CHAPTER – I

INTRODUCTION
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Introduction

India today is poised to enter the 21st Century as one of the Asia's most dynamic economies. This is part of the assessment made by international financial institutions, based on India's economic reforms initiated in 1991 and brought to fruition in the budget for 1993-94. In fact, the achievement is the cumulative effect of yester years coupled with economic reforms in Indian economy. The economic liberalisation, based on the firm pillars of fiscal discipline and structural reform, has yielded strong dividends.

The progress of any economy mainly depends on the pace of industrial development which in turn depends on the financial system of the country. Indian economy is no exception to this. The importance of industrialisation affirms an effective means for solving the problems of economic and social in India and elsewhere in the developing nations of the world.

Industrialisation: Its Need

Industrialisation brings some basic changes in the production function and techniques, occupational structures and level of activities in other sectors of the economy. These changes will move the obstacles to growth and will promote the economic interest of the country. Since the industrial sector has been a key factor in the rapid expansion and development of
agriculture, generation of employment avenues, in securing a sizeable amount of foreign exchange earnings and in improving the standard of living, the industrialisation has become a major objective of the economic policies of not only India but also of most of the underdeveloped countries. Hence, industrialisation has been given top priority in the Indian Plans.

Industrial development of any country depends mainly on the supply of finance. In fact, finance is the life-blood of industry without which the health and soundness of the industrial system cannot be geared up and for which the well developed capital market as well as money market is essential.

The industrial development during the Second World War period was influenced more by scarcity situation due to inadequate financial supports. In fact, the post-independence period has been witnessing rapid proliferation of much needed financial institutions. It was also realised that, given the human resources and natural resource endowments and the vast size of the domestic market, the country needs a strong financial support to accelerate the pace of industrialisation. One of the major and important causes for slow development of industries among other things, has been the absence of adequate financial facilities. A fairly long experience of problem in regarding the policy of commercial banks, because of which they could not provide adequate long-term investment requirements. With the declaration of Industrial Policy Resolution in 1948 and the Development programme of industries under the Five Year Plans,
the setting up of financial institutions for providing long-term finance for industrial development saw the light of the day.\textsuperscript{1} The Industrial Policy Resolution and the successive Five Year Plans have been equally articulate in stressing the need to achieve industrial dispersal to improve the standard of living of people in different parts of the country and thus to reduce the inter-regional disparities. Moreover, in addition to the Monetary and Fiscal Policies available, these institutions also constitute an important policy instrument of the Government, in the context of their intervention for bringing about desired allocation of capital resources among different sectors of industry.

Planned economic development for realisation of socio-economic objectives, like achievement of a high growth rate of gross national product, generation of employment opportunities, a more equitable distribution of income as well as means of production and balanced regional development calls for formulation of programmes and their implementation through the instrumentality of specially designed institutions. Rapid industrialisation has been recognised as an important means for achieving socio-economic changes as set out in the Industrial Policy Resolution. The task of transforming a predominantly agrarian economy into an industrial nation simultaneously ensuring balanced regional development, is a very challenging task.
Indian Financial System: A Synoptic Overview

The Indian Financial System, as it has evolved, is comparable in many respects with the financial system of the most advanced developing countries as well as some of the developed countries. It has a well-diversified structure of financial institutions and instruments and, in fact, financial development has out-placed economic development.

Growth and Diversification

The financial system has developed at a fairly rapid pace since 1950-51 and its growth rate has exceeded the growth rate of Gross Domestic Product of Gross Capital Formation. The ratio of financial assets of the system to gross domestic product has increased from 62 per cent in 1981 to 94 per cent in 1990 and the financial inter-relations ratio (net increase in financial assets to net capital formation) has risen from 0.98 in 1965-66 to 2.50 in 1990; this marginal financial inter-relation ratio is comparable with the average financial inter-relation ratio in the U.S.A. (V.V.Bhat 1980 Chapter 10).

