

Chapter – 4

A FRESH LOOK ON SOURCES OF INDUSTRIAL FINANCE

- 4.1 Risk Capital and Technology Finance Corporation Ltd. (RCTC)
- 4.2 Technology Development and Information Company of India Ltd. (TDICI)
- 4 3 Tourism Finance Corporation of India Ltd (TFCI)
- 4 4 North Eastern Development Finance Corporation Ltd (NEDFI).
- 4.5 Investment Institutions of India
- 4 6 Commercial Banks
- 4 7 Post Liberalization Policy Reforms in Industrial Finance Since 1991.

Conclusion

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The mid-eighties posed challenges in a new, competitive and deregulated environment in India. The financial institutions set up by the government of India in the post-Independence time continued efforts to reorient their business strategies. They diversified their range of activities from time to time to suit the demand of the era. Correspondingly, they have as well undergone a structural change in the area of venture capital, technology finance and infrastructure finance to further, directly or indirectly, the industrial development. The government too captured the spirit of the time and set up specialized financial institutions to meet the present growing needs of finance of the Indian industry. These specialized institutions include:

4.1 Risk Capital and Technology Finance Corporation Ltd. (RCTC):

Risk Capital Foundation (RCF) established by the IFCI was operating since 1975. In January 1988, the Risk Capital and Technology finance was set up. It was no different but just a reconstitution of the old RCF. It provides risk capital, venture capital assistance and technology finance, all under one roof. It, thus, encouraged the innovative entrepreneurs and technocrats for their technology oriented ventures. Projects that envisage advancement, promotion, transfer, adaptation, technological upgradation and commercialization of new technologies etc. for the modernization of industries are supported by the technology finance schemes.

Since 1991, the RCTC has been managing, the Venture Capital Unit Scheme-III (VECAUS III) to promote potential and highly profitable ventures that involve innovative products/technology services and that aim at new markets. Such ventures involve high risk and high

return. Ventures that involve adaptation of imported technologies to suit domestic conditions too receive assistance from the said institution.

In 1999, Government launched the National Venture Fund to promote the software and IT industry. It is called the NVFSIT. It provides funds for technology development/demonstration, especially to small and medium scale industries. This venture fund is managed by the SIDBI. Further, it was liberalized in the 2000-2001 budget to serve as a strong boost for NRIs. To invest some of their capital, knowledge and enterprise in ventures in the Silicon Valley or else where in India.

The RCTC provides assistance in the form of conventional loans, interest free and conditional loans on a profit and risk-sharing basis or as a direct subscriber to the equity of a project. It is expected that it would ensure modernization of the Indian industry.

4.2 Technology Development and Information Company of India Ltd (TDICI):

Technology knowledge, information and know-how and technological development through technology upgradation was the spirit of the late 1980s. To echo the spirit and to reinstate the development of the Indian industry. The ICICI and the UTI set up in 1988, the Technology Development and Information company of India Ltd (TDICI). The company sought to promote technology development through transfer and upgradation of technology and by providing of technology information. It is at its spirit a technology venture finance company that grants project finance to new technology ventures for development of indigenous technology, technologist entrepreneurship and to support commercial R & D operations in industries. The TDICI provides assistance primarily to small and medium scale industries. The assistance goes to technocrat entrepreneurs in the form of project loan, direct subscription to equity, conditional loans, equipment support, venture capital, techno-managerial guidance and so on. These activities are operated through two Venture Capital Fund Scheme, viz., VECAUS I

and VECAUS II. Recently, the TDICI is known as the ICICI Venture Funds Management Co. Ltd.

4.3 Tourism Finance Corporation of India Ltd. (TFCI):

The tourism industry was booming in the late 1980s. As an industry to supplement the development of the main stream Indian industry, it was needed to be supported and promoted. In this light, the Tourism Finance Corporation of India Ltd. (TFCI) commenced its business in February 1989. It caters the financial requirements of the tourism industry for their allied activities, facilities and services. It provides financial assistance to both conventional and non-conventional tourism projects in terms of loans, underwriting of and direct subscription to industrial securities, deferred payments, suppliers credit and equipment leasing.

Recently, the institution provides advisory and merchant banking services as well for the development of tourism projects. It also proposes to set up the National Tourism Development Fund to develop basic infrastructure facilities, establish lead projects and to undertake research activities.

