Indian Financial System

Study Material

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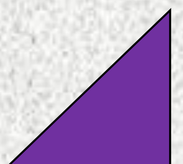

INDIAN FINANCIAL SYSTEM

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UNIT I

Financial System: Meaning, significance and components - Composition of Indian financial system. Indian money market – Indian capital market.

Finance:

Finance is defined as the management of money and includes activities such as investing, borrowing, lending, budgeting, saving, and forecasting. There are three main types of finance: 1. Personal 2. Corporate and Public / Government.

Indian Financial System:

The Indian Financial System is one of the most important aspects of the economic development of our country. This system manages the flow of funds between the people (household savings) of the country and the ones who may invest it wisely (investors/businessmen) for the betterment of both the parties.

Finance plays an important role in economic and business of a country. System and effective flow is needed for effective management used for business concern. Indian financial system has developed constantly to infuse the new blood to the economic development of the country.

If a country has to be economically strong and developed, it depends on how well its financial system is regulated. Financial systems are concerned about money, loan and finance and they are interrelated with each other.

Financial institutions

- These provides various services to the economic development with the help of financial instruments. Banking and non-banking institutions are considered as financial institutions.
- Again, banking institutions are further classified as commercial banks and co-operative banks.
- The two major categories of Non-Banking institutions are Non-Banking financial institutions and Non-Banking Non- financial institutions.

Financial markets

- Financial markets deal with financial instruments (shares, debentures, bonds etc.) and financial services (merchant banking etc.). Financial market is classified into capital market and money market.
- Capital market is an organised mechanism for effective and efficient transfer of money capital from individuals/institutional savers to Industrialist. Money market is defined as the market for lending and borrowing of short term funds.
- Money market is further divided into various categories based on instruments used in market (organised banking sector unorganised banking sector, bill market etc.)

Financial instruments

shares, debentures, bonds etc.

Financial services

These are categorised as fund base, fee base services. As the name suggests fund based financial services are related to funds transfer from one place/person to another (leasing, venture capital, insurance etc.).

Fee based services are not related to fund transfer (underwriting, project counselling, merchant banking etc.)

Concept of financial services:

Services offered by banking and financial companies are called financial services. Banking and financial companies include both assets management companies and liability management companies. Assets management companies include leasing companies, mutual funds, merchant bankers, and issue/portfolio managers. Liability management companies comprise of the bill discounting and acceptance houses.

Objectives and functions of Financial Services:

1. **Fund raising:**

Financial services help to raise the required funds from a host of investors, individuals, institutions and corporate. For this purpose, various instruments of finance are used. The funds are demanded by corporate houses, individuals etc..

2. **Funds deployment:**

An array of financial services are available in the financial markets which help the players to ensure an profitable deployment of the funds raised. Financial services assist in the decision making regarding the financial mix. Services such as bills discounting, factoring of debtors, parking of short-term funds in the money market, credit rating, e-commerce, and securitization of debts are provided by banking financial services firms in order to ensure efficient management of funds.

3. Specialized services:

The financial services sector provides specialized services such as credit rating, venture capital financing, lease financing, factoring, mutual funds, merchant banking, stock lending, depository, credit cards, housing finance, book building etc.,

4. Regulation:

There are agencies that are involved in the regulation of the financial services activities. In India, agencies such as the securities and exchange board of India (SEBI) Reserve Bank of India (RBI) and the department of banking and insurance, government of India, through a plethora of legislative measures, regulate the functioning of the financial services institutions.

5. Economic Growth:

Financial services contribute, in good measure to speeding up the process of economic growth and development. This takes place thorugh the mobilization of the savings of a cross action of people, for the purpose of channeling them in to productive investments.

Indian Financial System – An Overview

The services that are provided to a person by the various Financial Institutions like banks, insurance companies, pensions, funds, etc. constitute the financial system.

Given below are the features of the Indian Financial system:

- It plays a vital role in the economic development of the country as it encourages both savings and investment
- It helps in mobilizing and allocating one's savings
- It facilitates the expansion of financial institutions and markets
- Plays a key role in capital formation
- It helps forms a link between the investor and the one saving
- It is also concerned with the Provision of funds

The financial system of a country mainly aims at managing and governing the mechanism of production, distribution, exchange and holding of financial assets or instruments of all kinds.

Components of Indian Financial System

There are four main components of the Indian Financial System. This includes:

1. Financial Institutions
2. Financial Assets
3. Financial Services
4. Financial Markets

Let's discuss each component of the system in detail.

1. Financial Institutions

The Financial Institutions act as a mediator between the investor and the borrower. The investor's savings are mobilised either directly or indirectly via the Financial Markets.

The main functions of the Financial Institutions are as follows:

- A short term liability can be converted into a long term investment
- It helps in conversion of a risky investment into a risk-free investment
- Also acts as a medium of convenience denomination, which means, it can match a small deposit with large loans and a large deposit which small loans

The best example of a Financial Institution is Bank. People with surplus amounts of money make savings in their accounts, and people in dire need of money take loans. The bank acts as an intermediate between the two.

The financial institutions can further be divided into two types:

- **Banking Institutions or Depository Institutions –** This includes banks and other credit unions which collect money from the public against interest provided on the deposits made and lend that money to the ones in need
- **Non-Banking Institutions or Non-Depository Institutions –** Insurance, mutual funds and brokerage companies fall under this category. They cannot ask for monetary deposits but sell financial products to their customers.

Further, Financial Institutions can be classified into three categories:

- **Regulatory –** Institutes that regulate the financial markets like RBI, IRDA, SEBI, etc.
- **Intermediates –** Commercial banks which provide loans and other financial assistance such as SBI, BOB, PNB, etc.
- **Non Intermediates –** Institutions that provide financial aid to corporate customers. It includes NABARD, SIBDI, etc.

2. Financial Assets

The products which are traded in the Financial Markets are called the Financial Assets. Based on the different requirements and needs of the credit seeker, the securities in the market also differ from each other.

Some important Financial Assets have been discussed briefly below:

- **Call Money –** When a loan is granted for one day and is repaid on the second day, it is called call money. No collateral securities are required for this kind of transaction.
- **Notice Money –** When a loan is granted for more than a day and for less than 14 days, it is called notice money. No collateral securities are required for this kind of transaction.
- **Term Money –** When the maturity period of a deposit is beyond 14 days, it is called term money.

- **Treasury Bills –** Also known as T-Bills, These are Government bonds or debt securities with maturity of less than a year. Buying a T-Bill means lending money to the Government.
- **Certificate of Deposits –** It is a dematerialised form (Electronically generated) for funds deposited in the bank for a specific period of time.
- **Commercial Paper –** It is an unsecured short-term debt instrument issued by corporations.

3. Financial Services

Services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested.

The financial services in India include:

- **Banking Services –** Any small or big service provided by banks like granting a loan, depositing money, issuing debit/credit cards, opening accounts, etc.
- **Insurance Services –** Services like issuing of insurance, selling policies, insurance undertaking and brokerages, etc. are all a part of the Insurance services
- **Investment Services –** It mostly includes asset management
- **Foreign Exchange Services –** Exchange of currency, foreign exchange, etc. are a part of the Foreign exchange services

The main aim of the financial services is to assist a person with selling, borrowing or purchasing securities, allowing payments and settlements and lending and investing.

4. Financial Markets

The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares and other assets is called a financial market.

The financial market can be further divided into four types:

- **Capital Market –** Designed to finance the long term investment, the Capital market deals with transactions which are taking place in the market for over a year. The capital market can further be divided into three types:
  - **(a)**Corporate Securities Market
  - **(b)**Government Securities Market
  - **(c)**Long Term Loan Market
- **Money Market –** Mostly dominated by Government, Banks and other Large Institutions, the type of market is authorised for small-term investments only. It is a wholesale debt market which works on low-risk and highly liquid instruments. The money market can further be divided into two types:
  - **(a)** Organised Money Market
  - **(b)** Unorganised Money Market
- **Foreign exchange Market –** One of the most developed markets across the world, the Foreign exchange market, deals with the requirements related to multi-currency. The transfer of funds in this market takes place based on the foreign currency rate.
- **Credit Market –** A market where short-term and long-term loans are granted to individuals or Organisations by various banks and Financial & Non-Financial Institutions is called Credit Market.

INDIAN MONEY MARKET

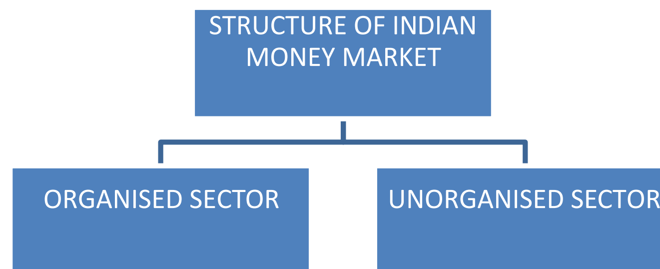
Meaning

The Money Market is a market for lending and borrowing of short-term funds. It deals in funds and financial instruments having a maturity period of one day to one year. It covers money and financial assets that are close substitutes for money. The instruments in the money market are of short term nature and highly liquid.

structure (OR) components of Indian money market.

The Indian money market consists of two segments, namely organized sector and unorganized sector. The RBI is the most important constituents of Indian money market. The organized sector is within the direct purview of RBI regulation. The unorganized sector comprises of indigenous bankers, money lenders and unregulated non-banking financial institutions.

The structure or components of Indian money market is depicted in the chart 5.1.



- Call and Notice Money Market
- Treasury Bills Market
- Commercial Bills Market
- Market for Certificates of Deposits (CDs)
- Market for Commercial Papers (CPs)
- Repos Market
- Money Market Mutual Funds (MMMFs)
- Discount & Finance House of India (DFHI)

- Indigenous Bankers
- Money Lenders
- Unregulated Non-Bank Financial
- intermediaries (Chit Funds, Nidhis and Loan Companies)
- Finance Brokers

(A) Organized Money Market Instruments and Features

1. **Call and Notice Money Market:** Under call money market, funds are transacted on overnight basis. Under notice money market funds are transacted for the period between 2 days and 14 days. The funds lent in the notice money market do not have a specified repayment date when the deal is made. The lender issues a notice to the borrower 2-3 days before the funds are to be paid. On receipt of this notice, the borrower will have to repay the funds within the given time. Generally, banks rely on the call money market where they raise funds for a single day.
   The main participants in the call money market are commercial banks (excluding RRBs), co- operative banks and primary dealers. Discount and Finance House of India (DFHI), Non-banking financial institutions such as LIC, GIC, UTI, NABARD etc. are allowed to participate in the call money market as lenders.
2. **Treasury Bills (T-Bills):** Treasury bills are short-term securities issued by RBI on behalf of Government of India. They are the main instruments of short term borrowing by the Government. They are useful in managing short-term liquidity. At present, the

Government of India issues three types of treasury bills through auctions, namely – 91 days, 182-day and 364-day treasury bills. There are no treasury bills issued by state governments. With the introduction of the auction system, interest rates on all types of TBs are being determined by the market forces.

3. **Commercial Bills:** Commercial bill is a short-term, negotiable, and self-liquidating instrument with low risk. They are negotiable instruments drawn by a seller on the buyer for the value of goods delivered by him. Such bills are called trade bills. When trade bills are accepted by commercial banks, they are called commercial bills. If the seller gives some time for payment, the bill is payable at future date (i.e. usance bill). Generally the maturity period is upto 90 days. During the usance period, if the seller is in need of funds, he may approach his bank for discounting the bill. Commercial banks can provide credit to customers by discounting commercial bills. The banks can rediscount the commercial bills any number of times during the usance period of bill and get money.
4. **Certificates of Deposits (CDs):** CDs are unsecured, negotiable promissory notes issued at a discount to the face value. They are issued by commercial banks and development financial institutions. CDs are marketable receipts of funds deposited in a bank for a fixed period at a specified rate of interest.

   CDs were introduced in India in June 1989. The main purpose of the scheme was to enable commercial banks to raise funds from the market through CDs. According to the original scheme, CDs were issued in multiples of Rs.25 lakh subject to minimum size of an issue being Rs.1 crore. They had the maturity period of 3 months to one year. They are freely transferable but only after the lock in period of 45 days after the date of issue.
5. **Commercial Papers (CPs):** Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note with fixed maturity. They indicate the short-term obligation of an issuer. They are quite safe and highly liquid. They are generally issued by the leading, nationally reputed, highly rates and credit worthy large manufacturing and finance companies is the public as well as private sector. CPs were introduced in India January 1990. CPs were launched in India with a view to enable highly rated corporate borrowers to diversify their sources of short-term borrowings and also to provide an additional instrument to investors. RBI has modified its original scheme in order to widen the market for CPs.

   Corporates and primary dealers (PDs) and the all India financial institutions can issue CPs. A corporate can issue CPs provided they fulfill the following conditions:

(a) The tangible net worth of the company is not less than Rs.4 crore.
(b) The company has been sanctioned working capital limit by banks or all India financial institutions, and
(c) The borrowed account of the company is classified as a standard asset by the financing institution or bank.

6. **Repos:** A **repo** or **reverse repo** is a transaction in which two parties agree to sell and repurchase the same security. Under repo, the seller gets immediate funds by selling specified securities with an agreement to repurchase the same at a mutually decided future date and price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller at an agreed date and price. The repos in government securities were first introduced in India since December 1992. Since November 1996, RBI has introduced “Reverse Repos”, i.e. to sell government securities through auction.

7. **Discount and Finance House of India (DFHI):** It was set up by RBI in April 1988 with the objective of deepening and activating money market. It is jointly owned by RBI, public sector banks and all India financial institutions which have contributed to its paid up capital.
   The DFHI deals in treasury bills, commercial bills, CDs, CPs, short-term deposits, call money market and government securities. The presence of DFHI as an intermediary in the money market has helped the corporate entities, banks, and financial institutions to invest their short-term surpluses in money market instruments.
8. **Money Market Mutual Funds (MMMFs):** RBI introduced MMMFs in April 1992 to enable small investors to participate in the money market. MMMFs mobilizes savings from small investors and invest them in short-term debt instruments or money market instruments such as call money, repos, treasury bills, CDs and CPs. These instruments are forms of debt that mature in less than a year.

(B) UNORGANIZED SECTOR OF INDIAN MONEY MARKET

The unorganized Indian money market is largely made up of indigenous bankers, money lenders and unregulated non-bank financial intermediaries. They do operate in urban centers but their activities are largely confined to the rural sector. This market is unorganized because it's activities are not systematically coordinated by the RBI.

The main components of unorganized money market are:

1. **Indigenous Bankers:** They are financial intermediaries which operate as banks, receive deposits and give loans and deals in hundies. The hundi is a short term credit instrument. It is the indigenous bill of exchange. The rate of interest differs from one market to another and from one bank to another. They do not depend on deposits entirely, they may use their own funds.
2. **Money Lenders:** They are those whose primary business is money lending. Money lenders predominate in villages. However, they are also found in urban areas. Interest rates are generally high. Large amount of loans are given for unproductive purposes. The borrowers are generally agricultural labourers, marginal and small farmers, artisans, factory workers, small traders, etc.
3. **Unregulated non-bank Financial Intermediaries:** The consist of Chit Funds, Nithis, Loan companies and others.

(a) **Chit Funds:** They are saving institutions. The members make regular contribution to the fund. The collected funds is given to some member based on previously agreed criterion (by bids or by draws). Chit Fund is more famous in Kerala and Tamilnadu.

(b) **Nidhis:** They deal with members and act as mutual benefit funds. The deposits from the members are the major source of funds and they make loans to members at reasonable rate of interest for the purposes like house construction or repairs. They are highly localized and peculiar to South India. Both chit funds and Nidhis are unregulated.

4. **Finance Brokers:** They are found in all major urban markets specially in cloth markets, grain markets and commodity markets. They are middlemen between lenders and borrowers.

FEATURES OF INDIAN MONEY MARKET AND THE DEFECTS OF MONEY MARKET IN INDIA.

Several steps were taken in the 1980s and 1990s to reform and develop the Indian money market. Despite these efforts, Indian money market continues to remain lopsided, thin and extremely volatile. Indian money market is relatively underdeveloped

when compared to advanced markets like London and New York money markets. Its main defects are explained below:

1. **Existence of Unorganized Money Market:**This is one of the major defects of Indian money market. It does not distinguish between short term and long term finance, and also between the purposes of finance. Since it is outside the control and supervision of RBI, it limits the RBI's control of over money market.
2. **Lack of Integration:** The Indian money market is broadly divided into two sectors, the organized money market and the unorganized market. The organized market constitutes several institutions such as RBI, State Bank of India, commercial banks, cooperative banks and financial institutions. RBI as an apex body regulates their working. The unregulated sector is not homogenous in itself. It constitutes indigenous bankers, loan companies, money lenders, etc. There is no uniformity in their practices and there is multiplicity of functionaries.
3. **Multiplicity in Interest Rates:** There exists too many rates of interest in the Indian money market such as the borrowing rate of government, deposits and lending rates of cooperative and commercial banks, lending rates of financial institutions, etc. This is due to lack of mobility of funds from one section of the money market to another. The rates differ for funds of same durations lent by different institutions.
4. **Inadequate Funds:** Generally there is shortage of funds in Indian money market on account of various factors like inadequate banking facilities, low savings, lack of banking habits, existence of parallel economy, etc. However, the banking development particularly branch expansion, has improved the mobilization of funds to some extent in the recent years.
5. **Seasonal Stringency of Money:** The seasonal stringency of money and high rate of interest during the busy season (November to June) is a striking feature of Indian money market. There are wide fluctuations in the interest rates from one season to another. RBI has been taking various measures to avoid such fluctuations in the money market by adding money into the money market during the busy season and withdrawing the funds during the slack season.
6. **Absence of Bill Market:** A well organized bill market is necessary for linking up various credit agencies effectively to RBI. The bill market is not yet developed on account of many factors such as the practice of banks keeping a large amount of cash for liquidity purposes, preference for borrowing rather than discounting bills, dependence of indigenous bankers on one another, widespread practice of using cash credit, high stamp duty on usance bill, etc.
7. **Inadequate Credit Instruments:** The Indian money market did not have adequate short term paper instruments till 1985-86. There were only call money and bill markets. Moreover there were no specialist dealers and brokers dealing in the money market. After 1985-86, RBI has introduced new credit instruments such as 182-day treasury bills, 364-day treasury bills, CDs and CPs. These instruments are still in underdeveloped state in India.

   The above defects of Indian money market clearly indicate that it is relatively less developed and has yet to acquire sufficient depth and width. Thus, it cannot be compared with developed money markets such as London and New York money markets.

THE REFORMS UNDERTAKEN IN INDIAN MONEY MARKET.

