tbody>
</table>


The potential for the growth and spread of life insurance is high, as in many other Asian countries, due to stronger economic growth, rapid ageing of populations, and a weak social security and pension system which leaves a vast majority of worker with no old age income security. However, great speed and deepening of insurance in India would need reforms which include revitalizing and restructuring of the public sector companies and opening up the sector to private players.

1.5.3 Market Scenario of Securities and Brokerage Firms

The new issue market in India is not fully developed as compared to other advanced countries like U.S.A., U.K. and Germany. But there has been tremendous growth in the sphere of new issue activity in India in the 1980s and 1990s. Table given below shows the trend in the amount of capital raised by non-government public limited companies on the new issues market in India. The total amount of capital raised during 1961 was only Rs. 74.0 crores which increased to Rs. 87.7 crores during 1971 and to Rs. 301.1 crore during 1981. The amount of capital annually raised continued its increasing trend up to the year 1987. Then three was a temporary decline in the volume of capital raised during 1988. The new issue (primary capital) market received an encouragement in the year 1976 in the form of a number of issues raised for the purpose of dilution of foreign equity holding under FERA. Subsequently the liberalization of industrial and new capital issue policies in 1984-85 gave a real shot in the arm to the securities market. Further the relaxation of norms relating to
foreign investments and incentives provided by the government helped to sustain the impetus of growth in the market.

In the recent years, a number of new instruments such as PCDs, FCDs, PSBs and CCPs etc. have been introduced in the securities market resulting into an upsurge in the new issue market. The securities scam during 1991 caused a temporary set back to the growing new issue market in India. But the new economic policy of the Narasimha Rao government and the setting up of Securities and Exchange Board of India to promote orderly and healthy growth of securities market providing investor protection has to be regarded as one of the most important developments on the securities market of India, in recent years. As a result of these developments, the institutional investors and the mutual funds have gained importance, both in the primary as well as the secondary market. Another recent development that took place in the market is the setting up of the Over-the Counter Exchange of Indian (OTCEI) which began its operations in 1992 permitting smaller companies to raise capital. During the year 1993, there has been a tremendous growth in the new issue activity resulting into Rs. 19.825 crores of capital raised by non-government public limited companies in India.

In 1994-95 and 1995-96, the new issued market remained subdued due to number of reasons, including political uncertainty.

Despite the maintenance of pace of primary market reforms aimed at providing greater flexibility to the issuers and strengthening the criteria for the entry of first time issuers to the primary market, the downward trend in primary markets continued in the year 1996-97. The primary market was characterized by a reduced number of issues and lower amounts raised. The capital raised through new issues during the period of April to December 1996, was down to Rs. 10369.21 crore from Rs. 14151.1 crore
raised in the corresponding period of the previous year. In a similar trend, the number of issues fell from 1132 in 1995 to 793 in 1996. However, the average size of capital issues rose from 12.5 crore to Rs. 13.07 crore, the main reasons behind this downtrend in the primary market issuance include, the strict eligibility criteria introduced by SEBI and the general downtrend in the secondary market.

The down trend in the capital market continued in 1997-98 also despite the fact that SEBI took a number of measures designed to boost investor confidence. The primary market remained depressed with substantial decline in number of issues and amount, raised. Capital raised through new issues during 1997-98 registered a steep decline to Rs. 4570 crore from Rs. 14276 crore in 1996-97. The number of issues also fell substantially to 111 in 1997-98 from 882 in 1996-97 and 1726 in 1995-96. The table given below depicts the issues launched from 1995-96 to 1999-2000.

During April-December, 1999, a sum of Rs. 5723 crore was raised through public and right issues from the primary market. This represented an increase of 46 percent over the amount raised in the same period of the previous year. During this period, the proportion of resources raised through public issues declined to 75.8 percent from 89.6 percent in the corresponding period of 1998-99. The average issue size however, remained unchanged at about Rs. 95 crore during April-December, 1999. The share of initial public offers (IPOs) increased from 7.8 percent to 31.9 percent, indicating improvement in the prospects of new/ unlisted companies for resources mobilization from primary market. Most of the resources mobilization from primary market in 1999-2000 has been by the private sector.
A number of initiatives were taken to further rationalize the Initial Public Offer (IPO) norms during the year 2000-2001. Despite these initiatives, the year witnessed a noticeable decline in resource mobilization from the primary market. During April-December, 2000, resource mobilization through public and right issues registered a significant decline by 25.9 percent to Rs. 4,240 crore through 124 issues from Rs. 5,723 crore through 60 issues during the corresponding period of 1999-2000 of the total resource mobilization from primary market as against 75.8 percent last year.

Resource mobilization through public and right issues during the first nine months of 2001-2002 amounted to Rs. 3,777 crore, which constituted 89.1 percent of the relatively modest amount of Rs. 4,240 crore raised during the corresponding period of the previous financial year. Resources mobilization through IPOs accounted for only 5.5 percent of the total resource mobilization during April-December 2001 compared to 56.7 percent in the corresponding last year.