Financial Institutions: Central Bank

The Reserve Bank of India (RBI) is the central bank of India. RBI performs the traditional central banking roles of note issue and banker to government and the commercial banks. It formulates and manages the monetary and credit policy by setting deposit and lending rates and lending targets. It also manages
the foreign exchange market and the exchange control system. RBI regulates, supervises all commercial banks and manages the public sector commercial banks. It provides deposit insurance and credit guarantees for some bank loans, through a subsidiary - Deposit Insurance and Credit Guarantee Corporation. In the money market RBI established the Discount and Finance House of India Ltd. (DFHI) in 1988 to encourage secondary trading in treasury and commercial bills and to facilitate open market operations. Finally, RBI has played a developmental role by providing refinance lines. Two of them have been spun off into separate development finance institutions for industry (Industrial Development Bank of India) and agriculture (National Bank for Agriculture and Rural Development).

Financial Institutions: Deposit Institutions

Commercial banks still dominate the financial system. Their widespread network of nearly 59,000 branches enables them to raise deposits country-wide. The large banks effectively operate as universal banks, taking in all types of deposits and offering many kinds of loans; in addition, some banks have established subsidiaries for leasing, underwriting, mutual funds, merchant banking and other corporate services.

Commercial banking is dominated by 20 public sector banks and 196 Regional Rural Banks. Public banks account for over 90 per cent of commercial bank assets and deposits. RBI controls the operations of all public sector banks through directives and
guidelines and a comprehensive annual financial review. Private commercial banks consist of 29 Indian scheduled banks, 21 foreign banks and three small non-scheduled banks.

Financial Institutions: Term Lending and Apex

Three important all-India industrial development financial institutions (DFIs) provide term finance to industry: Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI) and Industrial Finance Corporation of India (IFCI). In addition, the Industrial Reconstruction Bank of India (IRBI) assists in restructuring the firms experiencing operational and financial difficulties. At the State level, there are State Finance Corporations (SFCs) and State Industrial Development Corporations (SIDCs). There is also a Small-scale Industry Bank, providing refinance to financial institutions which provide credit to small industry. IDBI acts as the apex and co-ordinating institution; about 30 per cent of its disbursements represent refinance. IDBI also holds equity positions in IFCI, IRBI, the Unit Trust of India (UTI) and SFCs. IDBI has taken a major role in promoting consortium finance for industrial projects which currently governs about 90 per cent of all direct lending by DFIs. IDBI, IFCI and SFCs are all government-owned institutions, while ICICI is a semi-private institution.
Financial Institutions: Capital and Money Markets

India's capital market is among the largest in the developing world. The market is comprised of 15 regional exchanges selling long-term government debt, debentures and shares. Nearly 6000 firms are listed on the Indian stock exchanges, more than any other country than the U.S.A.; market capitalisation of listed firms in 1987 was similar to Brazil, Malaysia, Singapore and Denmark, but much smaller than Korea. Until recently, the government securities market was the largest segment of the capital market. In the 1980s, however, private issues have grown dramatically. Large companies now raise about 70 per cent of their new funding in the market; for them, it has become a viable, low cost source of funds and a way around the limits on credit and its high cost.

The Indian money market is composed of transactions between financial intermediaries (call money, inter-bank funds and rediscounting of bills), treasury bills and the inter-corporate market. RBI has taken a major role in stimulating the development of the money market.

Financial Institutions: Finance for Agriculture

Institutional finance for agriculture is provided to farmers by primary agricultural co-operative credit societies (PACs) which extend short and medium-term credit to members; branches of co-operative land development banks (LDBs) provide term loans;
and branches of commercial banks and RRBs provide credit of all maturities. Other credit, largely short-term, comes from money lenders, input dealers, relatives and so forth; these informal market transactions are extremely important aspect of agricultural finance as well as finance for all types of small enterprises.

