UNIT 13 FINANCING THROUGH FIs

Objectives

The objectives of this unit are to:

- trace out the historical setting with respect to the role of FIs in financing industrial units,
- analyse the trends in financing extended by FIs to different sectors, industries, etc.
- discuss the norms on the basis of which finance is extended,
- survey the reforms initiated by the government together with the action taken and the future agenda.

Structure

13.1 Historical Setting

13.2 Financing by All FIs

13.3 Role of Banks in Term Finance

13.4 Financing Norms

13.5 Share of FIs in the Company Financing

13.6 Reforms in the DFIs Sector

13.7 Summary

13.8 Self Assessment Questions

13.9 Further Readings

13.1 HISTORICAL SETTING

Financial Institutions (FIs) popularly known as Development Banks have started engaging the attention of the people in the industry as early as in 1822, when the Societe Generale de Belgique was founded in Belguim. This was followed by the establishment of the French Credit Mobilier in 1852. By the turn of the century, there was great interest generated in this exercise and almost every country followed suit. In 1902, Japan founded the Industrial Bank of Japan. England started its effort with the setting up of "Carterhouse Industrial Development Company" in 1934 and Industrial and Commercial Finance Corporation and Finance Corporation for Industry in 1945. Germany set up its first development bank in 1949 for the purpose of supplying long term loans to the industry. Encouraged by the success of 'Credit Mobilier', countries like Austria, Netherlands, Italy, Switzerland and Spain have also floated financial institutions of the French kind. A review of the experiences of the various countries reveals the fact that almost all the countries realised the need for creating a separate machinery for financing industrial development. As a matter of fact, though there were attempts at founding a congenial agency for financing industrial development, the real impetus for the development of FIs took place only after the Second World War. The economies in the west shattered by the war followed by the Depression found it a necessity to innovate on the industrial front including the financing of it. This even led to the founding of the International Bank for Reconstruction and Development [IBRD]. Though there is lot of diversity in the structure, objectives and methods of financing across the globe, the core activity — financing industrial units - however remained common to all FIs.

Developing economies, which happen to be the colonies of the West, always looked to their rulers for innovation in forstering development. India, being no

exception to this kind of a tendency, also emulated the experiments of the West and founded its first financial institution - Industrial Finance Corporation of India [IFCI] in 1948 to cater to the medium and long-term credit needs of industrial units. The constitution of IFCI was changed in 1993 from a statutory corporation to a company under the Companies Act, 1956 to ensure greater flexibility in the operations and to cope up with the changing financial system of the country. IFCI provides financial assistance by way of both rupee and foreign currency loans, underwriting, direct subscription to shares, debentures, guarantees, suppliers credit and equipment leasing. It provides a variety of merchant banking services which include project counselling, issue management, loan syndication, financial restructuring, mergers, acquisitions and debenture trusteeship. The IFCI has now been merged with Punjab National Bank.The IFCI followed by the setting up of the Industrial Credit and Investment Corporation of India [ICICI] Limited in 1955 as a public limited company. The primary objective of establishing ICICI was to promote industries in the private sector and to meet their foreign currency requirements.

The next agency that was set up in this network for the provision of industrial finance was the Refinance Corporation for Industry Limited (RCI) in 1958. This institution was promoted jointly by the RBI, LIC and some leading commercial banks. The RCI was intended primarily to provide refinance facilities to commercial banks in respect of their medium term lending to medium sized borrowers in the private sector. However, The RCI was merged with the Industrial Development Bank of India (IDBI) in September 1964. During the same time, several state governments have floated a variety of Financial Corporations and Industrial Development Corporations. Thus, the SFCs and SIDCs came into existence during 1950s. Further, in 1955 the Government of India set up an exclusive agency for the development of small industry in the name of National Small Industries Corporation Limited (NSIC).

Financing through FIs, however, took a sharp turn with the establishment of the IDBI in July, 1964 under an Act of Parliament as a principal financial institution to provide credit and other facilities for the development of industry in the country. The main objective of IDBI was to provide term finance and financial service for the establishment of new projects as well as for expansion, diversification, modernisation and technology upgradation of existing industrial projects. As a premier organisation, IDBI was also vested with the responsibility of coordinating the activities of the other financial institutions engaged in the promotion and development of the industry.

The activity of establishing some more specialised agencies for taking care of financial and non-financial needs of the industries is continuing till now. As at present, the structure of Financial Institutions catering to the needs of Indian Industry comprises of 6 All-India level FIs, 4 specialised financial institutions, 3 investment, 18 SFCs, 28 SIDCs, besides NABARD, Export Import Bank and many other technical consultancy organisations.