Public offerings are classified into Initial Public Offerings (IPOs), where a company goes public for the first time, Right Issues, where a company sells additional shares to existing shareholders, and Seasoned Equity Offerings (SEOs), where a listed company sells shares to the public.

It is revealed that primary market activity in the first seven months of the year has been fairly subdued, compared with the low levels experienced in the previous year. There is a substantial scale of securities issuance taking place through the private placement route. The private placement route has become a mechanism where securities can be placed with a few wholesale buyers of securities, without incurring the overheads of the public issue.
The volume of public issues rose by roughly five times to a level of Rs. 35859 crore in 2004. Out of which equity issuance amounted to Rs. 33475 crore. It was the highest ever level of public equity issuance in India’s history. Over two times higher than the previous peak of 1995. The public debt market continued to remain at low levels. The means IPO size rose from Rs. 31 crore in 2001 to Rs. 870 crore in 2004.

A major development in the Indian primary market has been the introduction of Screen based book building, where securities are auctioned through an anonymous screen based system and the price at which securities are sold is discovered on the screen. This eliminates the delays, risks and implementation difficulties associated with traditional procedure. Resource mobilization through book building rose steadily from 25 percent of public equity offerings in 2001 to 53 percent in 2002, 64 percent in 2003 and 99 percent in 2004.

1.6 Attitude of Consumers Towards Financial Services

The creation and implementation of customer retention strategies has become one of the core necessities of financial institutions.

There are a range of strategies that are being implemented according to customer’s position in the customer lifecycle. The lifecycle is shown below along with the value that different types of customers contribute to the business at different parts of the cycle, thus they require different types of services and products. Therefore products and services need to be tailor-made according to their position in customer life cycle.
1.6.1 New

The single largest group of customer retention strategies that can be implemented in the new section of the customer lifecycle is Onboarding. Onboarding is the process of bedding a customer into your organisation and includes ensuring that their personal data is correct, that they understand the products they have purchased and how to quickly contact the organisation. It has been proved time and again that customers that are properly onboarded will stay with the company longer and spend more money than other customers. Thus polices like customer friend is being implemented in various financial institutions. The customer friend specializes in solving all the quarries related to a product or services.

1.6.2 Existing

The best bank customer retention strategy for existing customers is to classify each type of customer (silent attrition, ideal and unhappy) and create appropriate initiatives to change their behaviour. For instance customers in silent attrition are those that have reduced or stopped using a product but where the account is still open. Examples for instance are...
credit card accounts with little or no spending. For these customers you must determine why they are no longer using your product, and create initiatives to change their behaviour.

1.6.3 Exiting

Customers that are Exiting are those customers that have started the process of moving their business to another company or are in the process of considering that move. The first step in creating bank customer retention strategies for Exiting customers is to identify which customers are in each camp. Indicators of customers considering a move include requests for loan payout details. For customers in the process of moving their business you will need to understand the product drop cycle, i.e. the order in which customers drop your products before leaving. With this information you can create effective customer retention strategies to target those customers.

1.6.4 Exited

Generically, strategies that are aimed at recapturing customers that have left the organisation are called Win back strategies. This is the most expensive and lowest ROI place to try to implement your bank customer retention strategies. Mentally customers have already moved to another organisation and it takes a large inducement to bring them back.

If you do choose execute Win back strategies then you will need to carefully manage the level of incentive that your staff can offer to customers. For instance you will need rules to tailor the incentive level to each specific customer in order to ensure that the level of inducement is not larger than the future business generated by that customer.
1.7 Impact of Financial Services on Financial Institutions

The financial sector reforms were initiated in the early nineties of the last millennium and much of the financial repression that the country was subjected to in the past is no more in existence. As has been indicated earlier, the reforms on the fiscal front supported the sustainability of the financial sector reforms.

Government’s willingness to stop recourse to central bank for financing fiscal deficits and rather to borrow from the market at market interest rates gave the credibility to the interest rate deregulation process.

