Chapter-4

NON-BANKING FINANCIAL INSTITUTIONS

Financial Institution:

Financial institution is an institution that provides financial services for its clients or members. There are two types of Financial institutions: **Banking Institutions**

Non-Banking financial institutions

Non-Banking Financial Institution (NBFI):

Meaning:

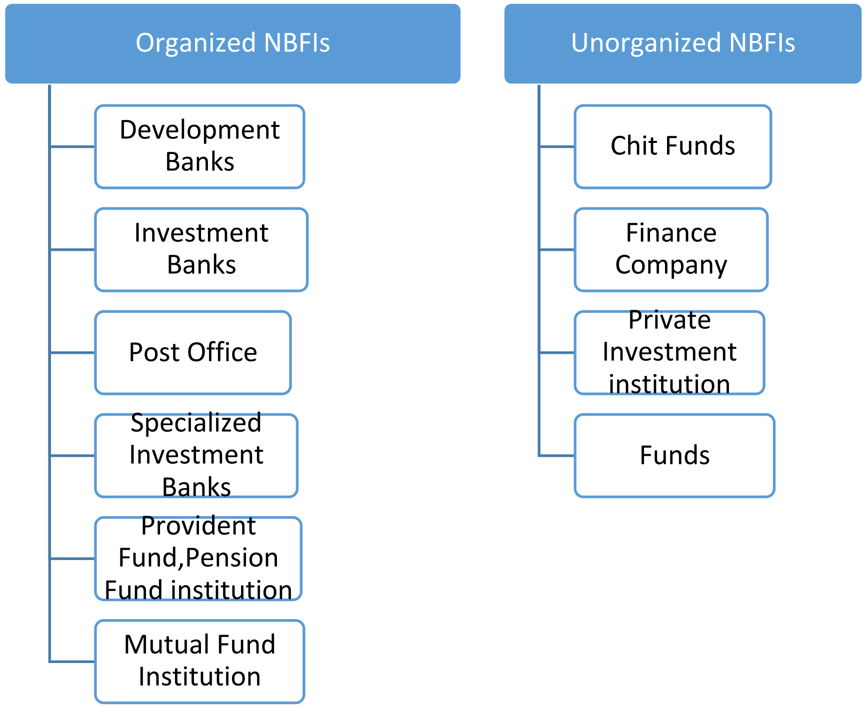
An institution which collects funds from people in different forms & places them in financial assets, such as deposits, bonds etc. It also lends loans and advances to needy people and institutions. NBFIs are registered under company act and must be approved by RBI as Non- Banking Financial Institution.

Examples: IDBI, IFCI,ICICI, LIC,GIC,SFC etc.

Features of NBFIs:

- These are small entities in terms of their size and scope
- These are less capital intensive
- Easy availability of loans
- Loan Rescheduling option is available(converting short term loan to long term)
- NBFIs fulfills several needs of the economy (Financial assistance to agriculture, industry, trade etc.)
- They conduct their activities independently
- Efficiency in work
- It involves risk of recovery of loans from borrowers

Classification of Non-Banking Financial Institutions:



<u>Some of the important Organized NBFIs in India</u>

1. Industrial Development Bank of India (IDBI)

Industrial Development Bank of India was established in 1964 as a wholly owned subsidiary of Reserve Bank of India. The bank was to act as an apex institution coordinating functions of all the financial institutions into a single integrated movement of development banking.
The ownership of IDBI was transferred to Central government on February 16, 1976. It is now working as state owned autonomous corporation.

Objective: To provide finance to industries and refinance to other financial institutions those involved with industrial finance.

Financial Resources of IDBI

(!) Share Capital:

IDBI was formed with an authorized capital of 50 crores which was raised a number of times. In the year 2018 – 2019 the authorized capital of IDBI stood at 15,000 crores.

(!!) Borrowings:

The bank is authorized to raise its resources through borrowing from Government of India, RBI & other financial institutions.

Management of IDBI

The management of IDBI is vested in a Board of Directors consisting of 22 persons including a fulltime Chairman cum Managing Director appointed by the central government. The other members of the board consists of representatives of RBI, a representative each of the all India financial institutions, two officials of the central government, 3 representatives each of the public sector bank & SFC's & 5 representatives having special knowledge & experience of industry.

The board consists of Executive committee consisting of 10 directors.

Functions of IDBI

The main functions of IDBI are as follows;

1. To co ordinate the activities of other institutions providing term finance to industry & to act as an apex institution.
2. To provide refinance to financial institutions granting medium & long term loan to industry.
3. To provide refinance to scheduled banks or cooperative banks.
4. To provide refinance for export credit granting by banks & financial institutions.
5. To provide technical & administrative assistance for promotion, management or growth of industry.
6. To undertake market survey & techno-economic studies for the development of industry.
7. To gain direct loans & advances to industrial concerns.
8. To render financial assistance to industrial concerns.

