PART - I.

CHAPTER - I

INTRODUCTION

Development banks have an important role to play in the industrial development of a planned economy. Their dimensional role has increased with their initiative in the recent years even in agricultural development, though no less a person than William Diamond had cautioned in the late 1950s that for development banks the problem of farm credit would be different in kind from that of industrial credit. These banks would inject capital, enterprise and management and catalyse investment in the private sector.

1.1 Significance of capital in economic development

The process of industrial growth requires as one of its accompanying structural changes within the economy, the development of a capital market that will provide an adequate and properly distributed supply of finance to those entrepreneurs — whether public or private — for setting up new industrial


2. Ibid, p.4
plants or expanding existing ones. Finance in itself produces no output until capital equipment and raw materials are purchased with it, to enable entrepreneurs to gain control of the real resources, and engage in industry by producing and distribution of industrial products. Capital accumulation besides creating capital assets results in more roundabout methods of production, whereby capital stock and structure of production are widened, inducing technical progress, discovery of what was not known before, or more commonly, in the adaptation of present knowledge so as to allow of its commercial exploitation through some innovation in product, process or material. The 'malleability' property is unique in capital which permits it to expand indefinitely for speedy industrialization.

It would be an over-simplification to regard economic development as a matter of capital accumulation alone. Other things are needed in addition,

such as entrepreneurship and the training of workers and public administrators. Economic evolution is not an automatic result of capital accumulation and technical change but it is a result of a creative response of the human material to the objective opportunities in a given milieu. The quality and the strength of the creativity of human material accelerate the dynamic of the socio-economic process. And above all, it is the intensity of the desire for economic development in both the state and individuals and their social groups which is the nucleus of the matter. Yet capital accumulation and technological development may very well be regarded as the core process by which all other aspects of growth are made possible, and the final goal of development programming depends on the best way of breaking the vicious circle between a capital shortage and underdevelopment and to design the most efficient and optimum rate of capital accumulation. The familiar traps of vicious circles in low level income, low growth rate, low purchasing power, low profitability, low investment can be crossed over through an increasing rate of capital accumulation. All the same we can conclude

this short digression on capital by stating that capital is a necessary but not a sufficient condition for progress; or as Edward Nevin had put it, that capital, like patriotism, is not enough and economic growth requires a great deal more than an outpouring of capital. But capital is the limiting factor of many of the needs for the conditioning of the whole environment so that it becomes one in which the initial and delicate stage of economic growth can be sustained and higher stages can be attained with a flourish. 9

1.2 Governmental measures to boost capital formation

Some deliberate Governmental measures are required to accelerate the rate of capital formation to attain higher growth rate, when savings and investments ratios are very low in under-developed countries. Domestic savings are the more reliable source of investment to break the vicious circle of poverty and under-development. During the post-war period Governments in many under-developed countries initiated the establishment of special institutions in an attempt to increase the supply of necessary ingredients for industrialisation. In the under-developed economies the greater part of


their productive capacity has not attracted investment from private funds and institutions, unlike what happened in many industrial countries, where specialised institutions have evolved through the process of market pressure and their organisation and functions developed after long periods of experiments. In the developed countries of today, it took scores of years to develop these specialised agencies, but the present under­developed countries, impatient to develop fast and attain higher levels of economic development in a much shorter space of time, do not wish to rely upon the process of slow evolution of the specialised institutions. Hence to mobilise domestic savings and such other funds available even from abroad, the institutional framework to assist the flow of funds must be deliberately created and supported by government concerns. 10.

In many West European countries the private business sector relies heavily on non-marketable forms of credit granted by banks and non-banking financial institutions, both public and private, to finance investment in general, albeit self-finance has been the most important source of funds for investment.

The relatively small importance of the new issues market is partly a result of the close direct links between financial institutions and industry in many European countries. Government, business and consumers alike have come to lean more heavily on external finance in these countries.11.

The World Bank and the International Finance Corporation have initiated efforts jointly with domestic interests, in the establishment of special institutions in many countries. These institutions are wholly owned by the state and in some instances they are jointly owned by private interests—domestic and foreign. These institutions known as 'development corporation' and 'development banks' have taken variegated forms—some are established for the promotion and financing of government enterprises and for broad planning functions, some others are meant exclusively for private investments, while there are others who help both public and private enterprises. Again some only lend while others lend and invest in equities; some even set up and manage their own enterprise.


Some of these banks cover the entire economy while others concentrate only on a single sector; some are regional and others national. We even have international developmental agencies and certain others covering a group of countries in a region. Ownership, sources of finance, degree of dependence on government, objectives and methods of operation differ over a broad range of possibilities.\textsuperscript{13} However, in spite of the distinction between these different kinds of development institutions, it gets blurred if one considers the main functions of providing long term capital and promoting and managing corporate enterprises into one integrated function as essential to supply the needed capital and management in under-developed economies. Thus, a development bank may be defined as an institution either wholly or partially owned by government or by private interest (both domestic and foreign) which can combine in it an assortment of functions, such as providing long term capital (both loan and equity), stimulating and invigorating new issues market, and supplying entrepreneurship including technical know-how and management to the private corporate sector.\textsuperscript{14} The role

\begin{itemize}
\item \textsuperscript{13} William Diamond, op. cit, pp.1-2.
\item \textsuperscript{14} Prabhu N. Singh, Role of Development Banks in a Planned Economy, Vikas Publishing House Pvt.Ltd., p.7. 1974.
\end{itemize}
of development banks and other lending institutions can summed up as follows:

Firstly, they serve to provide repositories for savings of a relatively small average amount from a large number of individual sources. Such agencies will not only permit small amounts of savings to be handled and invested conveniently but also will allow the owners of savings to retain liquidity individually but finance long term investment collectively. The poorer a country is, in fact the greater is the need for the agencies to collect and invest the savings of the broad spectrum of persons and institutions.

Secondly, given the high degree of risk inherent in investment in economy, it is essential that these institutions are supported by the guarantee of their governments, and these are the only organisations which are able to spread their own risk over the entire economic life of the community. In fact they form the only part of the system, whose function it is to accept the uncertainties inherent in the development of economy as a whole. Private individuals cannot assess, as much as these institutions can do, the extent of the risk fairly, or take it entirely on their shoulders.

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Thirdly, proper advice, guidance, information and general investment consultancy can be provided by these institutions besides capital, and it is a highly desirable function of an investment institution in an under-developed economy to secure and administer management consultancy of this kind to provide 'both ante-natal diagnosis and after-care'. Fourthly, these institutions can ensure that the scarce supply of capital is distributed in accordance with the priorities of the development of the economy.

I.3 Development Banking in India

Development planning in India has changed the very conception of the industrial financing problem, especially since the Second Five Year Plan, when it was necessary to secure for industrial investment a sufficiently large share of the total annual flow of savings and to ensure its proper distribution over different sectors of industry as per the priorities in different plans. The main task of an industrial financing institution is to wrest from the economy a rising share of the savings flow for a growing industrial sector. Though the first development bank, the Industrial Finance Corporation of India was established in 1949, and later the Industrial Credit & Investment Corporation of India in 1953, both operating

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at all-India level alongside a number of State Financial Institutions in different states, yet since a co-ordinating apex bank in the Industrial Development Bank of India, emerged late on the scene, to a great extent these earlier banks helped the industrial units in filling only certain specific gaps, analogous to the 'Macmillan gap'. A development bank identifying completely with problems of agricultural finance was absent and small scale industries did not get the required fillip through adequate and easy finance, though in the planning a key role has been assigned to these industries. No doubt an institution concerned with finance of small scale business can scarcely hope to conduct its business on economic lines albeit they are regarded as a matter of social importance. Because of high administrative expenses and probability of defaults involved, it is an almost universal experience that institutions lending funds to small scale business are running at a loss. Similarly, even in agricultural credit a development finance institution cannot hope to achieve profitability. On practical considerations, it was rightly suggested, that separate arrangements be made to meet the flow of credit for such social investments, despite the disadvantages of separating one element of the flow of credit from social investment finance over the economy as a whole. Such business ( in financing agriculture
and small scale industries) is simply incompatible with the operation of an institution on a break-even basis, let alone a profitable one. 17.

The important measures adopted by the Government of India included, inter-alia, special type of concessional finance for small scale industries through the apex development bank, and the creation of a specialised development bank exclusively for agricultural developmental needs, working under the close supervision of public authorities, and drawing their funds partly from government, central banks, partly from conventional financial institutions, and in certain cases, partly from international institutions.

The United Nations Report pointed out that in India cheap and easy credit has often enough been the ruin of thriftless individual farmers, and that instead, he should be provided cheap but controlled credit. The abolition of the small farmer, according to this report, was neither feasible nor desirable for the issue was both an economic and a social one; it suggested that assistance to the small farmer might be given with the idea of eventual repayment of only a part of this assistance, without hoping for total reimbursement.

17. Edward Nevin, op. cit, pp.24-25.
more as a relief measure than as extension of credit. Further the institution involved in agricultural finance must be concerned with a range of services well outside the strictly financial sphere, usually taking the form of provision of equipment, seeds, marketing facilities and at the same time providing all these well below the true cost. Thus keeping in view the peculiar problems associated with agricultural credit to be maintained by a separate institution, which could itself be closely integrated with the various other agencies of agricultural development in the country, the Agricultural Refinance Corporation - now renamed as the Agricultural Refinance & Development Corporation, was established in May 1963, the emergence of which was rather late in the general economic development process in the country.