4.4 North Eastern Development Finance Corporation Ltd. (NEDFI):

In the overall development of the Indian industry since the Independence, the upper most and remote corner of the Indian subcontinent in the North-East received little attention. During 1990s, the government realized that such facts would not go in the interest of balanced development of the Indian industry in all regions. With this realization, it set up the North Eastern Development Finance Corporation Ltd in 1995. It was expected that it would help accelerating industrial and infrastructural development in the northeast region. The primary focus of the NEDFI at its initial stage remains on identifying and develop entrepreneurship and to finance the establishment of new

industrial and infrastructure projects in the north-east region. It also pays adequate attention to expansive diversification and modernization projects of existing industrial enterprises.

With a view to promoting industrial development in the North Eastern Region, the NEDFI provides financial assistance in terms of loans or advances, refinance for working capital, discounting, rediscounting of bills of exchange or promissory notes, underwriting, subscription to shares and debentures. It also provides guarantees, deferred payment credits, technical consultancy and research facilities.

4.5 Investment Institutions of India:

Imparting finance remains the need for industrial growth. Raising finance too remains the need to recoup the finance for further investment in industry. Hence, a need was felt to have an institutional network in India that would raise finance from competent sources and divert it to investment in industry. One such competent source of finance is the Indian public and one such institutional network would be the Investment Institutions of India. These investment institutions are Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC) and Unit Trust of India (UTI). They were set up in 1956, 1973 and 1964 respectively. The LIC deals in life insurance business and the GIC deploys their funds in accordance with the government guidelines. The UTI mobilizes savings of small investors through sale of unites and channelises them into corporate investments.

Besides the unit and insurance schemes, the investment institutions of India are also participating in financing of industrial projects or concerns along with financial institutions through term loans, underwriting of and direct subscription to shares and debentures. The target clientele is new and existing industrial enterprises and the objective is industrial and infrastructure development.

4.6 Commercial Banks:

After the Independence, commercial banks have emerged as a significant sources and managers of funds to the Industry. The bulk of bank finance remains of short-term nature particularly to meet working capital requirements of industries. It may be released against security and personal guarantee. After 1974, banks have been extending medium and long-term loans also. Their operations of investment are so far confined largely to the sale and purchase of government securities rather than in holdings of industrial securities.

Recently, with the change in the business environment, commercial banks have been diversifying its range of activities. They are permitted to set up financial subsidiaries to provide term finance to industries. Accordingly, they have set up merchant bank, hire purchase finance, mutual funds, venture capital companies and equipment leasing companies to mobilize funds for investment in industrial securities. Besides, these activities, they also underwrite new issues of industry and subscribing to the shares and debentures through financial institutions and then, provide term lending finance to industries.

In this way, the commercial banking sector has acted as tremendous and progressive forum of activities in the industrial sector during last one and half decades.

4.7 Post liberalization Policy Reforms in Industrial Finance Since 1991:

The financial sector is in the process of rapid change. It is consequent of structural adjustments initiated by the Government in various sectors of the economy since 1991. The government took several steps to implement reforms in the financial sector in a phased manner. It acted on the recommendations of the Khan Working Group and the Narasimham Committee. The Khan Working Group was constituted by the RBI under the chairmanship of S.H. Khan. The purpose was to harmonize the role of development of the financial

institutions and banks. The Narasimham Committee too was expected to report on reforms in the financial sector. The recommendations of both the committee laid significant implications on the operations of development financial institutions. They recommended several reforms to harmonize to co-ordination between the role and operations of banks and the DFIs. These reforms addressed to reduction of resource requirement, de-regulation of interest rates, introduction of prudential norms like income recognition, asset classification, provision for bad and doubtful debts and capital adequacy strengthening of bank of DFIs supervision etc., and improvement in the competitiveness of the system particularly by allowing entry of private sector banks etc.. Some of the recommendations have been accepted by the RBI and the Government of India.

With a view to meeting the challenges posed by the new competitive and deregulated business environment, the Government of India introduced the following reforms in the financial sectors. The basic thrust of the policy reforms is that the access of financial institution to the SLR and other concessional funds are reduced. They are now encouraged to approach the capital market for funds. Therefore, the DFIs have taken steps to widen their resource base and mobilize funds from the domestic market as well as from international markets. For instance, in March 1995, the parliament ratified the amendment of the IDBI Act 1964, following ordinary promulgated reforms in the financial sector since 1994. The amended Act permitted the IDBI to issue equity share capital and empowered it to raise equity from the capital market. This was subject to the Government holding not dipping below 51 percent. Following the amendment; the IDBI launched its first ever public issue of equity shares in July 1995. The IFCI also was converted into a company in July 1993. It announced maiden public issue to rise over Rs.600 crores as equity (including premium). Accordingly, the IRBI and the SCICI were also drawing up their corporate plans to expand their operational field to all sectors of industries. The DFIs are now raising their increased resources from the

capital market and money market through innovative products at market related interest rates.