13.2 FINANCING BY ALL FIs

Overall Position of Sanctions and Disbursements:

As indicated earlier, Financial institutions have been instrumental in providing term finance to industry. Responding to the emerging needs of the industry, these institutions have developed and introduced a variety of products and diversified into newer areas. Starting with the operations of IFCI, the Financial Institutions today have been advancing finance in sizeable amounts. In retrospect, the sanctions and disbursements of IFCI during 1949-50 stood at only Rs. 2.90 and Rs. 2.08 crore respectively. The network has spread now to

13 institutions at the national level and 46 at the state level. All these institutions could sanction and disburse an amount of Rs. 6181747 crore and Rs. 4354065 crore respectively registering an annual growth rate of over 40 per cent by the end of March 2000 (See Table 13.1). One particular problem with the financial assistance sanctioned by these FIs is that it lacks consistency. This would be evident from the growth rates of sanctions and disbursements. These rates varied from the lowest of 2.6 per cent to the highest of 18.3 per cent in case of sanctions and between 4.9 and 43.0 per cent in case of sanctions during 1980-96. The individual record of the FIs during the same period presents diversity of a still higher magnitude. In case of some of the FIs there is even negative growth in the finance extended by them to the industrial units.

Institution-wise Assistance:

Among the FIs, highest amounts were sanctioned by IDBI. It sanctioned an amount of Rs. 1,73,978 crore and disbursed Rs. 1,17,687 crores by the end of March 2000. This was followed by the IFCI and UTI (See Table 13.2). Though IFCI was the first to be set up, it could not excel in sanctions for want of limited funds available at its disposal, compared to the fund base of IDBI. While IDBI had Rs. 69849 crores at its disposal by the end of March 2000, IFCI had only Rs. 22,974 crore at its command. The differences that could be noticed in the figures (Table 13.2) mainly account for this reason.

Sector-wise Assistance:

To whom assistance should be sanctioned is always a matter of concern. Some FIs concentrated in financing the public sector projects; while others were engaged in the task of promoting the private sector. Similarly, the size and nature of activities also varied depending upon the peculiar conditions under which FIs were constituted and operated. As a matter of fact, development banks established in the underdeveloped countries in the initial years were required to execute government investment projects. Some were even authorised to formulate plans for economic development.

But the objective of setting up FIs in India was stated to be the financing of private sector enterprisese. While piloting the bill for the setting up of IFCI, the then Finance Minister was reported to have observed that the IFCI was not intended to meet the financial requirements of nationalised industries; but only to provide finance for the needs of private industry. However, these restrictions are not followed now and by following the rules and regulations any industrial enterprise can get sanction from the FIs; although private sector is the major receipient of their assistance. Of the cumulative sanctions made so far by all the FIs in India, 84.2 per cent went to private sector, 9.4 per cent to public sector and 6.4 per cent to joint sector.

Forms of Assistance:

These FIs are mainly set up to finance long-term operations of the industrial units. This may be in the form of equity, loans and guarantees. To a great extent, they sanction assistance in the form of loans at specified rates of interest. Their participation into the equity was once very limited. It is only after the constitution of IDBI in 1964, FIs started providing direct finance in the form of subscription to shares and debentures of industrial concerns. Altogether a new dimension is added after the establishment of UTI in 1964, since the very objective of this Trust was to channel household sector savings for investment in risk bearing industrial securities. Above all, underwriting of new issues of companies has been the continuous activity of FIs since their inception. The intention of these institutions in extending underwriting support was not merely to ensure that the financing of the project was fully tied up,

but also to indicate that the project was support-worthy and that investors could take the risk of investing in such securities.

Further, the form in which assistance in sanctioned by the FIs is also dependent on the specific provisions incorporated in their legislations, besides the financial standing of the promoter, financing pattern, and the agreements already entered into by the promoter. For instance, under section 23 of the IFC Act, the Corporation was authorised to carry on and transact the following kinds of business:

i) guaranteeing loans raised by industrial concerns;

ii) underwriting the issue of stock, shares, bonds or debentures by industrial concerns;

iii) granting loans or advances to or subscribing to debentures of industrial concerns;

iv) acting as agent for the central government and/or with its approval, for the IBRD in respect of loans sanctioned by them to industrial concerns; and

v) extending guarantee in respect of diferred payments by importes who are able to make such arrangements with foreign manufactures.

The powers given under section 23 of the Act were widened in 1960 through an amendment to the Act to enable the Corporation to guarantee: (i) loans raised by industrial concerns from scheduled banks or state co-operative banks; (ii) deferred payments in connection with the purchase of capital goods manufactured in India; and (iii) with the prior approval of the central government, loans raised from or credit arrangement made by industrial concerns with any bank or financial institution outside India in foreign currency. The Corporation was also empowered to subscribe directly to the stock or shares of any industrial concern.

In much the the same way, the SFCs were authorised to provide financial assistance of the following types to small scale and medium sized industries:

i) granting loans or advances or subscribing to debentures of industrial concerns;

ii) guaranteeing loans raised by industrial concerns on such terms and conditions as may be mutually agreed upon; and

iii) underwriting the stock, shares, bonds and debentures.

These restrictions on the form of assistance have started losing their significance after the setting up of IDBI in 1976 with a considerable measure of operational flexibility. The Bank has been empowered to finance all types of industrial concerns in whatever form it prefers to.