Thus, the machinery of special institutions has been buttressed and diversified to meet the emerging challenges in industry and agriculture from time to time, by adding newer institutions with more flexible structures and by enlarging the scope of the functions of existing institutions together with enlarging their resources. These institutions, some of which are formed

to cover the entire country and some others only regional in scope, have under their operations the whole gamut of industry from small to giant enterprises. Besides the unique one (ARDC) that covers the agricultural needs, they provide medium and long term loans as well as facilities for underwriting new industrial issues, which in purely quantitative terms have become a massive source of finance. Commercial banks have also been introduced to term lending and underwriting and are required through credit control measures to survey an increasing share of their advances into industry and agriculture. 21.

I.4. Development of Backward Regions

Planning as an instrument of economic development has many dimensions and in India, as in most underdeveloped countries, it has almost restricted its programmes to the national level in accelerating the development process in terms of a set of directions and goals for the orientation of the economy as a whole. Unfortunately only at a late stage of economic development in India the problem of regional development received due attention. Active promotion of industries in relatively backward regions to bring about a better distribution of benefits of growth, is attempted by the Government only in the recent years.

Lopsided and distorted development resulted in the earlier programmes of development planning in this country, though ever since the First Plan period there has been stress on balanced development in the planned document. The some of the already developed regions enjoyed the benefit of development at the cost of stagnation backward regions. Due to historical reasons under the British regime and as ill-conceived public investment programmes, the better developed regions in India are enjoying the initial advantages they gained. It is not only for the sake of backward regions needing to develop and catch up with already developed regions but also for the overall development of the national economy as a whole, that it is imperative to devise suitable policies for the promotion of balanced regional development which will eliminate inter-regional imbalances, by stimulating growth in backward areas while at the same time restricting over-saturated developed areas from getting into congestion.

In doubt from the point of view of an optimum use of resources, left to themselves, market forces divert capital and enterprise alongwith infrastructural

familiar "spillover" effects from developed regions to other regions may be present, it is the "backwash" effects, diverting enterprise, savings, skilled labour, and other factors of development, to relatively developed regions, that are all the more pronounced as they constitute the best use of resources. The events of last 50 years or so in various countries have made it increasingly clear that market forces do not lead to regional income equalization as it was believed by the classicists; and the focus on regional economics has been enhanced due to policy implications. Lagging regions suffer from capital flight as well as out-migration, while agglomeration economies favour a further build-up in prosperous areas. There is no gainsaying the fact that no purpose will be served by intervening to alter the distribution of industry if industries were location-bound, but 20th century technological change has made it possible for an effective regional policy implementation as industries have no longer to depend on raw material and energy location as much as they used to previously. However, it is not wise for a government on purely economic grounds to make a great deal of fuss about regional inequities in conditions of general unemployment, since aggregate full employment
ranks a higher priority in government objectives. The pressure on government to intervene is based primarily on equity grounds, and income distribution goals are likely to receive much attention only after employment goals have been satisfied. But regional communities complain if they suffer higher rates of unemployment than those prevailing elsewhere; There is apt to be a widespread sense of grievance whenever the central government's economic policy is thought to be discriminatory. Relatively low incomes, relatively high unemployment and net outward migration are often found together and indicate a relative poverty of economic opportunity in a region. The inferior economic opportunities in one's region prove hurtful insofar as one is either unable to move to the richer pastures, or one is so attached to home that one is reluctant to do so, or so identified with one's community that one feels a sense of injustice on its behalf.

A definition of regional analysis specifically in terms of its objectives has been provided by

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Walter Isard An analyst is confronted with many problems typical of a region. One problem is to identify specific industries which can individually or in groups operate efficiently and with profit in the region. Another related problem is to improve the welfare of the people of the region in terms of increase in per capita incomes and achieve a more equitable distribution of income; the associated problem of measurement of income and of the performance of a society is also posed. Yet another problem is to avoid an industrial mix which is oversensitive to the ups and downs of national and world business and which is constituted by too much of old, slow growing or declining industries — the problem of diversification. Finally, a fourth problem is in planning industrial development for a region, as part of system of regions in an internally consistent manner, and at the same time taking care to put to best use a limited endowment of resources. This definition's emphasis is in fact, on what an economist would normally recognise as economic problems. Inter-regional macroeconomics is a useful

24 W. Isard, Methods of Regional Analysis, M.I.T. Press, 1960, p. 413.
approach for saying a great deal about the links between regions in the national economy, though it is true that no light is thrown on what happens within a region. This type of analysis abstracts from distance, and it is difficult to understand 'space' economy unless the economic effects of distance are known. Such an approach further assumes that regions are homogeneous, but the feature of the space economy is its non-homogeneity. It is found that there are agglomerations in economic activity and in population distribution at given locations. These agglomerations can be found within the national economy as some regions have a denser population, a higher share of industrial activity and a more cosmopolitan outlook than others and again within the single region there are dominant centres towards which population, goods and services, communications and traffic gravitate. Even within a city there is a nucleus where most of the city's business, commercial and social activities take place. Acceptance of lack of uniformity in the space economy and recognition that it may have economic significance lead us to the concept of nodal or polarized regions. Nodal regions consists of heterogeneous units but they are closely inter-related with each other functionally.

The agglomeration economics related to scale are:

- Internal economies — economies external to the firm but internal to the industry which are in Isard's terms 'localization economies' 27 and external economies to an industry, which are gains arising on account of increase in total economic size due to expansion of multifarious firms in all industries at a given location, consists primarily of urbanization economies. The strongest agglomeration advantages arise as a result of economies external to individual industries and these economies are found greatest in urban centres and are termed as 'urbanization economies' 28 or 'economies of urban concentration'. 29 These include access to a large market, the development of urban labour market and pools of managerial talent, the presence of commercial banking and financial facilities (including cheaper capital), economies connected with transport services like improved terminal facilities, communication economies that include

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28 Ibid, pp. 182-188.

face to face contact with specialist services such as accountants, business consultants and advertisement firms; and economies of scale in public services whereby the unit costs of energy due to increase demand are reduced; social, cultural and leisure facilities also exist which influence location decisions.

The first location theorist Weber gave two crucial concepts in respect of localization economies, viz. 'locational weight' and 'critical isodapane'. The locational weight means the total weight of all goods (products, materials, fuel etc.) that have to be transported to and from the production site per unit of output— it consists of the weight of a unit of a finished product plus the weight of localised materials (that is materials which are not available at all sites) required per unit of output. An isodapane is a curve of equal transport cost which measures deviations from the minimum transport cost (M.T.C.) point. If we take the M.T.C. site (P₁) and plot around this point all the loci for a given level of transport costs higher than at (P₁), we obtain, assuming transportation is possible in all directions, a closed curve viz. the isodapane. Weber concluded that the optimal site will be that which offers the lowest transport cost for the total combined output.

30 Harry W. Richardson, op. cit., p.72
However Weber's analysis excluded institutional factors such as economies due to interest, insurance and taxes. 31.

Like Weber, Isard in his work 32 on location theory outlined a simple model where the search for the optimum location involved the minimisation of transport cost. The basic concept in Isard's analysis consists in 'transport input', which is defined as the movement of a unit weight over a unit distance and transport inputs could be expressed in ton-miles. Transport inputs are measured in terms of the efforts (man hour) required to overcome the resistance encountered in movement through space. And 'space discounting', just as discounting over time, can be done by comparison of values of two or more goods (materials) specially separated from any given geographical point of reference. The rate of discount over space is the transport rate. In the real world there are many different transport rates reflecting length and character of the haul, type of product transported, degree of competition in the transport sector, topography of the territory over which goods are carried. But just as in discounting over time one speaks of the

31 Harry W. Richardson, op. cit., p. 77.
32 W. Isard, Location Space Economy, Chap. IV and VI and X-XI, 1956, pp. 77-142 and 221-27.
interest rate though there are several interest rates varying between regions and according to degrees of risk and the period of the loan, one can think of the transport rate as a hypothetical representative rate. Both Weber and Isard recognised that transport cost alone was not the decisive determinant of location and both expounded the least cost location arising on account of a substitution between the transport and non-transport cost. But Isard's discussion of locational factors other than transport cost were more elaborate than Weber's. Nevertheless Isard focused on the fact that transport cost alone, as distance functions, can impart regularity to the spatial ordering of economic activity.  

D.R. Gadgil speaking on district plan 34 emphasised public action on a large scale in respect of provision of utilities and social services which in the context of India, must be considered with reference to the physiogeographic frame. Provision of communication is most vital in the initial stages, and most backward regions suffer on account of lack of means of communications. In

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fact no area or territory can gain from economic development that has taken place in other parts of the country, if it is not closely integrated with the economic life of the rest. Thus the prerequisite of the plan of development is a system of communication reaching out to all areas and all locations. A physico-geographic plan is a plan primarily of communication and of the development of a number of connected centres at and from which certain services and amenities are provided.

A rational regional policy consists of two broad components. Firstly, it should help to promote growth in the national economy, and any attempt to stimulate growth in a planned economy can hardly avoid having a regional aspect. As said earlier, social investment is relevant to growth and if obstacles to national growth are regional, then a programme of social investment that discriminates between regions increases the aggregate growth rate.