The Committee to Review the Working of Monetary System chaired by S. Chakravarty made several recommendations in 1985 to develop Indian money market. As a follow-up, the RBI set up a Working Group on money market under the chairmanship of N. Vaghul, in 1987. Based on the recommendations of Vaghul Committee, RBI initiated a number of measures to widen and deepen the money market. The main measures are as follows.

1. **Deregulation of Interest Rates:** From May 1989, the ceiling on interest rates on the call money, inter-bank short-term deposits, bills rediscounting and inter-bank participation was removed and the rates were permitted to be determined by the market forces. Thus, the system of administered interest rates is being gradually dismantled.
2. **Introduction of New Money Market Instruments:** In order to widen and diversify the Indian money market RBI has introduced many new money market instruments such as 182-days treasury bills, 364-day treasury bills, CDs & CPs. Through these instruments the government, commercial banks, financial institutions and corporate can raise funds through the money market. They also provide investors additional instruments for investments. In order to expand the investor base for CDs and CPs the minimum amount of investment and the minimum maturity periods are reduced by RBI.
3. **Repurchase Agreements (Repos):** RBI introduced repos in government securities in December 1992 and reverse repos in November 1996. Repos and reverse repos help to even out short-term fluctuations in liquidity in the money market. They also provide a short-term avenue to banks to park their surplus funds. Through changes in repo and reverse repo rates RBI transmits policy objectives to entire money market.
4. **Liquidity Adjustment Facility (LAF):** RBI has introduced LAF from June 2000 as an important tool for adjusting liquidity through repos and reverse repos. Thus, in the recent years RBI is using repos and reverse repos as a policy to adjust liquidity in the money market and therefore, to stabilize the short-term interest rates or call rates. LAF has, therefore, emerged as a major instrument of monetary policy.
5. **Money Market Mutual Funds (MMMF):**RBI introduced MMMFs in April 1992 to enable the individual investors to participate in money market. To make the scheme flexible and attractive, RBI has brought about many modifications. The important features of this scheme as of now are:

(i) It can be set up by commercial banks, financial institutions and private sector.
(ii) Individual investors, corporates and others can invest in MMMFs.
(iii) Resources mobilized through this scheme can be invested in money market instruments as well as rated corporate bonds and debentures with a maturity period upto one year.
(iv) The minimum lock in period is now 15 days.

6. **Discount and Finance House of India (DFHI):** In order to impart liquidity to money market instruments and help the development of secondary market in such instruments, DFHI was set up in 1988 jointly by RBI, public sector banks and financial institutions.
7. **Development of Inter-bank Call and Notice Money Market:** The call and notice money market is an inter-bank market the world over and therefore the Narsimham Committee has recommended that we adopt the same in India. However RBI in the past had given permission to non-bank institutions to participate in the call money market as lenders. As per the recommendations of Narsimham Committee RBI in 2001-02 has

underlined the need for transforming the call money market into a pure inter-bank money market.

8. **Regulation of NBFCs:** The RBI Act was amended in 1997 to provide for a comprehensive regulation of NBFC sector. According to the amendment, no NFBC can carry on any business of a financial institution, including acceptance of public deposit, without obtaining a Certificate of Registration (CoR) from RBI.
9. **The Clearing Corporation of India Limited (CCIL):** The CCIL was registered on April 30, 2001 under the Companies Act, 1956, with the State Bank of India as the chief promoter. The CCIL clears all transactions in government securities and repos reported on the Negotiated Dealing System (NDS) of RBI.

CAPITAL MARKET IN INDIA

Capital market is the market for medium and long term funds. It refers to all the facilities and the institutional arrangements for borrowing and lending term funds (medium-term and long-term funds). The demand for long-term funds comes mainly from industry, trade, agriculture and government. The central and state governments invest not only on economic overheads such as transport, irrigation, and power supply but also an basic and consumer goods industries and hence require large sums from capital market. The supply of funds comes largely from individual savers, corporate savings, banks, insurance companies, specialized financial institutions and government.

The role (OR) Significance of Capital Market in economic development.

Capital market has a crucial significance to capital formation. Adequate capital formation is indispensable for a speedy economic development. The main function of capital market is the collection of savings and their distribution for industrial development. This stimulates capital formation and hence, accelerates the process of economic development.

A sound and efficient capital market facilitates the process of capital formation and thus contributes to economic development. The significance of capital market in economic development is explained below.

1. **Mobilisation of Savings:** Capital market is an organized institutional network of financial organizations, which not only mobilizes savings through various instruments but also channelizes them into productive avenues. By making available various types of financial assets, the capital market encourages savings. By providing liquidity to these financial assets through the secondary markets capital market is able to mobilize large amount of savings from various sections of the people such as individuals, families, and associations. Thus, capital market mobilizes these savings and make the same available for meeting the large capital needs of industry, trade and business.
2. **Channelization of Funds into Investments:** Capital market plays a crucial role in the economic development by channelizing funds in accordance with development priorities. The financial intermediaries in the capital market are better placed than individuals to channel the funds into investments which are more favourable for economic development.
3. **Industrial Development:** Capital market contributes to industrial development in the following ways:

(a) It provides adequate, cheap and diversified finance to the industrial sector for various purposes.

(b) It provides funds for diversified purposes such as for expansion, modernization, upgradation of technology, establishment of new units etc.

(c) It provides a variety of services to entrepreneurs such as provision of underwriting facilities, participating in equity capital, credit rating, consultancy services, etc. This helps to stimulate industrial entrepreneurship.

4. **Modernization and Rehabilitation of Industries:** Capital market can contribute towards modernization, rationalization and rehabilitation of industries. For example, the setting up of development financial institutions in India such as IFCI, ICICI, IDBI and so on has helped the existing industries in the country to adopt modernization and replacement of obsolete machinery by providing adequate finance.

5. **Technical Assistance:** An important bottleneck faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to the preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in the capital market play an important role in stimulating industrial entrepreneurship. This helps to stimulate industrial investment and thus promotes economic development.
6. **Encourage Investors to invest in Industrial Securities:** Secondary market in securities encourage investors to invest in industrial securities by making them liquid. It provides facilities for continuous, regular and ready buying and selling of securities. Thus, industries are able to raise substantial amount of funds from various segments of the economy.
7. **Reliable Guide to Performance:** The capital market serves as a reliable guide to the performance and financial position of corporate, and thereby promotes efficiency. It values companies accurately and toes up manager compensation to stock values. This gives incentives to managers to maximize the value of companies. This stimulates efficient resource allocation and growth.

THE STRUCTURE (OR) COMPOSITION OF CAPITAL MARKET IN INDIA.

In the financial market all those institutions and organizations which provide medium term and long- term funds to business enterprises and public authorities, constitute the capital market. In simple words, the market which lends long-term funds is called the capital market.

The capital market is composed of those who demand funds and those who supply funds. Thus, the borrowers and lenders in the financial market for medium-term and long-term funds constitute the capital market.

The Indian Capital Market is broadly divided into two categories:

1) The securities market consisting of
   (a) The gilt-edged market and (b) The industrial securities market; and
2) The financial institutions (Development Financial Institutions) (DFIs). Thus, the Indian capital market is composed of

(a) The gilt-edged market or the market for government securities and industrial securities or corporate securities market.

(b) Capital market includes Development Financial Institutions (DFIs) such as IFCI, SFC, LIC, IDBI, UTI, ICICI, etc. They provide medium-term and long-term funds for business enterprises and public authorities.

(c) Apart from the above, there are financial intermediaries in the capital market such as merchant bankers, mutual funds, leasing companies, venture capital companies etc. They help in mobilizing savings and supplying funds to investors.

THE CAPITAL MARKETS IN INDIA

(1) Gilt- Edged Market:

Gilt-edged market is also known as the government securities market. As the securities are risk free, they are known as gilt-edged i.e. the best quality securities.

The investors in the gilt-edged market are predominantly institutions. They are required by law to invest a certain portion of their funds in these securities. These institutions include commercial banks, LIC, GIC, and the provident funds.

The transactions in the government securities market are very large. Each transaction may run into several crores or even hundred crores of rupees. Since June 1992,

government securities have been mostly issued sealed bid auctions.
RBI plays a dominant role in the gilt-edged market through its open market operations. Thus, government securities are the most liquid debt instruments.

(2) The Industrial Securities Market:
It is a market of shares, debentures and bonds which can be bought and sold freely.
This market is divided into two categories:

(A) Primary Market:
The new issue market called the primary market and (b) old issue market, commonly known as stock exchange or stock market. It is called the secondary market.
The new issue market is concerned with the raising of new capital in the form of shares, bonds and debentures. Many public limited companies often raise capital through the primary market for expanding their business. It may be noted that the new issue market is important because of its impact on economic growth of the country.

(B) Secondary Market:
The stock exchange market or the secondary market is a market of the purchase and sale of quoted or listed securities. It is a highly organized market for regulating and controlling business in buying, selling and dealing in securities.

(3) Financial Institutions: We have mentioned that there are special financial institutions which provided long-term capital to the private sector in the capital market. These institutions are called Development Financial Institutions.

(4) Financial Intermediaries: The Indian capital market has shown steady improvement after 1951. During the Five-Year Plans, Capital market has witnessed rapid growth. Both the volume of saving and investment have shown phenomenal improvement. In fact, in the last two decades, the volume of capital market transactions has increased substantially. Besides, its functioning has been diversified indicating the growth of the Indian economy.

The capital market reforms introduced in India.
The reforms in the capital market are explained below with respect to primary and capital markets in India.

PRIMARY MARKET REFORMS IN INDIA
A number of measures has been taken in India especially since 1991 to develop primary market in India. These measures are discussed below:

8. **Abolition of Controller of Capital Issues:** The Capital Issues (Control) Act, 1947 governed capital issues in India. The capital issues control was administered by the Controller of Capital Issues (CCI). The Narasimham Committee (1991) had recommended the abolition of CCI and wanted SEBI to protect investors and take over the regulatory function of CCI. Thus, government replaced the Capital Issues (Control) Act and abolished the post of CCI. Companies are allowed to approach the capital market without prior government permission subject to getting their offer documents cleared by SEBI.
9. **Securities and Exchange Board of India (SEBI):** SEBI was set up as a non-statutory body in 1988 and was made a statutory body in January 1992. SEBI has introduced various guidelines for capital issues in the primary market. They are explained below.
10. **Disclosure Standards:** Companies are required to disclose all material facts and specific risk factors associated with their projects. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures.

11. **Freedom of Determine the Par Value of Shares:** The requirement to issue shares at a par value of Rs.10 and Rs.100 was withdrawn. SEBI has allowed the companies to determine the par value of shares issued by them. SEBI has allowed issues of IPOs through "book building" process.
12. **Underwriting Optional:** To reduce the cost of issue, underwriting by the issuer is made optional. It is subject to the condition that if an issue was not underwritten and was not able to collect 90% of the amount offered to the public, the entire amount collected would be refunded to the investors.
13. **FIIs Permitted to Operate in the Indian Market:** Foreign institutional investors such as mutual funds and pension funds are allowed to invest in equity shares as well as in debt market, including dated government securities and treasury bills.
14. **Accessing Global Funds Market:** Indian companies are allowed to aces global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Indian companies can list their securities on foreign stock exchanges through ADR./GDR issues.
15. **Intermediaries under the Purview of SEBI:** Merchant bankers, and other intermediaries such as mutual funds including UTI, portfolio managers, registrars to an issue, share transfer agents, underwriters, debenture trustees, bankers to an issue, custodian of securities, and venture capital funds have been brought under the purview of SEBI.
16. **Credit Rating Agencies:** Various credit rating agencies such as Credit Rating Information Services of India Ltd. (CRISIL – 1988), Investment Information and Credit Rating Agency of India Ltd. (ICRA – 1991). Cost Analysis and Research Ltd. (CARE – 1993) and so on were set up to meet the emerging needs of capital market.

SECONDARY MARKET REFORMS

A number of measures have been taken by the government and SEBI for the growth of secondary capital market in India. The important reforms or measures are explained below.

1. **Setting up of National Stock Exchange (NSE):** NSE was set up in November 1992 and started its operations in 1994. It is sponsored by the IDBI and co-sponsored by other development finance institutions, LIC, GIC, Commercial banks and other financial institutions.
2. **Over the Counter Exchange of India (OTCEI):** It was set in 1992. It was promoted by a consortium of leading financial institutions of India including UTI, ICICI, IDBI, IFCI, LIC and others. It is an electronic national stock exchange listing an entirely new set of companies which will not be listed on other stock exchanges.
3. **Disclosure and Investor Protection (DIP) Guidelines for New Issues:** In order to remove inadequacies and systematic deficiencies, to protect the interests of investors and for the orderly growth and development of the securities market, the SEBI has put in place DIP guidelines to govern the new issue activities. Companies issuing capital in the primary market are now required to disclose all material facts and specify risk factors with their projects.
4. **Screen Based Trading:** The Indian stock exchanges were modernized in the 90s, with Computerised Screen Based Trading System (SBTS). It electronically matches orders

on a strict price / time priority. It cuts down time, cost, risk of error and fraud, and therefore leads to improved operational efficiency.

5. **Depository System:**A major reform in the Indian Stock Market has been the introduction of depository system and scripless trading mechanism since 1996. Before this, the trading system was based on physical transfer of securities. A depository is an organization which holds the securities of shareholders in electronic form, transfers securities between account holders, facilitates transfer of ownership without handling securities and facilitates their safekeeping.
6. **Rolling Settlement:** Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day are settled after certain days.
7. **The National Securities Clearing Corporation Ltd. (NSCL):** The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of the NSE. Clearing and settlement of trades and risk managemnt are its central functions.
8. **Trading in Central Government Securities:**In order to encourage wider participation of all classes of investors, including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nationwide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.
9. **Mutual Funds:** Emergency of diversified mutual funds is one of the most important development of Indian capital market. Their main function is to mobilize the savings of general public and invest them in stock market securities. Mutual funds are an important avenue through which households participate in the securities market.

Examine the Role / Significance of SEBI.

SEBI was established as a non-statutory board in 1988 and January 1992, it was accorded statutory status. The regulatory powers of SEBI were increased in January 1995. It has now become a very important constituent of the financial regulatory framework in India. The SEBI is under the overall control of the Finance Ministry.

17. **Promotion and Development of Capital Market:**One of the important role of SEBI is the promotion and development of the capital market. It protects the rights and interests of investors, especially the individual investors. It prevents trading malpractices. Its regulatory measures are meant for the healthy development of capital markets.
18. **Regulatory Role:** Another important role of SEBI is the regulation of the security markets in India. The SEBI can frame or issue rules, regulations, directives, guidelines, norms with respect to primary and secondary markets.
19. **Protection of Interest of Investors:** An important role of SEBI is the protection interest of investors in securities. SEBI has introduced various measures to protect the interests of investors. To ensure no malpractice takes place in the allotment of share, a representative of SEBI supervises the allotment process.
20. **Investor's Education:** SEBI has a role of educating the investors about the securities market. It issues advertisements from time to time to enlighten the investors on various issues related to the securities market and of their rights and remedies.
21. **Investor's Grievances Redressal:** SEBI plays another role of redressing the investor's grievances. SEBI has introduced an automated complaints handling system to deal with

investor complaints. The Investor Grievances Redressal and Guidance Division of SEBI assists investors who want to make complaints to SEBI against listed companies.

22. **Primary Market Policy:** SEBI looks after all the policy matters and regulatory issues with respect to primary market. It is responsible for vetting of all the prospectuses and letters of offer for public and right issues, for co-ordinating with the primary market policy, for registration, regulation and monitoring of issue related intermediaries.
23. **Secondary Market Policy:** SEBI is responsible for all policy and regulatory issues for secondary market and new investment products. It is also responsible for registration and monitoring of members of stock exchanges, administration of some of the stock exchanges and monitoring of price movements and insider trading.
24. **Institutional Investment Policy:** SEBI look after institutional investment policy with respect to domestic mutual funds and Foreign Institutional Investors (FIIs). It also looks after registration, regulation and monitoring of FIIs and domestic mutual funds.
25. **Facilitates Mobilisation of Resources:** The SEBI plays an important role in facilitating an efficient mobilization and allocation of resources through the securities market, stimulating competition and encouraging innovations.

UNIT II:

Reserve Bank of India: Organization; Management; Functions – credit creation and credit control; Monetary policy.

ORIGIN OF RBI:

The origins of the Reserve Bank of India can be traced to 1926, when the Royal Commission on Indian Currency and Finance – also known as the Hilton-Young Commission – recommended the creation of a central bank for India to separate the control of currency and credit from the Government and to augment banking facilities throughout the country. The Reserve Bank of India Act of 1934 established the Reserve Bank and set in motion a series of actions culminating in the start of operations in 1935. Since then, the Reserve Bank's role and functions have undergone numerous changes, as the nature of the Indian economy and financial sector changed.

The Reserve Bank of India (RBI) is India's central bank, also known as the banker's bank. The RBI controls monetary and other banking policies of the Indian government. The Reserve Bank of India (RBI) was established on April 1, 1935, in accordance with the Reserve Bank of India Act, 1934. The Reserve Bank is permanently situated in Mumbai since 1937.

Establishment of Reserve Bank of India

The Reserve Bank is fully owned and operated by the Government of India.
The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

- Regulating the issue of Banknotes
- Securing monetary stability in India
- Modernising the monetary policy framework to meet economic challenges

The Reserve Bank's operations are governed by a central board of directors, RBI is on the whole operated with a 21-member central board of directors appointed by the Government of India in accordance with the Reserve Bank of India Act.
The Central board of directors comprise of:

- Official Directors – The governor who is appointed/nominated for a period of four years along with four Deputy Governors
- Non-Official Directors – Ten Directors from various fields and two government Official

Organisation Structure

- Governer
- Deputy Governors
- Executive Directors.
- Principal chief general managers.
- Chief general managers
- General managers
- Deputy general managers.
- Asst. General Managers.
- Managers
- Asst. managers.
- Support Staffs.

Objectives
The primary objectives of RBI are to supervise and undertake initiatives for the financial sector consisting of commercial banks, financial institutions and non-banking financial companies (NBFCs).
Some key initiatives are:

i. Restructuring bank inspections
ii. Fortifying the role of statutory auditors in the banking system

Legal Framework
The Reserve Bank of India comes under the purview of the following Acts:

- Reserve Bank of India Act, 1934
- Public Debt Act, 1944
- Government Securities Regulations, 2007
- Banking Regulation Act, 1949
- Foreign Exchange Management Act, 1999
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- Credit Information Companies(Regulation) Act, 2005
- Payment and Settlement Systems Act, 2007

FUNCTIONS OF RESERVE BANK OF INDIA:

1. Issue of Notes —

The Reserve Bank has a monopoly for printing the currency notes in the country. It has the sole right to issue currency notes of various denominations except one rupee note (which is issued by the Ministry of Finance). The Reserve Bank has adopted the Minimum Reserve System for issuing/printing the currency notes. Since 1957, it maintains gold and foreign exchange reserves of Rs. 200 Cr. of which at least Rs. 115 cr. should be in gold and remaining in the foreign currencies.

