CHAPTER I

INTRODUCTION

1.1 BACKGROUND:

Industrialisation has a major role to play in the economic development of the developing countries. The gap in per capita income between the developed and developing countries is largely reflected in the disparity in the structure of their economies, the former are largely industrial economies, while in the latter, production is confined predominantly to agriculture. The industrial sector which possess a relatively high marginal propensity to save and invest contributes significantly to the eventual achievement of a self-sustaining economy with continued high levels of investment and rapid rate of increase in income and industrial employment. Besides, the process of industrialisation is associated with the development of mechanical knowledge, attitudes and skills of industrial work, with experience of industrial management and with other attributes of a modern society which in turn, are beneficial to the growth of productivity in agriculture, trade, distribution and other related sector of the economy. Industrialisation is thus inseparable from substantial, sustained economic development because it is both a consequence of higher incomes and a means of higher productivity.¹

Soon after independence, there was a widespread belief that without increasing the role of the state, it was not possible either to accelerate the process of growth or to create an industrial base for sustained economic development of the country. An important requirement of industrial growth is the development of a financial network that will provide an adequate and properly distributed supply of finance to these entrepreneurs whether public or private who are setting up new industrial plants or
expanding existing ones. This network consists of those institutions through whose services the would be demanders of finance are able to gain access to either direct suppliers of financial capital or various intermediate supplying institutions to which, in turn, ultimate suppliers are willing to entrust their financial resources in the hope of a return. One of these strategic institutions has been historically, the development banks popularly known as Development Financial Institution (DFI) which are distinct from other financial institutions by their development orientation and emphasis on the spirit of enterprises.

1.2 CONCEPT OF A DEVELOPMENT BANK:

Any study on the evaluation of the performance of the development bank should be preceded by a comprehensive discussion on the concept and the important dimensions of its functions. Various authors have given their opinion on what constitutes the important requirements of functioning of a development bank. The conceptual definition put forward by them differs from country to country and from time to time depending on the nature of economy and the state of economic development process. A few of the important definitions, referring to the concepts and functions of development banks, have been discussed in this section.

Diamond defines development banks as "an institution to promote and finance enterprises in the private sector".

Boskey has given a broader definition. To him, the development banks are, "Institutions, Public/Private, which have one of their principal functions, as the making of medium and long-term investment in the industrial projects".
Kane goes a step further, when he says that these institutions transfer not only the domestic but also the firm savings to investments and thus, contributes in the economic development. He defines development bank as a "Financial intermediary supplying finance to economic development of projects and providing related services".5

Another effort to provide a framework of identifying development banks is made by Nyhart and Janssens. They identified development banks as those institutions which provide general medium term and long-term financial assistance in a developing economy.6

According to World Development Report, "Financial intermediaries are those, which emphasize the provision of capital (Loans and equity) for development. It may specialize in particular sector, for example, industry, agriculture, or housing".7 In similar line Hook suggests, that development banks have two functions to perform i.e. banking and development".8 As a banker the development banks are expected to finance those projects which are "bankable". A project is bankable if it is in the nature of self-financing. Elaborating self-financing projects Kane says; that a project is self-financing, if it is able to generate enough income within a specified period of time to (i) cover the cost of operations (once the plant begins operations), (ii) repay the principal and interest charges there on and (iii) leave a residual profit enough to remain in operations.9

The above definitions reveal the pervasiveness of the nature of a development bank. Some are found to be government sponsored and others are privately owned and still others are in both hands. The range of services varies widely among them. However, all of them carry a commitment
towards faster growth and fulfilment of the aspirations of the economy. Some have broad planning functions, some can lend and take equities and some can set up and manage enterprises on their own account. Some are concerned with the entire economy, others with but a single sector, some are regional, other national.¹⁰ This great variety among existing banks indicates "that no single model is suitable to all, perhaps not even to any two, countries".¹¹

Despite their diverse nature, they have been devised to provide, at least a few, if not all the fundamental ingredients of economic development, the lack or adequacy of which may retard or accelerate the pace of progress. Thus, a development bank is intended to provide the necessary capital, enterprise, managerial and technical known-how where these are inadequate or non-available and also assist in building up the financial and socio-economic infrastructure, favourable to quick economic development. The emphasis on its various activities has shifted from one country to another according to its peculiar needs and circumstances. In some countries the stress has been on finance, in some others, on promotion, in yet others on technical skill and advice, and again elsewhere on economic planning itself.¹²