Secondly, a soundly based regional policy should redress inequities arising from large inter-regional disparities in indices of growth and welfare. It is not only policy makers in lagging regions that must bear the onus. National planning too should include an equity as well as growth component. Admittedly, there may be contradictions between the objective of maximising real
per capita national income and that of equalising (or at least bringing closer together) regional standards of living, because the sum of maximised income per head in each region does not equal maximised national income per head except in a world of perfect competition. Regional planners may take measures to maximise regional income within a given region, but this may involve use of resources that may prove inefficient from a national point of view.

There is no easy escape from the dilemma. The solution lies in seeking a compromise between the pursuit of national efficiency and attention to regional problems to balance growth and equity considerations. A national decision model must bring regional planning under it and aim at certain broad objectives such as for instance, that the performance of any region in relation to any particular goal should not fall below a specified level — a 'minimum attainment constraint' or a constraint to be imposed on regional growth rates so that the slowest growing region grows at least as fast as the aggregate economy. Or another alternative is that of not imposing direct regional constraints but instead one of imposing a national constraint on a national planning model so that this will help in bringing forth certain desired regional effects.
instance, if the depressed regions in the economy are agricultural regions, an appropriate constraint might be a specified relative increase in rural income per head a national constraint. The problem, however, is that the regional objectives that can be accommodated with this approach of constraints inserted in national level decision models, may be too broad. A severely depressed region may require to pursue multiple objectives simultaneously which need deployment of a host of policy instruments to deal with them and though they may be implementable at the national level in most cases, in some however the responsibility may fall upon regional policy makers—a potential conflict between national interests and regional objectives in these cases always loom large. But in selecting from the different methods available to attain a given objective, and to minimise the conflict between regional policies and national efficiency, one should choose the method that interferes least with the most efficient allocation of resources. 35.

It is often thought that subsidies should be given to enable industries in underdeveloped regions to benefit from increasing returns to scale and external agglomeration economies. Subsidies to firms at specific locations should

be judged in terms of future income growth or the generation of external economies. Efficiency should also play some role here and this can be done by including the opportunity cost of an investment in any subsidy evolution. This suggests the desirability of selective inducement rather than blanket subsidies to all firms in all industries wherever feasible. Negative controls in the forms of restrictions on plant expansion and new capital development in developed regions may also be employed but not indiscriminately. A more extreme measure is to give directives to industrialists to go to certain areas, but these are unacceptable in a liberal democracy. Hence the acceptable solutions include counter-acting agglomeration trends in private capital with an offsetting movement of public funds to depressed regions and/or to subsidise private industry there. The range of measure available is very broad: the provision of information; increasing the supply of basic services and infrastructure at locations selected for development; investment in education and retraining; price-fixing powers in public utilities which can affect regional location; regional discrimination in government contracts and other items of public capital expenditure; financial inducements to firms which include investment allowances, grants, loans or tax rebates; the selection of growth points. The
choice of instruments will depend partly on policy objectives and partly on their effectiveness in given institutional environments.\footnote{H.W. Richardson, Elements of Regional Economics, 1969, pp. 128-129.}

The foregoing analysis of regional economics, in terms of the choice between intervention and non-intervention by the government, as also the justification of granting special subsidies, is only to emphasise the fact that there is no easy escape from the dilemma for us in India, where we face a multiplicity of problems, especially the problem of widespread poverty and the finding of jobs for millions. All these problems require equally urgent attention, while their solutions remain elusive.

Nevertheless in 1968, at the time of Fourth Five Year Plan, the Planning Commission realising the urgent need for an effective policy framework to co-ordinate efforts aimed at initiating a process of growth in backward regions, appointed two working groups — the Pande Group and the Wanchoo Group. The former was entrusted to identify on the basis of certain economic indicators, the areas — the whole state or certain districts in a state, that could be marked as backward; while the latter was to indicate the nature of concessional finance and the role to be played by the financial institutions.
Subsequently in 1976, the Naik Committee reviewed the assistance and incentives (as well as disincentives for investments in comparatively more developed districts to avoid congestion) given for the development of backward districts and came out with fresh suggestions.

1.5 Measures of the financial institutions

The Planning Commission identified about 240 districts and regions as 'specified backward regions', soon after the submission of the Pande Committee Report, in 1969-70. At this time financial institutions introduced schemes of concessional assistance to attract projects in backward regions. These concessions are in the form of lower interest rates, longer amortisation period, reduction in the underwriting commission and in commitment charges on the undrawn balances. The Central Government also provided an outright grant of subsidy in selected districts — initially, the subsidy was at the rate of 15 per cent of the project cost with a maximum of Rs.15 lakhs and was given irrespective of the project cost. 

The IDBI, the apex development bank in India, asserts that the overall strategy in the backward region must have a good blend of agricultural and industrial

37 Development Banking in India, Published by IDBI, Tata Press Ltd., Bombay, 1976, p.13
policy components and that industrialisation is not the only way of initiating growth process. Wherever the infrastructural facilities are lacking and agricultural productivity and incomes are low, the leading sector for economic growth has to be agriculture while the infrastructure should also be improved on priority basis. Further, the incentives offered should not outlive their true social functions and result in leakages from contemplated benefits. For this it is necessary that the operation of a system of incentives incorporating flexibility should take note of changing income weights which have taken place on account of overall economic growth in the region. In fact a scheme of graded incentives for different regions, is operated in some of the states — the quantum of incentives is directly linked to the degree of backwardness of the regions. Financial institutions have simultaneously undertaken even non-financial developmental activities to prepare a sound information base which includes the industrial potential service of all backward regions. It is essential to assess the potentialities of industrial growth of different backward regions since backward areas differ from each other in their degree of backwardness as well as in their development potential.

38 Development Banking in India, op. cit., pp.13-14
I.6 The Objectives and Scope of the present study

A) The main purpose of the present study is to assess the role played by the development banks and commercial banks in the planned economic development in India, where planning is implemented within the framework of democracy. The Industrial Development Bank of India has focused on the fact that the priorities for assistance of about 60 development banks in the country, which form a blended cohesive structure endeavouring to realise the nation's planned socio-economic objectives, inter alia, are: projects set up in the backward areas; projects set up in the small scale sector; projects promoted by new and technician-entrepreneurs; projects producing goods of mass consumption; projects in the nature of export-promoting and import substituting industrial units.

In the initial chapters we intend to assess the financial and promotional operations of the development banks and commercial banks in the country as a whole, viz. at the all-India level.

As preliminary remarks, it may be stated that the commercial banking system in India though sufficiently sophisticated after several decades of operations, failed to participate satisfactorily in the socio-economic development of this country and only after 1969,
when nationalisation of 14 major banks was undertaken, this objective was pursued vigorously. Hence the present study will try to evaluate the performance of commercial banks, especially public sector banks, since 1970. As said earlier, in an initial chapter we will review the operations of these banks at the all-India level.

B) Another equally important purpose in undertaking the present dissertation, is to identify backward districts on the basis of a composite measure of development. As stressed earlier the development of backward districts is receiving increasing attention from several quarters — Government, Press and Public — in the recent years, but the foremost question always is: How to identify a backward area? Exercises of identifying backward areas have been undertaken by the Planning Commission as well as the Finance Commission for the purposes giving special concessions and grants-in-aid. It is customary to identify whether a region is backward or advanced in the levels of development, on the basis of per capita income. This is a very rough methodology to focus attention on the degree of backwardness. But as H. Myint has pointed out, there are shortcomings to this approach for differences in per

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39 H. Myint, The Economics of Developing Countries, Hutchinson University Press, 1964,
capita income in different regions do not necessarily reflect the different standards of living.

In the context of the formulation of the earlier Draft Fourth Plan (1966-71), the Planning Commission, while urging the State Governments to devote special attention to subject of development of backward areas, classified five categories as: (a) desert areas; (b) chronically drought affected areas; (c) hill areas including border areas; (d) areas with high concentration of tribal population; and (e) areas with high density of population, low levels of income, employment and living, for which it recommended further indicators such as: total population, number of workers engaged in agriculture, percentage of gross irrigated area to net sown area, number of workers per lakh of population employed in registered factories, mileage of surfaced roads, etc., in all 15 such indicators. The Fourth Finance Commission also determined the relative backwardness on the basis of ten such indicators.

The approach of Pandit Committee to this aspect was different from the above two in that it stressed the need to select certain backward districts only in industrially backward states for incentives/concessions for industrial development even though it did recognise that all the states which may not be considered industrially backward
according to a certain set of criteria, still had a good number of backward areas — in fact as backward as of those areas of the states which could qualify as industrially backward states according to the set of criteria. For the purpose of identification of backward states/Union territories, the Pande Committee applied certain criteria such as: (i) Total per capita income; (ii) Per capita income from industry and mining; (iii) Number of workers in registered factories; (iv) Per capita annual consumption of electricity; (v) Length of surfaced road and railway mileage in relation to (a) population; (b) the area of the state. And for identifying backward districts in industrially backward states, the criteria adopted were: (i) District outside a radius of about 50 miles from large cities or large industrial projects; (ii) Poverty of the people indicated by low per capita income starting from the lowest to 25 per cent below state average; (iii) High density of population in relation to utilisation of productive resources and employment opportunities.

We try here to contribute through a special independent study a process of identifying backward areas (districts) on the basis of a composite index of development using mathematical/statistical methods. In the earlier studies a number of physical indicators were taken into consideration and these variables were combined
together just for the sake of comparability, but unless the variables are weighted, the comparability cannot be scientific. And any attempt to attach weights to the variables, is riddled with subjectivity and value judgement.