There are no restrictions as regards nature and type of security that may be accepted from the industrial concerns. The financial sector liberalisation initiated in early nineties has also led to a structural transformation in the business of FIs. They are now expected to respond to the challenges imposed by the new competitive and deregulated financial environment. The FIs are now diversifying into both project and non-project lending and fee-based services.

Table 13.3 provides the details regarding the different forms of assistance sanctioned by diverse FIs by the end of March 2000. It is evident from the table that loans forming part of the direct assistance are occupying the prime place. Their significance seems to be more pronounced in case of SIDCs. As indicated earlier, underwriting and direct subscription to the securities of

industrial units is also a preferred activity of the FIs. Nearly, one-fifth of their money is earmarked for this purpose.

Certain Special Schemes of FIs:

Yet another glaring feature of the assistance of FIs is that they have launched diverse schemes to cater to the special needs of the industrial units. As a matter of fact, the list of such schemes is quite exhaustive; however specific mention may be made of the following:

Development Assistance Fund of IDBI:

This fund was set up by the IDBI in 1965 with its own resources and from the resources of the central government. The fund is intended to provide assistance to those industries which, for various reasons like heavy investment involved or low anticipated rate of return, may not be able to obtain funds in the normal course. Assistance from the fund requires prior approval of the central government. The government, in turn, is to be satisfied that the proposed project is necessary in the interests of industrial development of the country. The IDBI is supposed to maintain separate accounts for this fund and also to submit a report on the operations of the fund to the Central Government.

Risk Capital Foundation Scheme of IFCI:

This scheme was started by IFCI in June 1976 with an initial money of Rs. 1 crore. The objective of this scheme was to meet the seed capital requirements of entrepreneurs who have other abilities but no finance to launch a project. This was meant to enable the new entrepreneurs to contribute their share of promoter's equity. The loans from the foundation were granted on liberal term such as no interest, limited service charge and repayment in 15 years. These loans were to be repaid by the promoters out of their own income. This scheme was similar to the Seed Capital Scheme of IDBI. This scheme was merged with the Risk Capital and Technology Finance Corporation (RCTFC) from January 1988. The RCTFC Ltd., extended the operation of this scheme to include innovative technologies, products, processes, control of environmental pollution, energy conservation and other venture capital schemes.

Soft Loan Scheme of IDBI:

This scheme is meant to finance traditional industries such as cotton, juste, textiles, cement, sugar and some engineering industries towards modernisation, replacement, renovation of their old and obsolete plant and machinery. Though this scheme was originally introduced by IDBI in November 1976, the same is now operated jointly by IDBI, IFCI and ICICI. The scheme is named as such because of a number of concessions offered by the FIs to industrial units such as low interest rates, less promoters contribution, high debt equity ratios, long repayment periods, etc. Further, a liberal view is taken in respect of imposing margins and security.

Seed Capital Assistance Scheme of IDBI:

In order ot encourage new enterpreneurs having technical and other skills, IDBI has introduced this scheme in 1976. Under this scheme, entrepreneurs are provided with necessary finance upto Rs. 3 crore as seed money. This money is granted free of charge. This scheme is intendedto induce and encourage the setting up of small and medium industrial units. The assistance is also extended for the projects which have been appraised by the IDBI or any other all India FI. The scheme is operated through the SFCs and SIDCs. These state level FIs are expected to make a thorough evaluation of the entrepreneur as to his capability to set up and run the project successfully;

establish on the basis of appraisal, the technical, financial, economic and feasibilities of the project and continously monitor the progress of the unit at various stages. This scheme has been liberalised to make it more worthwhile and effective. Now that not only technically qualified persons, but also any one who has a worthy project can approach IDBI for this assistance. Similarly, the scheme is no longer restricted to projects in backward regions or priority sectors.

Suppliers' Line of Credit Scheme of ICICI:

This scheme was introduced by ICICI to help indigenous machinery manufacturers to offer deferred payment facilities to the buyers so as to increase the sales. Under this scheme, payment is made by ICICI directly to the supplier of equipment without involving banks. The facility under this scheme is available only to actual users of equipment. The supplier will get around 80-90 per cent of the invoice value much early. The purchaser is provided with a deferment period varying between 5 and 7 years.

Industry-wise Assistance:

Though there are some restrictions at least in the initial years, regarding the grant of assistance to different sectors, and in different forms, the FIs are relatively free to choose the industry of their choice. Perhaps, they are obliged to look into the priorities indicated in the Five-Year Plans regarding the encouragement to be given to a particular type of industry. As one can observe from the operations of the FIs, there is a general preference towards the funding of projects promoted by new entrepreneurs and technologists, those located in backward areas, those having foreign exchange earning potential, those based on indigenous technoloy and those that are designed to fulfill the increased demand for mass consumption goods like medicines, textiles, sugar and other food products and those engaged in the creation of necessary infrastructure for the development of Indian industry.

Table 13.4 provides the relevant statistics pertaining to the allocation of FIs assistance to different industrial sectors. It is clear from the table that the industries such as textiles, chemicals, electricity generation and services have got major share of the assistance from FIs. Each of them have got around 10 per cent of the total assistance. Compared to over fifty categories of industries considered by them for assistance, the above industries certainly had a better preference.