Operations of IDBI

The operations of IDBI can be discussed in two categories:

1. Direct Assistance

(!)Project Finance Assistance:

Under project finance scheme, the IDBI extends direct assistance to industrial concerns in the form of:

a. Project loans
b. Subscription to &/ underwriting of issues of shares & debentures.
c. Guarantee for loans & deferred payments.
d. Bank gives preference to units set up by new entrepreneurs or projects located in backward areas. The repayment period is normally8-10 years with a grace period of 2-3 years.

e. Concessional rate of interest will be available to small & medium units having project cost up to 3 crores.

(!!) Soft Loan Scheme:

IDBI introduced in 1976 the soft loan scheme to provide financial assistance to productive units in selected industries. Industrial concerns which are not in a position to bear the normal lending rate of interest of the other financial institutions are provided concessional assistance to the full extent of the loan. The repayment period is 15 years.

(!!!) Technical Development Fund Scheme:

The government of India introduced this scheme in March, 1976 for the issue of import licenses for import of small value balancing equipment, technical know-how, foreign consultancy services etc.

(!) Rehabilitation Assistance to Sick Units

The problem of growing industrial sickness in India is a cause of worry. It adversely affects production, employment, generation of income& utilization of productive resources. With a view to combat sickness, IDBI has advised the refinance scheme for industrial rehabilitation.

2. Indirect Assistance

a. Refinance of Industrial Loans:

IDBI provides refinance facility against term loans granted by the eligible credit institutions to industrial concerns for setting up of industrial projects as also for their expansion, modernization & diversification. IDBI provides refinance to commercial banks, development corporations or other institutions extending term loan assistance to industrial units.

a. **Rediscounting of Bills:**
IDBI introduced another indirect financing scheme in 1965, whereby rediscounting facility of machinery bills was introduced. This scheme was to help indigenous machinery manufacturers & their purchases. The usual deferred period is 5 years but in deserving cases it can be extended up to 7 years.

b. **Seed capital Assistance:**
With a view to help first generation entrepreneurs who have the skills but lack financial assistance, IDBI started seed capital assistance scheme in September, 1976. The maximum amount of assistance under this scheme is 20 % of the cost of the project or 2 lakh whichever is less & for medium sized projects it is 1 crore. The assistance is interest free with a service charge of 1% per annum, repayment period is 5 years.

2. Industrial Finance Corporation of India (IFCI)

The Government of India established the IFCI on **July 1st, 1948,** as the first development financial institution in the country to cater to the long term finance needs of the industrial sector. It was established under the INDUSTRIAL FINANCE CORPORATION ACT 1948.
The IFCI was the first specialized financial institution set up in India to provide finance to large industries in India.

Objectives of IFCI

To provide medium & long term financial assistance to large scale industrial undertakings, particularly when ordinary bank accommodation does not suit the undertaking or finance cannot be profitably raised by the concerned by the issue of shares.

Functions of IFCI:

- For setting up a new industrial undertaking.
- For expansion & diversification of existing industrial undertaking.
- For renovation & modernization of existing concerns.
- For meeting the working capital requirements of industrial concerns(in some exceptional cases like huge projects only)

Services/Operations of IFCI:

(!) Financial Operations

a. **It provides various schemes of loan under Debt Segment:**
   Short term loans of less than 3 years duration.
   Corporate loans of 3-5 years duration.
   Project loans of 5-15 years duration.
   Different types of guarantees & non-fund based facilities.
b. **Equity Segment**
   Investment in IPO, Right issue, Qualified Institutional placement.
   Strategic investment in unlisted companies.
   Trading in the secondary market including equity derivatives.

(!!) Financial assistance for Project development

a. Hydro power projects
b. Thermal power projects
c. Renewable power projects
d. Infrastructure projects

(!!!) Corporate advisory services

a. Corporate advisory services
b. Infrastructural advisory services
c. Monitoring public issues

3. State Financial Corporation's (SFC's)

The State Finance Corporation Act was passed in 1951, which authorized each state & union territory to set up a State Finance Corporation. Punjab was the first state to set up a corporation under the act in **1953.**

Karnataka State Financial Corporation was established in the year 1956, to meet the long term financial needs of small &medium scale industries in the state of Karnataka. Currently KSFC is located in Bengaluru. Similarly ,Kerala SFC, Haryana SFC, Odisha SFC, AP SFC etc. are functioning in India.

Objectives:

1. To establish uniformity in regional industries.
2. To provide incentive to new industries.
3. To bring efficiency in regional industrial units.
4. To provide finance to small scale, medium sized & cottage industries in the state.
5. To provide regional financial resources.

Management:

The supreme authority for management & conduct of business rest with Board of Directors which would act with the help of Managing Director & an Executive Committee. The board consists of 12 members both elected & nominated.