Another important feature of a development bank relates to the purpose for which funds are made available by it. The accent of the development bank is on development¹³, so that its purpose is the provision of "development finance", that is finance for new real investment in fixed assets. In contrast, a good deal—perhaps the greater part of the financing operations of conventional financial institutions is not related or directed to new real investment and serves mainly to provide liquidity to investment made earlier.¹⁴
Finance, truly speaking, is not a resource but a numeraire in which all resources are expressed. But it has its own strength as well as weakness. Mere creation of finance without corresponding creation of goods and services within a reasonable time, could be inflationary. A development bank just can not be merely a lending agency. It has to take into account the strength of finance in the sense that it could command all resources and exploit this strength to the maximum benefit of the nation. The manner in which finance is disbursed to projects, very much determines the claims of assisted units on scarce resources such as power, fuel and transport. By following an appropriate location policy, while assisting projects; it could help determine the geographical dispersal of industries and facilitate in reducing regional imbalances by creation of income and employment in the relatively backward regions of the country. And depending on the kind of entrepreneurs it assists, it could also determine the emerging pattern of ownership and means of productions. Thus, even within the framework of this traditional lending activities, there is considerable scope for a development bank in optimising the use of scarce resources, in achieving a socially desirable product - mix, in bringing about industrialisation in hither to backward regions in preventing concentration of economic power and in promoting the growth of small, new and technical entrepreneurs on the country.\textsuperscript{15}

In nutshell, it can be said that a development bank is associated with all types of financial and promotional aspect of economic development. The most important is to assist the process of development and the criterion of success is the extent to which it helps the process of development of resources.\textsuperscript{16}
1.3 DEVELOPMENT BANKING NETWORK IN INDIA:

With the end of the second World War, the urge for speedier industrial expansion got strengthened. At the same time, there was also a great need for modernisation and replacement of obsolete machinery in already established industries. The usual agencies meant to provide finance for large-scale industries were either apathetic or were found inadequate and hence the Government of India came forward with a series of financial institutions to provide funds to the large industrial sector. It set up the Industrial Finance Corporation of India (IFCI) in 1948, the Industrial Credit and Investment Corporation of India (ICICI) in 1955, the Industrial Development Bank of India (IDBI) in 1964, the Industrial Reconstruction Corporation of India (IRCI) in 1971, now called Industrial Investment Bank of India Ltd. (IIBI), the Export and Import Bank of India (EXIM Bank) in 1982, the Small Industries Development Banking of India (SIDBI) in 1990 and so on. During 1990s, the Government set up Risk Capital and Technology Corporation Ltd. (RCTC), Tourism Finance Corporation of India Ltd. (TFCI) and Technology Development and Information Company of India (TDICI). At the state level, the State Financial Corporation (SFCs) and State Industrial Development Corporations (SIDCs) were set up. All these institutions have come to be known as public sector financial institutions or term lending institutions. The Narasimham Committee (1991) has called them Development Financial Institutions (DFIs).

1.4 FINANCIAL SECTOR REFORM AND DEVELOPMENT FINANCIAL INSTITUTIONS:

India has witnessed a phenomenal expansion in the geographical coverage and functional spread of the banking and financial system since bank nationalisation in 1969. Despite impressive quantitative
achievements in resource mobilisation and in extending the credit reach, several distortion had over the years, crept into the banking and financial system. As a result, productivity and efficiency of the system had suffered, its portfolio quality had badly deteriorated and profitability had been eroded. Several public sector banks and financial institutions had become weak financially and some public sector banks had been incurring losses year after year. Their customer service was poor, their work technology outmoded and they were unable to meet the challenges of a competitive environment. These problems become more aggravated after the opening of the economy in 1991 and consequent entry of new players into the financial market. It was under these circumstances that the Government of India set up a high level committee with Mr. Narasimham, a former Governor of the RBI as Chairman to examine all aspects relating to the structure, organisation, functions and procedures of the financial system. This committee on the financial system submitted its report in November, 1991 and many of its recommendations were implemented. This phase of development in the Indian financial system named as Financial Sector Reform-I, 1991.

The recommendations of the Narasimham Committee, 1991 are based on the committees assumption that the DFIs are relevant in the Indian contest, even through their promotional and development role would diminish as the Indian economy required greater sophistication with greater industrial development. At the same time, with the progressive deregulation of industry and curtailment of the area of industrial licensing, the responsibility devolving on DFIs would be much greater. The major recommendations of the Narsimham Committee (1991) on DFIs were as follows:18
i) The ownership pattern of DFIs should be made more broad based.

ii) The Government should work out an action plan to be implemented in the next three years which would usher in a measure of autonomy of the DFIs in matters of internal administrations.

iii) The boards of DFIs should include representations from the industrial sector.

iv) The DFIs should raise their funds from the capital market at market-related rates. They should also mobilise the savings of the household sector through such schemes which did not conflict with the commercial banks.

v) As regards loan sanctions, each DFI should have the sole responsibility in loan sanctions. It should be guided by professional appraisal of the technical and economic aspects of the project, evaluation of the promoter's, competence and integrity. The DFIs should supervise their own loan implementation.

vi) The system of consortium funding should be given up. The cross-representations in each others boards would not be necessary with the giving up of consortium funding.

vii) In the matter of corporate take-overs, DFIs should lend support to existing managements with proven record beneficial to all concerned, except in those cases, where the new management could do better. In all cases, the DFIs should exercise their individual professional judgement free of any extraneous pressures.