The banking sector which was dominated by the State and reeling under the erstwhile policy stance of directed lending/investment was nurtured back to health, through sequencing and gradual escalation of several reforms initiatives. The capital infusion which on a cumulative basis accounted for less than 1% of GDP has been much lower compared to cost of recapitalisation of banks elsewhere. Most of the nationalised banks have since returned such capital to government besides benefiting the government through higher stock valuations (most of the nationalised banks have offered shares to the public and are listed on stock exchanges quoting with a price-earnings multiple of around 12). The capital adequacy of all scheduled commercial banks operating in India stood above 12% and the gross and net non performing assets are around 1.9% and 0.7% respectively. As a result, as at the end of March, 2006 the ratio of net non performing loans to capital (a worst case scenario measure for asset quality) is around 15.5% compared to 71.3% as at the end of March 1999.
<table>
<thead>
<tr>
<th>Year</th>
<th>SCBs</th>
<th>PSUs</th>
<th>OPSB</th>
<th>NPSB</th>
<th>FB</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-97</td>
<td>7.0</td>
<td>7.8</td>
<td>5.2</td>
<td>1.3</td>
<td>2.1</td>
</tr>
<tr>
<td>2000-01</td>
<td>4.9</td>
<td>5.3</td>
<td>5.1</td>
<td>2.1</td>
<td>3.0</td>
</tr>
<tr>
<td>2004-05</td>
<td>2.5</td>
<td>2.7</td>
<td>3.2</td>
<td>1.6</td>
<td>1.4</td>
</tr>
<tr>
<td>2005-06</td>
<td>1.9</td>
<td>2.1</td>
<td>2.5</td>
<td>1.0</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Table 1.3: Gross NPAs of Scheduled Commercial Banks

SCBs - All scheduled commercial banks; PSUs - Public sector undertakings (banks); OPSB - Old private sector banks; NPSB - New private sector banks; FB - Foreign banks

Source: Reserve Bank of India.

In terms of reach and concentration the banking industry in India has done quite well. To instill competition into the banking industry, private sector entry into banking was encouraged and the outcome could be seen from the fact that ICICI Bank, one of the private sector banks incorporated in 1994 could become the second largest bank in India well within a decade (though, a major contribution to its balance sheet size came from the reverse merger of its parent and the leading financial institution ICICI in 2002 - what is however, important here is the competition from the private sector banks to the ones in the public sector). Further, the ownership of the domestic banks has been broad-based. Though the government is owning the majority stake, private equity has been infused into them and most of the State owned banks are subjected to market discipline through listing on the stock exchanges. Looking at the operating expenses of the Indian banks, at around 2% they were comparable to the best globally.
Table 1.4 : Growth of commercial banking in India

<table>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Commercial banks</td>
<td>73</td>
<td>154</td>
<td>272</td>
<td>288</td>
</tr>
<tr>
<td>Number of bank branches</td>
<td>8,262</td>
<td>34,594</td>
<td>60,570</td>
<td>68,339</td>
</tr>
<tr>
<td>Population per office ('000)</td>
<td>64</td>
<td>16</td>
<td>14</td>
<td>16</td>
</tr>
</tbody>
</table>

Source : Reserve Bank of India

To enhance the banks' ability to improve the credit quality several measures were initiated. The enactment of Credit Information Bureau Act and the establishment of credit information bureaus are going to bring necessary changes in the credit markets. Credit Information Bureau (India) Ltd., (CIBIL) has made sufficient progress on this front and has built a database of over 20 million borrowers. On the management of credit portfolio front, the enactment of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) gave the requisite comfort to the lending institutions in enforcing the contractual rights.

The divestment of bad loans to a separate government asset management company was not considered appropriate in view of the moral hazard Reddy (2006). Such asset reconstruction companies hence, were encouraged in the private sector. The fact that Asset Reconstruction Company (India) Ltd., (ARCIL) the first such asset reconstruction company, which has acquired around USD 4 billion worth of NPLs has posted 31% return on equity for the year ended March, 2006 and declared 12% maiden dividend shows the maturity of the financial markets in India.
As regards the capital market reforms, the period between 1992-96 was eventful. In 1992, SEBI, the securities market regulator became a statutory and powerful organization. The National Stock Exchange (NSE) and its associated institutions viz., National Securities Clearing Corporation Ltd. (NSCCL) and National Securities Depository Ltd. (NSDL) were established in the ensuing years.

The establishment of NSE has been a path-breaking initiative. Though promoted by a set of public sector institutions, it was allowed to function as a private corporate entity. Unlike many of the then existing stock exchanges, especially the Bombay Stock Exchange (BSE), it was not to be run by brokers and the brokers were instead to act only as franchisees without any say in the day-to-day functioning of the exchange. NSE could establish wider reach through the adoption of virtual exchange model, whereby, members spread over the length and breadth of the country were connected through satellite network. In fact it is the first stock exchange in the world to be connected by a satellite network. Anonymous order matching electronic trading platform replaced the age-old open-outcry system. The trade follow-up was supported by the NSCCL through “innovation” and a guaranteed settlement mechanism. The NSDL established in 1996 on the back of a proactive policy stance from SEBI, could promote dematerialization of stocks. These changes suddenly catapulted the equity market architecture in India to be on par with global standards. No wonder the NSE, within a year of its establishment became the largest stock exchange in the country in terms of volumes traded. Now for several years, it has been the third largest in the world in terms of handling the highest number of transactions. Coming back to the competitiveness of equity markets, we need to look at the transaction costs.
India has one of the world's lowest transaction costs based on screen-based transactions, paperless trading and a T+2 settlements cycle. The transaction cost is a combination of transaction processing cost and the market impact cost. Impact cost, which is the cost due to the adverse price movement while putting through a transaction itself, is also a measure of liquidity in the sense that a liquid market is one where the impact costs are the lowest.

