

# Performance Analysis of SFCs in India: A Case Study of Haryana Financial Corporation

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## Abstract

State finance corporations (SFCs) have been established to cater to the needs of small and medium scale enterprises in the respective states with a special focus on spreading industrial culture in the rural, semi-urban, and backward areas of the states. Haryana Financial Corporation was set up in 1967 to cater to the industrial needs of the state of Haryana. The present study evaluated the financial and operational performance of Haryana Financial Corporation (HFC) and concluded that HFC is inefficient from almost all sides of its functioning. HFC also failed to provide sanctions and disbursements rationally to develop the state of Haryana properly. The results of Mann-Whitney U-test indicated that there is no significant difference in the growth performance HFC and all SFCs (on an average). The paper suggests that in the present competitive scenario, to make the HFCs more viable, the policy makers should pay immediate attention towards its proper monitoring and functioning.

**Keywords:** Haryana Financial Corporation, liquidity analysis, solvency analysis, operational performance, ratio analysis

**JEL Classification:** G21, L8, L25

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Industrialization plays an important role in the development of any nation. In developing countries like India, growth of large, medium, small, and tiny/cottage industries has become more important as it can create numerous employment opportunities. Industrial Finance Corporation of India (IFCI) was set up in July 1948 in India to provide financial assistance to large public limited companies and co-operative societies. However, later on, the need of such institutions was felt in the country which could cater to the financing needs of the small units spread all over the country as it was not possible for only IFCI to fulfil the requirement of all types of industrial enterprises. To fulfil this gap, the State Financial Corporation Act was passed in 1951, which authorized each state and union territory to set up a state financial corporation. Punjab was the first state to set up a corporation under this Act in 1953. The main purpose of establishing the SFCs was to promote the growth of small, medium, and large-scale industries in the country in order to augment the growth of industries and make the nation self-sufficient. Accordingly, in Haryana, the Haryana Financial Corporation was established in 1967 to provide medium/long term loans to the entrepreneurs for the acquisition of fixed assets (land, building, plant and machinery, misc. fixed assets) (Verma, 2010).

Haryana is a relatively well-developed state in the country. In addition to its much-acclaimed success in modernization of its agricultural sector, Haryana has done equally impressively in the domain of the industrial and services sectors. Haryana currently produces two third of passenger cars, 50% of tractors, 60% of motorcycles, and 50% of refrigerators manufactured in India. About 25% of India's total production of sanitary ware is from Haryana. One out of four cycles produced in the country comes from Haryana. The state has been

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able to attract sizeable investment from multinational companies, large business houses, foreign investors, and non-resident Indians. Haryana is marketed as offering superior location advantage on the outskirts of the national capital (Aneja & Bishnoi, 2009).

In Haryana, the responsibility for the development of the small and medium scale sector rests largely with HFC, Haryana State Industrial and Infrastructure Development Corporation (HSIIDC), and District Industries Centres (DIC). HFC has played a key role in the development of industries in the state of Haryana. HFC provides financial assistance to the industries by way of term loans, working capital loans, equity participation, lease assistance, and so forth. HFC operates a number of refinance and equity type assistance on behalf of IDBI/SIDBI in addition to various schemes for special target groups (Garg & Gupta, 2011).

The assistance disbursed by HFC has increased remarkably over the years - it has increased from 113.61 lakhs in 1967-68 to 6545.46 lakhs in 2008-09. However, some of the existing studies claimed that HFC has failed to obtain the objective of balanced development, as most of the sanctions have been made only to a few districts of Haryana (Verma, 2010). Furthermore, the study conducted by Aneja and Bishnoi (2009) claimed that 14 out of 19 districts in Haryana are either industrially backward or are moderately developed. Therefore, in the present study, an attempt has been made to evaluate the operational and financial performance of the Haryana Financial Corporation.

## **Review of Literature**

A fairly long experience of working and performance of SFCs is available. Quite a few attempts have been made by various researchers to study the performance of SFCs. Singh, Arora, and Anand (1991) evaluated the operational and financial performance of PFC and HFC considering a time period of 23 years (1967-68 to 1989-90). The study concluded that the operational performance of PFC was better than that of HFC. The performance of HFC was better on the basis of debt coverage ratio and share of net refinance in total business of SFCs. The authors also observed that the profitability performance of HFC was better than that of PFC. Singh (2000) observed that amongst the 18 SFCs in the country, Tamil Nadu SFC, with sanctions of 92.41% to the small scale industries sector, and Himachal Pradesh SFC with 59.6% of sanctions to small scale industries were at the top and below of the group respectively. Punjab Finance Corporation, with 80% sanctions of its loans to small scale industries, thus played an important role in the industrialization of the state of Punjab.