The technique adopted here is that of 'Principal Component Analysis' — an off-shoot of 'Factor Analysis'. The method consists in finding out the principal component of the group consisting of several variables and of deriving the implicit weights therefrom. The composite index is worked out by combining the various indicators (variables) which are multiplied with the implicit weights that are already determined. The exercise is undertaken for two different years, 1969-70 and 1974-75, so as to assess the levels of economic development at two different points of time and also find out whether the ranking pattern of districts based on the composite index of economic development, has changed during this period 1969-70 to 1974-75.

(C) In this dissertation the study of districts in Maharashtra is of special interest. Maharashtra occupies the foremost place in the country's industrial development, and yet major areas in the state (14 districts out of 36 districts) are as backward as any other backward district in the country.
As a point of clarification, it is to be stated that states in India have sprung from factors such as language, religion or sect, race or tribe, traditional memory of things done or suffered, and regions within the state emerged not on the basis of economic characteristics but on social and political considerations and above all on the basis of administrative convenience. A 'district' is essentially a local administrative division and economic homogeneity to the extent that it is present in a district, is by accident and is due also to the fact that the district forms a part of a larger region which may be economically homogeneous. Historical traditions and other such factors, besides physical features and barriers also played their part in determining district boundaries. 40

The present study attempts to examine the role of development banks and commercial banks in purveying credit to the backward districts of Maharashtra and this will be of vital interest inasmuch as Maharashtra State has had the benefit of the funds of all-India financial institutions concentrated in the State. In addition to this, it has well developed state financial institutions in the Maharashtra State Financial Corporation (MSFC) and State Industrial & Investment Corporation of Maharashtra (SICOM).

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A separate section is devoted to Maharashtra, covering the identification of backward districts in the State by our method of analysis - Principal Component Analysis - in one chapter and the survey of funds of the financial institutions including those operating at the state level especially in the identified backward districts (identified as per our method of analysis) in another chapter.

New ground is covered in the thesis when we attempt to analyse the financial and promotional operations of the all-India financial institutions as also the State financial institutions in the districts in Maharashtra, for rarely have attempts been made to make such a study. Although there have been studies undertaken on institutional financing of economic development in India or industrial financing in India, all such works have been on all-India level and at the state level (financial assistance given for the state as a whole).

A model is suggested at the end of the dissertation for credit deployment by the development banks/commercial banks at the district level. For this purpose we shall be considering the districts of Maharashtra and results already arrived at while analysing the degree of backwardness of these districts by the method of Principal Component Analysis.
The ranking assigned to each district according to its backwardness on the basis of the Composite Index of Development, shall be used in the model. We shall be considering 'need' and 'effort' as two principles for purvey of credit in our model - 'need' approximated by the economic backwardness and 'effort' measured in terms of resources mobilised by a district by its own efforts. Details of the model are discussed towards the end of the thesis.

It is to be clarified here that the present study is confined only to those development banks at the all-India level and at Maharashtra State level, which are fundamentally financial in approach and purvey financial assistance to industrial concerns in the private sector. We have also included the study of the Agricultural Refinance Development Corporation in the role of a development bank and for that matter this is a new attempt insofar as such an inclusion of the study of ARDC has not been done in earlier works on development banking. Other development banks under the present study are: The Industrial Finance Corporation of India, The Industrial Credit & Investment Corporation of India, The Industrial Development Bank of India, The Maharashtra State Financial Corporation and The State Industrial & Investment Corporation of Maharashtra Ltd.
We also study, as indicated earlier, the role of commercial banks especially public sector banks both at the all-India level and also at the district level in "Maharashtra.

Our study is confined to the period 1971-72 to 1974-75. The significance of choosing this period is as follows:

(a) Our study has special reference to the role played by the development banks and commercial banks in the backward districts for which we have chosen Maharashtra state as a case study. As already said, a special policy was introduced by way of special assistance and incentives, was initiated only after the submission of the reports of the "Rural Committee" and "Vanchak Committee", in 1964-65.

(b) The nationalisation of 14 major commercial banks was done in July 1969.

(c) The "First Plan" commenced in the year 1960-61.

(d) In our assessment of the backwardness of the districts in "Maharashtra" by the "composite index of development in the principal component analysis", we consider two different years 1960-62 and 1974-75, so as to assess the levels of economic development just prior to "Plan" and at the end of the plan.
Again, when we undertook this exercise, the data relating to 1974-75 was the latest data available then.

1.7 Sources of Data

The study relies a good deal on the data collected from primary sources - data/information furnished by various development banks/commercial banks in their Annual Reports, Brochures, Special Notes, as also Official Files and other reports generously provided during my personal visits to these institutions.

Data given in Basic Statistical Returns, Currency and Finance and Banking Statistics, published by the Reserve Bank of India, have been extensively used and also different reports published by the Reserve Bank of India and Government of India in respect of banking.

1.8 Plan of the Study

The dissertation is to be in Four Parts, which will extend over Seven chapters.

In Part-I there are two chapters. The first chapter the present one, is the introductory chapter, while in Chapter-II, we present historical aspects of the evolution of the Indian development banks.
Here we take a review of the historical roots of the development banks elsewhere in some of the important countries.

Part-II contains two chapters - Chapter-III and Chapter-IV. In the former we discuss the role of the Indian Development banks in the overall development strategy of planning in India, covering their investment, financing and promotion aspects, while in the latter chapter we assess the role of commercial banks in the context of current development strategy.

Part-III focuses on Maharashtra State. Here we have two chapters, Chapter-V and Chapter-VI. We have also provided in an appendix details of the economy of the Maharashtra State.

Identification of backward areas and regional disparities in Maharashtra are analysed in Chapter-V, while in the next chapter we examine the financing operations of the all-India development banks, including that of the Agricultural Refinance Development Corporation, and the State's two prominent financial corporations namely, the NSFC and SICOM, in different districts in Maharashtra thereby attempting to understand whether funds of these institutions flow equitably to all districts, especially to those identified as backward. We have also analysed the credit survey of commercial banks in these districts.
In the last part, namely Part-IV, which contains one Chapter, Chapter-VII, we present conclusions by way of a critique of the role of development banks and commercial banks in India's economic development. We have also suggested here a model for the purveying of credit based on criteria adopted and mentioned above.
CHAPTER-II

EVOLUTION OF DEVELOPMENT BANKING ABROAD AND IN INDIA

In this chapter a historical account of some of the experiences of development banks of the advanced economies of today, during the years of their growth since the early 19th century, will be traced so as to determine their influences on the establishment of development banks in India, though it is true that development banks, like any other institutions, mirror the background — the economic, social, and political conditions and needs — of the country in which they appear. 1 In the beginning of this chapter, i.e. in Section (1) we shall consider their historical evolution abroad before we come to Indian scene in Section (2). We also present a short description of regional development banks including the Asian Development Bank, and the World Bank in Appendix-I to this chapter as they are significant developments in the sphere of development banking in the recent decades. However, their relevance to our study here is very limited.

Section (1) : Development Banking Abroad

There are various phases in the institutional development of industrial finance. The earliest institutions that were ever started with the particular object of industrial financing were Societe-Générale de Belgique founded in Belgium in 1822 and the once popular Credit Mobilier founded in France in 1852. It was intended that they should devote themselves specially to the development of the industry. They were the pioneers in the field of industrial financing, the forerunners of all later industrial banking. 2

Some believed that German banks were the earliest of specialised institutions to cater to industrial needs but this has been contradicted by pointing out that only at one stage of the evolution they had combined commercial with investment banking business and that in the post-war years these banks preferred more of deposit banking as in England. 3

II.1 Societe-Générale de Belgique in Belgium

The earliest of the industrial financing

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3. Ibid., p. 247.
Institutions like Société Générale de Belgique in Belgium, promoted new industrial companies, and established financial subsidiaries to hold the shares of these companies, besides taking up for itself considerable amounts of these shares.

The sources of funds of Société Générale de Belgique were: 1) its own paid-up share capital; 2) savings bank deposits; 3) the issue of fixed interest bearing debentures and notes payable on demand.

This Bank promoted companies for opening up coal fields and for the construction of railways and canals.

The Bank could not work satisfactorily due to its indiscriminate use of saving deposits in long term industrial finance, while its subsidiaries also indulged in heavy borrowings from the parent bank; unmarketable securities held by the bank also contributed to its downfall. However, after an enquiry into its working, a new Board of Management was formed. Its investment trust activities were restricted and the bank was required to devote itself to ordinary deposit banking business by 1851. A new bank in the name The Banque National de Belgique was established.

II.2 The Credit Mobilier

Another of the earliest development banks, the Credit Mobilier was founded by the Pereire Brothers in 1852.
This bank occupied a position of pre-eminence and drew the attention of one and all throughout the world in all discussions with reference to the establishment of specialised institutions for industrial finance. It served as a model to other countries for creating an industrial bank of their own.

The principal objective of the bank was to promote new enterprises by arranging the means of financing in such a manner that it would sell the shares in the undertakings it promoted when they were ripe for the market and then reinvest again the funds thus obtained in new enterprises:

Its achievements included the promotion of a large number of railways not only in France but also in Europe, the establishment of insurance companies and foreign subsidiary banks, the first French Transatlantic Line, gas lighting of Paris and other towns of France. It also issued sizeable amounts of French and foreign loans. Any estimate of the contribution of the Credit Mobilier will be incomplete without looking at the results of French enterprise in heavy industries abroad, especially in Germany. 