13.3 ROLE OF BANKS IN TERM FINANCE

Though the nexus between banks and industry is evident from the beginning of the growth of commercial banking during 19th century in India, banks have mainly concentrated on the financing of trade and commerce. Though they have opened their doors for industrial units, their financing is based on the British tradition with rule that banks provide only the working capital requirements of the industries. This was also because of the fact that the Central Banking Enquiry Committee in 1931 and the A.D. Shroff Committee in 1954 advised against the banks' entry into the term finance. Further, with the growth of various merchant banking activities, banks realised the potentiality of the corporate sector in their exercises for deposit mobilisation. They felt that they could improve their deposits only with closer contact with the industrial units. It is for this reason that banks have in recent years started exploring various possibilities and are participating in the 'Consortia' for meeting the term needs of the industrial units. More so, banks had the facility now to get 'refinancing facility' from IDBI and NABARD for the term loans extended by them. Thus term lending by commercial banks is of a recent phenomenon.

Initially, it was felt that the commercial banks could not afford to lock up large funds in long-term assets because it would affect their liquidity and would make it difficult for them to meet the working capital needs of trade and industry. However, since 1958, when Refinance Corporation was established by Reserve Bank of India (RBI), the latter was eager to recommend a change in the attitude of commercial banks towards term lending because, on the one hand, it could boost the profits of the lending banks and on the other hand, enable the borrowing units to enjoy certainty of having funds for a specified period irrespective of any change in the monetary policy. As a result of this the, commercial banks started evincing interest in term-lending but on a very nominal scale. In may 1975, the RBI urged the commercial banks to step up their term-lending particularly in the following areas:

a) Deferred export payments.
b) Industries where a significant portion of the output is meant for exports.
c) Industries having short gestation period particularly in the core sector and especially those producing mass consumption goods.
d) Agricultural sector.
e) Industries in the industrially backward areas.
f) Small scale industries involving investment and exceeding Rs. 25,000.
g) Capital good industries.

Quantitatively speaking, the share of term loans in total advances of scheduled commercial banks grew from one-tenth in seventies to about one-fifth now. Further, commercial banks also take part in a limited way and subscribe directly to theshares and debentures of the joint stock companies. Their holdings of these securities may be sometimes out of their underwriting commitments. Unfortunately, comprehensive data on investments in shares and debentures by Commercial Banks is not available. Available data reveal that the holdings of banks of shares and debentures aggregated to Rs. 12.7 crores; comprising of 8.7 crores of shares and 4.0 crore of debentures by the end of 1951. This has gone upto Rs. 92.7 crore by the end of March 1976; comprising of shares of 27.3 crores and debentures of 65.4 crore. A remarkable feature of the banks investment in these securities is that their investment in debentures vis-a-vis shares is increasing over time. Moreover, the holdings of banks of these securities (both shares and debentures) constitutes only around 2 per cent of the aggregate investments of banks.

Activity 1

a) Establish the need for founding specialised financial institutions for financing industrial units.

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b) Refer to the Memorandum of Association of any FI and list out the objectives for which it is set up.

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c) Explain different Forms of Assistance.

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d) Collect the Annual Report of any FI and write a note on its operations.

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13.4 FINANCING NORMS

There are certain aspects which need to be known to fully appreciate the issues involved in financing through FIs. They include the following:

1. Project appraisal
2. Security of loans granted
3. Interest rate
4. Repayment schedule
5. Disbursal procedures
6. Conversion option
7. Post sanction monitoring

Project Appraisal:

While granting financial assistance to industrial units, FIs appraise the projects of the latter from various feasibility points of view including economic, technical, financial and marketing. The economic feasibility may include the verification of the project's suitability in terms of plan priorities, use of resources and import substitution, export promotion. If satisfied,then the FI may conduct other feasibility studies and satisfy itself about the worthiness of the project.

Under the technical feasibility, the FI may go into the aspects such as:

i) Location of the project,
ii) Appropriateness of the technology,
iii) Scale of operation,
iv) Suitability of plant and equipment
v) Collaboration Agreements
vi) Project implementation schedule.

Financial feasibility relates to the aspects like cost of the project, mode of financing, capital structure, cash flow projections, rates of return and finally the viability of the project. Though FIs are often termed as Development Banks, they are more inclined to appraise the projects from the 'Commercial' point of view rather than 'development' point of view. This is really a paradox. Perhaps this is for this reason the word 'Development' has outlived its existence now.

Security of Loans Granted:

Security happens to be the basic tenet of lending. As many of us are aware, till nationalisation in 1969, commercial banks followed only 'security-based lending' instead of 'need-based lending'. Same is true in case of FIs also. Security is considered a necessary adjunct to financial appraisal. This is considered all the more important due to non-availability of accurate information to probe into the credit worthiness of the applicant in terms of his character. FIs accept many things as security including the assets of the business, personal guarantees of the Directors and promoters. FIs also try to ensure security for their loans by incorporating certain conditions in the loan agreements; which may be of the nature of : priority for repayment, restrictions on the payment of dividends, commission, maintenance of minimum working capital, etc.