Now the fact remains that the IDBI and the SIDBI have pledged to pick up a 35 percent equity stake in the North Eastern Development Finance Corporation Ltd, (NEDFI) following the proposal of the finance minister in his 1995-96 Budget Speech.

In reference to the policy reforms, the RBI issued guidelines regarding interest rates and concept of Long Term Prime Lending rate for the Development financial institutions. These guidelines are sensible to market conditions. The DFIs provides financial assistance at reducing rates. It in turn would enhance industrial development. Further in March 1994, the RBI announced prudential norms for the five, all India development finance institutions viz. the IDBI, the ICICI, the IFCI, the IRBI and the EXIM Bank to achieve higher capital adequacy ratio. These prudential norms are working as a means for the DFIs, to maintain financial health of institutions. They also follow norms for credit concentration, asset classification, income recognition, provisioning and balance sheet disclosure. In accordance with the credit policy announcement of the RBI, the DFIs have removed the ceiling on interest rates on debentures and bonds and lowered the floor rate of interest for a number of times for promotion of industrialization.

The DFIs have also amended their norms regarding promoter's contribution debt equity ratio to increase promoters stake in projects. The convertibility clause is no longer obligatory for assistance sanctioned by term lending institutions. Following the change in policy environment the DFIs are allowed to introduce short terms products. For instance, the IDBI introduced a new scheme for working capital finance during 1996-97.

In line with the above finance reforms and RBI guidelines, the financial institutions attempt to diversify their operational financial activities and business strategies from time to time. The IDBI has

recently expanded the scope of its venture capital scheme with a high risk and high potential returns. It has set up the National Stock Exchange with equity participation by financial institutions and banks. It has also promoted the Inventory Services Ltd, a company providing share registry services and acting as transfer agent. Further, the IDBI has expanded the range of its forex services. It has obtained the membership of the society for World-Wide Inter Bank Financial Telecommunication (SWIFT) user group in India. It has diversified its operations as corporate trusteeship, commercial bank, mutual funds and a stock broking firm.

Recently, in order to boost the economy and the industrial development, the Government has taken a number of steps in the field of infrastructure, information technology and knowledge based industries. Accordingly, the Government has announced to set up Infrastructure Development Finance Company (IDFC) to promote infrastructure investment in the field of key areas of power, telecommunications, ports and roads. The operation of the IDFC is expected to catalyze private capital flows for infrastructure finance on a commercially viable basis. Hence, in view of the large financial requirements of infrastructure projects, all India financial institutions have formed a joint committee to appraise the finance and financial implications of the proposed projects in power and telecommunication over the next five years.

The Government of India recently passed the Information Technology Bill. It is expected to stimulate the growth of e-commerce, Information technology and knowledge based industries in the country. Therefore, to accomplish this major thrust area of the economy, the government has stressed the need for higher investment in venture capital activity. It also launched the National Venture Fund for software and IT industry to provide funds for technology development/ demonstration especially for small and medium scale industries. This venture fund is promoted by the IDBI, the SIDBI and the Ministry of Information Technology, Government of India.

In view of the new opportunities thrown open by development in emerging sectors like IT, media and entertainment, bio-technology and food processing etc., the Government of India has further liberalized the tax treatment. The Venture Capital Funds would serve as a strong boost for the NRI in the Silicon Valley and elsewhere to invest some of their capital knowledge based enterprises or ventures in India.

Conclusion:

From the above description and analysis of the structure of industrial finance we may conclude that during the pre-Independence period, the business policy of the British imperialists was self-centered and exploitative in nature. Their attitude towards the proposal for creation of term lending financial institutions was lackadaisical despite of the facts that the industrial commission of 1916-18 and the Indian central Banking Enquiry Committee of 1931 had suggested to set up industrial banks to providing term landing finance to industries. Such approach of the British government nullified all the possibilities of industrial development in India. Despite of all odds, some Indian industrialists ventured to develop industry from the internal and external sources of finance. But these sources of finance were inadequate for the effective industrial development. The swadeshi movement of 1906-1913 sought to inspire some financial institutions to support the industrial development. But the problems like voluntary liquidation of the industrial banks and conservative nature of commercial banks defeated the very purpose of industrial development.