The Narasimham Committee had proposed that DFIs should adopt internationally accepted norms, restore capital adequacy, inject an element of competition in term-lending finance with a view to providing greater choice to the borrowers. The committee had also recommended that
commercial banks should be encouraged to extend term finance while the DFIs should start extending loans for short periods for working capital requirement.

After the seven year completion of the Financial Sector Reform-I, one new committee, i.e Narasimham Committee-II was set up to review the progress of banking sector reforms to date and chart a programme on financial sector reforms necessary to strength India's financial system and make it internationally competitive. "The Financial Sector Reform-II" (Banking Sector Reform) report prepared by the Narasimham Committee (II) has been submitted to the Government of India in April 1998. This report covers the entire gamut of issues, ranging from capital adequacy, bank mergers, the creation of global-sized banks, recasting bank boards and revamping bank legislation. Important finding and recommendations of this Narasimham Committee (II) are as follows:

i) The Committee has made out a strong case for a stronger banking system in the country, especially in the context of Capital Account Convertibility (CAC) which would involve large inflows and outflows of capital and consequent complications for exchange rate management and domestic industry. The committee recommended the merger of strong banks which will have a multiplier effect on industry.

ii) The committee also suggested that the Government should consider raising the prescribed capital adequacy ratio to improve the inherent strength of banks and to improve their risk absorption capacity. The committee has suggested higher capital adequacy requirements for banks and setting up of an Asset Reconstruction Fund (ARF) to take over the bad debt of the banks.
iii) The committee has considered the issue of "autonomous status" for the Board for Financial Supervision of RBI and the need to segregate regulatory and supervisory functions of RBI. The committee states:
"Regulation should be concerned with laying down procedural and disclosure norms and sound procedures and ensure adherence to these and not get into the day-to-day management of banks".

iv) The committee has suggested the urgent need to review the provisions of RBI Act, Banking Regulation Act, etc. so as to bring them in line with the current needs of the banking industry.

After the financial sector reform in 1991, banks and DFIs are providing diversified services, either in-house or as conglomerates. The RBI seems to favour the present cafeteria approach subject to appropriate regulation. For harmonising the role of DFIs and banks, RBI set up a high power group headed by S.H. Khan. This group has submitted its interim report to RBI towards the end of April, 1998. The basic assumption of the Khan working group is that the conventional distinction between commercial banking and development banking is getting blurred in India and that there is a need to move progressively towards universal banking. The Khan Working Group has, therefore, recommended that DFIs be allowed, over a period of time, to convert themselves into banks and that they be granted licences for this purpose.

In the interim period, DFIs may be permitted to have a banking subsidiary (with holding upto 100%), while the DFIs themselves may continue to play their existing role till the development of the debt market in India. The universal bank could have any corporate structure-single company, flagship or holding company and managements should be free to decide the type of structure to adopt.
During the period of transition from development to commercial banking, the Government and/or RBI should provide an appropriate level of financial support to enable DFIs to fulfil their development obligations.

Calling for speedy legal reforms, the Khan working group has demanded that debt recovery of banks and DFIs should be given top priority and that the 1993 Act of Recovery of debt should be overhauled.

The working group has accepted the existence of regulatory discrepancies as between DFIs and banks and has called for measures to smoothen out these regulatory discrepancies. The group has suggested that a super regulator be established to supervise and ensure uniformity in regulatory treatment.

The Working group has also made some more important recommendations to make the process of movement from development banking to universal banking easy and smooth. For instance, directed lending and concessional lending to certain sectors should be replaced by specifically targeted subsidies to the sector. The group has called for modification in the definition of priority sector by excluding all infrastructure loans from the definition of bank credit, which is used in computing the 40% priority sector target of banks.\textsuperscript{19}

1.5 RESEARCH PROBLEM:

The development banks have been operating in the country for more than 40 years. Their investment is mainly in large, medium and small scale industries. But providing finance is not the sole aim of the development banks. The task of development banks goes far beyond the conventional
function of providing term capital to qualifying entrepreneurs and mobilising resources for their lending operations. They have to act as the growth inducing sector in desirable direction. In India for a long time considerable emphasis has been given on redistribution of income and of productive assets, social justice, self reliance, preventions of concentration of economic power, regional balance of growth and promotion of new and technical entrepreneurs. Since 1991, there has been a qualitative shift in the emphasis of the Government from social goal maximisation to commercial viability and competitive efficiency. In this new situation, the development banks are forced to adapt their lending strategies and activities towards realisation of these objectives. However the transition from a purely protected and shelter market to a virtual open competitive market has thrown open a number of problems and challenges for the development banks in general. Some of the major problem and challenges being faced by the DFIs during the post-liberalisation period have been discussed briefly in the following pages.