Verma (2010) examined the performance of HFC in the liberalized era for the period from 1980-81 to 2008-09. The study presented an overall negative growth rate of loans sanctioned as well as disbursed by HFC. The author observed that HFC failed to obtain the objective of balanced development, as most of the sanctions were provided to only a few districts of Haryana, and a small share of the amount sanctioned went to the backward districts. Dhiman (2011) evaluated the financial performance of Himachal Pradesh Financial Corporation for the time period from 1993-2006, and found that due to the topography of the state and reluctance on the part of the govt., HPFC was not operating properly. The author also observed that due to sickness of industries in this Pradesh, HPFC was also suffering from huge losses and was facing various financial challenges. Garg and Gupta (2011) analyzed the role of SFCs from 1980-81 to 2007-08 in promoting and rendering financial assistance to small and medium scale industries with reference to HFC and PFC. Both the corporations were performing well in providing loans in the form of term loan, soft loan to promote various industries, like food, metal, garments and textile, and so forth.

## **Research Methodology**

The main objective of the study is to evaluate the performance of HFC in context of the operational performance and the financial performance of the corporation. The secondary objectives of the study are as follows: -

**(1)** To examine the profitability, liquidity, and solvency position of HFC.

- (2) To evaluate the growth in financial assistance in the form of loan sanctions and disbursement by HFC.
- (3) To analyze the assistance provided by HFC to small scale industries.
- (4) To explore the relationship between assistance sanctioned and disbursement to different industries by HFC.

The study is analytical in nature, covering a period from 2001-2011, and is mainly based upon secondary data. The data were collected from annual reports (various issues), manual, and other published literature from different journals.

The performance analysis of HFC is mainly divided into two sections- financial performance and operational performance. The financial performance of HFC was analyzed by considering different ratios like profitability ratios - net profit margin, selling and administration expenses to total income, return on capital employed, return on assets, return on long term funds, and earnings per share. Liquidity and solvency ratios used in the present study are debt-equity ratio, long term debt equity ratio, interest coverage ratio, financial charges coverage ratio, current ratio, and quick ratio. Operational performance was evaluated by analyzing the assistance sanctioned and disbursed by HFC to different industries, and assistance sanctioned to small and medium scale industries. Furthermore, to test the significant difference between the performance of HFC and average of all SFCs on assistance sanction and disbursement criterion, the Mann-Whitney's U-test was applied.

## Analysis and Results

The results related to the performance of HFC have been discussed under the following sub headings. The performance of HFC has been measured by considering two broad aspects - one is financial performance and another is operational performance, which was measured by using ratio analysis over the period from 2006-07 to 2010-11.

↳ **Financial Performance of HFC :** The financial performance of HFC has been analyzed by measuring the different profitability, liquidity, and solvency ratios. The results of these ratios are presented in the Tables 1 and 2. The Table 1 shows that HFC was suffering from losses during the time period from 2009-2011 as the net profit margin of HFC stood at - 8.67% in 2009-10 and - 48.71% in 2010-11. This clearly indicates that HFC was suffering from heavy losses. Selling and administrative expenses also increased year by year, while the total income decreased year by year. Selling and administrative expenses ratio was negative during 2009-11. This shows that the HFC did not have sufficient income to pay its selling and administrative expenses. Return on capital employed, return on assets, return on long term funds, and earnings per shares reduced year by year. All the above ratios show that during the initial 3 years of the study period, the performance of HFC was good enough, but during the last 2 years of the study period, the performance of HFC was sluggish. A higher value of these ratios signals towards the overall efficiency and profitability of a firm, and satisfies the shareholders that their money is profitably utilized. However, the reducing ratios of HFC reveal that the corporation was not been able to properly utilize the money invested in it.

**Table 1. Profitability Analysis of Haryana Financial Corporation**

Sr. No.	Profitability Ratios	2006-07	2007-08	2008-09	2009-10	2010-11	Average
1	Net Profit Margin	28.27	17.49	54.05	-8.67	-48.71	8.48
2	Selling & Adm. Expenses to Total Income	-0.18	-0.05	3.07	-0.06	-0.40	0.47
3	Return on Capital Employed	13.82	9.37	-19.39	4.92	4.37	2.62
4	Return on Assets	2.38	-30.81	-1.05	3.84	3.41	-4.45
5	Return on Long Term Funds	14.06	10.08	19.97	4.92	4.38	10.68
6	Earnings per Share	11.98	9.96	2.59	1.39	0.81	5.35