Further to support modern industries like cotton textile, jute textile, coal mining and iron & steel industries etc., the managing agency system emerged to organize, manage and finance them. However, their monopolistic and dominant nature hampered the industrial growth. Moreover, the complete absence of institutional promoter's investment banks, issue houses, underwriting agencies and term-lending financial intermediaries dimmed any further prospects of effective and balanced industrial development in India. Thus, before the

Independence, India inherited a weak, scattered, poorly diversified and uneven (regional) industrial structural base. It is chiefly due to the inadequate supply of term finance.

There was complete absence of organized attempts for economic development during the British Raj. Soon after the Independence the government of India undertook planned economic development i.e. economic development of the nation in an organized way. The first Industrial policy Resolution was introduced in 1948 and the First Five Year Plan in 1951. In brief, the main aim of the Five Year Plans and corresponding Industrial Policy Resolution statements was to affect and ensure rapid and even industrial development in the nation as a means of achieving a socialistic pattern of society. In the pre-reforms period, i.e. prior to 1985, the public sector was considered as the nuclei for even economic development in the nation. In that light, the private sector was given less importance. However, more concessions and incentives were announced by the government under various plans and policies from time to time to foster rapid economic development.

In pursuance of the broad economic and social aims outlined above, the financial system had to be reorganized and revamped after the Independence. The objective was to facilitate rapid industrialization & also to built up better socio-economic condition of the society. To accomplish this objective, it was required to establish more diversified financial institutions. The structural change in the financial sector was inevitable. Consequently, the government exercised close control over the privately operated financial institutions. The instances were nationalization of LIC, private commercial banks and abolition of the managing agency system and private money lenders etc.

Therefore, in line with the above direction, the task of the industrial financing was two fold, first to increase the share of the savings flow from the economy to finance investment requirement to ensure the rapid industrial development and second, to ensure optimal allocation of financial resources within the industrial sector, in view of

the priorities and objectives laid down in five year plans & corresponding Industrial Policy Resolutions. To solve the problem of raising share of saving, the government established Investment Trusts such as the LIC, the GIC and the UTI to mobilize savings of small investors and channelise them into corporate investment. Alongside, to facilitate & foster rapid balanced industrial development, the major aim of the planned economic development strategy and diversified sources of financing, this development was required. Accordingly, national level financial institutions such as the IDBI, the ICICI, the IFCI and state level agencies like the SFCs, the SIICs etc., were set up by the government from time to time under the close supervision of competent public authorities.

Further, on the eve of the Independence, the capital market of India was not organized and well developed. Therefore, as a source of industrial finance, it was not carrying any significance. The foreign exchange reserves was depleted and there was huge scarcity of skillful entrepreneurship in the country. Therefore, to invigorate the spirit of industrial development in the country, diversified structure of industrial finance was set up by the Government of India. Its specific purpose was to provide a wide range of financial and non-financial assistance to industrial sectors, viz, direct rupee and foreign currency loans, direct subscription to and underwriting of industrial securities, guaranteeing loans and deferred payments, refinancing and rediscounting, lease finance, advisory, consultancy and merchant banking services and so on.

Apart from the general financing activities of the financial institutions, the IDBI, the IFCI, the ICICI, the SIDBI and the SFCs have introduced a large number of special schemes of assistance. While announcing the schemes, they have considered certain specific problems of the industrial sector. The IDBI being an apex financial institution in the country, has introduced different schemes & corresponding instruments to support the plan priorities announced from time to time. It has not confined its operations to just financing

industries but also imparts in the counseling to industries that confront performance related problems. Further to support new inventions and research and development in the field of technology, the Technical Development Fund Scheme was introduced. In order to rehabilitate & modernize the technology of the industrial concerns, the Soft Loan Scheme was initiated & modified from time to time in response to the varying needs of the industry. For the development of a specific the IDBI launched in 1986 the Textile Modernization Fund to help to modernize old & obsolete technology of sick textile mills. The Venture Capital or Seed Capital Scheme was another initiative by the IDBI to support the new, high-risk industry with high return, whose technology & the product were never tested in the Indian market. This scheme mainly supported the electronic & Information Technology Sector (IT). To raise short-term resources, the IDBI introduced a new scheme for working capital finance to provide greater flexibility in resource mobilization and deployment in the money market.

Moreover, the IDBI commenced forex services; i.e. host of foreign exchange related services to support the privatization programme introduced more clearly & deeply through the 1991-New Industrial Policy Resolution Statement. It replaced the age old framework of industrial development articulated under the 1956 IPRs. Its objective was to promote industry in the corporate sector.