2. Banker to the Government–

The second important function of the Reserve Bank is to act as the Banker, Agent and Adviser to the Government of India and states. It performs all the banking functions of the State and Central Government and it also tenders useful advice to the government on matters related to economic and monetary policy. It also manages the public debt of the government.

3. Banker's Bank:-

The Reserve Bank performs the same functions for the other commercial banks as the other banks ordinarily perform for their customers. RBI lends money to all the commercial banks of the country.

4. Controller of the Credit:-

The RBI undertakes the responsibility of controlling credit created by commercial banks. RBI uses two methods to control the extra flow of money in the economy. These methods are quantitative and qualitative techniques to control and regulate the credit flow in the country.

5. Custodian of Foreign Reserves:-

For the purpose of keeping the foreign exchange rates stable, the Reserve Bank buys and sells foreign currencies and also protects the country's foreign exchange funds. RBI sells the foreign currency in the foreign exchange market when its supply decreases in the economy and vice-versa.

6. Monetary Authority

- Formulating and implementing the national monetary policy.
- Maintaining price stability across all sectors while also keeping the objective of growth.

7. Regulatory and Supervisory

- Set parameters for banks and financial operations within which banking and financial systems function.
- Protect investors interest and provide economic and cost-effective banking to the public.

8. Foreign Exchange Management

- Oversees the Foreign Exchange Management Act, 1999.
- Facilitate external trade and development of foreign exchange market in India.

9. Developmental role

- Promotes and performs promotional functions to support national banking and financial objectives.

10. Related Functions

- Provides banking solutions to the central and the state governments and also acts as their banker.
- Chief Banker to all banks: maintains banking accounts of all scheduled banks.

11. Other Functions:-

The Reserve Bank performs a number of other developmental works. These works include the function of clearing house arranging credit for agriculture (which has been transferred to NABARD) collecting and publishing the economic data, buying and selling of Government securities (gilt edge, treasury bills etc)and trade bills, giving loans to the Government buying and selling of valuable commodities etc. It also acts as the representative of the Government in the International Monetary Fund (I.M.F.) and represents the membership of India.

CREDIT CREATION

Demand deposits are an important constituent of money supply and the expansion of demand deposits means the expansion of money supply. The entire structure of banking is based on credit. Credit basically means getting the purchasing power now and promising to pay at some time in the future. Bank credit means bank loans and advances.
A bank keeps a certain part of its deposits as a minimum reserve to meet the demands of its depositors and lends out the remaining to earn income. The loan is credited to the account of the borrower. Every bank loan creates an equivalent deposit in the bank. Therefore, credit creation means expansion of bank deposits.
The two most important aspects of credit creation are:

1. **Liquidity** – The bank must pay cash to its depositors when they exercise their right to demand cash against their deposits.
2. **Profitability** – Banks are profit-driven enterprises. Therefore, a bank must grant loans in a manner which earns higher interest than what it pays on its deposits.

The bank's credit creation process is based on the assumption that during any time interval, only a fraction of its customers genuinely need cash. Also, the bank assumes that all its customers would not turn up demanding cash against their deposits at one point in time.

Basic Concepts of Credit Creation

- **Bank as a business institution** – Bank is a business institution which tries to maximize profits through loans and advances from the deposits.
- **Bank Deposits** – Bank deposits form the basis for credit creation and are of two types:
    - **Primary Deposits** – A bank accepts cash from the customer and opens a deposit in his name. This is a primary deposit. This does not mean credit creation. These deposits simply convert currency money into deposit money. However, these deposits form the basis for the creation of credit.
    - **Secondary or Derivative Deposits** – A bank grants loans and advances and instead of giving cash to the borrower, opens a deposit account in his name. This is the secondary or derivative deposit. Every loan crates a deposit. The creation of a derivative deposit means the creation of credit.
- **Cash Reserve Ratio (CRR)** – Banks know that all depositors will not withdraw all deposits at the same time. Therefore, they keep a fraction of the total deposits for meeting the cash demand of the depositors and lend the remaining excess deposits. CRR is the percentage of total deposits which the banks must hold in cash reserves for meeting the depositors' demand for cash.
- **Excess Reserves** – The reserves over and above the cash reserves are the excess reserves. These reserves are used for loans and credit creation.
- **Credit Multiplier** – Given a certain amount of cash, a bank can create multiple times credit. In the process of multiple credit creation, the total amount of derivative deposits that a bank creates is a multiple of the initial cash reserves.

Limitations of Credit Creation

While banks would prefer an unlimited capacity for creating credit to increase profits, there are many limitations. These limitations make the process of creating credit non-profitable. Therefore, a bank continues to create additional credit as long as:

- There is a negligible chance of the loans turning into bad debts
- The interest rate that banks charge on loans and advances is greater than the interest that the bank gives to depositors for the money deposited in the bank.

Hence, we can say that the limitations of credit creation operate through shifts in the balance between liquidity and profitability. The factors that affect the creation of credit are:

- The capacity of banks to create credit.
- The willingness of the banks to create credit
- Also, the demand for credit in the market.

Capacity to create credit is a matter of:

- The availability of cash deposits with banks
- The factors which determine their cash deposit ratio

As regards the demand for credit:

- The demand must exist in the market
- Creditworthy borrowers (to avoid bad debts)
- The amount of loan granted should not exceed the paying capacity of the borrower

CREDIT CONTROL:

Credit control, also called credit policy, includes the strategies employed by businesses to accelerate sales of products or services through the extension of credit to

potential customers or clients. At its most basic level, businesses prefer to extend credit to those with “good” credit and limit credit to those with “weak” credit, or possibly even a history of delinquency. Credit control might also be called credit management, depending on the scenario under review.

Credit control is an important tool used by Reserve Bank of India, a major weapon of the monetary policy used to control the demand and supply of money (liquidity) in the economy. Central Bank administers control over the credit that the commercial banks grant. Such a method is used by RBI to bring "Economic Development with Stability". It means that banks will not only control inflationary trends in the economy but also boost economic growth which would ultimately lead to increase in real national income stability. In view of its functions such as issuing notes and custodian of cash reserves, credit not being controlled by RBI would lead to Social and Economic instability in the country.

NEED FOR CREDIT CONTROL:

Controlling credit in the economy is amongst the most important functions of the Reserve Bank of India. The basic and important needs of credit control in the economy are-

- To encourage the overall growth of the "priority sector" i.e. those sectors of the economy which is recognized by the government as "prioritized" depending upon their economic condition or government interest. These sectors broadly totals to around 15 in number.
- To keep a check over the channelization of credit so that credit is not delivered for undesirable purposes.
- To achieve the objective of controlling inflation as well as deflation.
- To boost the economy by facilitating the flow of adequate volume of bank credit to different sectors.
- To develop the economy

OBJECTIVES OF CREDIT CONTROL:

The broad objectives of credit control policy in India have been-

- Ensure an adequate level of liquidity enough to attain high economic growth rate along with maximum utilization of resource but without generating high inflationary pressure.
- Attain stability in the exchange rate and money market of the country.
- Meeting the financial requirement during a slump in the economy and in the normal times as well.
- Control business cycle and meet business needs.

CREDIT CONTROL POLICIES

A company can decide on the type of policy it wishes to implement when drafting its credit control policy. The options typically include three levels: restrictive, moderate, and liberal. A restrictive policy is a low-risk strategy, limiting credit only to customers with a strong credit history, a moderate policy is a middle-of-the-road risk strategy that takes on more risk, while a liberal credit control policy is a high-risk strategy where the company extends credit to most customers.

Businesses that aim to gain higher levels of market share or that have high-profit margins are typically comfortable with liberal credit control policies. This also applies to companies that have a monopoly in their industry so that they can hold onto the

monopoly. That said, if the monopoly is firmly rooted, the firm may be inclined to adopt a restrictive policy, given the low threat of entrants to the market. A firm in this enviable position does not need to worry much about upsetting its customer base.

CREDIT CONTROL FACTORS

Credit policy or credit control primarily focus on the four following factors:

- **Credit period**: Which is the length of time a customer has to pay
- **Cash discounts**: Some businesses offer a percentage reduction of discount from the sales price if the purchaser pays in cash before the end of the discount period. Cash discounts present purchasers an incentive to pay in cash more quickly.
- **Credit standards**: Includes the required financial strength a customer must possess to qualify for credit. Lower credit standards boost sales but also increase bad debts. Many consumer credit applications use a FICO score as a barometer of creditworthiness.
- **Collection policy**: Measures the aggressiveness in attempting to collect slow or late paying accounts. A tougher policy may speed up collections, but could also anger a customer and drive them to take their business to a competitor.

A credit manager or credit committee for certain businesses are usually responsible for administering credit policies. Often accounting, finance, operations, and sales managers come together to balance the above credit controls, in hopes of stimulating business with sales on credit, but without hurting future results with the need for bad debt write-offs.

METHODS OF CREDIT CONTROL:

There are two methods that the RBI uses to control the money supply in the economy-

- Qualitative method
- Quantitative method

During the period of inflation Reserve Bank of India tightens its policies to restrict the money supply, whereas during deflation it allows the commercial bank to pump money in the economy.

I. Qualitative method

By Quality we mean the uses to which bank credit is directed.For example- the bank may feel that spectators or the big capitalists are getting a disproportionately large share in the total credit, causing various disturbances and inequality in the economy, while the small-scale industries, consumer goods industries and agriculture are starved of credit. Correcting this type of discrepancy is a matter of qualitative credit control.

Qualitative method controls the manner of channelizing of cash and credit in the economy. It is a 'selective method' of control as it restricts credit for certain section where as expands for the other known as the 'priority sector' depending on the situation. Tools used under this method are-

a. **Marginal requirement**

Marginal requirement of loan current value of security offered for ban-value of loans granted. The marginal requirement is increased for those business activities, the flow of whose credit is to be restricted in the economy.

For Example:- A person mortgages his property worth ₹ 1,00,000 against loan. The bank will give loan of ₹ 80,000. The marginal requirement here is 20%

b. **Rationing of credit**

Under this method there is a maximum limit to loans and advances that can be made, which the commercial banks cannot exceed. RBI fixes ceiling for specific categories. Such rationing is used for situations when credit flow is to be checked, particularly for speculative activities. Minimum of "capital: total assets" (ratio between capital and total asset) can also be prescribed by Reserve Bank of India.

c. **Publicity**

RBI uses media for the publicity of its views on the current market condition and its directions that will be required to be implemented by the commercial banks to control the unrest. Though this method is not very successful in developing nations due to high illiteracy existing making it difficult for people to understand such policies and its implications.

d. **Direct Action**

Under the banking regulation Act, the central bank has the authority to take strict action against any of the commercial banks that refuses to obey the directions given by Reserve Bank of India. There can be a restriction on advancing of loans imposed by Reserve Bank of India on such banks. e.g. – RBI had put up certain restrictions on the working of the Metropolitan co-operative banks. Also the 'Bank of Karad' had to come to an end in 1992.

e. **Moral Suasion**

This method is also known as "moral persuasion" as the method that the Reserve Bank of India, being the apex bank uses here, is that of persuading the commercial banks to follow its directions/orders on the flow of credit. It also be part of meetings between RBI and Commercial Banks. RBI persuades the commercial bank to follow their policies. RBI puts a pressure on the commercial banks to put a ceiling on credit flow during inflation and be liberal in lending during deflation.

II. Qualitative Method:

By quantitative credit control we mean the control of the total quantity of credit.

For Example- consider that the Central Bank, on the basis of its calculations, considers that Rs. 50,000 is the maximum safe limit for the expansion of credit. But the actual credit at that given point of time is Rs. 55,000(say).Thus it then becomes necessary for the central bank to bring it down to 50,000 by tightening its policies. Similarly if the actual credit is less, say 45,000, then the apex bank regulates its policies in favor of pumping credit into the economy.

a. **Bank rate**

Bank rate also known as the discount rate is the official minimum rate at which the central bank of the country is ready to re discount approved bills of exchange or lend on approved securities. Section 49 of the Reserve Bank of India Act 1934, defines Bank Rate as "the standard rate at which it (RBI) is prepared to buy or re-discount bills of exchange or other commercial paper eligible for purchase under this Act".

When the commercial bank for instance, has lent or invested all its available funds and has little or no cash over and above the prescribed minimum, it may ask the central bank for funds. It may either re-discount some of its bills with the central bank or it may borrow from the central bank against the collateral of its own promissory notes. In either case, the central bank accommodates the commercial bank and

increases the latter's cash reserves. This Rate is increased during the times of inflation when the money supply in the economy has to be controlled.

At any time there are various rates of interest ruling at the market, like the deposit rate, lending rate of commercial banks, market discount rate and so on. But, since the central bank is the leader of the money market and the lender of the last resort, all other rates are closely related to the bank rate. The changes in the bank rate are, therefore, followed by changes in all other rates as the money market.

The graph on the right hand side shows variations in the bank rate since 1935–2011.

b. Working of the bank rate

This section will answer how Bank Rate policy operates to control the level of prices and business activity in the country. Changes in bank rate are introduced with a view to controlling the price levels and business activity, by changing the demand for loans. Its working is based upon the principle that changes in the bank rate results in changed interest rate in the market. Suppose a country is facing inflationary pressure. The central bank, in such situations, will increase the bank rate thereby resulting to a hiked lending rate. This increase will discourage borrowing. It will also lead to a fall in the business activity due to following reasons.

- Employment of some factors of production will have to be reduced by the business people.
- The manufacturers and stock exchange dealers will have to liquidate their stocks, which they held through bank loans, to pay off their loans.

The effect of Rise in bank rate by the central bank . Hence, we can conclude that hike in Bank Rate leads to fall in price level and a fall in the Bank Rate leads to an increase in price level i.e. they share an inverse relationship.

MONETARY POLICY OF RBI:

Monetary policy is the process by which the monetary authority of a country, generally the central bank, controls the supply of money in the economy by its control over interest rates in order to maintain price stability and achieve high economic growth.[1] In India, the central monetary authority is the Reserve Bank of India (RBI).

It is designed to maintain the price stability in the economy. Other objectives of the monetary policy of India, as stated by RBI, are:

Price stability

Price stability implies promoting economic development with considerable emphasis on price stability. The centre of focus is to facilitate the environment which is favourable to the architecture that enables the developmental projects to run swiftly while also maintaining reasonable price stability.

Controlled expansion of bank credit

One of the important functions of RBI is the controlled expansion of bank credit and money supply with special attention to seasonal requirement for credit without affecting the output.

Promotion of fixed investment

The aim here is to increase the productivity of investment by restraining non essential fixed investment.

Restriction of inventories and stocks

Overfilling of stocks and products becoming outdated due to excess of stock often results in sickness of the unit. To avoid this problem, the central monetary authority carries out this essential function of restricting the inventories. The main objective of this policy is to avoid over-stocking and idle money in the organisation.

Promoting efficiency

It tries to increase the efficiency in the financial system and tries to incorporate structural changes such as deregulating interest rates, easing operational constraints in the credit delivery system, introducing new money market instruments, etc.

Reducing rigidity

RBI tries to bring about flexibilities in operations which provide a considerable autonomy. It encourages more competitive environment and diversification. It maintains its control over financial system whenever and wherever necessary to maintain the discipline and prudence in operations of the financial system.

INSTRUMENTS OF MONETARY POLICIES IN INDIA:

Open market operations

An open market operation is an instrument of monetary policy which involves buying or selling of government securities like government bonds from or to the public and banks. This mechanism influences the reserve position of the banks, yield on government securities and cost of bank credit. The RBI sells government securities to control the flow of credit and buys government securities to increase credit flow. Open market operation makes bank rate policy effective and maintains stability in government securities market.

Cash reserve ratio (CRR)

Cash reserve ratio is a certain percentage of bank deposits which banks are required to keep with RBI in the form of reserves or balances. The higher the CRR with the RBI, the lower will be the liquidity in the system, and vice versa. RBI is empowered to vary CRR between 15 percent and 3 percent. Per the suggestion by the Narasimham Committee report, the CRR was reduced from 15% in 1990 to 5 percent in 2002. As of 9th October 2020, the CRR is 3.00 percent.

Statutory liquidity ratio (SLR)

Every financial institution has to maintain a certain quantity of liquid assets with themselves at any point of time of their total time and demand liabilities. These assets have to be kept in non cash form such as G-secs precious metals, approved securities like bonds. The ratio of the liquid assets to time and demand liabilities is termed as the Statutory liquidity ratio. There was a reduction of SLR from 38.5% to 25% because of the suggestion by Narsimham Committee. As on 9th October 2020, the SLR stands at 18%.[6]

Bank rate policy

The bank rate, also known as the discount rate, is the rate of interest charged by the RBI for providing funds or loans to the banking system. This banking system involves commercial and co-operative banks, Industrial Development Bank of India, IFC, EXIM Bank, and other approved financial institutions. Funds are provided either through lending directly or discounting or buying money market instruments like commercial bills and treasury bills. Increase in bank rate increases the cost of borrowing by commercial banks which results in the reduction in credit volume to the banks and hence the supply of money declines. Increase in the bank rate is the symbol of

tightening of RBI monetary policy. As of 9th October 2020, the bank rate is 4.25 percent.

Credit ceiling

In this operation, RBI issues prior information or direction that loans to the commercial banks will be given up to a certain limit. In this case, commercial bank will be tight in advancing loans to the public. They will allocate loans to limited sectors. A few examples of credit ceiling are agriculture sector advances and priority sector lending.

Credit authorisation scheme

Credit authorisation scheme was introduced in November, 1965 when P C Bhattacharya was the chairman of RBI. Under this instrument of credit regulation, RBI, as per the guideline, authorise the banks to advance loans to desired sectors.

Moral suasion

Moral suasion is just as a request by the RBI to the commercial banks to take certain actions and measures in certain trends of the economy. RBI may request commercial banks not to give loans for unproductive purposes which do not add to economic growth but increase inflation.