Though SEBI was established in 1988, only in April 1992 it became a statutory body. Through innovation the clearing corporation interposes between buyer and seller and through the support of settlement guarantee fund it reduces the counterparty risk. Depositories front, the per transaction charges applied by the Indian depository institutions are among the lowest in the world.

The pre-trade and post-trade transparency promoted by NSE has improved price evolution process on the bourses (since anybody can watch the order book at any point of time) and the supervisor's supervisory capacity respectively. Risk containment is through margining, settlement guarantee fund of the clearing corporation contributed by the members, marked to market mechanism for margin maintenance and real time monitoring of members' exposure limits. NSE has been the first stock exchange in the world to introduce the system of monitoring members' exposure limits on a real time basis. Further it was the first Indian bourse to allow internet trading. Thus, through satellite communication and later through the internet, NSE has reached the households across the length and breadth of the country. This is by all means innovative and path breaking.

The spectacular developments we saw in the equity market could not be replicated to promote the corporate debt markets. The debt markets
are dominated by government securities. Unlike the equity market, the
direct retail interest in fixed income products is not widespread. For the
small investors, there are other superior options available such as small
savings schemes and bank deposits. The retail interest in equity markets is
also due to the fact that the retail investor in this market looks for capital
gains rather than dividend yield. Credit markets still dominate the corporate
financing requirements and this is a constraint for the corporate debt
markets to come up with critical volumes. The regulatory aspects still are
said to be cumbersome, and whatever market exists for corporate debt, it
is predominantly a private placement market. Currently a lot of attention is
being paid to develop the corporate debt market given the huge financing
requirements of the infrastructure sector.

(Rs. In billion)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td>45.49</td>
<td>52.84</td>
<td>23.83</td>
<td>0.66</td>
</tr>
<tr>
<td>Equity</td>
<td>24.20</td>
<td>28.91</td>
<td>334.75</td>
<td>303.25</td>
</tr>
</tbody>
</table>

Table 1.5 : Resources Raised through Primary Markets

On the other hand, the developments in the government securities
markets could be explained by the initiatives taken by the Reserve Bank of
India (RBI) in its role as the government debt manager. The growth in
fiscal deficit and the market borrowings contributed to the development of
the markets. Removal of tax deduction at source on trading in government
securities, established demat facility, auction system for primary market
offerings, consolidation of loans through reopening/re-issuance,
introduction of primary dealers, improving indirect monetary policy tools
such as open market operations, introduction of derivatives such as
interest rate swaps and futures have improved the depth of the market.

(Rs. in billions)

<table>
<thead>
<tr>
<th>Gross issuance</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. in billions</td>
<td>1,202.13</td>
<td>1,130.00</td>
<td>1,195.00</td>
<td>1,293.50</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>End year market capitalisation</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. in billions</td>
<td>6,551.48</td>
<td>9,599.03</td>
<td>9,963.41</td>
<td>10,515.21</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Turnover ratio*</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>197.48</td>
<td>16.48</td>
<td>107.48</td>
<td>71.42</td>
</tr>
</tbody>
</table>

Table 1.6: Government Securities Market

*as a percent of market capitalization.

The negotiated dealing system (NDS) launched in 2002 was a screen based trading system that uniquely combined the advantages of both OTC trading (flexibility) and screen-based trading (transparency). It was in a way an extension of the then already exiting system of telephone based trading with such improvements as dissemination of on-line price information and electronic trading. In 2005, RBI launched an electronic order-matching module on its Negotiated Dealing System (NDS). The new system — NDS-OM, for short — is an anonymous order matching system where the identity of parties is not revealed before or after the trade. The need for such a system, which is similar to the hugely successful model pioneered by the National Stock Exchange for the equity segment, has been felt for a while.

The establishment of Clearing Corporation of India Ltd., (CCIL), with clearing and settlement of Government securities as one of its major functions, has brought about a significant reduction in both the processing costs and the settlement risk. CCIL derives these benefits for the members through a process of novation and multilateral netting mechanism. The multilateral netting vis-à-vis a bilateral netting system has other
advantages to the counterparties in terms of reduced capital charge against the exposures and a reduction in back office processing work. Besides, the clearing corporation clears the transactions in the local foreign exchange market and also runs NDS-call, a screen based trading system for transactions in overnight money.

The creation of the Institute for Development and Research in Banking Technology (IDRBT) was an important initiative of the Reserve Bank of India. IDRBT, since its establishment, has created substantial technological infrastructure for the benefit of the banking community with the aim of sharing expensive IT resources to achieve economies of scale. Besides operating the Indian Financial Network (INFINET), IDRBT also conducts research in banking technology and provides consultancy services and educational/training facilities for the banking community.