**Table 2. Liquidity and Solvency Analysis of Haryana Financial Corporation**

Sr. No.	Ratios	2006-07	2007-08	2008-09	2009-10	2010-11	Average
<b>Solvency Ratios</b>							
1	Debt-Equity Ratio	4.98	4.77	2.27	1.23	3.72	3.39
2	Long term Debt-Equity Ratio	4.88	4.46	2.18	1.23	3.72	3.29
3	Interest Coverage Ratio	1.33	1.29	-2.98	0.96	0.61	0.24
4	Financial Charges Coverage Ratio	1.37	1.40	-2.94	1.00	0.64	0.29
<b>Liquidity Ratios</b>							
5	Current Ratio	1.50	1.38	2.15	2.45	2.39	1.97
6	Quick Ratio	1.58	1.60	2.30	2.16	2.08	1.94

Moreover, the earnings per share of HFC declined during the study period. It declined from 11.98 in 2006-07 to 0.81 in 2010-11. This indicates that the earning power of HFC decreased year by year. It cannot be treated as a happy situation for HFC. Furthermore, HFC would not be able to raise money through shares as there are no proper returns on investment.

The Table 2 presents the solvency and liquidity position of HFC. The debt-equity ratio shows the extent to which debt financing has been used in the business. The debt-equity ratio of 1:1 may be considered to be satisfactory. In HFC, the debt-equity ratio from the years 2006-07 to 2010-11 was very high. This created unnecessary burden of interest payment on HFC and also increased the undue pressures of creditors. The HFC also faced the same problem in case of long term debt-equity ratio (as shown in the Table 2). The interest coverage ratio indicates the number of times interest is covered by the profits available to pay the interest charges. The interest coverage ratio also decreased year by year. It shows that HFC did not have sufficient profits to pay its interest charges. During the last 3 years, it was less than 1, as the profits were not sufficient to cover the interest charges for a single time. Financial charges coverage ratio also decreased continuously in the last 3 years. It shows that the corporation did not have sufficient funds to pay its financial charges.

The current ratio in the Table 2 indicates that HFC was able to pay its current obligations in time as and when they became due. In other words, HFC had sufficient funds to pay its current liabilities without facing liquidity-related difficulties. A look at the quick ratio indicates that HFC could pay its current obligations immediately. It is important to mention here that a quick ratio of 1:1 is considered satisfactory as per standard accounting theories. In case of HFC, a very high quick ratio indicates improper cash management within the corporation. This can have an adverse effect on the long term financial planning of HFC.

In a nutshell, with reference to the financial performance of HFC, it can be said that the organization was not functioning efficiently from any angle. It was neither sound in its profitability position, nor in its solvency and liquidity positions. Its net income was negative as it was not successful in controlling its expenses ; in addition, it had high current and quick ratios, which means that huge funds were lying idle. There was no proper cash management as the same was not invested in proper channels, which creates a problem for the solvency of the corporation.

➤ **Operational Performance of HFC :** The operational performance of HFC can be ascertained from the Table 3. To capture the trend precisely, the best fit models were chosen, namely linear, logistic, compound, exponential, quadratic, semi-log model, and so forth. The criterion for choice of the model was the value of coefficient of determination or  $R^2$ . However, when this model was applied to the variables, none of the variables observed any specific trend as the  $R^2$  value for each variable was found to be very low. Therefore, only year to year growth rate of each variable was measured.

The Table 3 reveals that the assistance sanctioned and disbursed by HFC fluctuated year by year from 2001-2009. During the period from 2001-2005, the assistance sanctioned increased from INR 17246.18 lakhs to INR 27872.97 lakhs from 2001-02 to 2004-05 and then declined to INR 9060.5 lakhs in 2008-09. Similarly, assistance

**Table 3. Assistance to Industries by Haryana Financial Corporation (in ₹ Lakhs)**

Year	Total Sanctions	Year-to-year Growth Ratea (%) of Total	Disbursement to all type industries	Year-to-year Growth Rate (%)	Disbursement-Sanction Ratio (%)
2001-02	17246.18	-	9182.29	-	53.24
2002-03	13432.41	-22.11	11518.03	25.44	87.75
2003-04	27173.37	102.3	12818.35	11.29	47.17
2004-05	27872.97	2.58	23159.04	80.68	83.09
2005-06	14540.09	-47.8	13025.28	-43.76	89.58
2006-07	17958.84	23.50	10694.34	-17.90	59.55
2007-08	11534.17	-35.78	7889.12	-26.33	68.40
2008-09	9060.65	-21.44	6545.46	-17.03	72.24

**Table 4. Comparative Performance of HFC and all SFCs**

Year	HFC Disbursement-Sanction Ratio (%)	ALL SFCs (On Average) Disbursement-Sanction Ratio (%)
2001-02	53.24	81.88
2002-03	87.75	69.92
2003-04	47.17	70.69
2004-05	83.09	78.50
2005-06	89.58	80.35
2006-07	59.55	87.18
2007-08	68.40	81.55
2008-09	72.24	71.86

Mann-Whitney U-test, Z Score: 0.630, Significant at the 5% level of significance.

disbursed increased from INR 9182.29 lakhs to INR 23159.04 lakhs from 2001 to 2005, and then declined to INR 6545.46 lakh in 2009. This was followed by negative year to year growth of assistance sanctioned and assistance disbursed. This fluctuating operational performance of HFC can be interpreted in two ways ; one, this may be due to increasing competition with commercial banks in the market. Secondly, it may be due to the socio-cultural turbulence in the state of Haryana during the last decade, which has not marred the demand for funds for new projects.