Repo rate and reverse repo rate

Repo rate is the rate at which RBI lends to its clients generally against government securities. Reduction in repo rate helps the commercial banks to get money at a cheaper rate and increase in repo rate discourages the commercial banks to get money as the rate increases and becomes expensive. The reverse repo rate is the rate at which RBI borrows money from the commercial banks. The increase in the repo rate will increase the cost of borrowing and lending of the banks which will discourage the public to borrow money and will encourage them to deposit. As the rates are high the availability of credit and demand decreases resulting to decrease in inflation. This increase in repo rate and reverse repo rate is a symbol of tightening of the policy. As of May 2020, the repo rate is 4.00% and the reverse repo rate is 3.35%

UNIT III:

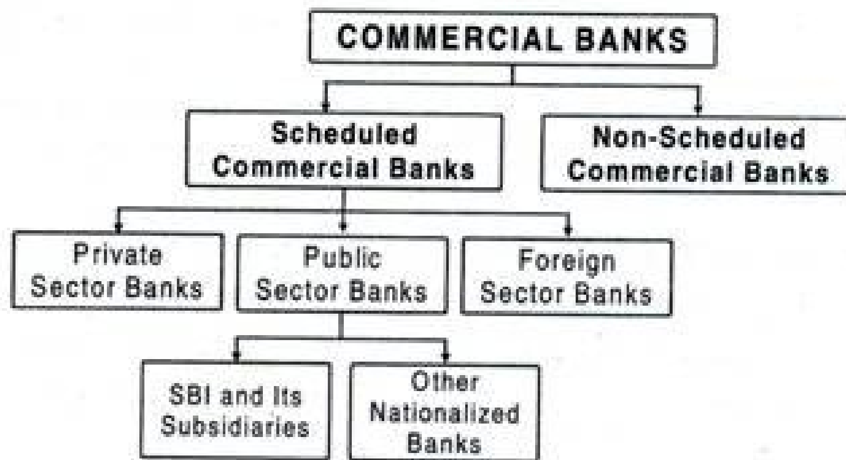
Commercial Banks: Meaning; Functions; Management and investment policies of commercial banks; Recent trends in Indian commercial banks.

COMMERCIAL BANK:

A bank is an institution, usually incorporated, whose business is to receive money on deposit, cash, cheques or drafts, discount commercial paper, make loans and issue promissory notes payable to bearer known as banknotes.

A commercial bank is a monetary institution which serves the interests of its depositors by providing security to the deposits of money and on the other hand, makes profits by investing such deposits in the protective measures by extending loans. Commercial banks are the most common and important type of banking institutions.

STRUCTURE OF INDIAN COMMERCIAL BANKS



Having established the pivotal role performed by the banking system in the Indian financial sector and by implication, in the overall financial intermediation process, thus supporting the real sector of the economy. The strong points of the financial system are its ability to mobilize savings, its vast geographical and functional reach and institutional diversity. Between 1965 and 1990, the household sector's gross savings in the form of financial assets rose from 5.5 per cent to 12.2 per cent of net domestic product. Since 1969 when major banks were nationalized, the number of commercial bank branches increased from about 8,300 to well over 65,000 by 2005.

The commercial banking structure in India consists of: Scheduled Commercial Banks and Unscheduled Banks. Scheduled commercial banks constitute those banks, which have been included in the Second Schedule of Reserve Bank of India (RBI) Act, 1934. RBI includes only those banks in this schedule, which satisfy the criteria laid down vide section 42 (6) (a) of the Act. Indian banks can be broadly classified into nationalized banks/ public sector banks, private banks and foreign banks. The Indian banks include 27 public sector banks excluding 196 Regional Rural Banks (RRBs).

Classification of Commercial Banks -

Commercial Bank may be classified into - (i) Scheduled Commercial Banks and Non-Scheduled Commercial Banks (ii) Licensed Commercial Bank and Non-Licensed Commercial Bank (iii) Public Sector Banks and Private Sector Banks (iv) Indian Banks and Foreign Banks.

Commercial Banks may be classified into following categories –

(i) Scheduled Commercial Banks and Non-Scheduled Commercial Banks
(ii) Licensed Commercial Bank and Non-Licensed Commercial Bank
(iii) Public Sector Banks and Private Sector Banks
(iv) Indian Banks and Foreign Banks

(i) Scheduled Commercial Banks and Non-Scheduled Commercial Banks:

Scheduled Commercial Banks –

Scheduled Commercial Banks are the banks which have been included in the Second Scheduled of the Reserve Bank of India Act, 1934 (R.B.I). According to Section 42(6) of Reserve Bank of India Act 1934, the Banks dealing with banking business in India and fulfilling the terms and conditions provided in the said Act would be included second Scheduled of Reserve Bank of India Act, 1934.

Scheduled Commercial banks may remit the funds by draft, etc. through the offices of the Reserve Bank and its agencies free of cost or concessional rates. The Reserve Ban deals with sale and purchase of Promissory Notes and Bill of Exchange etc. through scheduled Bank only. Reserve Bank deals with the sale and purchase of foreign currency through Scheduled Banks only. R.B.I grants loan on security to the Scheduled Banks only up to a period of 90 days. Reserve Bank of India may borrow money from Scheduled Banks only for a maximum period of 1 Month.

Non- Scheduled Commercial Banks-

Non-Scheduled Commercial banks are the Banks which have not been included in Second Scheduled of the Reserve Bank of India Act, 1934 due to non-fulfillment of requirements mentioned under Section 42(6) of the said Act.

(ii) Licensed Commercial Banks and Non-Licensed Commercial Banks:

According to Section 22(1) of the Banking Regulation Act, 1949 No one Banking Company can Start or deal with banking Business without Prior permission of Reserve Bank of India.

Licensed Commercial Banks-

Reserve Bank issues the Licence to the Bank. It may impose suitable and appropriate conditions at the time issuing the License. If concerning bank fulfills such conditions, The Reserve Bank issues the license to the bank. The bank which is granted a license by Reserve Bank of India is called Licensed Commercial Bank.

Non- Licensed Commercial Banks –

Under Section 22 of the Banking Regulation Act 1949, The Banks which do not obtain the License from Reserve Bank of India are called Non-Licensed Commercial Banks.

(iii) Public Sector Banks and Private Sector Banks :

Commercial Banks may also Classified into Public Sector Banks and Private Sector Banks –

Public Sector Banks –

Public Sector Banks have an important place in Economic Condition of the country. These are Banks where majority stake is held by the Govt. of India or Reserve Bank of India. In 2012 the Largest Public Sector Bank was the State Bank of India. This consist of 14 banks which are nationalized in the year 1969 and six banks which are nationalized in 1980.

Private Sector Banks –

Private Sector Banks are banks that the majority of share capital is held by Private Individuals. In private Sector, Small Scheduled Commercial Banks and newly established Banks with a network of 8,965 branches are operating. To encourage Competitive efficiency, the setting up new private Bank is now encouraged.

(iv) Indian Banks and Foreign Banks:

The Commercial banks may be further classified in Indian Banks and Foreign Banks -

Indian Banks have their registered offices in India, on the other hand, foreign Banks are registered and have their headquarters in foreign Country but operates their branches in India. Apart from the financing of foreign trade, these banks have performed all functions of Commercial Banks and they have an advantage over Indian banks because of their vast resources and superior management. Till September 2010 there were 34 foreign banks in India.

Functions of Commercial Bank

Functions of Commercial Bank can be categorized into Primary Functions, Secondary Function and Modern Functions.

i) Primary Functions of Commercial Bank

Primary functions of the commercial bank consist of accepting deposits(receive deposits), lending money (making Loans and Advances) and investment of funds.

A) Accepting Deposits-

The primary function of commercial banks is to accept deposits from the public. Banks maintain deposit account for their customers and convert deposit money into cash and vice versa, at the discretion of the latter. Banks accept money from the public by receiving deposits by way of different accounts.

(1) Saving Bank Account

Savings bank account is useful for the person who deposits money by small savings. The customer is at liberty to deposit money in this account at a number of times on the same day. In case of savings deposit, there are certain restrictions on the number of withdrawals or on the amount that can be withdrawn per week. Generally, the Bank account holder can withdraw money twice a week from such account. A minimum balance of Rs 100 should be maintained and if cheque book facility is allowed, the minimum balance should be Rs 1000 on this saving deposit. The rate of interest in such account is comparatively lower than the other accounts.

(2) Current Account

A current account is running account which is continuously in Operation. In this account money or funds can be deposited many times on the same day. Similarly, withdrawal can be made by the account holder many times on the same day. Usually, a bank does not allow any interest on this kind of deposit, because Bank cannot utilize

this short-term deposits. This type of deposit accounts is generally opened by Business people for their convenience

(3) Recurring Deposit Account

Recurring deposits is one form of saving deposit, in this type of deposit, at the end of every week or month, a fixed Amount deposited regularly. the amount can be withdrawn only after specified period. this deposit works on the Maxim " little drops of water make a big ocean".The rate of interest on such account stands favorably as compared to the rate of interest on the savings bank account because such account partly resembles the fixed deposit account.

(4) Fixed or Time Deposit Account

Fixed or time deposit account, the money is deposited for a fixed period and cannot be withdrawn before the expiry of that specified period. The rate of interest on such deposit depends upon the length of time of deposit. This account is also called the time deposit because the money is repayable on the expiry of the fixed period of time only. The terms and condition of such accounts are regulated by Reserve Bank of India.

B) Lending Money –

Lending money is one of the important functions of a bank. This is the lending or advancing of money either upon or without security. Bank accepts deposits from those persons who have surplus money and grant loan and advance to those who need. Charge comparatively higher rate of interest on the amount advanced as a loan. These loans are advanced by the bank in the following ways.

(1) Loans:

In this facility, certain amount in the form of an advice is given for a certain period. This sanctioned amount of Advanced is deposited the bank in the current account of the person concerned. The interest is charged on the whole amount of the loan. It is irrelevant whether the whole amount was withdrawn by the debtor or not. The loan may be refunded as a whole in one time or installments. The property is to be Pledged or mortgaged for such Loan.

(2) Cash Credit:

The Businessman generally need regular loans, and therefore it may be inconvenient for them to make fresh agreement every time. Thus, they make an agreement in this regard for an anticipated certain amount required in the year. Such amount is not withdrawn as a whole in one time but the customer withdrawals only such amount whichever is required at a time. The interest is charged only on the amount withdrawn. The cash credit is generally allowed on the securities only

(3) Overdraft:

Overdraft is an arrangement between a banker and his customer by which the customer is allowed to withdraw over and above the credit balance in the current account up financial assistance. It is given either on personal security or on the security of assets.The main difference between the overdraft and cash credit is that the facility of overdraft may be available to the current account holder only while such cash credit may be given to any person.

(4) Discounting of Bills:

Bank grants advance to their customers by discounting bills of exchange or pronote (Promissory Note). When the bank gives advance on the bills

before the date of maturity, then the interest till the date of maturity from the date of sanctioning the advance is deducted. This deduction is called discounting.

C) Investments of Funds –

While making an investment a bank is required to observe three principles, namely liquidity, profitability and safety. A bank invests its funds in government securities issued by central government as well as state government. It also invests in other approved securities like the units of UTI, shares of GIC and LIC, securities of State Electricity Board etc.

ii) Secondary Functions of Commercial Bank

a) Agency Functions

Bank perform agency functions for their customers as given below –

1) Collection of cheques, Bills etc -

Bank collect the cheques, bills, Drafts and other Negotiable Instruments deposited by their customers.

2) Making and collecting payments –

Banks make payments of the premium of insurance policies, house rent etc. On behalf of their customers. Similarly, they accept/recover rents and other deposits on behalf of their customers.

3) Accepting Bills -

Banks accept bills of exchange as per orders of their customers. They make also the payment of cheque, bills and hundis of their customers.

4) Remittance facilities-

Bank remits money from one place to another for the facility of their customers.

5) Purchase and Sale of Shares and Securities –

Bank purchase and sell shares and securities etc. As per order of their customers.

6) Reference Letter-

Bank sends the information of the financial condition of their customers to the Businessman of the country and abroad. Similarly, they give the information of the financial condition of other Businessman to their customers.

7) Acting as Trustees-

Banks take the liability for management of the properties of their customers and act as trustees.

b) General utility Services –

(1) It issues letter of credit, Traveller's cheques, gift cheques.

(2) It provides Tax Consultancy services. It gives advice on income tax and other Personal taxes

(3) It facilities easy and quick transfer of fund from one place to another, place by means of cheques, drafts MT, TT etc.

(4) It deals with foreign exchange transactions thereby helping the importers and exporters

(5) Bank makes arrangements for transport, insurance and warehousing of goods

(6) It provides consultancy services on technical, financial, managerial and economic aspects for the benefit of micro and small enterprise

iii) Modern Functions of Commercial Bank

1. It issues Credit Cards, Debit Cards, Smart Cards etc.
2. Changing Cash for Bank deposit and Bank deposits for cash
3. Providing 24 hours facility of payment through ATM's
4. Transferring Bank Deposit between individual or companies
5. Exchanging deposits for bills of exchange government Bond, secure and unsecured promises of trade and industrial units Underwriting capital issues

MOTIVES OF INVESTMENT POLICY

The commercial banks have to follow the guidelines issued by RBI for investments. The following are the motives of investment policy of RBI.

1. **Safety and security**. Safety and security of the funds which are deposited by the customers of the bank is very important in banks. The money which is deposited by the customers in banks should be safe and they should get back whenever they require. The banks should see that the money which is deposited in commercial banks should not be misused by the banks through its unscrupulous management or mismanagement and lead to loss and consequently lead to bankruptcy. Hence the RBI will guide the commercial banks through its monetary policies and issues guidelines to follow in their investment policies. To safeguard the interests of the depositors in commercial banks the deposits are insured up to Rs. 1,00,000.
2. **Liquidity of funds in banks.** Commercial banks have to maintain liquidity of funds deposited by the depositors of the banks. The banks should see that the money deposited is allowed by the banks to withdraw whenever the customers require during working hours of the bank. This will ensure more confidence among the customers of the bank. There are several cases where Indian commercial banks ensured liquidity to the depositors of the bank. Recently during 2001 the rumours spread among the customers of the ICICI Bank in Maharashtra that there is no cash in the bank. Hence many customers went for withdrawing of the funds deposited and the ATM counters were flooded with customers. The bank also made arrangements for cash and also assured the customers not to panic. Immediately the RBI assured that there is no liquidity problem in the bank. Hence liquidity in banks is a very important motive of the investment policy. Therefore banks are directed to keep some percentage of the funds in the form of Cash Reserve Ratio in RBI and also insist to invest in Statutory Liquid Ratio to convert into easy liquidity.
3. **Profitability of the bank.** The soundness of any bank is measured by its profitability. The customers will come forward to deposit their funds with banks on the basis of the profitability of the banks. Hence the banks have to earn profits.

Factors Determining Liquidity of Banks

The liquidity of a bank is determined by the top management of the bank on the basis of the nature of business conditions in a country. This is also guided by the central bank of that country to ensure liquidity in an economy. The extent of liquidity is ensured on the basis of the following factors.

1. ***The size of liquid reserves***. The size of the liquid reserves will depend upon the extent of liquid reserves considered essential by the banking community. If the liquid reserves in a bank will increase the liquidity position of the banks but the

amount available for lending will decrease. During the year 1991 to 1995 the CRR of the commercial banks with the RBI was 15 to 14.5 percent on Net Demand and Time Liabilities (NDTL), hence the amount available with the banks for lending was less hence it hampered the growth of our economy. By realizing this problem RBI after accepting reform process in the economy reduced this ratio. Since then the amount available for lending with the banks has increased, consecutively the Credit Deposit (CD) ratio also increased. It was around 56 percent during 2004 it went up to 71 per cent during the month of February 2006 by showing good symptom of growth in the credit activities in an economy.

2. ***Banking habits of the people.*** Liquidity of a bank depends upon the banking habits of people. If the country is.
3. ***Well organized money market.*** Well organized and developed money market is another factor which will have its influence on the liquidity position of the banks. If the money market is well organized, the commercial banks will borrow and lend their cash in the money market which reduces the idle money with the banking sector and also supports the liquidity position in the banking sector and also in an economy.

ASSET STRUCTURE OF COMMERCIAL BANKS

Assets structure will reflect the deployment of sources of funds of commercial banks. The main source of funds of commercial banks is deposits. The other sources of funds are borrowings from other banks, capital, reserves and surplus. The deposits of commercial banks are from savings deposits, current account deposits and term deposits. These deposits constitute 80 per cent of the total sources of funds. Out of the total deposits, term deposits constitute 50 per cent. Borrowings are around 5 per cent of the total liabilities of the commercial banks. These sources are deployed by the commercial banks mainly on its financial assets i.e, loans and advances which constitute 48.6 per cent of the total assets of the banks. The investments is another important component of the assets of commercial banks which is around 40 per cent of the total assets of the banks during the year 2005. This is because of pre-emptions like SLR and CRR requirements in the banking sector. The investments in commercial banks have increased also because of surplus liquidity in Indian banks during this period due to reduction of SLR and CRR to 25 and 4.5 respectively during that period and less demand for loans and advances from credit-worthy customers. This scenario is changing in India due to increasing demand in credit from industrial, agriculture sector and also the growth of FMCG market.

The assets structure of the banks is governed by certain principles, like liquidity, profitability, shiftability and risklessness. The other factors which influence the assets structure of commercial banks are nature of money market, economic growth of the country, policies and vision of the governments. In the countries like India, China, Russia, North Korea and Brazil there is a boom in the growth of the economy hence naturally there will be heavy demand for the credit.

Now let us examine each of the important assets of the commercial bank.

1. **Cash in hand and balances with RBI**. From the point of the liquidity in the commercial banks cash in hand is a very important asset but it is idle and it will not fetch any earnings to the banks. Cash in commercial banks depends upon various factors like uncertainty in the economy due to wars, famine, internal

disturbance, the growth of banking system, network of branches, networking of banks, automation in banks and so on. The cash reserve requirements in the commercial banks was more during pre-reform period it was 15 per cent during the year 1994-
95. Gradually RBI reduced it to 4 per cent based on the requirements of credit and it is now 5 per cent on Net Demand and Time Liabilities.

2. **Money at Call and Short Notice.** It is second line of defense of the commercial banks in cases of emergencies. If the call money market is well developed the commercial banks can lend their surplus funds in the call market for a day or up to 14 days it is called call market or over night market without keeping their surplus money idle. It can also lend for short period, where the borrower has to return the money borrowed from the banks when short notice is given by the banks. This is becoming a good business in the money market and constitutes around 4 per cent of the total assets of the commercial banks. The banks instead of keeping the money idle lend their surplus funds for short periods in the call market.
3. **Investments.** Investments constitute one of the important assets of the bank next to loans and advances. A bank makes investments for the purpose of earning profits. First, it keeps primary and secondary reserves to meet its liquidity requirements. Banks invest in securities either for fulfilment of SLR/CRR requirements or for earning profit on the idle funds. Banks invest in "approved securities" (predominantly Government securities) and "others" (shares, debentures and bonds). The values/rates of these securities are subject to change depending on the market conditions. Some securities are transacted frequently and some are held till maturity. Total investments during the year 2005 by the commercial banks in India were Rs. 8,43,081 crores which is 37 per cent of the total assets. During the month of February and March 2006 the investments in Indian commercial banks have reduced because of heavy demand for credit. Some banks even sold their surplus investments in government securities which was more than SLR requirements and converted them into cash for lending.
4. **Loans and Advances.** The commercial banking industry in India has been playing a very important role in intermediating between the economic units, which have surpluses and deficits in their current budgets. By mobilizing financial surpluses in the economy and by channeling these resources into various sectors and segments of the economy, they are guiding the pattern of utilisation of a large proportion of the economy. The Government of India which owns a large segment of the industry, and the RBI, which is the central banking authority of the country, have been persuading the commercial banks to deploy larger and larger volumes of financial resources into certain identified priority sectors, for the purpose of accelerating the growth of these sectors. The total advances of commercial banks include bills purchased and discounted, cash credits, overdrafts, loans, unsecured loans, and priority sector advances. The component of loans and advances in the total assets of commercial banks is 48 to 50 per cent—in fact still growing in India. The management of this asset is a very important aspect in the banking sector. The non-performing assets in banks is

increasing. In addition to this banks are exposed to various risks such as credit risk, liquidity risk, market risk and operational risk.