In fact its contribution to economic development was of considerable significance and "perhaps the most important of all its contributions to economic development was the 'idea' of development and the 'spirit' of enterprise which was implicit in its conception. Its direct and immediate contributions to the mise en valeur of Europe were considerable, but the indirect and intangible effects of its activities were of greater importance and generated more lasting benefits."

However, its resources became hopelessly entangled in unmarketable securities, mainly of public utility enterprises, and it committed the basic error of using funds other than long term for investment purposes. Though it had the idea of issuing debentures, this was not put into practice. In its hurry to attain success and gain large profits in the shortest time, it overlooked the basic tenet of distributing its risks, which brought about its downfall.

II.3 German Banks

These banks for a long time merely collected and distributed available funds to certain lines of production, like coal mining, iron and steel-making, electrical and general engineering, and heavy chemical

output. The textile industry, the leather industry, and
the food stuff producing industries remained on the
fringes of banks' interest - the main interest was in
heavy rather than light industry.

The Cartelization movement of German industry is
attributed mainly to the amalgamation of German banks.
During the last three decades of 19th Century, Germany
witnessed a rapid concentration movement in banking,
which enabled them to occupy positions, from which to
control competing enterprises. From this vantage position
of centralised control, these banks perceived profitable
opportunities of cartelization and amalgamation of
enterprises. This resulted in the rapid growth of the
average size plant which in turn needed a significant
increase in the banks' assistance more than ever before. 7

It was almost a marvel that ordinary commercial
banks should engage in activities of so diverse and
complicated a character and be able to cope up with such
varied forms of activities and yet maintain their
soundness and liquidity - this they could achieve only
by a punctilious insistence on self-balancing

7. Alexander Gerschenkron, Economic Backwardness
in Historical Perspective, in The Progress of
Underdeveloped Areas, Bert Hesselitz (Ed.),
University of Chicago Press, Chicago, 1952,
transactions and by a judicious distribution of risks.

The secret of their success was that short term deposits were used only for short term credits, whereas loans on long term were based, without exception, on such sources as could be locked up for long periods. The system was undoubtedly suited to the genius of the German people. Finance and industry went hand-in-hand and the grim determination of German people to achieve rapid economic development only strengthened this process of alliance.

But during the war, the system of close liaison between the banks and industries crumbled, as industries made windfall profits without banks sharing in them. The post-war inflation and great depression took their toll of the system and there were several instances of bank failures in Austria and Germany by 1930. The value of the Mark had also fallen, which aggravated the banks position. With the appointment of the commission of investigation into the working of the banking system, mixed banking was brought to an end and the German Credit Act of December 5, 1934 separated investment banking and deposit banking business.

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II.4 **Russian Experiences**

Alexander Gerschenkron cites the case of Russia in his historical perspective, to focus upon Russia's emergence from the revolutionary years of war and civil strife in 1905-06, after the depression in 1900, through the development of St.Petersburg banks which were conducted upon principles that were characteristic not of English but of German banking. The spectacular industrial growth achieved in the nineties was resuscitated in the years 1907-14, and Russian industry reached a stage where it could throw away the crutches of government support and conduct its business on western lines, to which end the banks played a pivotal role. A different type of bank emerged in St.Petersburg banks, overshadowing the Moscow "deposit" banks. A significant point here is that after the initial efforts of the state to reduce economic backwardness, the use of a different instrument of industrialisation suitable to the new 'stage of backwardness', became applicable in terms of St.Petersburg banks.

The continental practice in the field of industrial investment banking must be conceived as a specific instrument of industrialisation in a backward country, but use of such an instrument must be regarded

as specific not to backward countries in general, but rather to countries whose backwardness does not exceed certain limits.\textsuperscript{12}

II.5 The Industrial Bank of Japan

At the dawn of 20th century, the first specialised financial institution to appear on the Asian scene was the Industrial Development Bank of Japan sponsored by the Government of Japan, to finance Japanese industrial development. The French Credit Mobilier gave a fillip to the creation of this institution, which was cited as a model in the deliberations of The Indian Industrial Commission of 1917 and of the Indian Central Banking Enquiry Committee 1931.

The father of the banking system in Japan, Prince Watsukata believed in establishing distinct groups of banks to fulfil different functions and thus found a central bank, an exchange bank and later in April 1902, the long term lending institution, namely The Industrial Bank of Japan.

The Government of Japan lent huge funds at a very reasonable rate of interest through the Deposit Bureau of the Department of Finance, where postal savings deposits received by the Government were kept. The Government did not subscribe directly to the capital of the bank.

\textsuperscript{12} Alexander Gerschenkron, op. cit, pp.12-13.
The bank was empowered to issue debentures not exceeding ten times its paid-up capital, redeemable by lot within 30 years from the year of issue. Such debentures included both the internal and external variety. Long and short term loans were raised by borrowing from the market. The institution dovetailed the functions of an issue house and those of a mortgaged bank.

It also floated and underwrote Government and municipal loan bonds and engaged in commercial banking business too, which included primarily receiving of deposits and discounting of bills.

The Bank had to consult the committee of investments of the Deposits Bureau of the Department of Finance (Government of Japan) for all its investments to ensure that the interest of the State and the public were guarded in a profitable way.

The Bank furnished loans on security of real estate, land and factory building, as also on moveable securities like local and national bonds, shares and debentures of companies. A peculiar feature of this specialised institution is that its long term financing is restricted to five years and hence one can say that the Japanese banks did not provide long term industrial finance at all and at best it was only a medium term loan.
One more glaring feature is that no statutory provision for amortisation of its industrial loans was incorporated whereas in fact such a provision is a distinct characteristic of a mortgage bank dealing with long term credit.

As an issue house, an investment banker and as an underwriter, the Japanese bank assisted a number of companies by floating and underwriting the debentures issued by them. Initially the bank engaged in financing heavy industries like iron and steel, engineering and chemical industries and its association with the ship building industry was conspicuous. During the First World War the bank made considerable profits by its investment in ship building industry but due to the slump that followed after the war, a large portion of the bank’s advances on security of ships became unrealisable and bank was compelled to discontinue its zealous policy of making advances to ship companies for some years after. The public utility companies which were assisted by the banks included railways, tramways, electric power, paper, sugar, waterpower, motor bus, and artificial manure companies.

The bank's generosity in exceptional circumstances was witnessed when it used large funds in restoring vast areas devastated by earthquake. Again, during the financial crisis of 1927 and later in 1930, the bank
proved a saviour, when it took the lead in pulling through some of the most important concerns by not only meeting their working expenses but also by carrying their burden in meeting the commitments in respect of debentures and finance bills, which were due for repayment at that time. The bank always fostered close relations between itself and the industrialists who were its clients. The bank also maintained close co-operation with other banks. It also represented itself in the management of the aided enterprises so as to ensure the safety of its funds; it took special interest in the maintenance of proper accounting system in these companies so that the funds advanced were put to the most efficacious, safe and sound use.¹³

The industrial bank took a leading part in the formation of the Industrial Investigation Association, which signalled a new approach towards industrial finance in the country because of the close co-operation between the industrial bank and the industrialists on the one hand and between itself and other leading banks on the other.

It took special interest in financing and nursing small scale industries especially after the earthquake of 1923 and during the financial crisis of 1927.

It is to be emphasised that even private bankers like the famous house of Mitsubishi, Mitsuis, Sumitomos and Yasudas have played their role in the industrial development of Japan and there are very few enterprises to which one or other of these groups is not linked.

II.6 British Evolution

Until the First Great War, British industries did not depend on long term bank assistance. Industry ran on a small scale, and on a family basis - banking facilities were extended by family banks which had their main offices in the very provinces where the industries developed space. The industrialisation process in Britain was of a gradual nature. Accumulation of capital took place first from earnings in trade and modernized agriculture, and only later from industry itself. This rendered unnecessary any development of specialised institutions to cater to the financial needs of growing industry in the country.14.

Britain had the good fortune of having a large class of investors with money to invest, who could exercise an independent judgement without depending upon banks to advise them in the matter of selection of their investments. This class of investors was present at the crucial time of industrial development in the country and for a long time after.

Issue houses and merchant bankers were also present in the early stages of the country's industrial development, yet they did not make any tangible contribution to the development of British industries. The issue houses kept their assets in a highly liquid form and did not bother to 'nurse' any issue. These houses did not take any risk in holding any issues and were always looking for ways of disposing them off as quickly as possible and of making some profit in the process.

The aftermath of the First War gave rise to a growing realisation of the need for reformation in the financial system so as to plug the serious gap that existed in meeting the medium/long term capital needs of the industry. The British commercial banks, though functioning very satisfactorily at that time, within their prescribed framework, could not go a long way to meet industries' evergrowing finances. A committee of the Board of Trade, appointed in 1916, concluded, that there existed sufficient scope for an institution, without disturbing unduly the present set-up of banking by the British jointstock banks and the colonial banks etc., whereas on the contrary, complimenting their business operations, This institution could provide assistance to British industries in a
manner that was not possible under the then existing conditions. The committee envisaged that such a new institution could assist in a variety of ways, like assistance in overseas business, necessary finances for the extension of existing plants and the amalgamation of existing work to reduce the costs of production, while also encouraging a new class of young entrepreneurs. The British Trade Corporation which was to have been formed on the recommendations of this Committee (1916) turned out to be still-born.

The vexed question of long term financial facilities, was considered before the Balfour Committee on trade and industry in the late 1920s. This Committee felt, that there was a gap in the machinery available for the financing of industry on a long term basis and urged the government to take effective steps to fill this gap.