The mechanized cheque clearing system has matured with overall reject ratio of around 1% as against international experience of around 2% (Reddy Y.V. 2006). In compliance with the BIS Core Principles for Systemically Important Payment Systems, RBI had taken initiatives to establish the Real Time Gross Settlements (RTGS) System and an evaluation of the critical parameters of our RTGS indicate that have been quite close to the standards set by BIS. RTGS is available across 50 centres in the country today linking around 24,000 bank branches with an average daily settlement of more than US$ 13 billion. RBI has also implemented the National Electronic Funds Transfer System to facilitate retail funds transfer, that covers more than 5000 branches of 32 banks across 200 centres.

In the absence of a well-developed repo market other than where
RBI acts as a counterparty, the initiatives taken by the CCIL in crating a new Money Market Instrument – "Collateralised Borrowing and Lending Obligation" (CBLO) is worth mentioning. In 2004 CCIL started clearing and settlement of ATM transactions of National Financial Switch operated by Institute for Development and Research in Banking Technology (IDRBT).

As regards the insurance industry, private participation is allowed to improve competition. While opening up the sector for private participation many would not have expected that the public sector monolith, the Life Insurance Corporation (LIC) of India would survive, but to disprove such apprehensions, LIC has improved its performance and retained its dominance. However, compared to OECD standards, the penetration of the insurance industry especially the non-life sector has been poor.

Giving support to the financial sector, the monetary and exchange rate policies have been fine-tuned over the years. The current stance of the exchange rate policy in India, the so-called managed float has evolved over a period of time from fixed exchange rate against single currency through fixed exchange rate against a basket of currencies. In fact, the origins of reforms go back to the BoP crisis and both the exchange rate policy and the policy relating to accumulation and management of forex reserves were fine-tuned as we learnt lessons from various currency market crises elsewhere. The move towards current account convertibility was preceded by a brief transition to dual exchange rate mechanism. This was accompanied by reduction in trade.

This is the repo RBI enters with eligible counterparties for conducting open market operations. A tripartite repo involving CCIL protection and a gradual opening of the capital account. Banks were gradually allowed
larger leeway. Managing capital flows have over the years posed challenges to monetary authorities and it was a paradox that the problem of paucity turned into a problem of plenty over the years. FII flows into the capital markets subsequent to the capital market reforms added to the concerns about a possible increase in volatility of stock prices and exchange rates. On the other hand, the policy stance was clear in discouraging short-term external debt flows into the country. In the absence of sufficient demand for forex, the inflows were to be sterilized; government securities were issued under market stabilisation scheme (MSS) and in order to neutralize the impact of MSS on the fiscal, the amount mobilized through sale of such government securities was immobilized with the Reserve Bank of India.

The stance of the exchange rate policy is to leave it to the market with intervention only to address sharp volatility which is not caused by fundamental factors. Unlike developed economies which have the wherewithal to absorb the risks associated with exchange rate fluctuations, developing countries such as India with their labor intensive economies and output at the lower end of the value chain where the profit margins are extremely vulnerable to competitive pressures, exchange rate volatility has significant employment, output and distributional consequences Mohan and Rakesh (2006) Thus the capital account liberalization depends on several factors such as fiscal and financial sector strength so that the capital account fluctuations are managed by the financial markets efficiently so that they do not impact the real sector. The recommendations of the committee set up by the Reserve Bank of India are largely in this direction.
1.8 Impact Of Financial Services on Economy

The financing of a plan involves the diversion, through the use of various financial instruments including taxation, of the required volume of real resources for purposes of investment, without inflation and subject to certain other basic considerations such as equity and efficiency. The interdependency of physical and financial planning arises from the fact that while the volume of resources that could be diverted for investment would depend on the rate of investment and the growth of income, the feasible volume of investment, in turn, would depend on how much resources could be mobilised without inflation. Thus, the physical plan targets of investment and the financial targets have to be worked out simultaneously, and in the present exercise, the two sets of targets have been made consistent with each other through a process of iteration.

The total of resources available for investment consists of domestic savings and inflow of capital from abroad. The volume of domestic savings that could be mobilised depends on the pattern of past behaviour and long-term tendencies in the economy such as the propensity to save of the population and the elasticity of the tax system as well as on conscious efforts to raise the rate of savings through taxation, incentives and institutional and policy changes.

Although it is true that there is scope for increasing the productivity of capital, in its present stage, the Indian economy requires and can sustain a higher rate of savings than realised in recent years. The rate of gross savings, which had reached a peak of 24.6 percent in 1978-79, has stagnated around 23 percent during the Sixth Plan. One of the important
tasks of policy in the Seventh Plan would be to induce a rise in the rate of domestic savings.