Development Banks: Its Evolution

An important feature of industrial finance system in the country is the participation of major investment institutions in CONSORTIUM financing with other All-India financial institutions to meet the financial requirements of the industrial sector. In the evolution of the structure of the Development Financial Institutions in India, the creation of specialised institutions to cater to the financing needs of rehabilitation of sick industrial units, export finance, agriculture and rural development operation has been of significance.

The creative role of a development bank does not end with the appraisal of projects and sanction of assistance. As a matter of fact, this is the beginning of a long term relationship and the development continue to contribute to the success of the enterprise through post sanction monitoring of the project. The follow-up report enables the development banks in keeping a finger on the pulse of the enterprise, diagnosing the problems and advising on their solutions. It includes forecasting of factors and situations which might affect the operations of the
financial institutions, well before they become obvious and difficult to remedy. This, however, does not mean that the development banks participate in the management. On the contrary, they like to develop a relationship with the entrepreneur which permits constructive contribution to broad management policies, without interfering their day to day operations.

The central role of IDBI in the industrial finance system in the country, as underlined by the then Union Finance Minister, was that "Where a long term view is necessary and a certain amount of risk has to be taken, the existing institutions tend, by reason of their statutory obligations and traditions, to be conservative and cannot in any case be very helpful. The new Industrial Development Bank as a central co-ordinating agency, which ultimately will be concerned, directly or indirectly, with all problems or questions relating to the long and medium term financing of industry, and will be in a position, if necessary, to adopt and enforce a system of priorities, in promoting future industrial growth."

The role of IDBI was, therefore, conceived as one of establishing appropriate working relationship among institutions, co-ordinating their activities and a pattern of inter-institutional co-operation to effectively meet the changing needs of the industrial structure. As a development agency, IDBI was also given special responsibility to undertake market and investment research and surveys as techno-economic studies in connection with development of industries and plan, promote and develop industries to fill vital gaps in the industrial
structure. Appraisal and supervision of projects assisted on a consortium basis are being co-ordinated to avoid duplication of work and delays.

IDBI Statute enables it to have considerable operational flexibility. It can finance all types of industrial concerns. There are no restrictive provisions in the IDBI Act as regards the nature and type of security to be obtained. There are no maximum or minimum limits prescribed either for assistance to a unit or the size of the units itself. In order to perform the various roles assigned to it, IDBI provides finance directly to medium and large-sized units, and then extends refinance assistance to institutions like SIDCs and SFCs and banks against their industrial loans.

Co-ordination Among Development Financial Institutions

At present the country is served by over 60 Development Financial Institutions (DFIs) in the field of industrial finance. IDBI co-ordinates the activities of DFIs at the National and State level, maintains close working relationship with other financial institutions in all matters relating to policy formulation, procedural improvements, project appraisal and follow-up. Such co-ordination is ensured primarily through the channel of Inter-Institutional Meetings (IIMs) and Senior Executive Meetings (SEMs).

Apart from IIMs and SEMs, inter-institutional co-ordination is ensured through appropriate representation on the Board of
Directors of the financial institutions. IDBI is represented on the Boards of IFCI, ICICI, LIC, UTI, GIC, SFCs and SIDCs. Similarly, the Board of Directors of IDBI has representatives of All-India Financial Institutions, Public Sector Banks, and SFCs. Besides, IDBI is closely involved in the annual exercise on business plan and resource forecast undertaken by each SFCs and SIDCs. Periodical conferences are also held under the aegis of IDBI. Thus, the co-ordinating efforts of IDBI have contributed significantly towards the emergence of a common culture among DFIs operating in different parts of the country.

Objectives of Development Financial Institutions

It is quite common and certainly very appropriate to refer to the financial institutions in the developing countries as development banks, implying that their task goes far beyond the conventional functions of providing term capital to qualifying entrepreneurs and mobilising resources for their lending operations. In developed countries, particularly in Germany and Japan, the financial institutions, especially banks did play an important and active role in evaluating the growth process by providing merchant banking services and meeting the term capital requirements of entrepreneurs. These were the days when international trade was active as an engine of growth, problems of marketing and availability of raw-materials were less pressing and relatively speaking, there was no dearth of entrepreneurs. Active support from government in creating supporting infrastructure and ready response of the financial institutions
further smoothened the process of growth. They can surely act as the growth inducing sector in desirable directions and can make the task of entrepreneurs easier by providing finance in time and even before that by providing information on market and other related services.