Again in 1929, the British Government appointed another Committee known as the Committee on Finance and Industry with Rt.Hon'ble H.P.Macmillan as its Chairman; included also more eminent economists and businessmen. The Committee recognised that small and medium industries were put to much hardship and that a 'gap' in the financing mechanism existed, which till
today is referred to as "Macmillan gap", as this was highlighted in clear terms for the first time. The Macmillan gap focussed on two needs - firstly; that of "intermediate credit", which is, too long for bank credit and too short for the new issue market; secondly; credit for the "small man", whose capital requirements are not large enough to be handled economically by the new issue market.

Some efforts were made to fill the 'gap' even before the Macmillan gap was widely known, in the creation of the Securities Management Trust Ltd. in 1927, as a private company owned by the Bank of England, and in 1930, in the formation of the Bankers Industrial Development Company with the Governor of the Bank of England as its Chairman, even though it was a private company. The Securities Management Trust took special interest in implementing and financing rationalisation schemes, while the Bankers Industrial Development Company (1937-40) was a unique body, characterised as a national consortium of British bankers, in which the representative of every important bank and issue house and above all even Bank of England was present. It limited its scope to only those schemes that related to an entire industry and not to an individual enterprise.
Credit For Industry Limited was one more institution that came into existence in March 1934, under the United Dominions Trust, of which the Bank of England had become the largest shareholder. This institution took special interest in small and medium size industries, though it provided credit for all types of industries for periods longer than the temporary accommodations of the banks. The borrowers banks recommendations for loans from this institution were essential, along with their commitments in respect of their overdraft facilities to these borrowers.

Concrete steps to fill the 'Macmillan gap' were taken in the post-war period in the creation of the Industrial and Commercial Finance Corporation Ltd. (ICFC) and The Finance Corporation for Industry Ltd. (FCI), both in 1945. Again in 1948, the Colonial Development Corporation and in 1952 the Commonwealth Development Finance Company, were created and all these post-war developed institutions go beyond the role of merely filling the 'Macmillan gap' and can rightly be described as the development banks. The ICFC was created to provide finance to small and medium size industrial and commercial units, which did not get help from banks or which were not in a position to raise funds in the stock market. In other words, the facilities provided by the ICFC were meant
to augment and not to replace existing finance, and the proprietors of the enterprises assisted by the corporation were asked to have a substantial stake in the business. The Corporation intervenes to help out any enterprise when need for additional working capital arises, to cope up with increased turnover, resulting from acquisition of additional fixed assets. It may so happen that the Balance Sheet and Prospects of a company do not justify an unsecured loan but the company may need additional working capital to finance an increased turnover. Here the Corporation helps by extending finance partly on mortgage of the fixed assets and partly in preference shares, while the floating assets are left free as security for the bank, as this step strengthens the position of the company in the banker's eyes. This policy of the corporation has often been used in collaboration with several of the banks and has been popularly termed as "I.C.F.C. Sandwich".

Whereas the ICFC's interest is in small and medium industries, the FCI concentrates on those large scale industries which have bright prospects in the future, and yet cannot be immediately financed by the banks or through the capital issues. The FCI's emphasis is on development of the key industries of
the future. The Corporation can participate in equity capital, besides providing fixed interest loans on lien basis. The FCI is wholly owned by the consortium of insurance companies, trust companies and the Bank of England in the proportion of 40, 30 and 30 per cent. A major source of its finance is through borrowing powers amounting to four times the amount of its capital viz. £100 million.

The Industrial Reorganisation Corporation (IRC) is one more institution, set up in 1966, to participate in schemes for concentration, rationalisation and modernisation of industry, and in particular for the merging and regrouping of firms into larger units to meet the changing situation in the markets for many products.

II.7 The European Mortgage Banks

A number of mortgaged banks in Europe emerged soon after the World War I, for reconstruction and modernisation of Europe. These banks granted long term amortisation loans on first mortgages of property and issued bonds to raise the funds to meet these loans. Hypothecation of real property, factories, buildings, machinery and plants were considered for the purpose of loans. Some of the important of these banks are the Industrial Mortgage Bank of Finland Ltd., the National Hungarian Industrial Mortgage Institute Ltd.,
the Provincial Mortgage Bank of Saxony, and the National Economic Bank of Poland. These banks played a vital role in rebuilding the war-torn industrial economy of their respective countries. For instance, The Industrial Mortgage Bank of Finland, which was one of the earliest and most important of the institutions to be established in post-war Europe, granted the long term credit requirements of industries by way of amortisation loans on mortgage of real estate, ground, machinery, forest, water power and factory buildings in Finland. This Bank did not subscribe to share capital nor underwrite the shares. It did not even provide working capital to industry. The amount of loan sanctioned in each case was not to exceed 50% of the value of the industrial property mortgaged. The period of amortisation of loan was not to be more than 25 years. A restriction imposed was that a single industrial undertaking could not be granted more than 15% of its total borrowings. The bank had to transfer 25% of its profits to a Reserve Fund until the fund amounted to 25% of the share capital and thereafter not less than 5% until the Reserve Fund amounted to 50% of the share capital. Shareholders might get 6% as dividend only after the Reserve Fund amounts to 50% of share capital and moreover a provision was made for a fund which would redeem the guarantees undertaken by the Bank on behalf of its borrowers. The Board of Directors of the Bank consisted of 7 members, one of whom
was appointed by the Ministry of Finance as the Finnish Government guaranteed the bond loans floated abroad by the Bank.16.

In contrast to the mortgage type of industrial banks on the European continent after World War I, other institutions which combined long term lending with issue, underwriting and the holding of shares were, the Industrial Credit Company of Ireland, Netherlands company for Industrial Financing, the Swedish Industrial credit Company. The Industrial Credit Company of Ireland, for instance, included in its functions - a) capital underwriting and issue house services; b) direct share investment; c) long term and medium term loans; d) special loans for reequipment and expansion; e) hire purchase finance for new industrial plants and for machinery.17.

II.8 Industrial Financing in America

Before the Civil War American enterprises were comparatively small, and so self finance was adequate - entrepreneurs used their own and their families funds, and expansion occurred mostly through reinvestment of profits. In this way, the efficiency of the entrepreneur


as a manager had a direct bearing on American Industrial expansion.\(^{18}\).

After 1820, to meet the need for large capital for the growth of transportation and public utility enterprises, the American entrepreneurs and the government devised new techniques of combined European and American origin. This resulted in purchase of stocks by commercial banks for their portfolio, commercial banks' renewable loans, the cooperation of real estate companies, construction companies and state and local governments.\(^{19}\).

Commercial banks played their part by accommodating manufacturers and farmers with loans of long term, besides financing some of the early developments in railways. Development of a local unit banking system, in contrast to British Banking system, grew in response to needs of local entrepreneurs in the frontier areas, who required finance for their own local needs, against the security they could offer, most often land - this type of security was in contrast to the types of security required by the English banking system. Right until the civil war, the banking


\(^{19}\) Ibid., pp.345-348.
system was consistently overloaded, by British or Indian standards, with credit deposit ratios of more than 100% at times. 27.

As in Europe, investment banking and the securities markets developed out of federal and state government flotations — special companies were created to issue stocks and bonds in which State and local governments invested heavily, alongside the commercial banks.

Funds were required before the Civil War, mainly for the construction of railways, turnpikes, and canals. A good part of the capital also came from Europe, specially from Great Britain, where shares and bonds of American railways and canals, besides US Government bonds, were purchased. Foreign capital was also heavily engaged throughout the century in secondary industry. Between 1865 and 1900, about 1500 British companies were established west of Mississippi, chiefly in connection with railways, and also in cattle and sheep raising, mining, limbering. The participation of Governmental authorities in expansion of public works in the U.S., was of critical importance, where new and undeveloped

27. Barry Hammond, Banks and Politics in America - From the Revolution to the Civil War, Princeton University Press, 1957 (see George Rosen,'Some Aspects of Industrial Finance in India, New York, Asia Publishing House, 1962, p.3)
Different types of financial intermediaries were formed in U.S.A. before the Civil War and towards the end of 19th century. These intermediaries became important means of financing most of the country's large scale industrial enterprises, as the enterprises grew and Corporation came into vogue with industrial securities appearing in the exchanges. The American capital market grew in stature and served the ever expanding American economy. Large scale enterprises especially have skimmed the cream off the activities of the capital market. 22.

The banking system, even today, continues to provide term loans for small as well as large concerns. Bankers also take active interest through participation in the Board of Directors and approval of the management of companies they created or controlled through their finance. 23.


Self financing seems to have increased in the country since World War II, and in many cases there is a tendency not to approach the capital market mechanism. Small business units still faced difficulties in respect of arranging for long term capital, inspite of the efforts of the Reconstruction Finance Corporation, the Federal Reserve Bank and the Small Business Administration. It was estimated in the early 1950s, that 20% of small business units were put to much hardship in filling up the 'financial gap', some needing equity and others loans.

A new kind of local institution known as the Development Credit Corporation, most of them non-profit organisations obtaining funds from voluntary subscriptions or donations, supported by individual committees and in some cases local government, has been promoted to assist small concerns. Since their beginning in 1949, these Development Credit Corporations have assumed large dimensions in many states and their funds position have vastly improved due to assistance from other financial institutions, the Small Business Administration, and at times from Government contributions.