Financial planning involves not only the mobilisation of resources to match the targetted magnitude of physical investment, but also the allocation of the total available savings among the major investing sectors according to their respective requirements. In what follows, total domestic resource availability is arrived at through projections of sectoral savings, i.e., savings by the household, private corporate, government and public enterprise sectors. Then, given the investment targets of the sectors and allowing for inter-sectoral transfers and the expected inflow of capital from abroad (which includes the desired amount of commercial borrowings), the balance between sources and uses of funds is worked out for each sector. This gives the amount of savings to be transferred from the 'surplus' to 'deficit' sectors.

In projecting the savings of the Government sector (current revenue - current expenditure), a view has been taken of the amounts of additional resource mobilisation that could be reasonably undertaken by the Central and State Governments on revenue account through improvement in administration, structural changes and adjustments in rates. Similarly, in regard to public enterprises, in estimating savings (retained profits plus depreciation) effects of action to improve productivity and efficiency as well as adjustments in prices, where considered necessary and reasonable, have been taken into account. Given the projected total tax revenues and transfers from Government to the household sector, the disposable income of the latter is derived. Household sector saving is then arrived at by applying trend values of the savings rate. The savings of the private corporate sector have been estimated separately on the basis of the
analysis of the operations and finances for the non-financial companies and on the basis of past trends for the financial companies.

Household sector saving is estimated at 20.5 percent of its disposable income in 1984-85 and is expected to remain at the same level in 1989-90 but public sector saving is expected to rise from 29.1 percent to 32.4 percent of its disposable income. The rise in the savings ratio of the public sector arises from its increasing share of disposable income (from 14.6 percent to 15.7 percent) and the high marginal savings rate (41 percent) assumed for the sector. All of the additional resources mobilised by public enterprises would go to augment the resources for investment. The share of the public sector in aggregate domestic saving would rise from 18.5 percent to 20.9 percent and that of the household sector would decline from 74.2 percent to 69.6 percent. Thus the success of the plan is predicated on a large savings effort by the public sector. The measures to be taken towards this end are indicated later in the Chapter.

The shares of the public and private sectors are expected to be 19 percent and 81 percent respectively. The share of the household sector would continue to be dominant (71 percent) though less than in the past. Of the total household sector savings, 47 percent are estimated to be held in the form of financial assets.

In estimating the total resources availability for plan investment, while conscious effort to raise the volume of savings through additional resource mobilisation effort on the part of the public sector is postulated, private sector savings have been estimated on the basis of past data. It would not be realistic to assume a significant rise in the savings rate in the short run. However, given that the value of the estimated marginal savings
rate is only of the order of 28.4 percent, there is scope for raising it through appropriate policy and institutional changes.

Aggregate gross domestic savings during the Seventh Plan would amount to Rs. 302,366 crores. Inflow of foreign capital to the extent of Rs. 20,000 crores is postulated. The aggregate resources would, therefore, amount to Rs. 322,366 crores, which is equal to the amount of investment contemplated in the plan. The savings of the sectors, inter-sectoral capital transfers (lending/borrowing) and investment by the sectors are given in Table 4.3. The own savings of the public and the private corporate sectors fall short of their investment plans while the household sector has a surplus of saving over its investment. It is envisaged that there would be a transfer of savings from the household sector to the extent of Rs. 102,253 crores to the other two domestic sectors. And, additionally, the inflow of capital from the rest of the world to the public sector would amount to Rs. 18,000 crores and to the private corporate sector Rs. 2,000 crores. These details provide a broad picture of the flow of funds on capital account in the economy during the Seventh Plan period. It is seen that the public sector investment of Rs. 154,218 crores is financed to the extent of 32 percent by own saving, 56 percent by draft on private savings and by around 12 percent by foreign borrowings. The corporate sector’s total investment of Rs. 54,236 crores is expected to be financed to the extent of around 53 percent by its own saving, 28 percent through recourse to the household sector saving via the capital market, 15.3 percent by the public sector and the remaining 3.7 percent by foreign borrowing.

Of the total household sector savings of Rs. 216,165 crores, financial savings are estimated to account for Rs. 102,253 crores, forming 47 percent. Projections of physical assets in the household sector have
been made on the basis of their relationship with personal disposable income in the past years. The total financial savings of the household sector amount to Rs. 134,681 crores in gross terms and to Rs. 102,253 crores in net terms (i.e., net of increase in liabilities) over the five-year period. The major forms of financial savings of the household sector are: deposits with scheduled commercial banks and cooperative societies, currency, life funds, provident funds, claims on Government including Unit Trust of India and corporate shares.