Interest Rates:

What should be the rate of interest charged to industrial units on the finance extended by FIs is a matter of great concern. For, FIs should not charge too low a rate to make loans to be a gift, nor they should put it high to drive away the business units. There is lot of focus on the interest rate policy of FIs. Apart from making available the needed finance, they should look into equity and their own cost of funds. No institution can lend at the rates lower than its own cost of capital. Then, they must add some spread to continue in the business.

The issue that engages the attention of many as for as interest rate policy of FIs is concerned is that whether they should charge market rate or a lower rate; since the FIs may secure funds from Government, Central Bank whose cost of funds is lower. Sometimes, FIs also receive grants from the Government having no interest element. When such is the case, whether FIs should necessarily extend the same benefit to business units in the form of lower interest rates. This argument is not accepted by many. The reason being that FIs also undertake various kinds of financial and non-financial services involving financial commitment. As such, in majority of the cases, the FIs used to charge a composite rate taking all its expenses into account.

In India, we have an administered interest rate system controlled by the Reserve Bank. This has little to do with the rates determined by the market forces. This is done as a matter of policy to maintain monetary stability in the economy. The RBI used to announce the changes in the interest rates (both for deposits and loans) from time to time keeping in view of the money supply and demand for credit. However, some relaxation is provided in this regime now. This process began in 1990 when the plethora of lending rates for different slabs of borrowing were rationalised into six. A minimum lending rate prescription for large borrowers was introduced in 1988. After the recent changes, there are only two rates of interest prescribed on the lending side and on the deposit side, there is only the prescription of a maximum rate. As far as FIs are concerned prime lending rate is decided and FIs can lend at varying rates subject to this. Consequent upon the recent policy changes (October 1997), there existed two prime lending rates, viz; one for the long-term loans and the other for the short-term and medium-term lending. As applicable from October 1997, the prime lending rate of IDBI, IFCI and ICICI is pegged at 13.5 per cent; whereas SBI could fix it at 12:75 per cent for long term loans.

Repayment Schedule:

In case of the financing through FIs, repayment is an important matter to be decided. Usually, the repayment period is decided taking into account the gestation period, life of the project and cash flow generation. The repayment period is also sometimes governed by the provisions in the respective legislations of the FIs. For example, under the provisions, IFCI is permitted to extend loans having a maximum of repayment period of 25 years. Similarly, the refinance facility extended by IDBI is subject to a specific maturity period. However, FIs are using their discretion subject to these limitations and the loans advanced by FIs are usually repayable in annual or semi-annual installments spread over a period of 10 to 15 years.

Disbursal Procedures:

As can be seen from the data contained in Table 13.1, there is lot of gap between sanctions and disbursements. Sometimes, disbursements are just little over half of the sanctions. As it is said in law that 'Justice delayed is law justice denied'; we can say that 'Disbursal delayed is assistance denied'. There

is enormous delay in the disbursal of assistance. Perhaps, this is caused due to cumbersome loan procedures adopted by the FIs. The FIs may take appropriate measures to cut short these delays. On the other hand, borrowers also should help the FIs in completing their responsibilities in terms of providing their contribution to the project, submitting the relevant information and other necessary documents.

Conversion Option:

Convertability option refers to a provision in the loan agreement, whereby the lender will have an option to convert his loan into equity at his discretion. This clause came into the picture in the industrial financing on the recommendations of the A.D. Shroff Committee. The objective of this provision was to check the use of public money for private gain and to curb concentration of economic power. The reasoning was that through convention, FIs would be able to participate in the management and control of industrial concerns and also in the profits made by them. FIs have started invoking this clause almost from 1970 in their loan agreements. Not only the stipulation, but the actual exercise of the option by FIs is also significant.

Because of the above, there was lot of opposition from the industrial units regarding the convertibility clause. Realising this, the FIs have related this to the magnitude of assistance. To start with convertibility clause was not introduced into the agreements if the amount of loan is below Rs. 25 lakh. It may be introduced at the discretion of the institution, if the assistance is between Rs. 25 to 50 lakh; and the clause is compulsorily introduced, if the assistance is more than Rs. 50 lakh. Usually, the institutions are expected to exercise the option only after two or three years of the implementation of the project. The government has relaxed these norms in June 1980. Thereafter, convertibility clause is introduced in the case of loans exceeding Rs.1 crore. Further, the FIs are forbidden to acquire more than 40 per cent of the total share capital of a company through loan conversions, excepting in the cases of persistent default by the company. In which case, the FIs can acquire upto 51 per cent of the total share capital. In addition, conversion option is not now applicable in case of loans sanctioned for the purpose of modernisation and rehabilitation.