To carry out the development functions of the DFIs, the Government for a long time used to provides the concessional finance through different routes. The debt instrument issued by the FIs were also classified as securities, qualifying for Statutory Liquidity Requirements (SLR) holding for banks, thereby providing recourse to captive and a cheap source of funds. With the launch of financial sector reform in 1991, the FIs were asked to function on a commercial basis by accessing the market for their resources. Before the economic reforms, they were operating in a protected market with the administered rate of interest on their loans, but after 1991, they have been forced to enter into the deregulated market environment with the market related rate of interest.20
Another important problem faced by the DFIs is the crisis of credibility. In the wake of economic liberalisation, globalisation and changing business environment, a significant amount of FI exposures have become bad. This increasing non-performing assets (NPAs) of the term-lending institutions is adversely affecting their profitability. They are facing difficulty even to meet their commitments. The problem of NPA got further accentuated due to ineffective debt recovery mechanism existing in the country.\textsuperscript{21}

The free market economy during the 1990's also witnessed keen competition for DFIs from the other players in the financial market, especially the commercial banks, NBFCs and others. Since, at present the commercial banks are financing both short-term and long-term finance to the corporate sector, it created a problem as also a challenge for the DFIs to increase and diversify their client base. It became easy for the commercial banks to finance both kinds of loans, because they are accepting deposits and transform that deposits to the loans. But for the DFIs, this type of facilities are not available and they basically depend on the market wholly for their resource mobilisation and financing.\textsuperscript{22}

The liberalisation and globalisation process started in the Indian economy, has revived the capital market and opened the door for the corporate sector to raise their resources directly from the market. This increasing dependance of the corporate sector on domestic and international market made them self capable to finance their projects without going to the DFIs. This disintermediation process in the Indian economy also adversely affected the functioning of the development banks.\textsuperscript{23}
An acute problem faced by the DFIs today is the lowering of their spread. After the financial sector reform, the DFIs entered into the capital market to raise their resources. These resources are generally raised with the market rate of interest which is higher than the previously administered rate of interest, so this results in an increase of their cost of borrowings. On the other hand the DFIs are forced to reduce their lending rates due to competition. Further there is also the problem of greater risk exposure and consequent higher NPA in their traditional investment portfolio. All these have resulted in declining of their income which obviously is squeezing of their spread and forced the DFIs to enter into the other types of activities specially, the fee based activities.

The reform process initiated in the economy also affect the DFIs due to their adoption of the Basle norms. The BIS norms state that the DFIs should follow certain guidelines in regards to their asset classification, income recognition, provisioning and capital adequacy norms. These norms forced the DFIs to raise more risk free capital and restructure their accounting and operating procedures which had an immediate adverse impact on their bottom line.

The increasing access of the DFIs to the Indian capital market through a number of equity issues has created a new type of problem for them with which they were not acquainted earlier. This is the problem of accountability to the shareholders. Instead of only Government and Governmental institutions, they have to face a large number of private individuals and institutions as their shareholders in the annual general body meeting. These shareholders with purely wealth maximisation objective want super performance from the company in the form of increasing rate of
dividend and higher appreciation of the share price in the market. Thus, the management of most of the DFIs in this competitive economy are always on their toes because of these increasing accountability from the public and more specifically from their private shareholders.

The concept of universal banking which has been recommended by the S.H. Khan Committee has put the DFIs into a fix. Since the concept of development banking is slowly going out of fashion, they have to get themselves converted either into an NBFC or an universal bank within a specific time period. While the task appears to be little easier for the commercial bank, it may prove to be very difficult, painful and time consuming for the DFIs.26

1.6 REVIEW OF SELECTED RESEARCH STUDIES:

In the background of the above problems, the present section includes a brief review of various research works conducted into the functioning of DFIs in India. Before 1980, many authors like Basu (1965), Gupta (1969), Saksena (1970) had produced some qualitative works on the functioning of development banks.27 However, the recent past has witnessed a rapid change in the operations of DFIs in India. Hence, the present study attempts to review only those research works which have been conducted since 1980 and onwards.

Deol (1981) has highlighted the problem of resource mobilisation faced by DFIs. He pointed out the changing relationship between Govt. and DFI due to the pressure on public funds from other claimants. He has marked that due to the declining support of govt., the distinctions among public and private DFIs would tend to disappear. He observed that in this
type of situation, private DFIs have developed linkages with international consortia of banks and lead managers to locate new resources of finance.\textsuperscript{28}

Pandey (1983) has vividly explained the policies of development banks, their lending preferences, mode of financing, terms and conditions of financing, capital structure, average etc. With reference to the ICICI, he found that cost of capital is an important concept for DFIs, and opined that the rate of interest charged by a DFI on its loan should be at least equal to its cost of funds.\textsuperscript{29}