Financial Resources:

The capital structure of the SFC's has been left to be determined by state Government within the limits of 50 lakhs to 5 crores, 25% of the capital can be subscribed by the public.

Functions of SFC:

1. Granting of loans or advances to industrial concerns repayable within a period not exceeding 20 years.

2. Subscribing to the debentures of industrial concerns repayable within a period not exceeding 20 years.
3. Guaranteeing loans raised by industrial concerns repayable within 20 years.
4. Underwriting the issue of stocks, shares, bonds or debentures issued by the industrial concerns.
5. Guaranteeing deferred payments due from any industrial concern in connection with purchase of capital goods in India.
6. Acting as an agent of the Central Government or State Government or the Industrial Finance Corporation of India in respect of any business with an industrial concern in respect of loans to them.

Problems of SFC's:

1. Default in collecting loans.
2. Inadequate records.
3. Insufficient securities.
4. Lack of technical personnel.
5. Inadequate resources.

4. Export & Import Bank (EXIM Bank)

The Export- Import bank of India, also known as EXIM Bank, was set up in January, 1982 but commenced its operations from **1st March, 1982**. EXIM Bank is the top most banking institution in the field of financing foreign trade of India. EXIM Bank looks after the export finance function of IDBI.The head quarter of the bank is located in Mumbai, India.

Capital:

The bank was set up initially with an authorized capital of 200 crores & a paid up capital of 100 crores. The capital is fully subscribed by the central government

Objectives:

1. Providing all kinds of assistance whether financial, technical or administrative in the field of import & export.
2. Financing export oriented units & helping them in the planning, promotion & development.

3. Carrying out research, surveys & studies in convection with the promotion & development of foreign trade.
4. Collecting compiling & disseminating market & credit information in respect of foreign trade.

Functions of EXIM Bank

In order to promote the export sector, the Bank provides the following assistance:

1. **Funded Assistance:**
   It is given to Indian exporters in order to boost the exports of the economy & help them to operate in international markets, It includes:

a. Direct financial assistance in the form of medium term credit.
b. Overseas investment finance is given to help Indian promoters of overseas joint ventures to finance equity participation in the form of export of plant & machinery.
c. Financing exports of technology & consultancy services.
d. Pre-shipment credit.
e. Overseas buyer's credit in order to help foreign importers import Indian capital goods & services.
f. Extending lines of credit to foreign government & financial Institutions.
g. Refinancing of export credit extended by overseas banks.
h. Rediscounting of export bills.

2. **Non-funded assistance:**
   It is extended in the form of guarantees on behalf of Indian exporters in favour of overseas importer in association with the Indian commercial banks.
3. **Assistance to EOUs**
   It includes a variety of financing programme for EOU's(Export Oriented Units), Importers & Overseas investment by Indian Companies.
4. **Project Finance/ Trade Finance assistance**
   It handles the entire range of export credit services such as Supplier's credit, pre-shipment credit to Agro-based Business group, to spearhead the initiative to promote & support Agri-export. The group handles projects & export transactions in the agricultural sector for financing.
5. **Advisory Services**
   Offers variety of advisory & value added information services aimed at investment promotion.

6. **Export Marketing Services:**
   Bank offers assistance to Indian companies, to enable them establish their products in overseas markets.
7. **Support Services Group:**
   It includes Research & Planning, Corporate Finance, Loan Recovery, Internal Audit, and Management Information Services, Information Technology, legal , Human Resources management & Corporate Affairs.

5. Industrial Credit & Investment Corporation of India (ICICI)

ICICI was established in 1994 as a wholly owned subsidiary. It is into the area of Investment, Credit, Insurance, capital market etc. It has both Banking and Non-Banking domain in India.

Objectives:

1. To assist in the creation, expansion & modernization of private concerns.
2. To encourage the participation of internal & external capital in the private concerns.
3. To encourage private ownership of industrial investment.

Functions of ICICI:

1. It provides long term & medium term loans in rupees & foreign currencies.
2. It provides the equity capital of the industrial concerns.
3. It underwrites new issues of shares & debentures.
4. It guarantees loans raised by private concerns from other sources.
5. It provides technical, managerial & administrative assistance to industrial concerns.

Mutual Funds

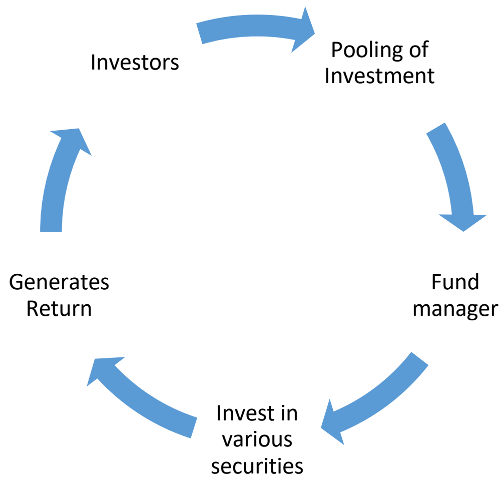
A mutual fund is an investment vehicle for investors who pool their savings for investing in diversified portfolio of securities with the aim of earning attractive yields & appreciation in their investment value. The formal origin of mutual funds can be traced in **Belgium** in the year **1822.** In India, first mutual fund was started in 1964 when Unit Trust of India was established.