The methods of estimation of the amounts which would be held in different forms are given below:

\[
\begin{array}{l|c}
1. & Currency & 8527 \\
2. & Deposits with scheduled commercial banks & 57288 \\
   & including cooperatives & \\
3. & Non-banking companies deposits & 8592 \\
4. & Life funds & 9845 \\
5. & Provident fund & 34675 \\
6. & Net claims on Government & 8750 \\
7. & Corporate/cooperative shares and debentures & 2911 \\
8. & Security of term-lending institutions & 23 \\
9. & Unit Trust of India & 2500 \\
10. & Other assets & 1570 \\
    & Total & 134681 \\
    & Liability & (-)32428 \\
    & Net financial assets & 102253 \\
\end{array}
\]

Table 1.7: Household Sector Financial Savings (1985-90)
<table>
<thead>
<tr>
<th>Items</th>
<th>Government</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Currency</td>
<td>8527</td>
<td>-</td>
<td>8527</td>
</tr>
<tr>
<td>2. Deposits with banks</td>
<td>23107</td>
<td>3595</td>
<td>31702</td>
</tr>
<tr>
<td>3. Non-Banking deposits</td>
<td>1857</td>
<td>5600</td>
<td>7457</td>
</tr>
<tr>
<td>4. Life Insurance Corporation</td>
<td>4950</td>
<td>874</td>
<td>5824</td>
</tr>
<tr>
<td>5. Provident fund</td>
<td>34675</td>
<td>-</td>
<td>34675</td>
</tr>
<tr>
<td>6. Claims on Government</td>
<td>7064</td>
<td>-</td>
<td>7064</td>
</tr>
<tr>
<td>7. Corporate shares</td>
<td>-</td>
<td>2911</td>
<td>2911</td>
</tr>
<tr>
<td>8. Securities including</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unit Trust of India</td>
<td>1882</td>
<td>641</td>
<td>2523</td>
</tr>
<tr>
<td>9. Other assets</td>
<td>-</td>
<td>1570</td>
<td>1570</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>87062</td>
<td>15191</td>
<td>102253</td>
</tr>
</tbody>
</table>

Table 1.8: Draft on Household Financial Saving by Instruments (1985-90)

1.8.1 Private Corporate Sector Savings

The private corporate sector is divided into two parts viz., (i) non-financial institutions and (ii) financial institutions. Non-financial institutions include (i) non-Government public and private limited companies and (ii) co-operative non-credit societies. The financial institutions comprise (a) co-operative banks and credit societies (b) non-nationalised commercial banks and (c) private financial and investment companies.

The projections of the savings of non-Government non-financial public and private limited companies for 1985-90 have been worked out on the basis of detailed studies of sales, fixed capital formation, inventories, borrowings, depreciation, profits, etc. The savings of the private financial institutions and co-operatives have been estimated on the basis of past
trends. The gross savings of the private corporate sector have been placed at Rs. 28,779 crores during the Seventh Plan.

1.8.2 Resources for the Public Sector Outlay-Sixth Plan

Although the additional resource mobilisation through budgetary measures undertaken by the Centre and the States exceeded the targets originally envisaged, the surplus from current revenues, including the revenue from additional resources mobilisation efforts, fell short of the original estimate by Rs. 862 crores in the case of the Centre and by Rs. 4,101 crores in the case of States (all in current prices).

The surplus from current revenues including the yield of additional resource mobilisation efforts which was envisaged to finance 28 percent of the Sixth Plan public sector outlay, actually contributed only 20 percent of the financing. The deterioration in the contribution from current revenues was due mainly to the sharp rise in non-plan expenditure partly resulting from the inflationary pressures developed during the Sixth Plan period. Besides the increase in the cost of maintenance of normal services, additional D.A. instalments had to be accommodated from time to time. In fact, inflation, far from enabling Government to increase the resources at its disposal, eroded them in real terms because revenues did not grow as fast as the cost of the goods and services bought by Government. Also, additional resource mobilisation efforts by the public enterprises were neutralised to a large extent by cost increases. Apart from the impact of inflation, certain large items of current outlay, such as defence, subsidies and interest liabilities, have also been growing at a fast pace at the Centre. While some of the States have been increasing their commitments unrelated to their plans, their commitments arising from plan expenditure seem to have also grown out of pace with the increase in their revenue
receipts (reckoned at the base year rates) which have not shown a corresponding buoyancy to fully offset the liabilities arising on account of growing expenditure. The ratio of tax to gross domestic product, which was 15.56 percent in 1980-81, increased to 16.65 percent in 1982-83 but came down to 16.25 percent in 1983-84. Similarly, the ratio of non-tax revenues to gross domestic product, accounting for 18 percent of total Government revenues, increased from 3.32 percent in 1980-81 to 3.80 percent in 1982-83 but decreased to 3.50 percent in 1983-84. The automatic growth in revenues (i.e. without ARM) was less than proportionate to the growth in national income, and thus the yield of additional measures undertaken during the Sixth Plan was partly neutralised by the fall in the automatic growth in revenues. While no doubt, it is necessary to take measures both at the Centre and the States to prevent the deterioration in budgetary savings, the reversal of the existing trend cannot be immediately ensured. This serious limitation cannot be lost sight of in evolving any scheme of development financing for the immediate future.