25. William Diamond, op. cit., p.34.
II.9 Industrial Development Bank of Canada

This was established after the World War II in 1944, as a subsidiary owned by the Bank of Canada, with a view to helping an enterprise with capital needs, which are of longer duration than given by bank practices, yet not large enough so as to raise the funds through a public issue or through securities. The main purpose of this bank is to supplement rather than to compete with the activities of the existing lending institutions and is operative principally in medium and in long term finance.

The bulk of finance is through direct loans though it has powers to share in or guarantee loans made by banks, besides the underwriting or the purchasing of securities issued by the borrower. Different types of assistance are provided to suit individual needs and interests. Mortgage of the existing buildings, hypothecation of machinery and equipments are considered as security but stress is also laid on the ability to repay a loan from prospective earnings.

II.10 The Industrial Finance Department of The Commonwealth Bank of Australia

The Central Bank of Australia opened a special department performing the same functions as the Industrial Development Bank of Canada or the I.C.F.C.
and F.C.I. of Great Britain, which were described earlier. But this Industrial Finance Department in Australia, has its own unique features. The department judiciously makes an assortment of overdraft and hire purchase facilities in such a way that the manufacturer, the distributor, the retailer and the individual buyer too, get finance from one single source — by this process it tries to lubricate with finance every link in the long chain from the producer to the ultimate consumer and facilitate smoothness in the operations between the various interests.26.

The functions of the Industrial Finance Department include27: (1) To provide finance for the establishment and development of Industrial undertakings specially small undertakings; (2) To provide advice on the operations of industrial undertakings with a view to promoting the efficient organisation and conduct thereof.

Financial assistance is provided in different forms suiting individual needs. They include:

1. Overdraft;
2. Fixed loan (mortgage or debenture);
3. Hire purchase finance;
4. Subscription of capital to a company;
5. Underwriting the issue of shares by

27 Section 95 of the Commonwealth Bank Act, 1945.
a company.

The Department does not get itself bogged down with normal banking standards for loans, while inability to provide full security does not preclude an undertaking from the purview of the department, if it thinks that with some finance, the undertaking can develop into a successful unit — in other words each proposal is handled on its merits. The Department satisfies itself that the proprietor has his own stake or equity in the undertaking. Economically viable and commercially successful units are always entertained.

II.11 The Chilean Development Bank

The Chilean Corporación de Fomento de la Producción established in 1939 in South America has been considered to be the best model on the American Continent and was specially launched for reconstruction and development after the disastrous earthquake. The Fomento was superimposed on already existing institutions such as the Mining Credit Bank, the Agricultural Credit Bank, the Industrial Credit Institute, the Agricultural Colonisation Fund and the People's Housing Fund.

The functions of this Fomento are: (i) to prepare long range programmes for the approval of political authorities; (ii) to undertake studies of all aspects of the economy; (iii) to raise capital from
foreign and domestic sources for the implementation of
development plans; (iv) to carry out these plans by
forming subsidiary corporations, participating in mixed
enterprises and investing in private enterprises;
(v) to purchase farm machinery and other equipments to
implement agricultural programmes and arrange for their
sale and delivery.

Thus the Fomento has promoted varied programmes
in industry, agriculture, construction of houses, public
utility services. It concentrates specially however on
electricity, petroleum, coal, metals, chemicals, cement,
rubber, textiles industries. The general policy of
Chile, which is not enamoured of socialism as found in
other South American countries, is one of promoting
industrial development by all means, like encouraging
the formation of private enterprises, participation in
their capitalisation, influencing their policies and
providing them with technical and administrative services.
Even if it participates in the share capital of industrial
concerns or governmentally owned enterprises or of public
utilities nature, it does not permanently bind itself
with shares, as its capital is considered as revolving
fund which continuously swells by the profitable sale of
its shares of the concerns, which having become firmly
established, no longer stand in need of the Fomento's assistance.

The Fomento has its sources of finance in internal and external loans, earmarked taxes in budgetary appropriations and above all from profits of its own investments and operations.\textsuperscript{29}

II.12 The National Financiera of Mexico

Though this was created in 1934, it acquired the character of a true development bank with its reorganisation in 1941.

It acted as a creator and financier of enterprises, a mobiliser of domestic capital, a channel for foreign lending, a regulator of stock exchange, and an agent for federal and local governments.\textsuperscript{30}

It now has various sources of funds: financial institutions subscribe to its shares in certain proportions; it borrows at home and abroad and can draw substantially on the Central Bank of the country; government funds are kept with it, which it can use for its own lending purposes by judicious management of these funds, after meeting governmental commitments.


\textsuperscript{29} Hermann Finer, The Chilean Development Corporation (LO Studies & Reports, New Series, No. 5, Montreal, 1947).

Its interests are concentrated on those enterprises where government is also a participant. Iron and steel, assembly and production of vehicles, food processing, transport, power and construction, have received its particular attention. These enterprises even obtain working capital from this Financiera, which also extends rediscounting facilities to private Financieras of Mexico and also to government banks. 31.

II.13 Development Bank in Philippines

The National Development Company was among the first of the development banks, established in Philippines in 1919. Its main functions were: to finance and engage in commercial, industrial, mining, agricultural and other enterprises, to hold agricultural and mineral lands, to purchase, pledge or dispose of stocks, bonds and securities of other corporations, to guarantee the bonds of other companies, to organise subsidiary companies under its own control and to take dominant part in public utilities and services.

However this Development Company did not succeed in making a significant impact on the economy of the Philippines. This was attributed to the fact that its

31 J.S. Srivastava, Capital Funds in Underdeveloped Countries, 1976, p. 219
autonomy was considerably circumscribed by the government and whatever it did, it did haphazardly and planlessly. 32.

II.14. Development Banks in Pakistan

A number of development banks have been established in Pakistan, for both small and large scale industries, like the Industrial Development Bank of Pakistan (IDBP), Pakistan Industrial Credit and Investment Corporation (PICIC), Pakistan Industrial Development Corporation (PIDC) and the Small Industries Corporation (SIC).

IDBP was set up in 1961, in place of the Pakistan Industrial Finance Corporation (PIFCO) which was originally established in 1949 on the pattern of Industrial Finance Corporation of India — this change was effected on the suggestion of the Credit Enquiry Commission of Pakistan. IDBP's main interests lie in medium and small industries with a view to widening the country's industrial base and also to creating a class of entrepreneurs. Certain commercial banking functions, like opening cash credit, granting letters of credit are also performed by the IDBP.

51 per cent of the share capital is held by the government and the rest by other financial institutions. Its foreign currency resources are higher compared to its Rupee resources and it prefers to finance export oriented or import substitute projects.

The PICIC has modelled itself on the pattern of our Industrial Credit & Investment Corporation of India—60 per cent of its capital is subscribed by private Pakistani investors and rest by the International Finance Corporation and private interests in U.S.A., U.K., West Germany and Japan. The PICIC provides loans, guarantees, underwriting facilities and also participates in equity. In addition it undertakes developmental functions.

The Pakistan Industrial Development Corporation was established in 1958, in a manner similar to our National Institute of Development Corporation, for helping large and medium size industries. For the expansion and the development of small scale and cottage industries, as we have done in India, in the establishment of National Small Scale Industries Corporation, the SIC was established in Pakistan in 1955. However later on its functions were taken over by the Pakistan Industrial Development Corporation.
Any historical survey of the growth of development banks is incomplete without reference to West Germany’s Kreditanstalt fur Wiederaufbau, popularly known as KfW (Reconstruction Loan Corporation), established in 1948, for giving loan assistance to the developing countries in addition to domestic enterprises. India has been one of the beneficiaries of such assistance. Another development bank, the Industriekreditbank, referred to as IKB, was formed in 1949, to provide long term finance for the reconstruction and modernisation of industries in Germany. KfW is a public institution while IKB is a private one.

II.15. Concluding Observations

The historical survey of development banking abroad in the foregoing pages enables us to draw certain conclusions that are useful when considering development banks of more recent origin, or those that are still to be set up. India too has benefited, in the setting up of variegated development banks to suit its developmental needs. The points to note are: (1) Many countries associated governments in the share holding of the development banks for sound working — in some it is part ownership and in others full ownership by the government prevails. For instance, we saw that The
Industrial Bank of Japan was sponsored by the Government of Japan; The Industrial & Commercial Finance Corporation Ltd. (ICFC), The Finance Corporation for Industry Ltd. (FCI) and The Commonwealth Development Finance Company, and The Industrial Reorganisation Corporation (IRC)—all these institutions were set up on the initiative of the U.K. Government; The Chilean Corporación de Fomento de la Producción was specially launched by the Chilean Government; even in Pakistan the Industrial Development Bank of Pakistan (IDBP), Pakistan Industrial Development Corporation (PIDC) and a few others were set up on the initiative of Pakistan Government.

2) Public ownership is also achieved by making the Central Bank of the country hold the shares of development banks, as in the case of the Central Bank of Australia, which opened a special department: or the Industrial Development Bank of Canada—a subsidiary owned by the Bank of Canada. The Canadian Royal Commission on Banking and Finance, which reviewed in 1964, the Central Bank's control over development bank, favoured the development bank as a subsidiary of the Central Bank, since this appears to shield it from interference in its exercise of sound business judgement.

3) Control of development banks by the Government proves effective as it can issue broad guidelines of policy or directions in consonance with development planning. The Central Bank can perform the coordinating function for different development banks — coordinating their policies and operations in keeping with national interest. However, there is always a feeling that government's interference in day-to-day operations should be kept at a minimum.