Pai (1984) has emphasized on the ability of DFIs to cope with changes in operating environment and taking advantages of them. He analysed different areas of DFIs like the sources of funds and their cost, deployment of available resources, scale and range of promotional services and the health of the assisted industrial units. He concluded that the recent changes in national and international economic and financial environment has created a lot of problems and DFIs should improve their knowledge and technique of fighting these problems from the experience of other countries.\textsuperscript{30}

Parekh (1984) while assessing the performance of ICICI observed that the crux of the development bank is to combine profit making with a developmental orientation. He emphasised the cooperation of such banks with institutes of technology, universities, research and development institutions and with Government to keep up with new implications of development.\textsuperscript{31}

Nadkarni (1984) opined that the relationship between DFIs and their client should be intimate and continuous drawing upon each others
expertise and experience to create a vibrant industrial ethos. He presented a discussion on non-financial input and support of DFIs like project counselling, management strengthening, rehabilitation of sick units, providing promotional efforts, supplying informations to clients. He felt that the DFIs in India have realised the utility of learning from the experience of other DFIs of Asia-Pacific region in these areas.32

Singh (1984) has put forward his views on involvement of DFIs in the assisted projects. He felt that it is necessary to identify the specific phase in the project cycle which has led the assisted projects into difficulties. Proper identification of the phase helps in a better understanding of the problem and finding an effective solution. He further emphasized the review of entire portfolio on a continuing basis by the DFIs with a view to taking preventive actions in time.33

Dave (1984) while elaborating the involvement of development banks in promotion of industries, development of backward regions and promotion and rehabilitation of sick units, has bestowed confidence on their operations to the extent they are well financed.34

Singh (1985) made an elaborate study on the functioning of the IDBI taking into account the detailed lending and promotional activities. He found out some lacunas in its functioning like skewed regional development and non-responsive role in the growth of capital market. Accordingly, he has suggested many ways to improve its operations and enhance its role in the capital market.35
Davar (1986) studied the relationship between DFIs and clients and suggested that in order to help the assisted concerns, organisations must be strengthened in areas like "industrial intelligence" and "economic intelligence". DFIs would also have to review their total assistance portfolio on a continuing basis to make timely change as and when needed. They have to supply equity capital requirements of sick units where reconstruction or financial reorganisations are evolved.36

Jain (1988) has vividly analysed the functional aspects of the IFCI with regards to profitability, resource management, inflation, project financing operations, stimulation of capital market, corporate control etc. On the overall view, he concluded that the future of the IFCI depends on its ability to mobilise additional funds at reasonable costs, augment its financial returns, exercise control over default and sticky accounts.37

Sharma (1989) examined the role of state level development banks in the industrialisation of Punjab. He has made a detail study on the performance of Punjab State Financial Corporation, State Industrial Development Corporations and Punjab Small Industries and Export Corporation. He found an positive correlations between the growth of industrialisation in this state and the financing of these institutions.38

Subramanium (1990) has observed that in the recent years there is a severe strain on the easy rupee resources coming from bond issues. On the other hand during these years the borrowings from foreign sources has picked up. He suggested that the DFIs in this situation shall have to go to market and tap non-traditional sources of finance.39
Vij (1991) in his research publications discussed the management policies in respect of IFCI and IDBI with regards to resources, spread, liquidity, lending and capital adequacy. He has suggested for more catalytic role of these institutions for attracting private funds through term deposits and commercial borrowings in foreign exchange. He stressed on the minimisation of administrative cost to maximise the return on total assets and on capital invested. In place of project financing, he favoured company financing on the part of the banks to provide various needs of a company.40

Bandhopadhyay and Ray (1991) in their empirical assessment of the role of the IDBI in removing regional imbalances in West Bengal have found that backward regions have not got any linkage advantages for their industrial development. They stressed on the financing of projects in such regions that would generate maximum linkage and employment in depressed regions.41

Mukarram (1991) has analysed the expanding business of the IDBI. He felt that the giant institutions is preparing to face a future with tough competition and less protection. In this regard, he found out certain new developments on the front of resources mobilisation and financing pattern.42

Vij (1992) explained the growing problems of resource mobilisations on the part of the IDBI and IFCI with regards to the non-availability of funds from Government and the rising interest cost. He suggested the thrust should be for better recovery of current overdues and creation of a culture amongst the constituents for prompt payment of dues.43
Sarkar (1992) has looked into the problems of separations of the IDBI operations from direct financing operations as per the Narasimham Committee recommendations. He however, preferred the existing pattern and an off-side supervisory role for term lending institutions, which could lay down pivotal norms and take punitive actions for deviations.44

Dattagupta (1993) studied the diversification of the IDBI in the changing circumstances. He observed that the competition, in the present environment has forced the IDBI to diversity into new growth areas and focus on short term assistance and leasing.45