5. **Fixed Assets and other assets.** The component of fixed assets and other assets do not form an important aspect in the funds of commercial banks since deals are more in financial assets than real assets.

PROFITABILITY OF COMMERCIAL BANKS

Profitability is a key parameter in assessing the performance of any business firm. Even in the banking sector after the banking sector reforms the priorities in banking operations underwent far reaching changes. There had been a shift in the emphasis from development or social banking to commercially viable banking. Profitability became the prime mover of the financial strength and performance of banks; hence the performance of the bank is measured on the basis of its profitability. Now the main agenda is to enhance the profitability and reduce the hurdles which are faced by the banks in their profit maximization and to develop strategies to achieve this objective. In this changed scenario, profitability and productivity are the twin indicators of the competitive edge of the banking industry.

The main reason for the fundamental paradigm shift in the banking from social banking to "profit banking" was the introduction of capital adequacy requirements. There are four ways to achieve and sustain the required capital adequacy: fresh equity issue, ploughing back of profit, debt offering and revaluation of assets. Raising capital through equity route is very difficult because servicing the equity base, offering reasonable returns, raising fresh capital when the capital market is not favourable and when the performance of banks is not good. Similarly debt raising also will have the limitations too, as tier II capital cannot exceed tier I capital and subordinated debt cannot exceed 50% of the tier II capital. The scope of revaluation of assets for improving capital adequacy is limited and hence banks are left fee-based activities like letters of credit, guarantees, and acceptance commission is also responsible for growth in profitability of the banks now-a-days because of thin interest margin.

1. **Provisioning for loan losses, loan quality improvements or non-Performing Assets**. Provisioning for loan losses and non-performing assets reduce the profitability of the banking system. NPAs, reduces the net profits of banks on account of loss in income and the provisioning for NPAs will reduce the profit of the banks.
2. **Interest rate movements**. Interest rate movements affect the net interest margins of the banks. A net interest margin refers to difference between interest on deposits and interest on advances. When interest rates increase, the impact is immediate on the advances, which reduces the demand for advances and reduces the profits of the banks. The change in interest rates are exposed to interest rate risks and asset- liability mismatches, which calls for Asset Liability Management (ALM).
3. **Rigidity of the operating cost structure**. About 60 to 70 per cent of the operating costs of Indian commercial banks is on account of employee costs. The other significant cost components are real estate and technology costs. These costs are non-controllable to a significant extent and are rising constantly hence, reducing the profitability of banks.

Unit Specific factors

1. **Banking structure**. Structure of the banking system will have its impact on the profitability of banks. The diversified banking structure with operations spread across regions having different economic/business profiles, like Indian public sector banks will have higher operating costs in view of a larger network, lower margins due to greater competition.
2. **Size of Bank**. Indian situation suggests that when banks are considered groups in terms of big, medium and small, the bigger banks have greater scope for economies of scale. The per centages of total expenses to working funds are lower for bigger size banks than for small size banks. Whereas in other countries like European Investment Banks, a study of American and Japanese banks have observed that there is no convincing correlation between the size of banks and earning power.
3. **Branch network or Franchise strength**. A large network of branches located at potential centres provides access to low cost deposits as well as increased scope for earning more fee-based income in the form of commission on remittance services and bills for collection.

Profitability Performance of Commercial Banks

Profitability is one major criterion for evaluating the performance of banks. If profitability has to be planned and improved, detailed, systematic and objective analysis is necessary. It calls for studying the factors determining profitability, how they behave, how they are related to each other and how valid inter-bank comparisons are.

To evaluate the profitability performance of the banks largely ratios are used as a tool for comparison. There is no unanimity in the selection of ratios. The ratios usually used are:

1. Net Profit / Net Worth
2. Spread / Working Funds
3. Burden / Working Funds
4. Interest Income / Total Earning Assets
5. Non-Interest Income / Total Earning Assets
6. Interest Expenses / Total Earning Assets
7. Non-Interest Expenditure (Operating Expenditure) / Total Earning Assets
8. Net Profit / Working funds
9. Net Non-Performing Assets / Net advances
10. Capital Adequacy Ratio
11. Savings Deposit / Total Deposits
12. Current Deposits / Total Deposits
13. Term Deposits / Total Deposits

shifted their attention to increasing non-interest income from fees. This fee based total revenue helps to raise net income flowing to bank stockholders.

Interest expense constitutes interest paid on deposits, RBI/inter-bank borrowings and others.

Non-interest expenses are also called operating expenses or overhead, which constitutes expenses incurred for establishment, rent, taxes and lighting, printing and stationery, advertisement, depreciation etc.

In order to evaluate the performance of the commercial banks the Reserve Bank of

India uses CAMEL method. The prime task of regulatory agencies is to frame regulations and examine their adherence by banks through the examination process. This will help the RBI to evaluate how far a particular commercial bank has compliance with the guidelines. This is a major strategy in enhancing the control mechanism, supervision by the regulatory authorities. Central banks address to the issue by on-sight and off-sight inspections/examinations.

CAMEL refers to:

C = Capital Adequacy Ratio A = Assets Ratios

M = Management Ratios E = Earning Ratios.

L = Liquidity Ratios

RECENT TRENDS IN COMMERCIAL BANKING IN INDIA:

Electronic Payment Services – E Cheques

Now-a-days we are hearing about e-governance, e-mail, e-commerce, e-tail etc. In the same manner, a new technology is being developed in US for introduction of e-cheque, which will eventually replace the conventional paper cheque. India, as harbinger to the introduction of e-cheque, the Negotiable Instruments Act has already been amended to include; Truncated cheque and E-cheque instruments.

Real Time Gross Settlement (RTGS)

Real Time Gross Settlement system, introduced in India since March 2004, is a system through which electronics instructions can be given by banks to transfer funds from their account to the account of another bank. The RTGS system is maintained and operated by the RBI and provides a means of efficient and faster funds transfer among banks facilitating their financial operations. As the name suggests, funds transfer between banks takes place on a 'Real Time' basis. Therefore, money can reach the beneficiary instantaneously and the beneficiary's bank has the responsibility to credit the beneficiary's account within two hours.

Electronic Funds Transfer (EFT)

Electronic Funds Transfer (EFT) is a system whereby anyone who wants to make payment to another person/company etc. can approach his bank and make cash payment or give instructions/authorization to transfer funds directly from his own account to the bank account of the receiver/beneficiary. Complete details such as the receiver's name, bank account number, account type (savings or current account), bank name, city, branch name etc. should be furnished to the bank at the time of requesting for such transfers so that the amount reaches the beneficiaries' account correctly and faster. RBI is the service provider of EFT.

Electronic Clearing Service (ECS)

Electronic Clearing Service is a retail payment system that can be used to make bulk payments/receipts of a similar nature especially where each individual payment is of a repetitive nature and of relatively smaller amount. This facility is meant for companies and government departments to make/receive large volumes of payments rather than for funds transfers by individuals.

Automatic Teller Machine (ATM)

Automatic Teller Machine is the most popular devise in India, which enables the customers to withdraw their money 24 hours a day 7 days a week. It is a devise that allows customer who has an ATM card to perform routine banking transactions without interacting with a human teller. In addition to cash withdrawal, ATMs can be used for

payment of utility bills, funds transfer between accounts, deposit of cheques and cash into accounts, balance enquiry etc.

Point of Sale Terminal

Point of Sale Terminal is a computer terminal that is linked online to the computerized customer information files in a bank and magnetically encoded plastic transaction card that identifies the customer to the computer. During a transaction, the customer's account is debited and the retailer's account is credited by the computer for the amount of purchase.

Tele Banking

Tele Banking facilitates the customer to do entire non-cash related banking on telephone. Under this devise Automatic Voice Recorder is used for simpler queries and transactions. For complicated queries and transactions, manned phone terminals are used.

Electronic Data Interchange (EDI)

Electronic Data Interchange is the electronic exchange of business documents like purchase order, invoices, shipping notices, receiving advices etc. in a standard, computer processed, universally accepted format between trading partners. EDI can also be used to transmit financial information and payments in electronic form.

Digitization

With the rapid growth of technology, digital services became an indispensable part of banking operations as these institutions needed to keep up with the changes and introduce innovations that made services convenient. In India, the initial phase of digitization began in the 1980s when information technology was used to perform basic functions like customer service, bookkeeping, etc. Gradually core banking solutions were also adopted to improve customer experience. The main shift came during the 1990s when liberalization opened the Indian market to the global world. Private and international banks which came into operation boosted technological changes in the banking sector. Features like online banking, IMPS (Immediate Payment Service), RTGS (Real Time Gross Settlement), tele banking enabled customers to avail banking facilities from anywhere.

Mobile Banking

Almost a decade back, even though digital services came into the picture, it was only done through desktop computers which means the customer must be at home or at a place with a computer and internet connection. But the vast penetration of smart phones created a need among customers to avail banking services on their mobile phones. Cheap data charges also contributed towards the increase in usage of mobile banking.

Unified Payment Interface (UPI)

UPI is a trend that emerged in the last couple of years and it is revolutionizing the way we pay and receive money. Transactions can be done within seconds using this interface. Goggle Pay and BHIM (Government of India) are two major interfaces among numerous other services that enable easy payment even if you are out of physical cash.

Block chain

Block chain is a robust technology that is still in the development phase. Security is a major factor as far as digital services are concerned. Despite technical advances, fraud practices are still a challenge in the digital domain. Block chain is the answer to these challenges. Like the way in which it operates, there is no scope for any malpractices in it. The technology works on computer science, data structures and cryptography.

Artificial Intelligence (AI) Robots

Many private and nationalized banks have started to make use of chatbots or Artificial Intelligence (AI) robots for assistance in customer support. The practice is still in its initial stage but will definitely evolve and make the entrance to the general public in the near future. Chatbots are one of the emerging trends that are estimated to grow.

UNIT IV:

All India Development Banks: Concept, objectives, and functions of various all India Development Banks; Operational and promotional activities of all India Development Banks – UTI

Development Banks:

Development banks are specialized financial institutions. They provide medium and long-term finance to the industrial and agricultural sector. They provide finance to both private and public sector. Development banks are multipurpose financial institutions. They do term lending, investment in securities and other activities. They even promote saving and investment habit in the public.

Definition:

There is no precise definition of the development bank. William Diamond and Shirley Bosky consider industrial finance and development corporations as 'development banks' Fundamentally a development bank is a term lending institution.

Development bank is essentially a multi-purpose financial institution with a broad development outlook. A development bank may, thus, be defined as a financial institution concerned with providing all types of financial assistance (medium as well as long-term) to business units, in the form of loans, underwriting, investment and guarantee operations, and promotional activities — economic development in general, and industrial development, in particular. "In short, a development bank is a development-oriented bank."

Development Banks in India:

Development Banks are the institutions which contribute to the development of industries in any nation and thereby contributing to national development and growth. here we will discuss history of development banks in India since independence.

Working capital requirements are provided by commercial banks, indigenous bankers, co-operative banks, money lenders, etc. The money market provides short-term funds which mean working capital requirements.

The long-term requirements of business concerns are provided by industrial banks and the various long-term lending institutions which are created by the government. In India, these long-term lending institutions are collectively referred to as development banks.

Development banks in India are classified into the following four groups:

- Industrial Development Banks: It includes, for example, Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), and Small Industries Development Bank of India (SIDBI).
- Agricultural Development Banks: It includes, for example, National Bank for Agriculture & Rural Development (NABARD).
- Export-Import Development Banks: It includes, for example, Export-Import Bank of India (EXIM Bank).
- Housing Development Banks: It includes, for example, the National Housing Bank (NHB).

Industrial Finance Corporation of India (IFCI) is the first development bank in India. It started in 1948 to provide finance to medium and large-scale industries in India.

The major objectives of development banks in India are as follows:

Development Banks are those financial institutions that provide funds and financial assistance to new and upcoming business enterprises. Development bank helps in According to Willian Diamond, “development bank is a financial institution to promote and finance enterprises in private sector.”

Development banks like IDBI, SIDBI, and IFCI etc. were set up to meet long term and short term capital requirements of the industry. Development banks coordinate the activities of those institutions, engaged in financing, promoting and developing industries. They help in accelerating industrial and economic growth.

The following are the objectives of development banks:

1. Rapid Industrial growth:

Industrial sector is the dynamic sector of the Indian economy. This sector contributes to the generation of employment and income in the country. Funds are provided by the development banks to start a new business venture, expansion and diversification of the business in new sector etc.

These funds are utilised to achieve several objectives that leads to accelerate industries and economic growth. Development banking supports the programmes of industrialisation of the country, by promoting entrepreneurial activities.

2. Encouraging entrepreneurs:

Industrialisation helps in curbing economic and social problems thereby making economies progress. Emerging entrepreneurs are encouraged to give shape to their ideas. Development bank helps those entrepreneurs by providing funds for commencing new business.

3. Balanced regional development:

There has been always an issue related to regional disparities. Development bank helps in curbing these regional disparities by providing funds to the entrepreneurs at low rate of interest if the organisation is planned in the backward areas. This would lead to the development of all areas thereby making balanced regional development.

4. Filling gaps:

It is not possible for the commercial banks to fulfill all financial needs of all the customers. Absence of organised capital market, absence of adequate facilities for financing industries arise the problem of slow development of industrialisation. Such development banks can fulfill the credit gap. They provide long- term funds for industries where gestation period may be longer.

5. Helps government:

Government formulates financial policies with the help of development banks. They also help in implementing these policies. For example, NABARD bank is set up as an apex development bank for extending support to the rural areas. It helps the government in matters relating to the rural development, offers training and research facilities for banks working in the field of rural development, and acts as a regulator for co-operative banks and RRB’s.

The Major functions of development banks in India are as follows:

1. To promote and develop small-scale industries (SSI) in India.
2. To finance the development of the housing sector in India.
3. To facilitate the development of large-scale industries (LSI) in India.
4. To help the development of agricultural sector and rural India.

5. To enhance the foreign trade of India.
6. To help to review (cure) sick industrial units.
7. To encourage the development of Indian entrepreneurs.
8. To promote economic activities in backward regions of the country.
9. To contribute in the growth of capital markets.

Now let's discuss each important function of development banks one by one.

1. Small Scale Industries (SSI)

Development banks play an important role in the promotion and development of the small-scale sector. Government of India (GOI) started Small industries Development Bank of India (SIDBI) to provide medium and long-term loans to Small Scale Industries (SSI) units. SIDBI provides direct project finance, and equipment finance to SSI units. It also refinances banks and financial institutions that provide seed capital, equipment finance, etc., to SSI units.

2. Development of Housing Sector

Development banks provide finance for the development of the housing sector. GOI started the National Housing Bank (NHB) in 1988.

NHB promotes the housing sector in the following ways:

1. It promotes and develops housing and financial institutions.
2. It refinances banks and financial institutions that provide credit to the housing sector.

3. Large Scale Industries (LSI)

Development banks promote and develop large-scale industries (LSI). Development financial institutions like IDBI, IFCI, etc., provide medium and long-term finance to the corporate sector. They provide merchant banking services, such as preparing project reports, doing feasibility studies, advising on location of a project, and so on.

4. Agriculture and Rural Development

Development banks like National Bank for Agriculture & Rural Development (NABARD) helps in the development of agriculture. NABARD started in 1982 to provide refinance to banks, which provide credit to the agriculture sector and also for rural development activities. It coordinates the working of all financial institutions that provide credit to agriculture and rural development. It also provides training to agricultural banks and helps to conduct agricultural research.

5. Enhance Foreign Trade

Development banks help to promote foreign trade. Government of India started Export-Import Bank of India (EXIM Bank) in 1982 to provide medium and long-term loans to exporters and importers from India. It provides Overseas Buyers Credit to buy Indian capital goods. It also encourages abroad banks to provide finance to the buyers in their country to buy capital goods from India.

6. Review of Sick Units

Development banks help to revive (cure) sick-units. Government of India (GOI) started Industrial investment Bank of India (IIBI) to help sick units.

IIBI is the main credit and reconstruction institution for revival of sick units. It facilitates modernization, restructuring and diversification of sick-units by providing credit and other services.

7. Entrepreneurship Development

Many development banks facilitate entrepreneurship development. NABARD, State Industrial Development Banks and State Finance Corporations provide training to entrepreneurs in developing leadership and business management skills. They conduct seminars and workshops for the benefit of entrepreneurs.

8. Regional Development

Development banks facilitate rural and regional development. They provide finance for starting companies in backward areas. They also help the companies in project management in such less-developed areas.

9. Contribution to Capital Markets

Development banks contribute the growth of capital markets. They invest in equity shares and debentures of various companies listed in India. They also invest in mutual funds and facilitate the growth of capital markets in India.

Structures of Development Banks In India:

1. Industrial Finance Corporation of India (IFCI), 1948
2. Industrial Credit and Investment Corporation of India (ICICI), 1955
3. Industrial Development of Bank of India (IDBI), 1964
4. State Finance Corporation (SFC), 1951
5. Small Industries Development Bank of India (SIDBI), 1990
6. Export-Import Bank (EXIM)
7. Small Industries Development Corporation (SIDCO)
8. National Bank for Agriculture and Rural Development (NABARD).

In addition to these institutions, there are also institutions such as Life Insurance Corporation of India, General Insurance Corporation of India, National Housing Bank, Unit Trust of India, etc., which are providing investment funds.

INDUSTRIAL FINANCE CORPORATION OF INDIA (IFCI)

IFCI, previously Industrial Finance Corporation of India, is a Non-Banking Finance Company in the public sector. Established in 1948 as a statutory corporation, IFCI is currently a company listed on BSE and NSE. IFCI has seven subsidiaries and one associate.

It provides financial support for the diversified growth of Industries across the spectrum. The financing activities cover various kinds of projects such as airports, roads, telecom, power, real estate, manufacturing, services sector and such other allied industries. During its 70 years of existence, mega-projects like Adani Mundra Ports, GMR Goa International Airport, Salasar Highways, NRSS Transmission, Raichur Power Corporation, among others, were set up with the financial assistance of IFCI.

The company has played a pivotal role in setting up various market intermediaries of repute in several niche areas like stock exchanges, entrepreneurship development organisations, consultancy organisations, educational and skill development institutes across the length and breadth of the country.

