FINANCIAL MANAGEMENT OF THE ALL-INDIA INDUSTRIAL DEVELOPMENT BANKS : A COMPARATIVE-DIAGNOSTIC STUDY

by

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CERTIFICATE

The thesis entitled "FINANCIAL MANAGEMENT OF THE ALL - INDIA INDUSTRIAL DEVELOPMENT BANKS : A COMPARATIVE DIAGNOSTIC STUDY", being submitted by Mr.MANOJ KUMAR GARG to the Indian Institute of Technology, Delhi, for the award of the degree of DOCTOR OF PHILOSOPHY, is a record of bonafide research work carried out by him. He has worked under my guidance and supervision, and has fulfilled the requirements for the submission of this thesis which has attained the standard required for a Ph.D degree of the Institute. The results presented in this thesis have not been submitted elsewhere for the award of any degree or diploma.

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ABSTRACT

Financial management of development banks is a complex task as the commonly accepted normative framework of maximisation of the wealth of shareholders', *per se*, is not applicable to them. The profit motive is not germane to the philosophy of such institutions operating in a developing country, like, India. In fact, their genesis lies in the need to allocate scarce financial resources in accordance with national developmental priorities - a task which the nascent capital markets of developing countries are unable to perform on their own.

Thus, an appropriate conceptual framework is to treat development banks as multi-goal institutions with developmental/promotional function/role as the *corporate goal* and viability of operations as the *constraint goal*. In other words, financial viability of operations of a development bank is a *sine qua non* to perform some of its basic functions.

The present study uses the above criteria to critically examine how efficiently the three All-India Industrial Development Banks (Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India and Industrial Development Bank of India) have managed their financial resources while performing their developmental role.

The study has been conducted in three distinct phases. Phase-I deals with operational efficiency of the three All-India Industrial Development Banks (AIIDBs) in terms of planning, mobilisation, management and generation of financial resources. The analysis in this phase is based on data for the period 1971- 92 (22 years), obtained from various official publications of the AIIDBs. Using financial ratios and frequency distribution as analytical tools, a simple verbal-descriptive approach has been followed to present the main findings.

The study brings out clearly the profitability of the AIIDBs in all the years of the study. They appear to have managed their long-term resources fairly efficiently and earned adequate profits to pay dividend and accumulate reserves. Besides, the study reveals that there is preponderance of non- performing loans in their portfolios, for which adequate provision does not seem to have been made. Thus, in effect, their profitability, especially, that of the two public sector AIIDBs (IFCI and IDBI) is more illusory than real.

The study further reveals that the exchange risk management policy of the AIIDBs is highly unsatisfactory. Their unwillingness to share exchange risk with the borrowers had resulted in accumulation of massive unutilised foreign currency resources with them in the later years of the study. In fact, the policy of shifting the entire exchange risk to the borrowers, who can neither bear nor hedge against it, amounts to

substitution of credit risk for price risk. Similarly, they do not seem to have made a conscious attempt for providing hedge against inflation.

Another notable finding of the study is that in spite of consistent and steady increase in paid up capital and retained earnings, the three AIIDBs have been working with 9 to 11 units of debt for each unit of equity. While it is true that debt- equity ratio and capital to risk-weighted assets ratio are almost within the prescribed norms, debt limit seems to have virtually reached its saturation level. The low level of actual and notional debt service coverage ratios is a further pointer towards the same.

Phase-II of the study examines allocational efficiency of the AIIDBs in terms of the *qualitative* aspects of their resource allocation function. The role has been examined in two ways : as a substitute for capital market and in stimulation of capital market. The study, *inter-alia*, uses primary data in respect of 623 non-government non-financial/trading public limited companies that approached the capital market between 1988-92 (5 years).

The study shows that the AIIDBs, continue to be the principal source of industrial finance in India. Besides, they have contributed to the growth of broad-based entrepreneurship and promotion of well diversified and geographically dispersed industrial structure. Other notable contributions include strengthening of institutional underwriting arrangements and creation of institutional infrastructure conducive to the development of capital market. The study, *albeit*, points out the frailty of the AIIDBs in widening investor participation through sale of their own securities as well as primary securities from their portfolios.

Finally, Phase-III of the study explores the nature of the AIIDBs' relationship with their clients and its implications for their operational efficiency and future role. The analysis is based on 105 usable responses received from non-government non- financial/ trading public limited companies listed at the Bombay Stock Exchange.

The study brings to the fore that the three AIIDBs, together, have enormous control potential in the assisted concerns by virtue of their equityholdings as well as representation of their nominees on the board of directors. It is gratifying to note that the client companies consider their experience with the AIIDBs to be "very satisfactory". A sizeable section of the sample companies has a liking for dealing with them in the matter of raising finance. Economy in flotation costs, flexibility in loan- repayment and convenience in rescheduling of loans, often at the same rate of interest, have been pointed out as the major preference factors.

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