Balu (1994) has emphasised on risk management on the part of development banks. He examined the various risk factors and identified risk analysis methods for a scientific approach of a project. He emphasised or good information support and identification of risk factors for a effective control on project risk.46

Upadhyay (1994) in his study, "the role of DFIs" has enumerated the growing problem of resource mobilisations, associated with non-availability of cheap funds, hike in interest rates, entering of other institutions into the field of project financing etc. He has observed a diversifications in DFIs activities into related areas like merchant banking, debenture trusteeship, forex management etc.47

Ranganathan (1995) has compared the performance of the IDBI, ICICI, SCICI and EXIM Bank for the year 1994-95 with regard to sources of funds. He found that financial institutions have largely depended on internally
generated resource to augment their resource position. Non-traditional sources like certificate of deposits, fixed deposits and short term borrowing are slowing taking the place of domestic bond borrowings. He found that FIs have become more conscious about bad and doubtful debts thus in their loan portfolio. Most of the FIs are attempting to maintain a reasonable spread and manage, the interest risk without incurring the asset liability mismatch.48

Ravulur (1995) found out an increasing pressure on spread of DFIs due to high interest rates, squeezing of Government sources and shaky industrial growth. While comparing the performance of the IDBI, ICICI and SCICl, he opined that in the coming years these financial institutions will have to face the difficulty in meeting their asset growth targets and will face a further narrowing of spreads. He further observed that while these institutions are fundamentally strong, the results in coming years will be guided more by external factors.49

Pati (1996) in his study "Development Banking in India: an evaluation of the performance by IDBI" described that, IDBI occupies the prime position in the development banking structure in India. During the three decades of its existence the bank has played a significant role in fostering India’s Industrial and financial development within the broad framework of national policies. He viewed that as the process of liberalisations and deregulations gathers momentum, market process will exert greater influence on the institutions. Further, IDBI will have to restructure and reorient its investment strategy according to the changing needs of the markets.50

Garg and Jain (1997) in their study "Financial Management in Industrial Banks", examined and compared the efficiency of the three all-India
development banks, viz., IDBI, IFCI and ICICI in the management of their financial resources. They found that over the years, the three DFIs have emerged as the primary financing agencies in the Indian industrial financing system and have taken various steps to improve their operational efficiency.\textsuperscript{51}

1.7 RELEVANCE OF THE PRESENT STUDY:

The review of the various research studies conducted from time to time on the functioning of the development banks suggest that most of the empirical works on development banks have focused on their economic appraisal, promotional role and resource mobilisation. Few studies have focussed attentions on the efficient utilisation of their financial resources.

Since the development is a dynamic process, DFIs most frequently review their policies and take necessary initiatives to meet the changing needs of the industrial sector. This changes may arise from revision of national priorities or from a new perception of the crucial problem of development or gross structural changes in the international environment.

Since, 1991, with the initiation of the financial sector reform policies by the Govt. of India, significant and far reaching changes have taken place both in the capital market and in money market. The financial institutions, notably the DFIs, which have long been operating in a protected and highly sheltered market, all of a sudden find themselves at the cross road. The very existence and basic rationale behind the setting of these banks have been repeatedly questioned.

Among all the DFIs, ICICI occupies a special place. Being only DFI established in the private sector, it has always taken the lead role in
bringing various innovations both in resource mobilisation and deployment of funds. However, in the new economic environment, ICICI is now forced with increased competition. The earlier formalised system of consortium lending has been replaced by an informal systems of loan syndications. Interest rate structure which was higher than administered is deregulated, enabling institutions to lend within an interest rate band depending on their perception of risk. There is a gradual decreasing of the low-cost fund from RBI/Government. ICICI will now depend increasingly on resources to be raised from the capital and money market through innovative products at market related interest rates, which would result in upward movements in the cost of funds. The higher borrowing costs coupled with competitive lending rates is likely to put a squeeze on the margins of the ICICI. Another significant development related to the decline of demand of funds from the ICICI, particularly from the set of high quality borrowers, who can easily access both domestic and international markets in the liberalised environment. In recent years, after liberalisation, ICICI has exposed itself to the retail business, but this retail business of ICICI has to some extent been affected by the state of the domestic market particularly by the NBFCs. Finally, like other DFIs, it is also affected by the rising NPAs, which is weakening the institution.

Keeping in view the present scenario in the development banking field, in this study an attempt is undertaken to analyse the financial performance of ICICI both in the pre and post reform periods. In addition, the study also made an indepth examination of resources and its operational efficiency including profitability and capital market operation.
This piece of research work on ICICI is the first of its kind to integrate both the analysis of operational and allocational efficiency with resource mobilisation. Considering the changing financial system and the ongoing planning process in this directions, the present piece of work would be relevant to a great extent to the planners and policy makers by highlighting the strength and weakness of the ICICI, so that the coming years would see the institution healthy, productive and more competitive.