The Govt. of India has placed a Venture Capital Fund of Rs. 200 crore for Scheduled Castes (SC) with IFCI with an aim to promote entrepreneurship among the Scheduled Castes (SC) and to provide concessional finance. IFCI has also committed a contribution of Rs.50 crore as lead investor and Sponsor of the Fund. IFCI Venture Capital Funds Ltd., a subsidiary of IFCI Ltd., is the Investment Manager of the Fund.

The Fund was operationalized during FY 2014-15 and IVCF is continuously making efforts for meeting the stated objective of the scheme.

Further, the Government of India designated IFCI as a nodal agency for the "Scheme of Credit Enhancement Guarantee for Scheduled Caste (SC) Entrepreneurs" in March, 2015, with the objective of encouraging entrepreneurship in the lower strata of society. Under the scheme, IFCI would provide guarantees to banks against loans to young and start-up entrepreneurs belonging to scheduled castes.

Until the establishment of ICICI in 1991, IFCI remained solely responsible for implementation of the government's industrial policy initiatives.

Objectives Of IFCI:

The main purpose or objective of IFCI is "to make medium and long-term credits more readily available to industrial concerns in India, particularly in circumstances where normal banking accommodations are inappropriate or recourse to capital methods is impracticable". IFCI provides financial assistance for the setting up of new ventures as well as for the modernization and expansion of existing enterprises. It gives priority to the dispersal of money to the industry, development of backward areas, etc. It pays special attention to the following types of projects:

a. Projects located in backward areas.
b. Projects based on indigenous technology.
c. Projects likely to meet the growing demand for essential commodities.
d. Projects promoted by new entrepreneurs and technocrats.
e. Projects having potential for export and import substitution.
f. Projects that provide plant and machinery, fertilizers, pesticides, and other inputs for agriculture.

Functions of the IFCI

- First, the main function of the IFCI is to provide medium and long-term loans and advances to industrial and manufacturing concerns. It looks into a few factors before granting any loans. They study the importance of the industry in our national economy, the overall cost of the project, and finally the quality of the product and the management of the company. If the above factors have satisfactory results the IFCI will grant the loan.
- The Industrial Finance Corporation of India can also subscribe to the debentures that these companies issue in the market.
- The IFCI also provides guarantees to the loans taken by such industrial companies.
- When a company is issuing shares or debentures the Industrial Finance Corporation of India can choose to underwrite such securities.
- It also guarantees deferred payments in case of loans taken from foreign banks in foreign currency.
- There is a special department the Merchant Banking & Allied Services Department. They look after matters such as capital restructuring, mergers, amalgamations, loan syndication, etc.
- It the process of promoting industrialization the Industrial Finance Corporation of India has also promoted three subsidiaries of its own, namely the IFCI Financial Services Ltd, IFCI Insurance Services Ltd and I-Fin. It looks after the functioning and regulation of these three companies.

INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI), 1955

The creation of Industrial Credit and Investment Corporation of India (ICICI) is another milestone in the growth of the Indian Capital Market. It was incorporated in the year 1955, as a company registered under the Companies Act. The ICICI was incorporated to finance small scale and medium industries in the private sector.

The IFCI and SFCs confined themselves to lending activity and kept away from underwriting and investing in business though they were authorized to subscribe for the shares and debentures of the companies and to undertake underwriting business. Therefore, a large number of up and coming enterprises faced continuous problems in raising funds in the capital market.

Besides, they were not in a position to secure the desired amount of loan assistance from the financial institutions due to their thin equity base. To encourage industrial development in the private sector, a considerable provision of underwriting facility was considered necessary to accelerate the phase of the industrialization. To fill these gaps, the ICICI was established.

Objectives of the ICICI

The major objective of the ICICI was to meet the needs of the industry for permanent and long term funds in the private sector. In general, the major objectives of the Corporation are:

1. To assist in creation, growth and modernization of business enterprises in the non-public sector.
2. To encourage and promote the involvement of internal and external capital sources, in such enterprises.
3. To motivate pvt ownership of industrial investment and to promote and assist in the expansion of markets.
4. To provide equipment finance.
5. To provide finance for rehabilitation of industrial units.

The Characteristics of ICICI Bank.

The important characteristics of the functioning of ICICI Bank are as follows.

i) The assistance related to finance as given by the ICICI bank consists rupee loans, loans of foreign currency, shares and debentures underwriting and so also shares and debentures direct subscription.

ii) Initially, the ICICI was started to give assistance of financial related to the industrial concerns in private sectors. But recently, the scope of this bank has been expanded by consisting industrial concerns in the public sector, private sector and co-operative sectors.

iii) This bank has been giving particular attention towards financing riskier and industries of the non-traditional such as heavy engineering, petrochemicals, products of metal, and chemicals. Thus such type of industries have mentioned for more than half of the whole assistance.

iv) The ICICI bank after some period gradually also assisting financial help to the small scale industries and the backward areas projects.

v) With the all other financial institutions, the ICICI bank has also strongly participated in adopting surveys to evaluate potential of industries of various states.

vi) The ICICI Bank also incorporated the Housing Development Finance Corporation Ltd., during the year 1977, to provide term loans for building and buying of residential houses.
vii) The ICICI has been giving assistance regarding leasing for modernization, schemes replacement; conservation of energy; orientation of exports; expansion of pollution controller and etc., Since from 1983.
viii) With concept from April 1, 1996, the shipping credit company of India Ltd was totally merged with ICICI bank.

Functions of the ICICI

In order to accomplish the above objectives, the Corporation performs the following functions:

1. Providing finance in the form of long-term or medium term loans or equity participation.
2. Sponsoring and underwriting new issues of shares and other securities,
3. Guaranteeing loans from other private investment sources.
4. Making funds available for reinvestment by revolving investment as rapidly as possible.
5. Providing project advisory services i.e. offering advice –
    i. to private sector companies in the pre-investment stages on Government policies and procedures, feasibility studies and joint venture search, and
    ii. to Central and State Governments on specific policy related issues.

Types of financial assistance of the ICICI

The Corporation provides finance-in the following forms:

1. Underwriting of public issues and offer or sale of industrial securities.
2. Direct subscription to such securities.
3. Securing loans in rupees payable over periods up to 15 years.
4. Providing similar loans in foreign currencies for payment of imported capital equipment and technical service.
5. Guaranteeing payments for credit made by others.
6. Providing credit facilities to manufacturers for promoting sale of industrial equipment on deferred payment terms.
7. Providing financial services like leasing, installment sale and asset credit.

The ICICI sells securities from its own portfolio to the investors whenever it can get a reasonable price for them. It does so for the dual purpose of revolving its resources for new investments and for encouraging the investment habit in others and thereby promoting a wide spread distribution of private industrial securities. Thus, unlike normal investors the ICICI does not retain successful investments merely because they are profitable.

ICICI assisted manufacturing industries in all sectors, that is, the private sector, the joint sector, the public sector and the cooperative sector but the major beneficiary was the private sector. ICICI's assistance comprised of foreign currency loans, rupee loans, guarantees, and subscription of shares and debentures. The Corporation showed increasing interest in the development of new industries in backward regions.

There was a remarkably significant increase in financial assistance by ICICI in recent years.

Role of the ICICI

The Corporation started a Merchant Banking Division in 1973 for advising its clients on a selective basis, on raising finances in suitable forms and on restructuring of finances in the existing companies. It also advises clients on amalgamation proposals. Assistance is provided in preparing proposals for submission to financial institutions and banks and for negotiations with them for loans, underwriting etc. This Division acts as Managers to the issue of capital. Assistance is also provided for completion of formalities connected with the public issue and of legal formalities for raising loans.

In 1982, the ICICI gave a new dimension to its merchant banking division by offering to provide counseling for industrial investment in India to non-resident Indians and persons of Indian origin living abroad. This is likely to prove not only the least expensive route for technological up gradation but also a source of foreign currency funds by way of risk capital.

It has set up Venture Capital Funds for the promotion of green field companies and risk capital investment and joined the other financial institutions in setting up SHCIL, CRISIL and OTC Exchange of India Ltd. It has recently set up its own bank and a mutual fund like the UTI.

The Corporation's vision has been extending far beyond its immediate function of funding industrial projects. It has been looking at all sectors of the economy and wherever a need was perceived, has designed either a new concept or a new instrument, or even a new institution to cater to it. In this regard, its development activities have encompassed such diverse areas as technology, financing, project promotion, rural development, human resources development and publications.

It has set up ICICI Brokerage Services Limited in March 1995. It is a 100% subsidiary of I-SEC. It commenced its securities brokerage activities in 1996. It is registered with the National Stock Exchange of India Limited and The Mumbai Stock Exchange.

ICICI set up ICICI Credit Corporation in 1997, which later renamed as ICICI Personal Financial Services Limited in 1999. It is offering a comprehensive range of goods and services to retail customers.

ICICI Capital Services Ltd. was originally set up as SCICI securities Ltd. as a wholly owned subsidiary of erstwhile SCICI Ltd. in 1994. Its object is providing stock broking services to the institutional clients and undertaking activities such as underwriting, primary market placements and distribution, industry and company research etc. It became a wholly owned subsidiary of ICICI with effect from April 1, 1996.

ICICI has established ICICI bank for performing commercial banking functions in 1994. The bank offers a wide variety of domestic and international banking services.

INDUSTRIAL DEVELOPMENT BANK OF INDIA (IDBI):

Industrial Development Bank of India (IDBI) established under Industrial Development Bank of India Act, 1964, is the principal financial institution for providing credit and other facilities for developing industries and assisting development institutions.

Till 1976, IDBI was a subsidiary bank of RBI. In 1976 it was separated from RBI and the ownership was transferred to Government of India. IDBI is the tenth largest

bank in the world in terms of development. The National Stock Exchange (NSE), the National Securities Depository Services Ltd. (NSDL), Stock Holding Corporation of India (SHCIL) are some of the Institutions which has been built by IDBI.

Organisation and Management:

IDBI consist of a Board of Directors, consisting of a chairman and Managing Director appointed by the Government of India, a Deputy Governor of the RBI nominated by that bank and 20 other Directors are nominated by the Central Government.

The board had constituted an Executive Committee consisting of 10 Directors, including the Chairman and Managing Director. The executive committee is empowered to sanction financial assistance.

The Head office of IDBI is located in Mumbai. The bank has five regional offices, one each in Kolkata, Guwahati, New Delhi, Chennai and Mumbai. Besides the bank have 21 branch offices.

Functions of IDBI:

The main functions of IDBI are discussed below:

1. To provide financial assistance to industrial enterprises.
2. To promote institutions engaged in industrial development.
3. To provide technical and administrative assistance for promotion management or expansion of industry.
4. To undertake market and investment research and surveys in connection with development of industry.

IDBI Assistance:

The IDBI provides financial assistance either directly or through some specified financial institutions:

(i) Direct Assistance:

The IDBI grants loans and advances to industrial concerns. There is no restriction on the upper or lower limits for assistance to any concern itself. The bank guarantees loans raised by industrial concerns in the open market from the State Co-operative Banks, the Scheduled Banks, the Industrial Finance Corporation of India (IFCI) and other 'notified' financial institutions.

(ii) Indirect Assistance:

The IDBI can refinance term loans to industrial concerns repayable within 3 to 25 years given by the IFCI, the State Financial Corporation and some other financial institutions and to SIDCs (State Industrial Development Corporations), Commercial banks and Cooperative banks which extend term loans not exceeding 10 years to industrial concerns. IDBI subscribes to the shares and bonds of the financial institutions and thereby provide supplementary resources.

Developmental Activities of IDBI:

(1) Promotional Activities:

In fulfillment of its developmental role, the bank continues to perform a wide range of promotional activities relating to developmental programmes for new entrepreneurs, consultancy services for small and medium enterprises and programmes designed for accredited voluntary agencies for the economic upliftment of the underprivileged.

These include entrepreneurship development, self-employment and wage employment in the industrial sector for the weaker sections of society through voluntary agencies, support to Science and Technology Entrepreneurs' Parks, Energy Conservation, Common Quality Testing Centers for small industries.

(2) Technical Consultancy Organisations:

With a view to making available at a reasonable cost, consultancy and advisory services to entrepreneurs, particularly to new and small entrepreneurs, IDBI, in collaboration with other All-India Financial Institutions, has set up a network of Technical Consultancy Organisations (TCOs) covering the entire country. TCOs offer diversified services to small and medium enterprises in the selection, formulation and appraisal of projects, their implementation and review.

(3) Entrepreneurship Development Institute:

Realising that entrepreneurship development is the key to industrial development; IDBI played a prime role in setting up of the Entrepreneurship Development Institute of India for fostering entrepreneurship in the country. It has also established similar institutes in Bihar, Orissa, Madhya Pradesh and Uttar Pradesh. IDBI also extends financial support to various organisations in conducting studies or surveys of relevance to industrial development.

STATE FINANCE CORPORATION (SFC), 1951

At the time of setting up of the Industrial Finance Corporation of India, the necessity of establishing similar other institutions at the state level for assisting the smaller industrial concern had not been recognised because it was not possible for a single institution to satisfy the capital needs of smaller concerns spreaded all over the country. In 1951, the State Financial Corporation was passed by the Central Government to create a separate financial corporation for the states. The S.F.C. meets the financial requirements of small industrial concerns in the private sectors.

Objectives and Scopes:

The main objectives of the S.F.C are to provide financial assistance to medium and small scale industries which are outside the scope of I.F.C.I. The main function of S.F.C. is limited within its states. It covers not only public limited companies but also private limited companies, partnership firms and proprietary concerns.

Functions Of SFC:

The main functions of S.F.C. are as follows:

1. It grants loan and advances to industrial concerns that are repayable within the maximum period of 20 years.
2. It subscribes the shares and debentures of industrial concerns.
3. It underwrites the shares and debentures of the industrial concerns.
4. It guarantees loans raised by the industrial concerns repayable within 20 years.
5. Guarantees deferred payments for purchase of capital goods with India.
6. It acts as an agent of the State and central Government.

According to section 2(C) of the SFC Act 1951 as amended in 1961, the SFC can assist an industrial concern that is engaged in any of the following activities:

1. Manufacture, preservation or processing of goods
2. Hotel Industries
3. Road Transport
4. Generation or distribution of electricity or any other form of power

5. Development of any area of land as industrial estate.
6. Fishing or providing facilities for fishing or manufacture of fish products.
7. Providing special or technical knowledge or other services for the promotion of industrial growth.

SFC provides foreign exchange loans under World Bank schemes. The SFC occupies an important place as an institution for industrial development in the country. The major beneficiaries of the SFC are assistances are the following industries:

1. Food Processing
2. Textile Chemical and Chemical Products
3. Metal Production
4. Cement.

SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA (SIDBI), 1990

The SIDBI was established as a wholly owned subsidiary of Industrial Development Bank of India (IDBI) under a special Act of the Parliament 1988 and started its operations on April 2, 1990. It took over the responsibility of administering Small Industries Development Fund and National Equity Fund which were earlier administered by IDBI. It is the Principal Financial Institution for the Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector and for Co-ordination of the functions of the institutions engaged in similar activities. It is managed by a team of 10 Board of Directors.

Objectives of SIDBI

To promote marketing of products of small scale sector. To upgrade technology and also undertaking modernization of small scale units. To provide more financial assistance to small scale ancillary and tiny sector. To encourage employment oriented industries.

Finance Facilities Offered by SIDBI

Small Industries Development Bank of India, offers the following facilities to its customers:

1. Direct Finance

SIDBI offers Working Capital Assistance, Term Loan Assistance, Foreign Currency Loan, Support against Receivables, equity support, Energy Saving scheme for the MSME sector, etc.

2. Indirect Finance

SIDBI offers indirect assistance by providing Refinance to PLIs (Primary Lending Institutions), comprising of banks, State Level Financial Institutions, etc. with an extensive branch network across the country. The key objective of the refinancing scheme is to raise the resource position of Primary Lending Institutions that would ultimately enable the flow of credit to the MSME sector.

3. Micro Finance

Small Industries Development Bank of India offers microfinance to small businessmen and entrepreneurs for establishing their business.

Functions of SIDBI (Small Industries Development Bank of India)

1. Small Industries Development Bank of India refinances loans that are extended by the PLIs to the small-scale industrial units and also offers resources assistance to them
2. It discounts and rediscounts bills

3. It also helps in expanding marketing channels for the products of SSI (Small Scale Industries) sector both in the domestic as well as international markets
4. It offers services like factoring, leasing etc. to the industrial concerns in the small-scale sector
5. It promotes employment oriented industries particularly in semi-urban areas for creating employment opportunities and thus checking relocation of people to the urban areas
6. It also initiates steps for modernisation and technological up-gradation of current units
7. It also enables the timely flow of credit for working capital as well as term loans to Small Scale Industries in cooperation with commercial banks
8. It also co-promotes state level venture funds

Benefits of SIDBI

1. Custom-made

SIDBI policies loans as per the requirements of your businesses. If your requirement doesn't fall into the ordinary and usual category, Small Industries Development Bank of India would assist funding you in the right way.

2. Dedicated Size

Credit and loans are modified as per the size of the business. So, MSMEs could avail different types of loans custom-made for suiting their business requirement.

3. Attractive Interest Rates

It has a tie-up with several banks and financial institutions world over and could offer concessional interest rates. The SIDBI has tie-ups with World Bank and the Japan International Cooperation Agency.

4. Assistance

It not just give provides a loan, it also offers assistance and much-required advice. It's relationship managers assist entrepreneurs in making the right decisions and offering assistance till loan process ends.

5. Security Free

Businesspersons could get up to INR 100 lakhs without providing security.

6. Capital Growth

Without tempering the ownership of a company, the entrepreneurs could acquire adequate capital for meeting their growth requirements.

7. Equity and Venture Funding

It has a subsidiary known as SIDBI Venture Capital Limited which is wholly owned that offers growth capital as equity through the venture capital funds which focusses on MSMEs.

8. Subsidies

SIDBI offers various schemes which have concessional interest rates and comfortable terms. SIDBI has an in-depth knowledge and a wider understanding of schemes and loans available and could help enterprises in making the best decision for their businesses.

9. Transparency

Its processes and the rate structure are transparent. There aren't any hidden charges.

EXPORT AND IMPORT BANK OF INDIA (EXIM)

The Export and Import Bank of India, popularly known as the EXIM Bank was set up in 1982. It is the principal financial institution in India for foreign and international trade. It was previously a branch of the IDBI, but as the foreign trade sector grew, it was made into an independent body.

The management of the EXIM bank is done by a board, headed by the Managing Director. There are 17 other Directors on the board. The whole paid-up capital of the bank (100 crores currently) is subscribed by the Central Government exclusively.