The contribution of public enterprises of the Centre at 1979-80 rates was higher by Rs. 2,507 crores than the original estimate. However, in the case of State public enterprises, there was a considerable deterioration. Originally they were estimated to incur a loss of Rs. 516 crores at base year rates, but, in fact, the amount of loss turned out to be Rs. 6808 crores. As a result, despite higher additional resource mobilisation by State public enterprises, the overall contribution amounted hardly to Rs. 516 crores as against Rs. 4,362 crores originally envisaged. While the total Sixth Plan expenditure of the Central and State public enterprises taken together was Rs. 56,360 crores, their contribution to plan resources (including the yield of additional measures) was Rs. 18,634 crores.
One of the major functions of public sector enterprises is to generate surpluses for financing further economic development. An analysis of Sixth Plan financing, however, shows that Central public enterprises financed only 28 percent of their development outlay from their own internal resources. They mainly relied on budgetary support, which accounted for 56 percent of their plan outlay. In the case of State enterprises like State Electricity Boards and State Road Transport Corporations, hardly 3.5 percent of their development outlay was financed through their own internal resources. The dependence of State enterprises on State budgetary support was far greater than in the case of the Central enterprises. This is evident from the magnitude of commercial losses of Rs. 4,472 crores and Rs. 961 crores that State Electricity Boards and the State Road Transport Corporations, respectively, are estimated to have incurred during the Sixth Plan. Thus, public enterprises becoming a vehicle of resource mobilisation for financing development expenditure in the country remains a distant goal. While there can be no two opinions that surpluses generated by public enterprises would have to be the mainstay of development financing in future, it would not be realistic to assume that all public enterprises, both Central and States, would turn the corner immediately in the Seventh Plan period and discharge their expected role in resource generation for meeting the growing development expenditure in the country.

Owing to the depletion of budgetary savings and the inability of the public enterprises to adequately contribute to the financing of their plan outlay through their own internal resources, the Government had to rely increasingly on domestic borrowings for financing public sector plan outlays. Total domestic borrowings accounted for 35 percent of the Sixth Plan public sector outlay. In the earlier plans, excepting the Fourth Plan,
domestic market borrowings ranged from 21 percent to 28 percent. Greater dependence on borrowings has implications in terms of increasing the burden on the Government budget for meeting interest payments as well as repayments of the principal amount. Further, in the case of a number of States, borrowings which should have been appropriately utilised for financing capital expenditure, have been used partly for meeting revenue expenditure. This trend is quite indicative of the nature of resource erosion.

In short, the development financing structure which has emerged during the Sixth Plan shows serious limitations in the matter of generation of resources to cope with the increasing demand for development expenditure in the country.

In the face of the resource crunch, mobilisation of financial resources, therefore, presents a real challenge to be faced in the Seventh Plan, both by the Centre and the States. This would obviously require restructuring of the present pattern of development financing so as to rectify emerging imbalances and maintain sound financial planning to achieve the desired goals. Much would depend on how far the different instruments of resource mobilisation respond to the challenge under a dynamic situation and maintain their resilience to adjust themselves to structural and non-structural changes. It is obvious that the process of resource erosion would have to be immediately checked and also reversed, in due course, if development is to be protected. In essence, the Indian fiscal system would have to accomplish the delicate task of raising adequate resources in a non-inflationary manner, besides providing enough incentives for savings and growth in production.
Within the above broad framework of fiscal objectives, the resources for financing the public sector outlay during the Seventh Plan have been assessed. The assessment has taken into account the past trends, the postulated rate of growth of the economy and the outlook for the future in different sectors of the economy. The estimates based on detailed exercises undertaken by the expert groups have been re-assessed in the light of the recommendations of the Eighth Finance Commission and the Government decision thereon. Concerned Central Ministries, State Governments, Union Territory Administrations, Reserve Bank of India, Life Insurance Corporation, General Insurance Corporation, Industrial Development Bank of India, the Provident Fund Commissioner, the Bureau of Public Enterprises, important public sector enterprises of the Central and State Governments, and various other agencies have been consulted at different stages to firm up the estimates. The Estimates of resources have been worked out at 1984-85 prices, assuming a non-inflationary situation over the Seventh Plan period. The revised projections are in broad alignment with the growth rates of receipts adopted by the Eighth Finance Commission for 1984-89 period.

1.8.3 Financial Resources for the Public Sector Plan (Seventh Plan)

The aggregate resources for financing the public sector outlay in the Seventh Plan amount to Rs. 180,000 crores at 1984-85 prices.

It will be seen that budgetary resources including borrowings and public enterprises would provide Rs. 148,000 crores or 82.2 percent of the total resources required for financing the Plan. External resources would account for Rs. 18,000 crores or 10 percent of the assessed resources. The balance of the required plan resources amounting to Rs. 14,000 crores (7.8 percent of the total) would be met through deficit financing.
Thus financial institutions need to come out with products and services that can be used by household sector and corporate sector to invest their disposable income.