Post-sanction Monitoring:

In view of the large stakes involved in the assistance sanctioned to different industrial units, there is a need to monitor the working of the assisted units closely, not only to ensure safety of the funds invested; but also to ensure effective utilisation of the funds and timely completion of the projects. In this regard, FIs have to call for periodical reports about the operations of the projects in terms of production, sales, cash flows, profitability, cost structure, etc. Depending on the necessity, FIs may hold discussions, consultations and conferences with the others interested in the project like bankers, stock brokers and fellow FIs. It is also important for the company to ensure that the assisted units recruit qualified and experienced technical and managerial personnel.

In this regard, FIs like IFCI, ICICI and IDBI have adopted a rigorous follow-up procedure and have made a practice of carrying out regular inspection of the projects financed by them. As a matter of fact, ICICI is publishing a report entitled 'Financial Performance of Companies: ICICI Portfolio" almost from the year 1971-72. This is a sample study of its assisted units (417) covering about 55 per cent of the paid-up capital of the non-government public limited companies at work in India by March 1981. Later, the coverage has been increased to 675 companies with almost the same percentage in

paid-up capital. In addition, ICICI has also initiated exclusive studies on the topics like export performance and capacity utilisation. Similar to this exercise, IDBI has also started compiling and publishing data on the performance of its assisted units.

Further, there is also the practice of nominating directors to the Boards of the assisted units. Where the assistence is large or where the project is complex, there is the practice of appointing nominee directors by the FIs. Nevertheless, there is lot of criticism on the role and function of these nominee directors. It should be constructive rather than destructive. Nominee directors are largely criticised for their inaction and overaction. Instead of using their own discretion, they are guided by the dictates of the employer. This is naturally denounced. It is felt that the role of the nominee directors should be an unmixed blessing rather than suspicious hindrance.

13.5 SHARE OF FIS IN THE COMPANY FINANCING

The foregoing analysis on the financing by FIs in terms of sanctions and disbursements clearly reveals the fact that FIs played a useful role in supporting the rapid industrialisation of the country. It is no matter of exxaggeration that these institutions have now assumed a position that without their support, hardly any large project in the corporate sector can materialise.

The discussion on the Financing through FIs cannot be considered complete, unless we also account for the share of FIs in the total company financing. For this purpose, we have compiled data from the finances of Public Limited Companies published by RBI. The data of RBI covers a sample of 1720 non-government, non-financial public limited companies, accounting for 32.6 per cent of such companies in terms of paid-up capital. The relevant data is presented in Table 13.5.

It is evident from the table that FIs could provide about one-fifth of the total external sources and around one-sixth in terms of the total sources in 1991-92. However, in the subsequent years, the relative contribution of FI's has significantly declined mainly due to entry of commercial banks in term financing business and growing financial disintermeditation resulting in greater reliance of the corporates on stock market.

Activity 2

a) Note down the salient features of Seed Capital Assistance Scheme of IDBI.

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b) Comment on the Role of Banks in Term Finance.

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c) Elucidate the project appraisal procedure of any FI.

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d) Write a note on the Interest Rates in India.

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e) Examine the link between sanctions and disbursements.

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f) Role of External sources in Company Financing.

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g) Conversion option.

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13.6 REFORMS IN THE DFIS SECTOR

Consequent upon the poor performance of the economy, Government has embarked upon initiating reforms from the beginning of nineties of the last century. The sweep of the reform process extends logically to the FIs sector also. In an attempt to making a systematic effort in the direction of reforms, Government constituted a committee in 1991 under the chairmanship of M. Narasimham to suggest reforms in the financial sector.

Recommendations of Narasimham Committee Relating to DFIs:

The following are some of the important recommendations of the Narasimham Committee in respect of Development Financial Institutions.

1. In view of increasing competition in the financial sector, pressure on the availability of concessional finance and progressive deregulation of interest rates, DFIs are required to become more and more competitive, efficient and profitable. They are also required to ensure operational flexibility and adequate internal autonomy in the matters of loan sanctioning and internal administration.
2. The present system of consortium lending is operating like a cartel. As such, the consortium lending should be disposed with. In its place, a system of syndication or participation in lending at the instance of lenders and borrowers should be introduced.
3. The present system of cross holding of equity and cross representation on the boards of DFIs should be done away with.
4. As a measure of enhancing competition and ensuring a level playing field, the IDBI should retain only its apex and refinancing role and that its direct lending function be transferred to a separate institution which could be incorporated as a company.
5. It is necessary to distance state level institutions from their respective state Governments to ensure that they function on business principles.
6. DFIs should seek to obtain their resources from the market on competitive terms and their privileged access to concessional finance through SLR and other arrangements should gradually be phased out over a period of three years.

7. The operations of the DFIs in respect of loan sanctions should be the sole responsibility of the institutions themselves based on a professional appraisal of the technical and economic aspects of the project, and evaluation of the promoter's competence and integrity and the financing and other aspects of the proposal. There should be no room for behest lending of any kind.
8. DFIs should also be covered by the operations of the Asset Reconstruction Fund (ARF), so that the contaminated portion of their portfolio is taken off the books.
9. While the entry of commercial banks into the provision of term finance is the first of necessary steps, it is also necessary to permit DFIs to enter the area of working capital finance.
10. In respect of corporate take overs, DFIs should lend support to existing management who have a record of conducting the affairs of the company in a manner beneficial to all concerned including the shareholders, unless in their opinion the prospective new management is likely to promote the interest of the company better. In doing so, the FIs are expected to exercise their individual professional judgement, free of any extraneous pressures.