1.8 RESEARCH DESIGN:

The present study is based on the descriptive type of research design in which ex-post facto approach has been followed. Accordingly, at the planning stage, specific objectives are set-up to provide the basis of enquiry. In the light of the objectives, the scope of the study is delimited and the method of data collection, period of study and tools of analysis are decided.

1.8.1 Objective of the Study

The present study has the following objectives:

i. To review the growth of development banks in India during the period between 1948 to 1998, with special reference to ICICI.

ii. To study the resource mobilisation pattern of ICICI and the shift if any, noticed during the post-liberalisation period.

iii. To examine its industrial financing operations and to evaluate the various procedural and operational strategies adopted by it to meet the fund requirement of different sectors of the economy.
iv. To analyse the operational efficiency through an observation of its profitability trend.

v. To evaluate the role of ICICI as a player in the capital market operation.

In order to get a better picture of the pattern of resource mobilisation, financing operations, operational efficiency and role in the capital market, the performance of ICICI in these spheres have been suitably compared with that of other all-India development banks, namely the IDBI and the IFCI.

1.8.2 Scope of the Study

The scope of the study is delimited as under.

i. The study includes the financial performance of the ICICI in the area of resource mobilisation, resource deployment, operational efficiency and capital market operations. It does not include any aspect of non-financial or promotional aspects of the ICICI.

ii. The financial analysis of the ICICI has been compared with only other two all India DFIs, viz., the IDBI and the IFCI. No attempt has been made to compare the performance of remaining all-India or state level financial institutions.

iii. This study does not make any attempt to examine the impact of ICICI's assistance on the growth of corporate sector, employment, production, export etc.
1.8.3 Methodology and Data Base

The present piece of research work is analytical and explorative in nature. The data for the study has been collected mostly from the secondary sources.

Secondary data have been collected from the Annual Reports of the ICICI, IDBI's Reports on Development Banking in India, RBI Bulletins, Annual Reports of IDBI and IFCI etc. The reports of various committees appointed by the Government/Planning Commission/RBI at different points of time in the area of Industrial Financing/Development Banks etc, have also been referred to collect specific information. Besides, various books, research publications, journals and other publications containing studies relating to the development banks have been used to fill up the gap in the availability of the required informations.

The data collected from the secondary sources have been suitably edited, analysed and interpreted according to the requirement of the study. For the purpose of analysis, simple statistical techniques like ratios, percentages, single annual growth rate, linear trend growth rate, rank correlation and simple regression have been applied. All the tabulations and calculations are made with the help of computer.

i. Simple Annual Growth Rate: It simply gives the percentage increase over the previous year i.e.

\[ g = \left( \frac{Y_t - Y_{t-1}}{Y_{t-1}} \right) \times 100 \]

where, \( g \) is the growth rate and \( Y_t \) and \( Y_{t-1} \) are the values of the variable \( Y \) in year \( t \) and \( t-1 \) respectively.
ii. **Linear Trend Growth Rate**: It is a compound growth rate. But unlike the ordinary compound growth rate, it is worked out for a period on the basis of the value of a variable for all the years. Therefore, it is considered as a better estimate. In this case, the least square trend is fitted for the given years with the given value of the variables for respective years. The given values of the variable are converted to natural logarithmic values to get a precise estimate of growth rate as compared to an ordinary logarithmic value. The exponential equations used is:

\[ y = A \cdot B^u \]  \hspace{1cm} \text{(1)}

\[ \log y = \log A + u \log B \]

\[ Y = a + bu \] \hspace{1cm} \text{(2)}

where \( Y = \log y \), \( a = \log A \), and \( b = \log B \)

The calculations for computing the trend values can be reduced considerably by changing the origin to the middle years in the series. By changing the origin, a new variable 'u' is obtained where \( \Sigma u = 0 \).

As \( \Sigma u = 0 \), the normal equations for estimating \( a \) and \( b \) in equation (2) are:

\[ a = \frac{\Sigma Y}{n} \]

\[ b = \frac{\Sigma uY}{\Sigma u^2} \]

\[ \therefore A = \text{Anti log } A \]

\[ B = \text{Anti log } B \]

Substituting these values in equation (1), we get the equation of the exponential trend function as

\[ y^* = A \cdot B^u \] \hspace{1cm} \text{(3)}

Putting \( u \) values in the above equation, we can get the trend values for \( x \) respectively.
The growth rate thus obtained from the equation (3) is  
\[ g = (B - 1) \times 100 \]

iii) **Rank correlation** : This is the calculation of correlation between variables by assigning ranks to each items of both the two variable. The formula for rank correlation is:

\[ r_s = 1 - \frac{6 \sum d^2}{n(n^2-1)} \]

where \( r_s \) is coefficient of rank correlation, \( n \) is number of paired observations, \( d \) is the difference between the ranks for each pair of observations and \( \Sigma \) is the notational meaning "the sum of".