Before proceeding further in detail, it is necessary to note the major objectives of the development of financial institutions in India. They are described as follows:

i. Activising the dormant entrepreneurship through types of assistance - technical, managerial, financial, marketing and so on;

ii. Availability of medium and long term credit at reasonable cost to aspiring entrepreneurs of worthwhile projects, i.e., to provide easy access to credit on favourable terms is a pre-requisite for rapid industrial and economic development of the country;

iii. As production gets diversified, technology becomes more and more complex, the demand for efficient and well-trained managerial personnel will be progressively increasing. Therefore, management development is an important responsibility of the development banks;

iv. In a planned economy like India's the working of the development banks (DBs) must subserve the social goals, plan objectives, priorities and targets. Physical planning, unless properly supported by the financial planning
through proper functioning of the financial institutions will defeat the very purpose of economic planning. The DBs have to perform an important function as financiers of economic development;

v. In countries like India sheer vastness of size necessitates considerable attention to be paid to the objectives of regional development. In the deployment of credit, development banks have to pay adequate attention to the regional development objectives. Persistence of regional economic inequalities poses a threat to democracy and national unity and so regional economic development must be one of the important development banking objectives;

vi. India had considerable industrial growth experienced in the pre-independence period such as industrial entrepreneurs like Tatas and Birlas were developed during the British rule. The so-called traditional industries so developed have been in need of modernisation as they also happen to be important export industries which has to sell in highly competitive world market. And in this respect the DBs can play a signal role through enabling these industries to modernise themselves;

vii. Development Banking have been paying attention to the small industries and their problems since the inception of the development banking. Small industry and enterprise development should continue to receive adequate attention of Development Banks;
viii. Foreign exchange continues to be one of the scarce inputs in the development process. Sensible allocation of earned and borrowed foreign exchange is a sine-quo-non of eventually achieving self reliance objective which implies among other things "Zero Foreign Aid" the DBs as purveyors of assistance in terms of foreign exchange must assure themselves that the scarce foreign exchange goes to the most needy and productive enterprises;

ix. Revealing the industrial gaps these banks must have a continuous system of identifying the opportunities where prospective entrepreneurs are entered;

x. Preparation of feasibility studies and project reports for small units and new aspirants these banks are of great use in this regard as such parties who really take benefits of consultants;

**State Industrial Development Corporations**

SIDCs were established in the sixties and early seventies under the Companies Act as wholly-owned State government undertakings for promotions and development of medium and large scale industries. Besides, providing assistance to industrial projects by way of term loans, underwriting and direct subscriptions to shares/debentures and guarantees. SIDCs undertake a variety of promotional activities.
There are 26 SIDCs at present operating in the country. nine of them also function as SFCs to provide assistance to small-scale units as well as act as promotional agencies. These twin-function of SIDCs are in North-Eastern Region - Arunachal Pradesh, Manipur, Mizoram, Nagaland and Tripura. and the remaining three are one each in Sikkim, Pondicherry and Goa, Daman and Diu. The SIDCs are financial institutions under section 8(1) (A) of the IDBI. Act, 1964. The SIDCs in Gujarat, Maharashtra and Goa, Daman and Diu are set up as Statutory Corporations and the remaining ones are incorporated under the Companies Act. The Andhra Pradesh and Bihar Governments took the lead and set up such institutions in 1960, followed by Uttar Pradesh and Karnataka, Maharashtra, Gujarat and Orrissa in 1972, Madhya Pradesh and Madras in 1965 and Punjab in 1961, the latest one to join this family was Manipur which set up SIDCs in 1984.4

