

## ROLE OF STATE FINANCIAL CORPORATIONS: AN OVERVIEW

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Dr. Naveen Kumar Ajmera\*

### ABSTRACT

*The IFCI was the first institution of its kind in India to be set-up and experts are justified in their assertion that its establishment "marks the beginning of the era of development banking in India". The role assigned was that of a gap-filler which implied that it was not expected to compete with the existing channels of industrial finance. It was expected to provide medium and long-term credit to industrial concerns including cooperatives, only when they could not raise funds by taking recourse to capital issue method or normal banking accommodation. The establishment of the IFCI was followed by the setting-up of financial institutions at the state level. The first state level development bank to be established was the Madras Industrial Investment Corporation. It was set up in 1940 and is known as the Tamil Nadu Industrial Investment Corporation. Other state level development banks were established in early fifties. SFCs have also started providing assistance to newer types of business activities like floriculture, tissue culture, poultry farming, commercial complexes and services related to engineering, marketing, etc.*

**KEYWORDS:** IFCI, Development Banking, Floriculture, Tissue Culture, Poultry Farming.

### Introduction

The Industrial Finance Corporation of India was set up to offer financial assistance to only large and medium-sized undertakings. Therefore, need for separate State Level development banks which could cater to financial needs of small and medium-sized industrial concerns was rightly felt. Accordingly, the State financial corporation Act was passed by parliament on September 28, 1951, as an enabling measure, under which State financial Corporations (SFCS) could be set up. The SFCs were set up with the objective of promoting economic growth, balanced regional development and widening entrepreneurial base by promoting and financing tiny, small scale and medium scale industries. The first SFC was set up in Punjab in 1953. Subsequently in other States too, SFCs were set up. At present there are, in all 18 SFCs in the country. Normally, operations of SFCs are confined to their respective States. However, in some cases they extend to neighboring States or Union Territories.

SFCs were set up with the objective of catalyzing higher investment, generating greater employment and widening the ownership base of industries. These were primarily set up as Development Financing Institutions (DFIs) and aimed at regional development through financing of mainly small enterprises in their respective areas of jurisdiction. These have assisted many small enterprises set up by first generation entrepreneurs at a period when no venture capital or angel funds existed. Many large corporate of today owe their origin to these SFCs. These companies with the little and timely assistance given by the SFCs have become international giants. These SFCs operating at grass root level have played a crucial role in bringing decentralized economic development by dispersing the industrial activity. They have played a crucial role in the promoting and development of SSI sector in their respective States. As the Banks normally do not giving loans to first generation entrepreneurs, the gap is being filled in by SFCs.

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\* Ph.D., Department of ABST, Faculty of Commerce, University of Rajasthan, Jaipur, Rajasthan, India.

**Business which Financial Corporation may Transact (Section - 25)**

The Financial Corporation may subject to the provisions of this Act, carry on and transact any of the following kinds of business, namely:

- Guaranteeing, on such terms and conditions as may be agreed upon
  - Loans raised by industrial concerns which are repayable within a period not exceeding twenty years, and are floated in the public market;
  - Loans raised by industrial concern from scheduled banks or State co-operative banks or other financial institutions;
- Guaranteeing, on such terms and conditions as may be agreed upon, deferred payments due from any industrial concerns in connection with its purchase of capital goods within India;
- Underwriting of the issue of stock, shares, bonds or debentures by industrial concerns;
- Transferring for consideration any instruments relating to loans and advances granted by it to industrial concerns;
- Acting as agent of the Central Government or the State Government or the Small Industries Bank or the IFCI Ltd formed and registered under the companies Act, 1956, or any other financial institution notified in this behalf by the Central Government in respect of any matter connected with, or arising out of, the grant of loans or advances to an industrial concern, or subscription to debentures of an industrial concern or relating to the business of the Development Bank, Small Industries Bank , IFCI Ltd or financial institution;
- Subscribing to, or purchasing of, the stock, shares, bonds or debentures of an industrial concern or any other concern;
- Retaining as part of its assets any stock, shares, bonds or debentures which it may acquire by subscription or in fulfillment of its underwriting liabilities and disposing of the stock, shares, bonds or debentures so acquired;
- Granting loans or advances to, or subscribing to debentures of, an industrial concern, repayable within a period not exceeding 20 years from the date on which they are granted or subscribed to, as the case may be:

PROVIDED that the Financial Corporation may, with the prior approval of the Small Industries Bank, exceed the said limit of twenty years up to a further period of ten years:

PROVIDED FURTHER that nothing contained in this clause shall be deemed to preclude the Financial Corporation from granting loans or advances to, or subscribing to debentures of, any industrial concern to which may be attached an option to convert such debentures or loans into stock or shares of the industrial concern.