🔗 **Comparative Picture of HFC and all SFCs** : SFCs operate a number of schemes and provide equity type assistance on behalf of IDBI/SIDBI in addition to the schemes for artisans and special target groups such as SC/ST, women, ex-servicemen, and physically handicapped. Sanctions and disbursement were ₹ 1908 lakhs in the year 2001- 02 and ₹ 2789 lakhs in the year 2008-09. SFCs serve multiple national objectives of rapid industrial growth, regional development, self-reliance, employment generation, and generation of income and production. Assistance provided to different types of industries on an average by all SFCs showed an increasing trend as it increased from ₹ 1563.40 lakhs to ₹ 2961.10 lakhs during the period from 2001-04; it showed a decreasing trend as it is decreased from ₹ 2961.10 lakhs to ₹ 1624.65 lakhs during the period from 2004-07. In the year 2008-09, it presented a progress of 9.9% as it is increased to ₹ 2005.06 lakhs (IDBI Report on Development Banks in India, 2008). Sanctions and disbursement figures indicate that all SFCs play an important role in the industrial development of different states respectively.

In this part of the study, an attempt has been made to access whether HFC was at par with the average performance of all SFCs. For the purpose, Mann-Whitney's U-test was applied on assistance sanction and disbursement criterion. It is hypothesized that no significant difference exists between the performance of HFC



and average performance of all SFCs. The Table 4 depicts that the disbursement-sanction ratio of HFC and all SFCs (on an average) showed a fluctuating trend in the last 10 years. Disbursement-sanction ratio of HFC increased from the years 2006-07. It can be seen that HFC contributed a lot in the industrial development of the state of Haryana in comparison to an average of all SFCs. Mann-Whitney U-test was applied to test the significance difference of the growth rate of disbursement and sanctions of HFC and all SFCs on an average. The null hypothesis of no significant difference is accepted as the Z score value is found to be less than the critical value. Therefore, it can be said that statistically, HFC had an average performance.

## Conclusion and Implications

SFCs have been playing a very crucial role in the industrial development of the different states respectively. As SFCs are building a road to make all the states industrially developed, they are also helping in removing regional disparity in India. The present study analyzed the financial and operational performance of HFC and concluded that in the years 2006, 2007, and 2008, the profitability, liquidity, and solvency position of HFC was good, but in the years 2009 and 2010, the performance of HFC was very poor, which is not a good sign for the functioning of the corporation.

During the said period, HFC performed inefficiently in every sphere of its management. HFC also failed to provide sanctions and disbursement rationally to develop the state Haryana. Some of the districts of Haryana are highly developed ; while on the other hand, a large number of districts are still industrially backward. HFC also failed in its objective of balanced development, as most of the sanctions were provided only to a few districts of Haryana, and a small share of the total amount sanctioned went to the backward districts. Moreover, the percentage share of arrears increased and recovery ratio also decreased year-by-year. The main emphasis of HFC was on the recovery of loans; therefore, there were few disbursements and few sanctions in loans made by HFC, which should be improved only by making effective plans regarding the financial performance of the corporation. HFC should increase the amount of loans sanctioned and disbursements, which will be helpful to improve its overall performance. In the present competitive scenario, to make the SFCs more viable, it is essential that proper monitoring should be done before financing the unit without any political pressure.

## Limitations of the Study and Scope for Future Research

The main limitation of the study is that it only considered only one institution, that is, Haryana Financial Corporation and other state finance corporations were not considered for the present study. The study is based upon secondary data; no primary data was used to validate the results obtained in the present study. In addition, only quantitative analysis of performance of state finance corporations was carried out, and qualitative factors like managerial competence, area covered, and exposure to risks were ignored. Though care was taken in this study to present an analytical picture of the state financial corporation, but the generalization is subject to certain limitations.

It is hoped that the findings of the study would be of interest to future researchers. The scope of the study can be widened by considering all the state finance corporations in India. Many internal and external factors affecting the performance of SFCs can be analyzed to make the future studies more prominent and comprehensive.

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