Action taken by the Government:

Based on the recommendations of the Committee, the Government has taken the following measures:

1. IDBI, IFCI, ICICI, IRBI and Exim Bank were advised to achieve a capital adequacy norm of 4 per cent by March 31, 1994. And those FIs having dealings with agencies abroad were required to achieve a norm of 8 per cent by March 31, 1995; while the rest were required to attain 8 per cent norm by March 31, 1996.
2. The Board for Financial Supervision (BFS) started supervising the DFIs w.e.f. April 1995.
3. Additional amounts have been sanctioned towards capitals of Certain DFIs. Further, they were permitted to approach capital market. During the last two years alone viz., 1995-96 and 1996-97, the six All India Financial Institutions (Companies of IDBI, IFCI, ICICI, SIDBS, IRBI and SCICI) raised an amount of Rs. 19,579 crore from the capital market. It is logical to assume that when the FIs raise such large amounts of funds from the market, they also insist on the borrowers the same market discipline.
4. The prudential and capital adequacy norms, hitherto applied to the commercial banks, are now made applicable to the FIs also. As per these regulations, FIs are also required to maintain stipulated standards in respect of capital adequacy, income recognition, asset classification and provisioning requirements.
5. There is reorganisation in some of the FIs intending to face emerging challenges in the liberalized environment. SCICI Ltd. was merged with ICICI Ltd., on April 15, 1997 and similarly the IRBI was converted into a company and was renamed as Industrial Investment Bank of India (IIBI) Ltd.

The Unfinished Agenda:

As it appears, there is lot of ground yet to be covered by the government towards implementing the recommendations of Narasimham Committee to ensure competition, operational flexibility and superior performance. The recommendations of the committee regarding the creation of asset reconstruction fund, consortium lending, ensuring a level playing field, distancing DFIs from their sponsors are all to be implemented.

In a lecture arranged by the A.D. Shroff Memorial Trust, Bombay, Narasimham remarked as follows (after two years of the submission of committee's report on 'Financial Sector Reforms'):

"Since the submission of the report, the authorities have taken several steps on different aspects of the recommendations. But essentially, the approach has been somewhat *ad hoc,* piecemeal and at times even hesitant. The approach is suggestive of incrementalism rather than a sequencing of reform as part of an integrated programme. It is pertinent to suggest that the committee's various recommendations should be compared with a Jig-saw puzzle where the picture becomes complete only when all the pieces are in place and until such time a piecemeal approach to the problem would not help us to obtain the full benefits of the exercise."

Even after a lapse of 5 years, the agenda is still unfinished, calling for a still greater attention by the Government.

Activity 3

a) Mention important Recommendations of Narasimham committee.

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b) What is the unfinished Agenda.

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13.7 SUMMARY

Attempt has been made in this unit to highlight the significance of financing extended to industrial units by Financial institutions. The discussion in this unit began with tracing out the historical setting leading to the founding of various FIs in the country. The discussion underlined for financing its industrial development programmes. This was followed by the assessment of overall position of sanctions and disbursements by the FIs as also according to sector, institution, form and industry. It was noted that the FIs in India tailored its process of industrial finance to the needs of the corporate sector.

With the entry of commercial banks into the term finance area, the latter ceased to be the prerogative of term-lending institutions. The increasing presence of commercial banks in this area has further radicalised the scene of industrial finance. Aspects pertaining to the lending norms such as project appraisal, security, interest rate, repayment schedule, disbursal procedures, conversion option and post sanction monitoring are also discussed in this unit. As a matter of fact, FIs are criticised by industrial units mainly because of these norms and the cumbersome procedures they are following in disbursing the loan applications. Financing by FIs has also assumed significance in the total financing position of companies. Nearly one-fifth of the external resource requirements are being met now by the FIs. However, its importance has diminished remarkably in recent years. Nevertheless, there is lot ground yet to be covered by our FIs. In view of increasing competition in the financial sector, pressure on the availability of concessional finance and progressive deregulation of interest rates, FIs are required to become more and more competitive, efficient, profitable and operationally flexible. The implementation of the recommendations of Narasimham Committee would go a long way in this regard.

13.8 SELF ASSESSMENT QUESTIONS

1. Bring out the significance of term lending organisations in the financing of industries.
2. What are the recent trends in the financing of industrial units? Are they going in healthy direction?
3. Briefly highlight the procedures and norms followed by the FIs in extending credit. Can you suggest any modifications to the existing procedure?
4. What is post sanction monitoring? How is monitoring exercised by FIs in India?
5. Bring out the role of nominee-directors in the industrial units. Should we continue this practice?
6. "Convertibility clause is a drag on the Financing facility provided by Indian Financial Institutions". Comment.
7. Highlight the important recommendations of Narasimham Committee relating to DFI sector. Are you satisfied with the way government is implementing them?
8. In the present day scenario, should there be restrictions on the form and type of assistance sanctioned by FIs in the country?
9. Briefly discuss the soft loan scheme of IDBI.

