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Role of Specialised Financial Institutions

20.1 Introduction

In the previous lesson you have learnt that companies raise long-term and medium-term finance by issuing shares and debentures. Specialised financial institutions are also an important source of such finance. In this lesson, we shall discuss the role and functions of specialised financial institutions.

20.2 Objectives

After studying this lesson, you will be able to :-

- explain the need for and importance of specialised financial institutions;
- identify the types of such institutions;
- describe the functions and objectives of Industrial Finance Corporation of India (IFCI) and State Financial Corporations (SFCs);
- discuss the role and objectives of Industrial Development Bank of India (IDBI);
- state the functions of IDBI;
- Recall the meaning of 'investment trust';

- discuss the objectives and function of Unit Trust of India (U.T.I.) ;
- Explain the objectives of Industrial Credit and Investment Corporation of India (ICICI) ;
- describe the functions of ICICI ;

20.3 Need for and importance of Specialised Financial Institutions (SFIs)

SFIs are institutions set up mainly by the government for providing medium and long-term financial assistance to industry. As these institutions provide developmental finance, that is, finance for investment in fixed assets, they are also known as 'development banks' or 'development financial institutions'. These institutions receive funds for their financing operations primarily from the government or other public institutions. These institutions also raise funds from the capital market.

Need for SFIs

The need for establishing SFIs arose mainly because of the following reasons:-

1. It was difficult for industry in general to procure sufficient long-term funds in the capital markets. There were no other institutions to supply long-term finance to industry. Traditionally, only short term finance could be availed from commercial banks. SFIs were established to ensure that industry get sufficient long-term funds and in the desired sectors in accordance with planned priorities.

2. Certain particular sections of the industry faced greater difficulties than others in procuring long-term finance. These included (a) Small and medium sized concerns, (b) new concerns set up by new entrepreneurial groups, (c) specific industries, such as cotton and jute, which required funds for modernisation, (d) concerns involved in innovation and new technological developments, (e) concerns requiring extra-ordinarily large amounts of finance with a long gestation period, (f) concerns in backward regions. SFIs were established to meet the long-term financial requirement of such concerns, on economic and social ground.

In general it can be said that the gap between the demand for and supply of industrial finance is sought to be filled through term loans by development financial institutions. Due to this role, they have been called gap-fillers.

Importance of SFIs

The importance of SFIs may be attributed to the following:

1. They constitute an important source of long-term finance to industry. Over a period of time, there has been a steady growth in the number of industrial units assisted, and in the amount of loan sanctioned and distributed by SFIs.

2. SFIs have played an important role in the development of (a) Small scale industry, and (b) Projects in backward areas.

3. They have helped new and small entrepreneurs in setting up industry.

4. Through their operations involving underwriting of and direct subscription to the issue of shares and debentures, they have been important players in the capital market. These operations have a favourable impact on the ability of industrial concerns to raise funds from capital market.

5. These institutions have improved the allocation of funds to industry and thus, have aided in better use of the available resources for the economic development of the country.

6. SFIs have been a source of technical and managerial advice to the industry. They have also helped in identification, evaluation and execution of new investment projects.

7. These institutions have been helpful in the establishment of concerns which required extra-ordinarily large amounts of finance for their projects with a long gestation period.

20.4 Types of Specialised Financial Institutions

Specialised financial institutions may be divided into the following types:

(a) All India Development Banks

1. Industrial Development Bank of India (IDBI)

2. Small Industries Development Bank of India (SIDBI)
3. Industrial Finance Corporation of India (IFCI)
4. Industrial credit and Investment corporation of India (ICICI)
5. National Bank for Agriculture and Rural Development (NABARD)
6. Industrial Investment Bank of India Ltd. (previously, Industrial Reconstruction Bank of India)

(b) State-level Institutions

1. State Financial Corporations (SFCs)
2. State Industrial Development Corporations (SIDC)
3. State Industrial Investment Corporations (SIIC)

(c) Investment institutions

1. Unit Trust of India (UTI)
2. Life Insurance Corporation of India (LIC)
3. General Insurance Corporation (GIC)

20.5 Objectives and Functions of Industrial Finance Corporations of India (I.F.C.I.)

IFCI was established as a statutory corporation on 1st July 1948 by a special Act of Parliament, IFCI Act, 1948. It was converted into a public limited company on July 1, 1993. Its main object is to provide medium and long term credit to eligible industrial concerns in corporate sectors of the economy, particularly to those industries to which banking facilities are not available.