Meaning & Definition:

Mutual Fund refers to pooling of investment from different investors who share a common financial goal and it will be invested collectively into diversified securities. With a mutual understanding both risk and return will be shared by these investors.

According to Securities Exchange Board of India (mutual funds) Regulation, 1996 , "A fund established in the form of a trust to raise money through the sale of units to the public or a section of the public under one or more scheme for investing in securities, including money market instruments".

Process of Mutual Fund



Classification of Mutual Funds

Types of Mutual Funds

According to Ownership
- Private Sector MF
- Public Sector MF

According to Time frame
- Open ended Scheme
- Close ended Scheme

According to Scheme of Operation
- Income fund
- Growth fund
- Balanced Fund
- Stock/ Equity fund
- Bond Funds
- Specialized funds
- Leverage Funds
- Taxation Funds
- Money market MF

According Location
- Domestic MF
- Off-shore MF

According to Ownership:

1. **Public Sector Mutual Funds:**
   In order to curtail the monopoly of UTI Central Government opened the operation of Mutual funds to the requirements of the common investors. SBI Mutual Fund was the first among all the public sector commercial banks that started operations during November 1987.
2. **Private Sector Mutual Funds:**
   Seeing the success & growth of Mutual Funds in the Indian Capital Market, the Government of India allowed the Private Sector corporations to join the Mutual Fund industry on February 14, 1992.

According to Time frame:

1. **Open-Ended Scheme:**
   Open Ended Scheme means a scheme of Mutual Fund that is available for subscription throughout the year. These do not have a fixed maturity & investors can conveniently buy & sell units at net asset value related prices.
2. **Close-Ended Scheme:**
   A close ended scheme is a stipulated maturity period which generally ranging from 3-5 years. The fund is open for subscription only during a specific period.
3. **Interval Funds:**
   Interval Funds combine the features of open ended & close ended schemes. They are open for sale or redemption during pre-determined intervals.

According to Scheme of Operation

1. **Income Fund:**
   These funds aim at providing maximum current return/ income to the investor. The investments are made in stocks yielding higher returns & capital appreciation is of small importance.
2. **Growth Fund:**
   These funds aim at providing capital appreciation in the value of investment. Such funds invest in growth oriented securities have a potential to appreciate in long run.
3. **Balanced/ Conservative funds:**
   The aim of balanced funds is to provide both growth & regular income. Such schemes periodically distribute a part of their earning & invest both in equities & fixed income securities in the proportion indicated in their offer document.

4. **Stock/ Equity Funds:**
   These funds mainly invest in shares of the Companies. The investments may vary from Blue chip companies to newly established companies.
5. **Bond Funds:**
   These funds employee their resources in bonds. These investments ensure fixed & regular income. Sometimes bonds are available in the market at lower than face value, the net income on these bonds goes higher because interest will be received on the face value of the bonds.
6. **Specialized Funds:**
   These funds invest in a particular type of securities. The funds may specialize in securities of companies dealing in a particular product, firms in a particular industry or of certain income producing securities.
7. **Leverage funds:**
   The primary aim of leverage funds is to maximize capital appreciation. These funds may use even borrowed funds for buying speculative stock which ensure a profit in the future.
8. **Taxation Funds:**
   Mutual Funds may be designed to suit the tax payers. The contribution to such funds may get some concession in income tax. The investors are required to keep the money with the fund for a certain period called lock up period which at present is 3 years in India.
9. **Money market Mutual Funds:**
   The schemes of mutual funds which has been set up with the objective of investing exclusively in money market instruments.

According to Location

1. **Domestic Funds:**
   These are the funds which mobilize savings of people within the country where investments are made.
2. **Off-shore funds:**
   These are the Mutual funds which raise or mobilize funds in countries other than where investments are to be made. These funds attract foreign savings for investment in India.

Advantages of Mutual Funds:

1. Diversification
2. Expert supervision & Management
3. Reduced risk

4. Tax advantage
5. Low operating Cost
6. Flexibility
7. High returns
8. Investor protection

Limitations of Mutual Funds:

1. Liquidity Crisis
2. Lack of innovation
3. Inadequate Research
4. Conventional Pattern of Investment
5. Inadequate disclosures
6. Delays in service
7. No rural sector investment base
8. Poor risk management.

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