Table 13.1: Assistance Sanctioned and Disbursed by All FIs

(Rs. in crore)

Year	Sanctions	Growth rate %	Disbursements	Growth rate %
1964 - 65	118.1	—	90.5	—
1970 - 75	1916.7	—	1296.7	—
1975 - 80	7102.4	—	4623.4	—
1980 - 81	2934.0	—	1847.9	—
1981 - 82	3281.0	11.8	2352.0	27.3
1982 - 83	3366.9	2.6	2468.4	4.9
1983 - 84	4195.1	24.6	3138.4	27.1
1984 - 85	5578.7	33.0	3618.0	15.3
1985 - 86	6548.2	17.4	4937.7	36.5
1986 - 87	8138.9	24.3	5708.9	15.6
1987 - 88	9576.0	17.7	7061.3	23.7
1988 - 89	11386.6	18.9	7713.0	9.2
1989 - 90	14429.1	26.7	9640.4	25.0
1990 - 91	19254.7	33.4	12810.1	32.9
1991 - 92	22443.7	16.6	16259.9	26.9
1992 - 93	33282.0	48.3	23258.7	43.0
1993 - 94	41010.8	23.2	26629.3	14.5
1994 - 95	59663.1	45.5	33528.7	25.9
1995 - 96	67618.0	13.3	38442.6	14.7
1999 - 2000	1043407.6	15.5	684804.2	63.5
Cumulative upto end-March 2000	**6181747.2**	—	**4354065.1**	—

Source : *Report on Development Banking in India, 1999-2000 Mumbai, IDBI.*

Table 13.2: Institution-Wise Assistance Sanctioned and Disbursed by All FIs

Financing Through FIs

(Rs. in crore)

Institution	Cumulative sanctions upto March 2000	Cumulative Disbursements upto March 2000
All-India Development Banks		
IDBI	1988112.9	1348938.1
IFCI	430141.9	390042.0
ICICI	1914572.6	1141987.3
SIDBI	554084.9	399505.1
IIBI	100898.1	72525.6
Sub-Total	**4969637.3**	
Specialised Financial Institutions		
IVCF	1546.6	1474.3
ICICI Venture	4710.2	4080.3
TFCI	19435.4	11561.6
Sub-Total	**25692.2**	**17116.2**
Investment Institutions		
LIC	330345.1	297323.3
UTI	623900.1	476699.2
GIC	109361.6	86695.4
Sub-Total	**1063606.8**	**860787.9**
State-level Institutions		
SFCs	323282.1	265950.7
SIDCs	207940.1	167998.2
Sub-Total	531222.2	433948.9
Grant-Total	**6181747.2**	**4354065.1**

* Including assistance to small scale sector upto end-March 1990.

Source: *Report on Development Banking in India, 1999-2000. Mumbai, IDBI.*

Table 13.3: Form-Wise Assistance (Cumulative) Sanctioned by FIs By the end of March 2000

(Rs. in crore)

Form of Assistance	All-India Dev. Banks	State-Level	Investment Institutions
Rupee Loans	3531949.8 (71.1)	5046498 (95.0)	307723.5 (38.9)
Foreignency Loans	616149.2 (12.4)		
Underwriting and direct subscription		23309.3 (4.4)	
	506914.1 (10.2)	58746 (18.4)	755883.3 (61.1)
Guarantees	314384.2 (6.3)	14339 (4.5)	3263.1 (0.6)
Total	**4969637.3 (100.0)**	**531222.2 (100.0)**	**1063506.8 (100.0)**

* Figures in the brackets indicate percentages to total assistance.

Source: *Report on Development Banking in India, 1999-2000 Mumbai, IDBI.*

Table 13.4: Industry-wise Cumulative Assistance Sanctioned by All Financial Institutions by March end 2000

Industry	Rs. in Crore
Textiles	541631.1
Chemicals	676552.0
Chemical Products	196127.6
Fertilizers	
Refineries or Oil Exploration	279291.1
Basic Metals	524411.2
Electrical & Electronic Equipment	299285.7
Infrastructure	944851.9
Services	715894.4
Total *(Including Others)*	**5938759.8**

Table 13.5: Share of 71s (Excluding Banks and Foreign 71s) in the company financing

Year	Net Borrowings from 71s (Rs. Crore)	As % of External Services	As % of Total Services
1991-92	3594	19.8	14.3
1993-94	3689	18.6	13.8
1994-95	1584	4.8	3.4
1998-99	4115	2.6	1.1
1999-00	4322	2.6	1.1
2000-01	4642	2.7	1.0

Source: *RBI Bulletins, January and October, 1997 and September, 2002*

11.9 FURTHER READINGS

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