State Financial Corporations

Basically, at the time of setting up of Industrial Financial Corporation of India (IFCI), the necessity to establish similar institutions at the State level for assisting smaller industrial establishment had been recognised because it was not possible for single institution to satisfy capital needs of smaller concerns sprawling all over the country. Moreover, a sole financial institution cannot be expected to shoulder the responsibilities of meeting the varied financial requirements of diversified small and medium scale industries. With the growth of the IFCI, the planners felt the dearth of funds for small and medium scale
industries. Accordingly, the Government of India in consultation with the Reserve Bank and the State government has enacted the State Financial Corporation Act, 1951. It has empowered the State governments to establish financial corporations for their respective Regions/States. In terms of the SFCs Act the State Govt. and the RBI through mutual consultations, shape the overall policy and functioning of these Corporations.

There are 18 SFCs at present, 17 of which was set up under the SFCs Act. Tamil Nadu Industrial Investment Corporation Ltd., which was set up under the Companies Act as Madras Industrial Investment Corporation in 1949, also functions as a full-fledged SFC.

Review of Literature

The study of earlier research works will certainly help the researcher in presenting the report in a clear and precise manner with valuable suggestions and conclusions. In fact, a brief history of yester years' surveys in the same area helps as a "backbone" for the present study and further it provides a cushion for presenting the report in a better way. To put it differently, the knowledge of earlier studies and of the conditions and / or circumstances prevailed under which the conclusions drawn and suggestions were made by the researchers would be of immense help and is imperative in the presentation of the analytical and critical report. Therefore, a review of the past, related studies in the field is as important as the present study.
A few value studies were conducted by institutions, individual researchers and professionals covering the various aspects and the functional areas of developmental financial institutions. Besides, the developmental financial institutions viz., IDBI, IFCI and ICICI have been studying corporate performance covering private and public sector companies time to time. These studies are concentrated on a particular objective, generally, to find out operational performance of different companies in different years.

A study relating to the Progress of Development Banking in India is the contribution of Lakshmana Rao. He has reviewed the overall progress of development banks in India with greater emphasis on sector-wise performance of SIDCs at two points of time interval. Workable suggestions for forming a sound and conducive management pattern for effective functionaries of the development banks were made by Srivastava, R.M., in his work on "Management of Indian Financial Institutions".

An attempt has also been mad by Saksena R.M., in his work on "Development Banking in India - IFCI Portrait. An overview of the organisational pattern and managerial aspects and also the performance of the IFCI have been discussed and analysed in this study. "Financial Institutions and Regional Development in India" is the contribution made by Ramakrishna Sarma, K. This study reveals the target set and the objectives achieved by the financial institutions with regard to "Balanced Regional Development".
A study relating to SIDCs is the contribution of Kallu Rao. In his analytical study - Functions of the State Industrial Development Corporations in India - the operational and financial performance of All India Financial Institutions are compared with State Financial Corporations.

Attempts were made by several researchers particularly in the areas of policies, managerial problems, financial policy aspects, financial infrastructure and economic development of development financial institutions. A few among them are: Bhat V.V.\textsuperscript{11}, Pandey, K.M \textsuperscript{12}, and Rangarajan, et.,al\textsuperscript{13}.

Several researchers conducted studies in the field of operational and financial performance, organisation structure and balanced regional development and related aspects of development financial institutions. To quote a few: Bapa Rao T.\textsuperscript{14}, Gupta Jagannath \textsuperscript{15}, Goyal Om Prakash \textsuperscript{16}, Jain Satyendra Kumar \textsuperscript{17}, Jha Awadu Kishore \textsuperscript{18}, Maheswari C.D.\textsuperscript{19} and Verma Shiva Pujan Sahai \textsuperscript{20}.