Objectives

The primary role of IFCI is to provide 'direct financial assistance' on medium and long term basis to industrial projects in the corporate and co-operative sectors. Over the years, the scope of activities of the corporation has widened. The objectives of the corporation are stated below.

(a) To provide long and medium-term credit to industrial concerns engaged in manufacturing, mining, shipping and electricity generation and distribution.

(b) The period of credit can be as long as 25 years and should not exceed that period;

(c) To grant credit to a single concern up to a maximum amount of rupees one crore. This limit can be exceeded with the permission of the government under certain circumstances;

(d) guarantee loans and deferred payments;

(e) underwrite and directly subscribe to shares and debentures issued by companies;

(f) assist in setting up new projects as well as in modernisation of existing industrial concerns in medium and large scale sector;

(g) assist projects under co-operatives and in backward areas.

Functions

The main functions of I.F.C.I. are as under:-

i) Granting loans and advances for the establishment, expansion, diversification and modernisation of industries in corporate and co-operative sectors.

ii) Guaranteeing loans raised by industrial concerns in the capital market, both in rupees and foreign currencies.

iii) Subscribing or underwriting the issue of shares and debentures by industries. Such investment can be held up to 7 years.

iv) Guaranteeing credit purchase of capital goods, imported as well as purchased within the country.

v) Providing assistance, under the soft loans scheme, to selected industries such as cement, cotton textiles, jute, engineering goods, etc.

vi) Providing technical, legal, marketing and administrative assistance to any industrial concern for the promotion, management and expansion of the industrial concern.

vii) Providing equipment (imported or indigeneous) to the existing industrial concerns on lease under its 'equipment leasing scheme'.

viii) Procuring and reselling equipment to eligible existing industrial concerns in corporate or co-operative sectors.

ix) Rendering merchant banking services to industrial concerns.

In 1995-96, 67% of the total financial assistance distributed by IFCI was in the form of rupee term loans, while foreign currency loans accounted for approximately 17% of total financial assistance. Thus the two types of assistance accounted for a total of 84% of the total financial assistance by IFCI. The remaining 16% of financial assistance, was in the form of underwriting, direct subscription, guarantees and equipment leasing.

20.6 State Financial Corporations (SFCs)

Objectives and Functions

IFCI was established to cater to the financial needs of industrial concerns in large scale corporate and co-operative sectors. Small and medium sized enterprises were outside the purview of IFCI. To meet the financial needs of small and medium enterprises, the government of India passed the State Financial Corporation Act in 1951, empowering the State governments to establish development banks for their respective regions. Under the Act, SFCs have been established by State governments to meet the financial requirements of medium and small sized enterprises. There are 18 SFCs at present.

Objectives

The objectives of state financial corporations are as under:

(1) Provide financial assistance to small and medium industrial concerns. These may be from corporate or co-operative sectors as in case of IFCI or may be partnership, individual or joint hindu family business. Under SFCs Act, "industrial concern" means any concern engaged not only in the manufacture, preservation or processing of goods, but also mining, hotel industry, transport undertakings, generation or distribution of electricity, repairs and

maintenance of machinery, setting up or development of an industrial area or industrial estate, etc.

(2) Provide long and medium-term loan repayable ordinarily within a period not exceeding 20 years.

(3) Grant financial assistance to any single industrial concern under corporate or co-operative sector with an aggregate upper limit of rupees Sixty lakhs. In any other case (partnership, sole proprietorship or joint hindu family) the upper limit is rupees Thirty lakhs.

(4) Provide Financial assistance generally to those industrial concerns whose paid up share capital and free reserves do not exceed Rs. 3 crore.

(5) To lay special emphasis on the development of backward areas and small scale industries.

Functions of State Financial Corporation (SFCs)

The functions of SFCs include

(1) Grant of loans and advances to or subscribe to debentures of, industrial concerns repayable within a period not exceeding 20 years, with option of conversion into shares or stock of the industrial concern.