PROVIDED ALSO that the Financial Corporation may, in the exercise of such option, convert the amounts outstanding on such debentures or loans into stock or shares of the industrial concern if such concern increases its subscribed capital by the issue of further stock or shares in accordance with the subject to, the provisions of s. 81 of the Companies Act, 1956.

- Accepting or discounting promissory notes and bills of exchange made, drawn, accepted or endorsed by industrial concerns or by any person selling capital goods manufactured by one industrial concern to another industrial concern;
- Undertaking research and surveys for evaluating or dealing with marketing or investments and undertaking and carrying on techno-economic studies or other activities in connection with the development of any industry;
- Providing technical and administrative assistance to any industrial concern or any person for the promotion, management or expansion of any industry;
- Planning and assisting in the promotion and development of industries;
- Providing consultancy and merchant banking services;
- Acting as the trustee for the holders of debentures or other securities;
- Leasing, sub-leasing or giving on hire or hire-purchase of industrial plant, equipment, machinery or any other asset;

- Factoring;
- Providing export related credit and services;
- Undertaking money market related activities;
- Setting up of mutual funds and undertaking asset management activity;
- Promoting, forming or conducting or assisting in the promotion, formation, or conduct of companies, subsidiaries, trusts or such other associations of persons as it may deem fit;
- Opening or confirming or endorsing letters of credit and negotiating or collecting bills and other documents drawn thereunder;
- Doing such other business as the SIDBI may authorize, and/or generally the doing of such acts and things as may be incidental to or consequential upon, the exercise of its power or the discharge of its duties under this Act.

#### **Power to Give Instructions to Financial Corporation on Questions of Policy (Section – 39)**

- In the discharge of its functions, the Board shall be guided by such instructions on questions of policy as may be given to it by the State Government in consultation with and after obtaining the advice of the Small Industries Bank.
- If any dispute arises between the State Government and the Board as to whether a question is or is not a question of policy, the decision of the State Government shall be final.
- If the Board fails to carry out the instructions on the question of policy laid down by the State Government under sub-section (1) of this section or the instructions given to the Board under sub-section (4) of section 37A, the State Government shall have the power to supersede the Board and appoint a new Board in its place to function until a properly constituted Board is set up, the decision of the State Government as to the grounds for superseding the Board shall not be questioned in any court.

#### **Enforcement Rights of SFCs**

##### **Special Provisions for Enforcement of Claims by Financial Corporation (Section – 31)**

- Where an industrial concern, in breach of any agreement, make any default in repayment of any loan or advance or any installment thereof or in meeting its obligations in relation to any guarantee given by the Corporation or otherwise fails to comply with the terms of its agreement with the Financial Corporation or where the Financial Corporation requires an industrial concern to make immediate repayment of any loan or advance under section 30 and the industrial concern fails to make such repayment, then, without prejudice to the provisions of section 29 of this Act and of section 69 of the Transfer of Property Act, 1882 (4 of 1882) any officer of the Financial Corporation, generally or specially authorized by the Board in this behalf, may apply to the District Judge within the limits of whose jurisdiction the industrial concern carries on the whole or a substantial part of its business for one or more of the following relief's, namely, -
  - For an order for the sale of the property pledged, mortgaged, hypothecated or assigned to the Financial Corporation as security for the loan or advance; or (aa) for enforcing the liability of any surety; or
  - For transferring the management of the industrial concern to the Financial Corporation; or
  - For an ad interim injunction restraining the industrial concern from transferring or removing its machinery or plant or equipment from the premises of the industrial concern without the permission of the Board, where such removal is apprehended.
- An application under sub-section (1) shall state the nature and extent of the liability of the industrial concern to the Financial Corporation, the ground on which it is made and such other particulars as may be prescribed.