Objectives of EXIM Bank:

1. To ensure and integrated and co-ordinated approach in solving the allied problems encountered by exporters in India.
2. To pay specific attention to the exports of capital goods;
3. Export projection;
4. To facilitate and encourage joint ventures and export of technical services and international and merchant banking;
5. To extend buyers' credit and lines of credit;
6. To tap domestic and foreign markets for resources for undertaking development and financial activities in the export sector.

Functions of the EXIM Bank

The main function of the Export and Import Bank of India is to provide financial and other assistance to importers and exporters of the country. And it oversees and coordinates the working of other institutions that work in the import-export sector. The ultimate aim is to promote foreign trade activities in the country.

1. Finances import and export of goods and services from India
2. It also finances the import and export of goods and services from countries other than India.
3. It finances the import or export of machines and machinery on lease or hires purchase basis as well.
4. Provides refinancing services to banks and other financial institutes for their financing of foreign trade
5. EXIM bank will also provide financial assistance to businesses joining a joint venture in a foreign country.
6. The bank also provides technical and other assistance to importers and exporters. Depending n the country of origin there are a lot of processes and procedures involved in the import-export of goods. The EXIM bank will provide guidance and assistance in administrative matters as well.
7. Undertakes functions of a merchant bank for the importer or exporter in transactions of foreign trade.
8. Will also underwrite shares/debentures/stocks/bonds of companies engaged in foreign trade.
9. Will offer short-term loans or lines of credit to foreign banks and governments.
10. EXIM bank can also provide business advisory services and expert knowledge to Indian exporters in respect of multi-funded projects in foreign countries

Importance of the EXIM Bank

Other than providing financial assistance, the Export and Import Bank of India bank is always looking for ways to promote the foreign trade sector in India. In the early 1990s, EXIM introduced a program in India known as the Clusters of Excellence.

The aim was to improve the quality standards of our imports and exports. It also has a tie-up with the European Bank for Reconstruction and Development. It has agreed to co-finance programs with them in eastern Europe.

In order to promote exports EXIM bank also has schemes such as production equipment finance program, export marketing finance, vendor development finance, etc.

SMALL INDUSTRIES DEVELOPMENT CORPORATION (SIDCO)

Small Industries Development Bank of India is an independent financial institution aimed to aid the growth and development of micro, small and medium scale enterprises (MSME) in India. Set up on April 2, 1990 through an act of parliament, it was incorporated initially as a wholly owned subsidiary of Industrial Development Bank of India. Currently the ownership is held by 34 Government of India owned / controlled institutions. Beginning as a refinancing agency to banks and state level financial institutions for their credit to small industries.

It has expanded its activities, including direct credit to the SME through 100 branches in all major industrial clusters in India. Besides, it has been playing the development role in several ways such as support to micro-finance institutions for capacity building and on lending. Recently it has opened seven branches christened as Micro Finance branches, aimed especially at dispensing loans up to 5 lakh.

Objectives of SIDBI

1. To promote marketing of products of small scale sector.
2. To upgrade technology and also undertaking modernization of small scale units.
3. To provide more financial assistance to small scale ancillary and tiny sector.
4. To encourage employment oriented industries.
5. To coordinate all the other institutions involved in the promotion of small scale

Functions of SIDBI

1. SIDBI refinances loans extended by the primary lending institutions to small scale industrial units, and also provides resources support to them.
2. SIDBI discounts and rediscounts bills arising from sale of machinery to or manufactured by industrial units in the small scale sector.
3. To expand the channels for marketing the products of Small Scale Industries (SSI) sector in domestic and international markets.
4. It provides services like leasing, factoring etc. to industrial concerns in the small scale sector.
5. To promote employment oriented industries especially in semi-urban areas to create more employment opportunities and thereby checking migration of people to urban areas.
6. To initiate steps for technological up-gradation and modernization of existing units.
7. SIDBI facilitates timely flow of credit for both term loans and working capital to SSI in collaboration with commercial banks.

8. SIDBI Co-Promotes state level venture funds in association with respective state government.
9. It grants direct assistance and refinance loans extended by primary lending institutions for financing exports of products manufactured by small scale units.

SMALL INDUSTRIES SERVICE INSTITUTES (SISIS)

Established in 1956 this institute—one in each State has been rendering very useful service to small scale industries. The assistance rendered by the institute and its extension centres in Tamilnadu may be listed as follows :

1. Technical Consultancy and Advisory Service: This relates to selector of profitable small enterprises, choice of appropriate machinery and equipment, appraisal of the technique of" manufacture, processing of raw materials, adoption of recognised standards of testing, quality performance of the small industry products and encouraging small units to participate in Governments stores Purchase Programme. The Institute explores the possibility of setting up small scale units to supply parts/components to large scale industries.

2. Common Facility Service: This includes supply of designs and drawings and provision of workshop facilities for the manufacture of dies, tools, jigs and fixtures and components.

3. Training Facilities: Training is provided to workers in basic trades in the workshops attached to this Institute and its extension centres, to increase their productivity and this helps to encourage development of small scale industries in rural areas.Training in various aspects of industrial and business management is also provided for the benefit of small industrialists. A training course in small industries entrepreneurship and management to young engineers with emphasis on the practical aspects of small industries management Is conducted. This has been Instrumental in creating a new class of qualified entrepreneurs.

4. Testing Facilities: Basic testing facilities (both physical and chemical) are provided in the laboratories and workshops attached to this institute at concessional rates.

5. Marketing Assistance: Economic information on the nature and extent of the market for specific products is collected and furnished to small industrialists at their request. The institute offers export promotion service by counseling on export procedures and trends in foreign markets. Market survey for specific products of small enterprises is also undertaken on a regional basis to enable a small industrialist to increase the sales of his products in the region.

The special information bureau, called the Tamilnadu Sub Contract Exchange, is a Central Information Centre where machine capacities of small scale industries are registered and enquiries from large industries for the manufacture of different components are passed on to registered small scale units having spare capacity, so as to enable them to feed the requirements of large scale units. The institute conducts economic surveys of particular areas to ascertain their industrial potential.

NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT (NABARD).

After independence, in order to improve rural credit, the government and Reserve Bank of India decided to set up a committee which would take up a study of agricultural credit in India. This committee was called All India Rural Credit Survey Committee. It was headed by Mr.Gorewalla. The committee's recommendations were

accepted by RBI and were implemented. Accordingly, RBI has started two major funds for providing loans to State Governments and also to cooperate banks. The role of RBI in agricultural credit was appreciated.

With the increasing role of RBI, it was found too difficult to concentrate on agricultural finance. Even the institution such as Agricultural Refinance Corporation could not provide the required amount of refinance. A decision was taken to delink agricultural finance from RBI and to set up a separate institution to provide agricultural finance. In 1981, a Committee to Review Arrangement For Institutional Credit for Agriculture and Rural Development (CRAFICARD) was set up under the chairmanship of Mr.Sivaraman. The recommendation of the CRAFICARD committee was accepted and NABARD came into existence on July 12, 1982.

Objectives of NABARD

The main objects of NABARD are as follows:

1. NABARD provides refinance assistance for agriculture, promoting rural development activities. It also provides all necessary finance and assistance to small scale industries.
3. NABARD in coordination with the State Governments, provides agriculture.
4. It improves small and minor irrigation by way of promoting agricultural activities.
5. It undertakes R&D in agriculture, rural industries.

Main functions of NABARD:

1. NABARD provides refinancing facilities to Commercial banks, State co-operative banks, Central Co-operative banks, Regional rural banks and Land Development banks.
2. It provides refinancing to agriculture, small scale industries and other village and cottage industries by lending to commercial banks.
3. It promotes rural industries, small scale and cottage industries including tiny sectors by providing loans to commercial and co-operative banks.
4. Special assistance is given by the bank for the promotion of small scale, cottage and village industries under service area approach.
5. The bills of commercial and co-operative banks are discounted to enable them to finance for agricultural operations.
6. The bank provides funds to State governments for undertaking developmental and promotional activities in rural areas. In order to promote rural development and to help the weaker sections, the bank refinances especially regional rural banks which are set up in backward areas in most of the States.
7. Towards long-term loan, the bank is providing loans to institutions involved in long-term agricultural loan against guarantee of State government.
8. The bank is also financing research and development of agricultural and rural industries.
9. The bank implements the policy of the Central Government and the RBI with regard to agricultural credit.
10. Provides finance for promoting non-form activities and employment in non-farm sectors for the purpose of reducing rural unemployment.
11. It strengthens the co-operative structure in the States by providing loans to both State co-operative banks and also to Land Development Banks.
12.It promotes minor irrigation projects by financing State Government's sponsored irrigation projects.

13. The bank is undertaking inspection work of Co-operative banks and Regional rural banks.
14. The bank has opened branches at all District headquarters by which it co-ordinates the District development programmes along with the district officials.
15. The bank also helps in the annual credit plan of the commercial banks and co-ordinates the activities of commercial and co-operative banks at the district level.
16. During natural calamities, such as droughts, crop failure and floods, the bank helps by refinancing commercial and cooperative banks so that the farmers tide over their difficult period.
Thus, the bank is providing short-term, medium term and long-term loans for agriculture and rural development.

Role of NABARD:

1. It is an apex institution which has power to deal with all matters concerning policy, planning as well as operations in giving credit for agriculture and other economic activities in the rural areas.
2. It is a refinancing agency for those institutions that provide investment and production credit for promoting the several developmental programs for rural development.
3. It is improving the absorptive capacity of the credit delivery system in India, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, and training of personnel.
4. It co-ordinates the rural credit financing activities of all sorts of institutions engaged in developmental work at the field level while maintaining liaison with Government of India, and State Governments, and also RBI and other national level institutions that are concerned with policy formulation.
5. It prepares rural credit plans, annually, for all districts in the country.
6. It also promotes research in rural banking, and the field of agriculture and rural development.

Some of the milestones in NABARD's activities are:

Business Operations:

1. **Production Credit:** NABARD sanctioned aggregating of 66,418 crore short term loans to Cooperative Banks and Regional Rural Banks (RRBs) during 2012-13, against which, the maximum outstanding was 65,176 crore.
2. **Investment Credit:** Investment Credit for capital formation in agriculture & allied sectors, non-farm sector activities and services sector to commercial banks, RRBs and co-operative banks reached a level of 17,674.29 crore as on 31 March 2013 registering an increase of 14.6 per cent, over the previous year.
3. **Rural Infrastructure Development Fund (RIDF)**

Through the Rural Infrastructure Development Fund (RIDF) 16,292.26 crore was disbursed during 2012-13. A cumulative amount of 1,62,083 crore has been sanctioned for 5.08 lakh projects as on 31 March 2013 covering irrigation, rural roads and bridges, health and education, soil conservation, drinking water schemes, flood protection, forest management etc.

New Business Initiatives:

1. **NABARD Infrastructure Development Assistance (NIDA):**

NABARD has set up NIDA, a new line of credit support for funding of rural infrastructure projects. The sanctions under NIDA during the year 2012-13 was 2,818.46 crore and disbursement was 859.70 crore.

2. **Direct refinance assistance to CCBs for short term multipurpose credit:**

Direct refinance assistance to CCBs was conceived and additional line of finance for CCBs in the light of recommendations of the "Task Force on Revival of Short Term Rural Cooperative Credit Structutre, which enables the latter to raise financial resources other than from StCBs. During 2012-13, refinance assistance aggregating 3,385 crore was sanctioned to 42 CCBs and disbursement stood at 2,363.45 crore.

Now it can be conclude that the Agricultural & rural development is totally dependent on the efficiency of the NABARD, which is doing its job as per the requirements of the economy.

OPERATIONAL AND PROMOTIONAL ACTIVITIES OF DEVELOPMENT BANKS:

The pace of development cannot be accelerated by providing financial assistance alone. There are factors which inhibit industrialization of an underdeveloped country. It is essential to make a correct diagnosis of those factors and plan things accordingly. The growth potential of different areas, the availability of natural resources, demand conditions, infrastructure facilities, etc. should be taken into account before deciding the pattern of industrialization of various places. The task of identification of growth potentialities and preparation of feasibility studies is not an easy task.

It requires huge finances and technical expertise which is beyond the competence of entrepreneurs of under-developed countries. It is in this area where development banks can play crucial role. In addition to providing the traditional role of providing financial assistance, development banks in India are undertaking promotional role also. Some of the areas where these banks are participating are:

(1) Surveys of Backward Areas

Under the Industrial Development Bank of India, development institutions conducted industrial potential surveys in June, 1970 with a view to identify specific project ideas for implementation in those areas. These surveys studied the availability of resources, demand potential and availability of infrastructures facilities. In 1982, Government of India identified 83 districts in the country where no medium or large scale industrial units existed. IOBI jointly with IFCI and ICICI launched a programme for identifying industrial opportunities and needs for. These project ideas were further screened and developed for arriving at some firm decision about their implementation. IDBI conducted feasibility studies and cleared projects for implementation.

(2) Inter-Institutional Groups (IIG's)

With a view to provide a forum to the national and state financial institutions, IDBI constituted 23 IIG's in various states and union territories These groups aimed to help accelerate the process of industrial development in a state with particular emphasis on less developed areas, An attempt was also made to evolve suitable strategies for industrial development within the framework of national and state policies and local requirements. IDBI has been constantly reviewing the functioning of these groups so as to evolve suitable measures for malting them effective.

(3) Establishing Technical Consultancy Organizations (TCO's)

There is a need for technical consultancy at the time of selling up a new unit and at the time of making change like modernization, expansion, diversification, etc. The small and medium scale units cannot pay high fees of consultancy agencies. With a view to help these entrepreneurs, financial institutions set up 17 consultancy organization for providing consultancy at nominal rates. These organizations provide consultancy services to small and medium entrepreneurs, commercial banks, state-level financial institutions and other agencies engaged in industrial promotion and development. The consultancy services covered so far include market surveys, preparation of feasibility and project reports, entrepreneur ship development programmes, diagnostic studies and rehabilitation schemes for sick units, services for implementing projects on turn-key basis. TCO's have been giving thrust to modernization small and medium scale sectors also. In this respect they have undertaken in depth studies of specific sub- sectors of small scale industry so as to identify their modernization needs and prepare modernization programmes.

(4) Entrepreneurial Development Programmes (EDP's)

Industrial development of a country is directly influenced by the quality of entrepreneurs it has produced, with a view to impart requisite training to entrepreneurs. IDBI has been encouraging entrepreneurial development programmes. It has mainly used the agency of TCO's for drawing up and conducting these programmes to cater to the needs of entrepreneurs from small and medium scale sectors. IDBI meets up to 50 per cent of the cost of such programmes and the balance cost is met by state governments or other sponsoring institutions.

Development banks have also been trying to strengthen the infrastructure for conducting entrepreneurial development programmes. The main thrust has been to institutionalize entrepreneurship activities, generating, sharpening and sharing knowledge through research documentation and publication, developing a cadre of professionals. A major step in this area was the setting up of Entrepreneurship Development Institute of India, Ahmedabad in 1983. The objective of this institution was to train EPP trainers, providing resource inputs running model development programmes, conducting.

(5) Technological Improvements

Development banks, especially IDBI have been helping small and medium sectors in developing and upgrading of their technology so that they arc able to match the pace of development. These banks also encourage entrepreneurs to adopt sophisticated technology with the help of academic and research institutes and also to encourage entrepreneurship among science and technology graduates. Development banks have done a good job in promoting industrial activities in various parts of the country. The development of backward areas is a gigantic task in India.

Private entrepreneurs cannot measure to this task of their own. So development banks are expected to play an important role in this regard. These banks should help in setting up new projects by associating private entrepreneurs so that their management is left to them. After a particular stage of a project the development institutions should transfer the responsibility to private sector and same resource should be used to develop more units. Development banks, in co-operation with private sector, can certainly help in accelerating the pace of industrial development.

UTI – UNIT TRUST OF INDIA

Unit Trust of India was first Set up in 1st February 1964 under the Unit Trust of India Act, 1963. It is a statutory public sector investment institution having the main objective to encourage and mobilize the savings of the community and canalize them into productive corporate investment.

A unit trust is an investment plan in which the funds are pooled together and then invested. The fund which is pooled is then unitized and the investor who is one party to the unit trust is called a unitholder, holding a certain number of units.

A second party i.e the manager is responsible for the day-to-day running of the trust and for investing the funds.

The trustee, governed by the Trust Companies Act 1967, is the third party, and their role is to monitor the manager's performance against the trust's deed.

The deed outlines the objectives and vital information about the trust. Also, the assets of the trust are held in the name of the trustee and then they are held "in trust" for the unitholders.

Objectives of Unit Trust of India (UTI)

Unit Trust of India Provides to the investor a safe return of the investment whenever they require funds. UTI provides daily price record and advertises it in the newspapers.

Thus, two prices are quoted on a daily basis, the purchase price and the sale price of the units. This price may fluctuate daily, but the fluctuations are nominal on a monthly basis.

The price varies between the month of July and the month of June. The purchase price of the various units is the lowest in the month of July.

An investor who wants to make an investment may purchase his units at this time of the year and receive the lowest offer price for the units.

The basic objective of the UTI is to offer both small and large investors the means of acquiring shares in the properties resulting from the steady, industrial growth of the country.

Primary Objectives of UTI

- to promote and pool the small savings from the lower and middle-income persons who cannot have direct access to the stock exchange, and
- to provide them with an opportunity to share the benefits of prosperity resulting from rapid industrialization in India.

Functions of UTI

- Mobilize the saving of the relatively small investors.
- Channelize these small savings into productive investments.
- Distribute the large scale economies among small income groups.
- Encourage savings of lower and middle-class people.
- Sell nits to investors in different parts of the country.
- Convert the small savings into industrial finance.
- To give investors an opportunity to share the benefits and fruits of industrialization in the country.
- Provide liquidity to units.
- Accept discount, purchase or sell bills of exchange, warehouse receipt, documents of title to goods etc.,
- To grant loans and advances to investors.

- To provide merchant banking and investment advisory service to investors.
- Provide leasing and hire purchase business.
- To extend portfolio management service to persons residing in other countries.
- To buy or sell or deal in foreign currency.
- Formulate a unit scheme or insurance plan in association with GIC.
- Invest in any security floated by the RBI or foreign bank.

Advantages of a UTI

- The investment is safe and divides the risk over a wide range of securities.
- The investors will be getting a regular and good income, as it distributes 90 percent of its income.
- Dividends up to Rs. 1,000 received by the individual investors are exempt from income-tax.
- There is a high degree of liquidity of investment as one can sell the units back to the trust at any time at a specific price.
- You have experts who are doing the hard work for you.
- There are various unit trusts to choose from.
- Investor’s resources are pooled with other investors, allowing you to make investments impossible as an individual investor.
- It also helps Investor’s to easily diversify your investments.
- An investor gets the benefits of greater economies of scale, such as reduced transaction costs.

UNIT V:

State Level Development Banks: Objectives, functions and role of state level banks; State financial corporations; Development banks in industrial financing.