(2) Guaranteeing loans raised by industrial concerns which are repayable within a period not exceeding 20 years.

(3) Guaranteeing deferred payments due from an industrial concern for purchase of capital goods in India.

(4) Underwriting of the issue of stock, shares, bonds or debentures by industrial concerns.

(5) Subscribing to, or purchasing of, the stock, shares, bonds or debentures of an industrial concern subject to a maximum of 30 percent of the subscribed capital, or 30 percent of paid up share capital and free reserve, whichever is less.

(6) Act as agent of the Central government, State government, IDBI, IFCI or any other financial institution in the matter of grant of

loan or business of IDBI, IFCI or financial institution.

(7) Providing technical and administrative assistance to any industrial concern or any person for the promotion, management or expansion of any industry.

(8) Planning and assisting in the promotion and development of industries.

Intext Question 20.1

Which of the following statements are true and which are false ?

(i) Specialised financial institutions provide medium and long-term financial assistance to industry.

(ii) Small scale industries are not financed by any SFI.

(iii) IFCI can underwrite issue of shares but cannot subscribe to share issues.

(iv) Among other functions, IFCI also guarantees foreign currency loans.

(v) The maximum limit of credit which IFCI can sanction to a single concern is Rs 1 crore but it can be exceeded if permitted by government.

(vi) IFCI can grant long-term loans to industries in the co-operative sector.

(vii) To set up a transport undertaking a businessman can get financial assistance from the SFC of the concerned state.

(viii) SFCs can guarantee loans of industrial concerns which are repayable within not more than 10 years.

(ix) Loans granted by SFCs can be converted into shares of the industrial concern.

(x) Financial assistance cannot be granted by SFCs to any proprietary concern.

20.7 Industrial Development Bank of India (IDBI)

You have already read about the functions of IFCI and SFCs. These institutions along with ICICI (discussed in the next section) met the financial needs of different sectors of industry, showed a steady growth in their operations and contributed substantially to the industrial development of the economy. However need was felt for a central coordinating agency to be ultimately concerned with all problems relating to long and medium term financing of industry and to act as an apex industrial financing and developmental agency.

The Industrial Development Bank of India was set up in July 1964 as a wholly owned subsidiary of the Reserve Bank of India. The purpose was to enable the new institution to benefit from the financial support and experience of RBI. After a decade of its working, it was delinked from RBI in 1976, when its ownership was transferred to the Government of India. The purpose was to allow RBI to concentrate on its central banking function and allow IDBI to grow into a developmental agency.

After the public issue of equity shares and sale of a part of Government's shareholding in July 1995, Government's shareholding in IDBI has been reduced to 72.14%.

IDBI is now the principal financial institution for co-ordinating the working of institutions engaged in financing, promoting or developing industry, assisting the development of such institutions and providing credit and other facilities for the development of industry. Thus the role of IDBI may be stated as under:

(1) As an apex financial institution, it coordinates the working of other financial institutions.

(2) It assists in the development of other financial institutions.

(3) It provides credit to large industrial concerns directly.

(4) It undertakes other activities for the development of industry.

Objectives

The main objectives of IDBI is to serve as the apex institution for term finance for industry in India. Its objectives include-

(1) Co-ordination, regulation and supervision of the working of other financial institutions such as IFCI , ICICI, UTI, LIC, Commercial Banks and SFCs.

(2) Supplementing the resources of other financial institutions and thereby widening the scope of their assistance.

(3) Planning, promotion and development of key industries and diversifications of industrial growth.

(4) Devising and enforcing a system of industrial growth that conforms to national priorities.

Function

The IDBI has been established to perform the following functions-

(1) To grant loans and advances to IFCI, SFCs or any other financial institution by way of refinancing of loans granted by such institutions which are repayable within 25 year.

(2) To grant loans and advances to scheduled banks or state co-operative banks by way of refinancing of loans granted by such institutions which are repayable in 15 years.

(3) To grant loans and advances to IFCI, SFCs, other institutions, scheduled banks, state co-operative banks by way of refinancing of loans granted by such institution to industrial concerns for exports.