In order to fortify the liberalization programme, several organisations like the SEBI, the EDII, the NSEIL, the SHCIL, the ISIL, the CARE, the INFUSE and the NSDL were established. All these organizations helped in changing the structure of the legal framework designed to protect the interest of investors. It as well helped development of the capital market and ensured entrepreneurship development. Finally in 1992, the IDBI established more specialized financial institution to cater to the financial needs of the small business, namely the Small Industries Development Bank of India. As an instance of more concentrated development approach, the IDBI also started

North Eastern Development Finance Corporation Ltd. to provide finance to backward regions in the north-east of the country.

The structural change in the industrial finance is not only confined to the IDBI. It has touched other institutions too like, the IFCI and the ICICI. Both have introduced different schemes to support rapid, diversified and balanced industrial development programme. For instance, the IFCI introduced the Risk-Capital Foundation Scheme in 1975 to provide supplementary finance to entrepreneurs to meet their part of project cost or promoter's contribution. It introduced seven non-financial activities during 1978 to 1984. They are in the nature of "Supportive measures" in relation to promotion of the small scale industries. Moreover, merchant banking & Allied activities were other ventures by the IFCI to safeguard issues like merger and amalgamation, loan syndication and project counseling aspects of the industrial development. During 1988-89, the IFCI introduced the equipment leasing scheme to provide finance to acquire imported or indigenous machinery in the industry. It also set up a commercial bank and an asset management company and a mutual fund.

Likewise, the ICICI too diversified its activities to keep the pace with the changing requirement of the industrial sector with time. Apart from being a general financing and underwriting activities, the ICICI was one of the earliest organizations to start merchant banking services in India. It has developed the field of lease finance and installment sales to provides assistance for computerization, modernization, replacement of equipment of energy conservation for industrial development. Since 1993, it has been running Project Advisory Services through different subsidiaries and agencies to support the development of the capital market, Mutual Fund & Investors services etc. Finally, the ICICI has promoted different companies and institutions such as the CRISIL, the TDICI, the SCICI, the PACT, the PACER, the Venture Capital Fund. They provide financial and different information services to industries in the private sector.

Since 1988, the promotion and sustenance of small scale industries continued to be the central plank of the macro economic reforms of the Government of India. Therefore, to support small scale industries, the SIDBI introduced the Equipment Finance Scheme in 1992-93 through which direct finance is provided to small scale industries for their modernization and upgradation of technology. It set up a Venture Capital Fund for SSI in 1992-93 and introduced Vendor Development Scheme in 1996-97. Both these to provide a package of financial assistance to the small scale industries. Further, to extend grant or assistance to SSI's, the SIDBI in 1996-97 introduced several schemes like the Technology Development and Modernization Scheme, the Single Window Scheme, the Automatic Refinance Scheme and the Scheme of Direct Assistance for Development of Industrial Infrastructure.

Decentralization of financing operation was the need felt in the late 1990s to augment the micro level financing structure and to better & easy access of finance to the hinterland of the different states. In that view, the government set up state level financial institutions. The SFCs were asked to finance small & medium sized industries. Together with industrial financing & refinancing term lending activities, the SFCs are also involved in providing assistance to artisans, women entrepreneurs, Ex-servicemen, Physically handicapped & technocrats. They also work to accelerate the industrial development of backward areas through a preferential scheme of concessional financial assistance to industrial units located in specified backward areas. The SFCs have diversified their financing activities from time to time to support diversified industrial activities. Like SFCs, the SIDCs also provide Seed Capital and Risk Capital Schemes to entrepreneurs by way of equity participation. In addition, the RCTC, the TDIC, the TFCI and the NEDFI etc. are a few other specialized financial Institutions established to provide risk capital, venture capital and technology finance.

In brief, the pre-Independence times witnessed a complete absence of organized and well-developed term lending financial

institutions. And the conventional financial sources available at that time were inadequate to diversify their business strategies to shot the requirements of the existing industries. Hence, the India under the British Rule could not achieve much on the front of industrial development mainly due to the inadequate supply of term financial resources. But after the Independence, the government of India organized efforts in the direction of planned economic development with will and vision. As a result, the financial institutions and their financial and non financial assistance have been strengthened with the passage of time. It has been carried out in two ways by addition of new institutions with more flexible structures and by enlarging resources and the scope of operations of the existing institutions. It held an objective to cater to the emerging financial needs or requirements of the rapid industrialization in changing new competitive and deregulated environment of business. Recently the financial institutions have also been diversifying their financial and non financial activities to render consultation on managerial, technical and administrative issues. They have, thus, reoriented their business strategies from time to time to face the challenges of the competitive business environment.