#### **Financial Resources of SFCs**

The resources of SFCs consist of the following:

- Capital and reserves;
- Bond and debenture issue;

- Borrowings from the Reserve Bank of India, the State Governments and finance from the Industrial Development Bank of India; and
- Fixed deposits

As far as SFC bonds and debentures are concerned, they are mostly subscribed by commercial banks, the Life Insurance Corporation of India and other financial institutions. They are presently an important source of the resources of the SFCs and account for about one-third of them. The SFCs also borrow from the Reserve Bank, the State Governments, IDBI and SIDBI. The borrowings of the SFCs including the bond issues at any time should not exceed 10 times of their paid up capital and reserves. During recent years, refinance from SIDBI has become an important source of funds for the SFCs.

#### **Specific Functions of State Financial Corporations**

The SFC's have been set up to extend long-term finance to small and medium-scale industrial undertakings organized as public or private companies, cooperatives, partnerships or proprietary concerns. The SFCs render assistance in the following forms:

- Subscription to debentures repayable within a period of 20 years;
- Grant loans or advances to industrial concern repayable within a period not exceeding 20 years.
- Guarantee of loans raised in the market or from scheduled or cooperative banks by the industrial concerns and repayable within 20 years;
- Guarantee of deferred payments for purchase of plant, machinery, etc., within India ;
- Underwriting the issue of stocks, shares, bonds and debentures by industrial undertakings.

Apart from independently rendering financial assistance in the above mentioned forms, the SFCs can also act as the agent of the Central and State Governments, the industrial Development Bank of India, The Industrial finance Corporation of India or some other special industrial financing institution in respect of grant of loans or advances or subscription to bonds or debentures.

#### **SFCs Contribution to Indian Economy**

Thus, there are at present 18 state financial corporation's spread over in the country providing financial assistance to small scale and medium scale industries. SME Sector contributes significantly to Indian economy. The role of Small and Medium Industries (SMEs) in the economic and social developments of the country is widely acknowledged. They are nurseries for entrepreneurship, often driven by individual's creativity and innovation, and make significant contribution to the country's GDP, manufacturing output, exports, and employment generation. SMEs contribute 8 percent of the country's GDP, 45 percent of manufactured output, and 40 percent of exports. The labour- capital ratio in SMEs is much higher than in larger industries. Moreover, SMES are better dispersed. Despite recession and economic slowdown small scale units still accounts for one-third of manufacturing GDP and more than two-thirds of manufacturing employment. It has been noted that with lower labour costs and skilled manpower, SMEs have the potential to cater to the outsourcing needs of large scale units and MNCs. Emergence of high-tech sectors such as aqua culture, tissue culture, agro processing industries, greenhouse farming etc., in rural areas open new vistas for growth for SME sector. However, for SMEs to surge ahead they must remain competitive.

Over 70% of the total assistance sanctioned and disbursed by all SFC's is provided to small scale industries. The SFC's sanctioned seed capital assistance under the seed capital schemes introduced and operated by SIDBI. This assistance is available to promoters of small business units. Since June 1989, SFC's have also been implementing special schemes of seed capital assistance to women Entrepreneurs. Assistance is extended in the form of loan or grant or a combination of both to voluntary agencies working for women in decentralized industries. In view of these factors, SMEs are important for achieving the national objective of growth with equity and inclusion. The SME sector has been consistently registering a higher growth rate than the overall industrial sector in the past few years. This impressive performance of SSI sector could not have been possible but for the ceaseless efforts of SFCs. It is also achievement of SFCs that these institutions have provided more than Rs. 6300 crore to small scale industry in 2010. SFCs have been working in India since 1951. So, these financial institutions have huge industrial information. A new entrepreneur can start his industrial research by contacting these institutions if he wants to open a new business.

**Conclusion**

Thus, there are at present 18 state financial corporation's spread over in the country providing financial assistance to small scale and medium scale industries. SME Sector contributes significantly to Indian economy. The role of Small and Medium Industries (SMEs) in the economic and social developments of the country is widely acknowledged. They are nurseries for entrepreneurship, often driven by individuals creativity and innovation, and make significant contribution to the country's GDP, manufacturing output, exports, and employment generation.

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