(4) To discount or rediscount bills of industrial concerns.

(5) To underwrite or to subscribe to shares or debentures of industrial concerns.

(6) To subscribe to or purchase stock, shares, bonds and debentures of other financial institutions.

(7) To grant line of credit or loans and advances to other financial institutions such as IFCI, SFCs, etc.

(8) To grant loans to any industrial concern.

(9) To guarantee deferred payment due from any industrial concern.

(10) To guarantee loans raised by industrial concerns in the market or from institutions.

(11) To provide consultancy and merchant banking services in or outside India.

(12) To provide technical, legal, marketing and administrative assistance to any industrial concern or person for promotion, management or expansion of any industry.

(13) Planning, promoting and developing industries to fill up gaps in the industrial structure in India.

(14) To act as trustee for the holders of debentures or other securities.

Subsidiaries

The following are the subsidiaries of IDBI.

(1) Small Industries Development Bank of India (SIDBI)

(2) IDBI Bank Ltd.

(3) IDBI Capital Market Services Ltd.

(4) IDBI Investment Management Company

Capital Structure and Operations

As on September 30,1996, the authorised Capital of IDBI was Rs.2000 crores. Issued, subscribed and paid up share capital was Rs.828.76 crores. Reserves were Rs.6309 crores. Loan funds were Rs.35450 crores. The total outstanding loans, investments and guarantee of IDBI stood at Rs.39,221 crore as on 31st March 1996.

Intext Question 20.2

Fill in the blanks with suitable words:

(i) IDBI serves as the _____________ institution for term finance to industries.

(ii) One of the functions of IDBI is to assist other financial institutions by ______________ of loans granted for exports.

(iii) The primary objective of IDBI is to __________, _________and ___________ the working of other financial institutions like IFCI, SFCs, UTI.

(iv) The IDBI can grant a _____________ or loans and advances to other financial institutions.

(v) The IDBI __________ and ____________ the shares and debentures of industrial concerns.

28.8 Investment Trusts

Meaning

Investment Trusts are investment institutions which are formed to provide to investors, particularly smaller ones having small savings, the benefits of diversified investment and skilled management in the sphere of investment in industrial securities.

These institutions sell their shares or units to small investors to mobilise their savings. These savings are invested in shares, debentures, bonds and loans of profit–making joint stock companies. The investments are diversified, that is, made in securities of a sufficiently large number of companies, generally from different industries, using professional management skills. This reduces the investment risk and ensures reasonable income from the investments. The trust receives income from investments by way of dividend on shares, interest on debentures, bonds and loans and profit on sale of securities. After meeting the management expenses, the income of the trust is distributed among the investors.

Thus the investment trusts, on the one hand, enable small investors to participate in the industrial prosperity of the country. and on the other hand, enable joint stock companies to obtain financial resources from wider sources.

Types of Investment Trusts

Investment trusts are basically of the following two types-

(1) 'Open-end' Investment Trusts

In U.K, such trusts are known as 'Unit Trust' while in USA, they are commonly known as 'Mutual funds'. The distinguishing characteristics of such trusts are -

(a) There is a definite arrangement under which the trust continuously offers to sell fresh shares or units at a price based on the net asset value of the underlying securities.

(b) There is also a definite arrangement under which the trust buys back its own shares or units at a price based on the net asset value of the underlying securities.

(c) The income of the trust is divided among the unitholders or shareholders of the trust after meeting management expenses.

(2) 'Closed-end' Investment Trusts

The distinguishing characteristics are as under -

(a) These Trusts do not continuously sell their shares or units;

(b) They also do not buy back their shares or units;

(c) The shares or units of the trust are listed on stock exchanges and can be bought and sold like shares of any other company;

(d) The market value of shares or units of these trusts depends upon the market forces of demand and supply;

(e) Such institutions can also raise loans to make investments;

(f) They may plough back a part of their profits.