STATE LEVEL DEVELOPMENT BANKS:

An outstanding financial development of the post-independence period has been the rapid growth of development banks in the country. These banks are specialised financial institutions which perform the twin functions of providing medium and long-term finance to private entrepreneurs and of performing various promotional roles conducive to economic development.

As the name clearly suggests, they are development-oriented banks. As banks, they provide finance. But they are unlike ordinary commercial banks in three ways.

- First, they do not seek or accept deposits from the public as ordinary banks do.
- Second, they specialize in providing medium-and long- term finance, whereas commercial banks have specialized in the provision of short-term finance.
- Third and most important, they are not mere purveyors of long-term finance like any ordinary term- lending institution.

As development banks (with emphasis on the word ‘development’) their chief distinguishing role is the promotion-of economic development by way of promoting investment and enterprise (the two most scarce inputs in LDCs) in their chosen (or allotted) spheres, whether manufacturing, agriculture, or some other.

This promotional role may take a variety of forms, like provision of risk capital, underwriting of new issues, arranging for foreign (exchange) loans, identification of investment projects, preparation and evaluation of project reports, provision of technical advice, market information about both domestic and export markets, and management services.

How much of these services a development bank is in a position to render depends upon the technical expertise it has been able to build up, the competence of its staff and their experience. The Indian development banks have as yet not developed so much as to be able to provide a whole gamut of development services. But their contribution in the channeling of finance has been sizeable and large-scale industry in the private sector has been the main beneficiary.

Objectives of State level Development Banks:

1. To Promote Industrial Growth,
2. To Develop Backward Areas,
3. To Create More Employment Opportunities,
4. To Generate More Exports and Encourage Import Substitution,
5. To Encourage Modernisation and Improvement In Technology,
6. To Promote More Self Employment Projects,
7. To Revive Sick Units,
8. To Improve The Management Of Large Industries by Providing Training,
9. To Remove Regional Disparities Or Regional Imbalance,
10. To Promote Science and Technology In New Areas by Providing Risk Capital,
11. To Improve Capital Market In the Country.

The financial assistance to industry is given in the following four main forms:

(i) Term loans and advances,
(ii) Subscription to shares and debentures,
(iii) Underwriting of new issues, and
(iv) Guarantees for term loans and deferred payments.

The first two forms place funds directly in the hands of companies as subscriptions to shares and debentures are subscriptions to new issues. The last two forms facilitate the raising of funds from other sources. For attracting risk capital into the industry, such underwriting of shares by development banks is at least as important as the direct subscription to these shares.

Guarantees from development banks assure creditors (banks and others) that their credit to industry whether in the form of loans or deferred payments is secured. For development banks, it only involves 'contingent liabilities,' that is liabilities which become payable only when the underlying agreements are not fulfilled. Therefore, such liabilities do not lock up funds of development banks, but are instrumental in attracting funds from other sources.

The development banks in India are a post-independence phenomenon (except the land development banks). Their structure is indicated in Figure 8.1. Some of them are for promoting industrial development; some for the development of agriculture; and one for foreign trade. Some are all-India institutions; others are state or lower level institutions.

At present, at the all-India level, there are five industrial development banks, one agricultural development bank and one export-import bank. The development banks for the industry are the Industrial Development Bank of India (IDBI), the Industrial Finance Corporation of India (IFCI), the Industrial Credit and Investment Corporation of India (ICICI), and the Industrial Reconstruction Corporation of India (IRCI) for large industries and the National Small Industries Development Bank of India (SIDBI) for small-scale industries. For agriculture, it is the National Bank for Agriculture and Rural Development (NABARD).

The National Industrial Development Corporation (NIDC), which was set up by the Government of India in 1954 for the promotion and development of industries, had also provided some finance till 1963. But since then it has been acting as only a consulting agency.

The "state level industrial development banks are the State Financial Corporation's (SFCs), the State Industrial Development Corporation (SIDCs) and the State Industrial Investment Corporations (SIICs). For promoting agricultural development, there are main district-level banks, called land development banks. The present article is devoted to a discussion of these several development banks.

RESOURCES OF SFCs/SIDCs & REFINANCE FROM IDBI/SIDBI

SFCs/SIDCs do not generally have large resources to meet the growing demand of industry within their regions. They raise resources by issue of share capital, issue of bonds and debenture guaranteed by State Governments. Additional resource are raised by accepting deposits from public and by borrowings from State Governments

Other main resource available to these state level institutions is refinance from Industrial Development Bank of India/Small Industries Development Bank of India.

Liberal refinance facilities ranging from 75% to 100% of the loans granted by these institutions to various borrowers under different schemes are available. The funds thus available from IDBI/SIDBI help these institutions to play an effective development role in promoting industries within their regions.

Small Industrial Development Bank of India provides refinance under two different schemes knowing as normal scheme and automatic refinance scheme. Automatic refinance scheme is applicable to loans granted for smaller projects and for composite loans to SC/ST and physically handicapped entrepreneurs etc. Individual approval of each project under the automatic scheme is not required. Under the normal scheme, each project is required to he approved from SIDBI for availing refinance.

IDBI/SIDBI have set out guidelines for these institutions under different schemes and SFCs/SIDCs have to disburse the facilities to the borrowers of the terms and conditions as stipulated in these guidelines. These guideline are, however, quite flexible and allow almost a free hand to these state level institutions to deal with their customers.

An important point, however, be noted here that the intending borrower have to deal only with primary lending institutions who will be completing the detailed appraisal of the project and sanctioning financial assistance for the project. These institutions will be then taking up the matter of refinance from IDBI/SIDBI on their own. It, therefore, does not make any difference, a least operationally, to the borrowers whether refinance against a particular project is obtained by the lending institution(s) or not.

SFCs and SIDCs confine their activities in promoting the industrial projects in small-scale and medium-scale sectors and projects costing up to Rs. 10 crore can normally be financed by these institutions. Projects where cost exceeds Rs. 10 crore are required to approach all India institutions for financial assistance.

The term loans sanctioned by SFCs were restricted to Rs. 90 lacs previously but now the assistance has been enhanced. In the case of Limited Companies, either Private or Public, SFCs can assist in the form of Term Loans upto Rs 240 lacs while in the case of proprietary concerns o partnership concerns, the limit is Rs. 120 lacs.

State Financial Corporations :

State Financial Corporations were established in the States under the Central Act, viz.. The State Financial Corporations Act, 1951, with the basic objective of promoting and developing small scale industries in the respective states with a special focus on spreading industrial culture in the rural, semi-urban and backward areas of the States. These corporations are owned by the respective state governments jointly with IDBI and they are functioning under the administrative control of the state governments. The Chairman and Managing Directors of these corporations are senior IAS officers appointed by the state governments in consultation with IDBI. The Board of Directors of SFCs is highly professional in character and consists of senior executives of the state governments, a representative each from RBI. IDBI and SIDBI, besides other interests like Co-operatives, Life Insurance, entrepreneurs are also represented on the Board. They are employing highly professional and technical personnel to carry on the business operations such as M.B.As.., C.As., engineers, marketing experts, etc. These corporations have opened a number of regional offices in the states to cater to the requirements of the entrepreneurs . SFCs provide term loan to small and medium scale industries for creation of assets, viz., land, building and machinery. They also provide

working capital term-loan to the industrial units on competitive terms. Various non fund based services like merchant banking, under-writing of public issues, project counselling, bill discounting, leasing and hire purchase are also been undertaken by them. They are operating a number of financial assistance schemes for the benefit of the entrepreneurs such as assistance for marketing activities, equipment finance, special schemes for assistance to ex-servicemen, single window scheme, etc. SFCs provide maximum loan upto Rs. 240 lakhs. The interest on loan ranges between 13.75% to 16.5% depending upon the size of the loan and its term.

State Industrial Development Corporations :

The State Industrial Development Corporations were set up under the Companies Act, 1956, as wholly owned state government undertakings for promotion and development of medium and large industries. In addition to provision of financial assistance, they are also involved in developing industrial infrastructure like industrial estates, industrial parks and setting up industrial projects either on their own or in the joint sector in collaboration with private entrepreneurs or as wholly owned subsidiaries. SIDCs exist in all the States and have developed industrial infrastructure facilities to enable prospective entrepreneurs to set up their industries in the states. These corporations render technical assistance to the entrepreneurs in the formulation of the project reports and also provide common facilities in the industrial estates. These corporations provide loans and advances to the industrial units in the medium and large sectors to the maximum of Rs. 400 lakhs. The interest rate ranges between 13.5% to 17% depending upon the size of the loan.

State Industrial Infrastructure and Investment Corporations :

The State Industrial Infrastructure and Investment Corporations have also been set up under the Companies Act under the overall control of the State Governments to develop industrial infrastructure in the States. As on date, only 10 such corporations have been set up in the States of Andhra Pradesh, Gujarat, Maharashtra, Orissa, Tamil Nadu, Uttar Pradesh, Delhi and Goa. These corporations are primarily engaged in developing infrastructure, which has been identified as the major thrust area for taking the country on the path of the economic growth. The infrastructure projects undertaken by these corporations include developing industrial growth centres, export promotion zones, software parks, industrial townships, industrial parks, as also industrial estates. To a large extent, these corporations are supplementing the efforts of State Industrial Development Corporations in so far as development of industrial infrastructure in the states is concerned.

INDUSTRIAL DEVELOPMENT

Industrial development is the building and growing of industries within an economy. These industries include mass production, technological advances, and other services. When an area or economy is industrialized it experiences an increased standard of living, job growth, and more productivity as it sustains growth. As productivity in an area increases, there is so much more opportunity.

Economic Growth

The economic growth provided by industrial development is a well-sustained growth that can transform an economy. Industrial growth and economic growth go hand in hand. Economies thrive when an industry is growing because a growth in the industry means more jobs, more money, and more opportunity. Industrial growth is often linked

with higher wages The production that industry provides buts more money and more services for the economy leading to higher income per capita and more labor productivity. The standard of living increases when industry increases. These opportunities can transform an area and inspire endless amounts of growth.

The Industrial Revolution

Historically, industrial growth has had a large impact on the economy. For example, the time period known as the Industrial Revolution in the 18th and 19th centuries led to some of the most important economic development known to man. The Industrial Revolution was a transition to new and more efficient manufacturing processes—leading to the cotton gin, the steam engine, electricity, the assembly line, and other important inventions that largely impacted the world. These advancements propelled the world forward as industrialization grew and resources advanced.

Prior to the Industrial Revolution, the manufacturing of goods was mostly done in people's homes with handcrafted tools. Though this made lead to unique items being made, it does not profit the economy much. When that production was shifted into mass production in factories, everything changed. Suddenly goods were more accessible, work was easier to find, and demand for products and services rose—all of these things sustain an economy. The world saw improvement in many ways, including job creation, more manufactured goods, advancement in transportation, communication, and living standards for some.

Why It's Still Important

As it has in the past, industrial development provides endless opportunity for an area. We live in a world that is always advancing—the technological age. This is really a growth in industry and provides a chance for even more growth. These changes in the industry are exciting as they open many doors and the window of opportunity. Progress is propelled by industrial development. A higher demand by consumers creates more products and services.

Industrial growth is not just a thing of the past. It is as relevant today as it ever was. As a population grows and industry develops there is an increased demand for goods and services, there is more innovation and more financial opportunity. We all profit as a community thrives through industrialization.

DEVELOPMENT BANKS AND INDUSTRIAL DEVELOPMENT:

The Industrial Development Bank of India (IDBI) is the premier institution in India purveying financial assistance to the industrial-sector projects. Its annual lending amounts to $6 billion. Recognizing the need to increase lending for energy efficiency and environmental management (ee/em) projects, the Asian Development Bank (ADB) provided a $150 million line of credit to IDBI. These funds were lent to cement, steel, paper, sugar and other industries. Accompanying the line of credit, ADB also provided funds for technical assistance to strengthen IDBI's capability for the assessment of projects related to energy efficiency and environmental management (ee/em).

The technical assistance (TA) focused on IDBI's institutional capability, the procedures it follows for lending in this area, studies of ten energy-intensive sectors, and training and data needs to improve its lending. The findings of the TA reveal a need to (1) use ee/em indicators during IDBI's appraisal, approval, and monitoring of projects, (2) increase the ee/em information resource base – in-house and out-house ee/em

experts, handbooks, computerized data bases – that IDBI staff can access, and (3) increase awareness of ee/em components among industrial borrowers. The sector studies show that there is at least a 20% lag compared to best practice for energy use, and that a significant potential, $1.0 billion, exists for investment in ee/em activities. These activities include (a) housekeeping measures such as improved lighting, variable-speed motors/drives, improving power factor, etc., (b) installing co-generation and captive power generation units, and (c) changing manufacturing processes to more efficient and less polluting ones. Training and data needs were also identified which would improve IDBI's lending for energy efficiency and environmental management.

Beginning in 1955, several financial institutions (Development Finance Institutions (DFIs) were established to provide funds to the large medium and small industry in India. The DFIs provide finance for the establishment of new industrial projects as well as for expansion, diversification, and modernization of existing industrial enterprises. In 1997-98, the Industrial Development Bank of India (IDBI) and the Industrial Credit and Investment Corporation of India (ICICI), the two largest DFIs, for instance, provided $12 billion worth of financing. In recent years, DFIs have been active in managing and lending for energy efficiency and environmental projects. Because of their role in lending for industrial institutions, the DFIs are in a position to transform the market for industrial energy efficiency and environmental pollution control activities.

We evaluated this potential role for IDBI in lending for energy efficiency and environmental pollution control activities. The Asian Development Bank (ADB) had provided IDBI a $1501 million loan for the Industrial Energy Efficiency Project (IEEP) at the request of the Government of India (GOI) to improve energy efficiency in the modernization and expansion of industry. The primary energy efficiency criteria for the selection of industrial projects were that the modernized or expanded plant show at a minimum an energy efficiency improvement of 18%. In addition, a technical assistance (TA) project accompanied this line of credit to IDBI. This TA project formed the basis for our evaluation

Sector Studies

The sector studies consumed bulk of the effort of this technical assistance. Ten industry sectors: chemicals (caustic soda), steel, fertilizers, cement, textiles, pulp and paper, aluminum, zinc, copper, and sugar were selected for study. Each sector report includes a description of the sector, technologies and processes used to manufacture the primary products in that sector, energy use in Indian plants and those in other countries, potential for reducing energy use and the associated cost, and environmental norms in that industry. Also included in each sector report is a list of suppliers for the equipment used in that industry, and a list of items that IDBI loan officers could check when appraising a loan for each sector, and information on the size of the market for energy efficiency and environmental management investments in each industry.

Production Capacity and Technology

India is a major producer of several energy intensive commodities. It ranks among the top five producers worldwide of aluminum, cement, steel, fertilizers, textiles, sugar, and paper. The demand for these products is growing faster than that worldwide because of the steady and relatively faster economic growth, and increased materialization of the Indian economy. The construction sector, which constitutes a major demand for products such as steel, cement, aluminum, etc., has grown faster

than the rest of the Indian economy and as infrastructure expansion is targeted by the Indian government; demand for these products is likely to increase in future. The quality of the technology being used to produce these products varies across sectors, but a few common features are worth observing in this context. We report on the findings for the aluminum, cement, steel, fertilizers, and caustic soda sectors.

IDBI Lending Process, Institutional Structure, Training, Information and Data Needs

IDBI was established in 1964 under an Act of Parliament for providing credit and other facilities for the development of industry. It also acts as the principal financial institution for coordinating the activities of institutions engaged in the finance, promotion, or development of industry. The Government of India's shareholding in IDBI amounts to 72%, and the rest of the shares are owned by the general public.

Institutional Structure

IDBI is governed by a Board of Directors and its operation is carried out under the supervision of the Chairman and Managing Director assisted by four Executive Directors and one Adviser. With its head office in Mumbai, IDBI has 43 additional offices throughout India. As of November 1998, IDBI was structured into 33 departments, which are organized into five groups to facilitate proper distribution of responsibility.

Project appraisal department.

The Project Appraisal Department (PAD) appraises all the industrial project proposals. PAD projects constitute the majority of projects sanctioned by IDBI in terms of value. Besides a number of smaller projects are funded at the branch level.

Corporate finance departments.

The three Corporate Finance Departments (CFDs) follow up on the projects that have already been sanctioned, in order to ensure their timely implementation and proper utilization of funds. In addition, a new concept of a Relationship Manager was instituted within the CFDs. These managers will be dedicated to manage IDBI's interactions with a major industrial (ownership) group, such as Reliance Industries, the Tata Group, etc.

Forex services and treasury departments.

The Treasury and Funding Division contracts, decides on utilization and monitors all lines of credit from multi-lateral institutions like the World Bank (WB) and the Asian Development Bank (ADB). It manages the various specialized loans and grants for energy and environmental technology projects, including this TA project

Organizational Structure

IDBI's organization structure is driven by its business objectives of offering the best services to the major industry groups. At the same time it is so organised to have industry specialists in important industrial sub-sectors as well. The organisational structure is geared to provide the best products and services in the present competitive environment while simultaneously attempting to meet its developmental role governed by "issue-based" lending. Following financial sector liberalisation, the environment has turned highly competitive compelling IDBI to organise itself in a manner to prioritise the objective of offering the best services to the major industry groups over focus exclusively for energy efficiency and environmental activities. There is a need to create a "home or center" for energy and environmental technical activities.

Energy efficiency indicators.

It is important from the viewpoint of ensuring effectiveness of investments made in energy efficiency and environmental management loans that there should be an assessment of the cost-effective potential for improving energy efficiency. This assessment needs to be conducted at the time of evaluating the loan application (ex-ante), as well as subsequently as the project is implemented.

Macroeconomic Conditions

These barriers pervade the Indian economy and affect the overall productivity of Indian industry. They inhibit energy efficiency improvements indirectly by maintaining conditions in which investments in energy efficiency are ignored, under-valued, or considered too risky by economic actors. The barriers include (1) low-level of competition among firms resulting from regulation of the domestic market and/or policies that constrain entry of imported products into the market, (2) high tariffs on imported goods, (3) low level of capital market development, and (4) high rate of inflation.

Energy Pricing

Energy pricing may not reflect the cost of supply that is borne by the supplier due to lack of marginal cost pricing or time-of-day pricing or the presence of price subsidies (which may involve cross-subsidies from one customer class to another, and/or subsidies from the government budget). In India, electricity price to agricultural customers is subsidized. The industrial sector, however, has paid a price above the average tariff, e.g. 70% above the average tariff, in 1994-95.

Institutional Weaknesses

Some industrial sectors have research organizations devoted to developing new technologies and improving productivity in Indian industry. Some of these play an important role in helping industry establish benchmarks and standards for energy efficiency. The textile research associations in India, ATIRA, BTRA, SITRA, and NITRA have established norms for thermal energy use by machine and plant type. Similar efforts are needed for other industries where many small firms dominate the industry, as in the case of paper mills.