Though the above mentioned research studies covered various aspects of development banking in India, they lack in a comparative operational and financial performance of All India Financial Institutions viz., IDBI, IFCI and ICICI over a decade period. Hence, the present study entitled, "IMPACT OF THE DEVELOPMENT BANKING ON INDUSTRIAL DEVELOPMENT IN INDIA", has been carried out. The study has been aimed at the achievements made by AIFIs particularly their contributions towards industrial
development in India. Ranking of development banks has been made to identify the position of individual banks in their achievement. This will certainly enable them to plan the future course of action effectively and efficiently. Keeping this in view the researcher has made an attempt to study the performance, particularly of IDBI, IFCI and ICICI.

**Selection of the Problem**

The policies of the Commercial banks do not permit them to provide adequate and long term finance to the industries. This situation necessitated the formation of Development Banks besides special financial institutions for meeting the long-term investment requirements. Accordingly the All India Development Banks viz., IDBI, IFCI and ICICI and financial institutions such as LIC, GIC, UTI, STC, etc., came into being to look after the promotion of industrial sector in particular through providing huge and sizable amount of assistance for the promotion, diversification and development of industries and the Indian economy in general. Apart from this, State level financial institutions such as SIDCs, SFCs, SIDCs, etc., are also extending their support for the promotion of the sector. These financial institutions are occupying the pivotal position in the Indian industrial development as well as in the capital market as the lending and investment policies of these institutions have a decisive influence on the flow of assistance in the economy.
Having given a serious and careful thought to industrialisation, the Government of India has taken effort to boost the splendid endeavour of planners and administrators. As a result, these financial institutions came into being to look after the promotion of industrial sector. It is a well-known fact that without adequate financial assistance the industry cannot prosper. The better functioning of an institution indicates the well-being of the clientele. Keeping this in view the researcher has made an effort to find out the performance of All India Financial Institutions, viz., IDBI, IFCI and ICICI individually. In addition the performance of these institutions have been compared with one another to identify their relative merits and demerits.

Objectives of the Study

The present study, "IMPACT OF THE DEVELOPMENT BANKING ON INDUSTRIAL DEVELOPMENT IN INDIA", has been taken up with the following specific objectives:

* To study the contribution of Development Financial Institutions towards the development of Backward areas
* To study the overall operational performance of IDBI, IFCI and ICICI: Sector-wise and Purpose-wise assistance
* To analyse Industry-wise performance
* To analyse State/Region-wise performance
* To compare the performance of IDBI, IFCI and ICICI
Period of Study

The present study covers a period of one decade from 1983-84 to 1992-93.

Sources of Data

The data for the present study has been mainly based on secondary sources and has been collected from journals, bulletins, brochures and the publications of IDBI entitled - Operational Statistics, Reports on Development Banking and the Annual Reports of IDBI and other Development Financial Institutions. Research studies done on the related topics, books published on the area, research papers/articles and the news appeared in various dailies on Development Banks are also become part of the sources of data for the present study.

Data Analysis and Statistical Tools Used

Data secured from different sources has been analysed and interpreted systematically with the help of statistical tools such as, Regression Analysis, Compound Growth Rates, Index Numbers. Percentages, Ratios, etc. Besides, Non-Parametric Tests have been applied to arrive at final inferences. Pictorial presentation of the important data has been done to understand the concept clearly and quickly.
Chapter Scheme

The present study has been divided into five chapters:

The first chapter, "Introduction", covers a brief history on the evolution, objectives, organisation of Development Banks, objectives of the study, methodology adopted and the review of literature.

The second chapter deals with the Operational Performance - Backward area assistance, Sector-wise assistance and Purpose-wise assistance - of IDBI, IFCI and ICICI.

Industry-wise Performance of IDBI, IFCI and ICICI has been evaluated in the third chapter.

The fourth chapter is kept aside for State-wise/Region-wise Performance of IDBI, IFCI and ICICI.

The fifth and final chapter covers Conclusions arrived at and possible Suggestions drawn.

Contribution to Knowledge

The present study, we hope, will serve as a source of literature in the field of Development Banking. It may help the authorities of IDBI, IFCI and ICICI to have better understanding on the impact of Development Banking on the industrial Sector of our country. And also it may help the academicians and the researchers who study in this area.