20.9 Unit Trust of India (U.T.I)

The Unit Trust of India is a statutory public sector investment institution established under the Unit Trust of India Act, 1963. It began functioning on Ist July, 1964. It commenced its operations with an initial capital of Rs.5 crores contributed as follows -

Reserve Bank of India .... Rs.2.5 crore

Life Insurance Corporation .... Rs.75 Lakhs

State Bank of India .... Rs.75 Lakhs

Scheduled Banks and other

financial institutions .... Rs. 1 crore

With the amendment of the Public Financial Institutions Laws, the contribution made by RBI to the initial capital and the control exercised by it are vested in the IDBI with effect from 16th Feb.1976.

Nature of the Trust

The Unit Trust of India is an investment trust. It mobilises the savings of people through sale of units. The savings as collected are invested in the shares and debentures of profit-making companies. The income received by the trust by way of interest and dividend is passed on to the unit holders by way of dividend after meeting management expenses of the trust. The small savers get benefit by participating in the investment schemes of UTI and thus in the industrial prosperity of the country. Investment through UTI results in lower risk of loss and higher return on investments due to professional management by U.T.I.

What are units?

The total investment made by UTI in industrial securities (shares, debentures and bonds) is divided into smaller parts called 'units'. The Unit Trust of India sell units under different schemes and also buys back its own units at the purchase price fixed by it from time to time. Units have a face value of Rs.10 each.

Objectives

The main objectives of UTI are as under -

(i) To encourage savings of people belonging to middle and low income groups;

(ii) To mobilise savings from the small savers;

(iii) To channelise savings to industrial growth;

(iv) To allow investors to participate in the prosperity of the industries.

Functions

The main functions of UTI are as follows -

(i) To mobilise the savings of the community through sale of units;

(ii) To invest the savings so mobilised in corporate securities such as shares and debentures, etc;

(iii) To serve unit holders along the length and breadth of the country;

(iv) To underwrite the issue of shares and debentures.

Intext Question 20.3

Write 'R' against statements which are right and 'W' against those which are wrong.

(i) Fresh shares or units of the 'open-end' investment trust are continuously offered for sale at their face value.

(ii) A 'closed-end' investment trust does not buy back its shares or units.

(iii) The UTI does not underwrite shares and debentures issued by companies.

(iv) Investment through UTI results in lower risk of loss and higher return.

(v) The market value of shares or units of closed-end trusts depends on the market forces of demand and supply.

20.10 Industrial Credit and Investment Corporation of India (ICICI)

Industrial Credit and Investment Corporation of India was established as a joint stock company in the private sector in 1955. Its share capital was contributed by banks, insurance companies and foreign institutions including the World Bank. Its major shareholders now are Unit Trust of India, Life Insurance Corporation of India and General Insurance Corporation and its subsidiaries. They together hold approximately 50% of the paid up share capital of ICICI.

Objectives

The ICICI has been established to achieve the following objectives:

(I) To assist in the formation, expansion and modernisation of industrial units in the private sector;

(ii) To stimulate and promote the participation of private capital (both Indian and foreign) in such industrial units;

(iii) To furnish technical and managerial aid so as to increase production and expand employment opportunities;

(iv) To assist in the development of the capital market through its underwriting activities.

Functions

The primary function of ICICI is to act as a channel for providing development finance to industry. In pursuit of its objectives of promoting industrial development, ICICI performs the following functions:-

(i) It provides medium and long-term loans in Indian and foreign currency for importing capital equipment and technical services. Loans sanctioned generally go towards purchase of fixed assets like land, building and machinery;

(ii) It subscribes to new issues of shares, generally by underwriting them;

(iii) It guarantees loans raised from private sources including deferred payment;

(iv) It directly subscribes to shares and debentures;

(v) It provides technical and managerial assistance to industrial units;

(vi) It provides assets on lease to industrial concerns. In other words, assets are owned by ICICI but allowed to be used by industrial concerns for a consideration called lease rent.

(vii) It provides project consultancy services to industrial units for new projects.

(viii) It provides merchant banking services.

The corporation is empowered to provide any amount of financial assistance to any business unit in the private sector, public sector, joint sector or co-operative sector. Any company with limited liability, any sole proprietary concern, partnership concern and any co-operative society may approach the corporation for assistance in financing a sound project. Normally it provides such assistance within the range of self imposed limits. Accordingly, Rs.5 lakhs is the minimum amount sanctioned by it to a single concern and normally it does not go beyond the maximum limit of Rupees one crore. However no project is too large for ICICI to handle. In promoting industrial investment, ICICI seeks to encourage other financial institutions, both Indian and foreign, to collaborate in its lending operations.