For small values of \( n \) (less than or equal to 30), the distribution of \( r_s \) is not normal and unlike other small sample statistics we have encountered, it is not appropriate to use the \( t \), distribution for testing hypothesis about rank correlation coefficient. Instead a separate table values are used to determine the acceptance and rejection regions for hypothesis.

Our hypothesis becomes:

- \( H_0 : \rho_s = 0 \) null hypothesis: there is no correlation in the ranked data of the population
- \( H_1 : \rho_s \neq 1 \) alternative hypothesis : There is a correlations in the ranked data on the population.

\( \alpha = .01/05 \) Level of significance for testing these hypothesis.

iv) **Simple Regression** : The regression coefficient "b" is calculated by the formula  
\[ b = r \frac{\delta y}{\delta x} \]
which gives the 'b' value of the year \( y \) on year \( x \).
Here 'r' is calculated by applying Karl Pearson's formula

\[ \frac{\sum x_i y_i}{n \delta_x \delta_y} \]

\(x_i\) is the deviation of original data from the mean of variable x and \(Y_i\) is the deviation from variable y. \(\delta_x\) and \(\delta_y\) represent the standard deviation of the variables x and y. 'n' is the number of pair of values for the dependent and independent variables.

v. Quotient of Assistance : The quotient of Assistance is calculated as :

\[
\text{Quotient of Assistance (Q.A.)} = \frac{\text{Share of the State in total assistance}}{\text{States share in total population}}
\]

Q.A. of more than '1' represents more than proportional assistance to the state than that of population.

vi. Coefficient of Specialisation :

The coefficient of specialization is analogous to P. Sargent Florence's coefficient of localisation. The formula for this measure is

\[
\text{Coefficient of specialization} = \frac{1}{2} \sum (Q_i - \mu)
\]

where \(Q_i\) = the percentage share of the state's sanctions in total sanctions.

\[\mu = 100\% \text{ divided by the number of states.}\]

The value of coefficient specialisation (C.S.) lies between '0' and '100'. High value of coefficient reflects high degree of concentration of assistance and less diversification.
1.8.4 Period of the Study

The present study is confined to a period of 15 years i.e. from 1982-83 to 1997-98. This duration has been divided broadly into two different phases for the purpose of analysis. These are:

1982-83 to 1992-93 Pre-liberalisation
1993-94 to 1997-98 Post-liberalisation

Even though economic liberalisation was initiated in Indian economy from 1991-92, most of the liberalisation policies were implemented from 1993-94. Hence, this study considers 1993-94 onwards as post-reform period.

The above phase-wise analysis is expected to throw sufficient light on the role and performance of the ICICI.

It is noteworthy to mention here that the closing date of accounting year of ICICI was changed from 31st December to 31st March in the year 1987-88, thus till 1986, the accounting year means 1st January to 31st Dec., but from 1987, it changed to 1st April to 31st March. Hence the year 1987-88 includes 15 months from 1st January 1987 to 31st March 1988.

1.8.5 Limitation of the Study

The major limitations of the study include the following:

(a) As the study is based on data collected from secondary source, all the findings are subject to the limitations normally associated with the availability of secondary data.

(b) Econometrical analysis of the data could not be done due to exploratory nature of the study, constraints of time and resources and the need to keep the study within manageable limits.
Very simple statistical tools like linear growth rate, simple regression etc. have been used to analyse and interpret the data.

No attempt has been made to adjust the figures relating to the financial assistance of the corporations. Since data from the assisted units have not been collected, the study does not reveal the impact of the ICICI's financial assistance in the financial structure and performance of assisted units like growth in employment, output value addition etc.

1.8.6 Plan of the Study

The study has been organised into seven chapters including introduction & conclusion. Chapter -I highlights the nature, concept and historical perspective of development banks along with the review of literature. This chapter also discusses the research problem, the relevance of the study, the objectives, methodology, period, limitations and chapter plan.

The Second Chapter presents a cursory look on the historical development and evolution of development banking in India. This chapter provides a detailed theoretical profile and review the promotional activities of ICICI.

The Third Chapter contains the analysis of sources of fund, the norms of debt-equity, reserve policy, capital adequacy and the problems faced by ICICI for mobilising resources after liberalisation.

The Fourth Chapter evaluates the financing activities of ICICI. It analyses the allocation of resources among different industries, states,
sectors and to different purposes through its various schemes of operations. A brief study has been made to evaluate the different types of risk to which it has exposed.

The **Fifth Chapter** enumerates the detailed operational profitability ratios to study the viability of the ICICI with regard to its return, spread and earnings.

The **Sixth Chapter** presents the role of ICICI in stimulating the Indian capital markets through purchase and sale of securities, financing intermediation, provision of merchant banking services and creation of institutional infrastructure conductive to development of the capital market.

Finally, the last chapter brings together the summary, main findings of the study and draws some suggestions to make ICICI's operations more efficient and productive.
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