Financial assistance granted and disbursed by ICICI over the years have grown steadily. ICICI has disbursed a total financial assistance of Rs.4225 crores during the three months period from Ist April 1998 to 30th June 1998. The total amount sanctioned during this period is Rs.9135 crore.

ICICI has promoted the following institutions in recent years, showing widening scope of activities of ICICI:

1. ICICI Securities and Finance Co. Ltd.

2. ICICI Asset Management Co. Ltd.

3. ICICI Investors Services Ltd.

4. ICICI Banking Corporations Ltd.

5. Credit Rating Information Services of India Ltd. (CRISIL)

6. Technology Development and Information Company of India Ltd. (TDICI)

7. Programme for the Advancement of Commercial Technology.

8. `Programme for Acceleration of Commercial Energy Research (PACER)

Intext Questions 20.4

Which of the following statements are true and which are false?

(i) ICICI is not a government controlled organisation.

(ii) Industrial concerns can secure project consultancy services from the ICICI.

(iii) Only industrial concerns in the private sector are eligible for grant of long-term finance by the ICICI.

(iv) Loans under deferred payment agreements are guaranteed by the ICICI.

(v) One of the many objectives of ICICI is to expand employment opportunities in the rural areas.

20.11 What you have learnt

Financial Institutions :

The IFCI which was established in 1948, provides financial assistance to industrial concerns for a period not exceeding 25 years. It also guarantees loans raised by industrial concerns in the open market and underwrites issues of shares and debentures. It grants financial assistance to industrial concerns in the corporate and cooperative sectors.

State Financial Corporation (SFCs) have been established by State governments under State Financial Corporation Act, 1951. There are at present 18 SFCs. These corporations grant assistance to industrial concerns for a maximum period of 20 years. Financial assistance can be granted to industrial concerns in corporate or co-operative sectors as well as sole proprietary or partnership concern. Financial assistance is granted to medium and small size concerns. Most of the financial assistance is in the form of term loans. Maximum financial assistance that may normally be granted to a single industrial concern is Rs. 60 lakhs. The paid up share capital and free reserves of the industrial concern seeking financial assistance should not exceed Rs 3 crore.

The IDBI was established in 1964, to regulate, supervise and coordinate the activities of other financial institutions. It supplements the financial resources of other financial institutions. It also provides loan directly to industrial concerns. It guarantees loans and deferred payments. It discounts and rediscounts bills of industrial concerns, refinances loans granted by other financial institution, promotes industries and provides merchant banking services.

The UTI was established in 1964 to stimulate and pool together the savings of people by selling its units to investors in different parts of the country. It invests its funds in shares and debentures of other industrial concerns and pays dividends to the holders of its units.

The ICICI was formed in 1955 to provide assistance to industrial units in the private sector. However the activities of ICICI have widened now in scope. Joint sector, public sector as will as co-operative sector industrial units are eligible for financial assistance from ICICI. It is empowered to provide any amount of financial assistance to business units. But normally, it provides such assistance in the range of Rs. 5 lakhs and Rs. 1 crore.

20.12 Terminal Exercises

1. Define the terms:
   (a) Specialised financial institution.
   (b) Investment trust
2 Name three all-India and three state-level financial institutions set up for providing medium and long-term finance to industrial concerns.
3 Write notes on:
   (i) Importance of SFIs
   (ii) Objectives of IDBI
   (iii) Functions of UTI
4 State and explain the functions of IFCI
5 Enumerate the main objectives of ICICI
6 What are the functions of SFCs ? Discuss

20.13 Answers to Intext Questions.

20.1 (i), (iv), (v), (vi), (vii), (ix), - True

(ii), (iii), (viii), (x), - False

20.2 (i) apex

(ii) refinancing

(iii) co-ordinate, regulate, supervise

(iv) line of credit

(v) underwrites, subscribes to

20.3 Right - (ii), (iv), (v), Wrong - (i), (iii)

20.4 True - (i), (ii), (iv), False - (iii), (v)