4) Financial assistance; it is provided through direct loans only, or loans and investments, including underwriting in assorted type. Direct loans can be in local currency or in foreign currency or both. Loans can be on medium term or long term basis. The earliest of all the industrial financing institutions, the Societe General de Belgique in Belgium, provided long term industrial finance and so too did the other pioneer in development banking, the Credit Mobilier in France. However, the Industrial Bank of Japan yet another old institution, did not provide long term industrial finance and at best the loans it provided were medium term loans only. In Britain the focus was on the 'Macmillan gap' viz, 'intermediate credit' — too long for bank credit and too short for the new issue market. The Credit for Industry Limited was
launched in March 1934, to fill up this 'gap' thereafter the Industrial and Commercial Finance Corporation Limited (ICFC), the Finance Corporation for Industry Limited (FCI) were both created in 1945. In the case of Industrial Development Bank of Canada, it is prepared to give assistance when an enterprise needs capital but not large enough to warrant the public issue of securities or when the bank loan needed is for a longer duration than that given under normal bank practices — in other words, it is intended to supplement rather than to compete with the activities of banks and other lending organisations.

The Australian experiment in creating Industrial Finance Department of the Commonwealth Bank of Australia, is unique insofar as the department judiciously combines overdraft and hire purchase facilities, to finance the manufacturer, the distributor, the retailer, and the individual buyer so that finance from one single source is made available to every link in the long chain from the producer to the ultimate consumer.

The National Financiera of Mexico, extends rediscounting facilities to private Financieras of Mexico as other government banks.

The two earliest institutions, namely the Societe-Generale de Belgique and the Credit Mobilier, promoted
new industrial companies by taking up for themselves considerable amounts of shares of the companies. The Japanese Industrial Bank assisted a number of companies by floating and underwriting the debentures issued by these companies. In Britain the PCI, can participate in the equity capital of the business units.

The Chilean Corporación de Desarrollo, though it participates in the share capital of industrial enterprises, does not bind itself permanently, as its capital is considered as a revolving fund, periodically replenished by the profitable sale of its shares in concerns which, having become firmly established, no longer require its assistance.

5) Units assisted: We have seen above that some of the development banks concentrate on medium and small units only, while others assist only large and medium scale units. For instance, the German banks devoted themselves to those branches of industry where cartelization opportunities were ripe and it was mergers in the field of banking that kept placing banks in the position of controlling competing enterprises and of reaping profits arising on account of the cartelization and amalgamation of enterprises.

Credit for Industry Limited in Britain, took principal interest in small and medium size industries,
while the Bankers Industrial Company, a unique body representative of every important bank, issue house and
the Bank of England, restricted its scope only to those
schemes that related to an entire industry and not to
an individual enterprise. Again, the ICPC's interest
has been with small and medium industries whereas the PCI
concentrates on large scale industries in Britain.

The Industrial Bank of Japan, though it promoted
large industries, took special interest in financing and
nursing small scale industries.

6) Types of industries assisted: The development
banks many a time concentrate on certain types of indus-
tries. For instance, even the German banks way back at
the time of World War I, devoted themselves essentially
to coal mining, iron and steel making, electrical and
general engineering, and heavy chemical output, in other
words it was heavy rather than light industry to which
attention was devoted. The Societe General de Belgique
promoted companies for opening up coal fields and for
the construction of railways and canals. The Credit
Mobilier promoted a large number of railways, insurance
companies, French Transatlantic lines, gas lighting of
Paris and other towns of France. The Industrial Bank of
Japan initially engaged in financing heavy industries,
which included shipping, iron and steel, engineering and
chemical industries.
The Securities Management Trust in Britain played a leading part in implementing and financing industrial rationalisation schemes.

The Chilean Fomento promoted varied programmes in industry, agriculture, construction of houses, public utility services, though it concentrated specially on electricity, petroleum, coal, metals, chemicals, cement, rubber, and textile industries.

7) Securities: Development banks furnished loans on security of real estate, land and factory buildings as also on moveable securities such as, local and national bonds, shares and debentures of companies, as we saw in the case of Industrial Bank of Japan, which provided a large portion of advances, in the earlier years of its existence, on security of ships while making advances to ship companies.

Normally the proprietors of any enterprise assisted by the development banks are expected to have a substantial financial stake in their business. Sometimes the borrower banks recommendations for loans from the development bank, as in the case of Credit For Industry Ltd., was essential along with their commitments that ordinary banking overdraft facilities would be continued as per requirements of the business.

Sometimes, as we saw in the case of ICF in Britain, the development bank intervenes to help out
a company when additional working capital is needed to cope up with increased turnover resulting from acquisition of fixed assets. An unsecured loan however is not justified, by a part mortgage of fixed assets and a part in preference shares, while leaving the floating assets free as security for the bank to strengthen the company's position to secure additional working capital as per banks norms (this policy, as we saw has been popularly termed as 'ICFC sandwich').

In the case of the Industrial Development Bank of Canada, we saw, that the bank considers the existing value of building, machinery and equipment as security besides the ability to repay a loan from prospective earnings.

To promote small scale industries, the security aspect recedes in to the background, as we saw in the case of the Industrial Bank of Japan and the Fomento in Chile.

8) Sources of funds:
   a) Share capital and Reserves (retained profits);
   b) Borrowings (largest source) through:
      (i) Public bond issue with institutional investors as the principal subscribers. We saw that the Industrial Bank of Japan was empowered to issue debentures not exceeding in times its paid up capital, redeemable by lot within 30 years from the year of issue - such
debentures consisted of both internal and external types.

The Societe-Generale de Belgique issued fixed interest bearing debentures and notes payable on demand.

The Credit Mobiler towards the end of its existence found itself in hopeless financial crisis mainly due to its failure to put into practice its original plan of issuing debentures.

(ii) Loans from government and Central Bank: As we saw above, the Government of Japan lent huge funds at a very reasonable rate of interest through the Deposits Bureau of the Department of Finance, where postal savings deposits received by the government are kept, or the Chilean Fomento, which borrows from the government, or the Industrial Finance Department of the Central Bank of Australia, which borrows from the Central Bank or the Industrial Development Bank of Canada which also borrows from the Central Bank. Borrowings are also resorted to from foreign sources, apart from borrowings at home, e.g. the National Financiera of Mexico, the Chilean Fomento.

(iii) Deposits of Government and other institutions: As we saw in the case of the National Financiera of Mexico, it has plenty of government funds which it uses for its operations, without endangering its commitments to the government - in other words the deposits received from time to time are judiciously managed for the purpose of loans and investments, which it concentrates
on those enterprises, where government is also a participant. As said earlier, even the Industrial Bank of Japan used profitably the postal savings deposits received by the government.

(iv) Budgetary allocations annually by government as grants: This type of source of funds is earmarked, as we saw, in the case of the Chilean Fomento and the National Financiera of Mexico.

c) Sale of investments from the portfolio and repayment of loans effected by borrowers from time to time of the loans availed from the development bank in the previous years: It is obvious that this source of funds is available to all the development banks described above.

d) Functions performed by development banks: They differ from bank to bank, as the emphasis on their various activities has shifted from one country to another according to its special needs and circumstances - in some countries the banks concentrated merely on finance, while in others the banks emphasised promotional aspects and in still some other countries technical skill and advice; economic planning itself is a burden placed on the development bank, 34 as we saw in the case of the Chilean Fomento, which has to

undertake studies of all aspects of the economy and carry out its plans by forming subsidiary corporations and participating in mixed enterprises. Even the earliest of the development banks, namely The Societe-General de Belgique and the Credit Mobilier promoted a large number of enterprises. The Industrial Bank of Japan did the same.

10) It should be kept in mind that the Societe-General de Belgique could not work satisfactorily on account of its indiscriminate use of savings deposits in long term industrial finance and its financial subsidiaries borrowing extensively from the parent bank on unmarketable securities. Even the Credit Mobilier after outstanding achievement, had to close its operations mainly due to its resources becoming hopelessly entangled in unmarketable securities and also due to its failure to follow the basic principle of distributing risks - it was in a hurry to attain success and gain large profits in a short time for which it even used short term funds for investment purpose. In the case of the Industrial Bank of Japan, though during the First World War, the bank made considerable profits by its investment in ship-building industry, during the slump that followed after the War, a large portion of the bank's advances on security of ships became unrealisable. On the contrary the secret of the
success of the German banks was that the short term deposits were used only for short term credit, whereas the loans on long term were based only on such funds available to be locked up for long periods. This is a cue for development banks of today.

11) Yet another cue to be taken by the present development banks is from the Chilean Fomento, which though it participates in the share capital of industrial enterprises and that too governmentally owned or of public utilities nature, does not hold the shares for long durations, as it considers its capital as a revolving fund, which is always to be replenished from time to time by the profitable sale of the shares of the business units, which no longer require the Fomento's assistance as by then they become firmly established. By this process new companies can be piloted by the Fomento.

12) For the most efficacious, safe and sound use of the funds supplied by the development banks, it is not only necessary to foster close relations between the development banks and the industrial units which obtain funds from it, but also it is useful to go a step forward and participate in the management and accountancy of the aided enterprises, to ensure the safety of the funds invested, as we saw in the case of Industrial Bank of Japan. Even the ICFC in Britain, as described above, provided advice on the operations
of industrial undertakings with a view to promoting efficient organisation and conduct thereof. This aspect should not be lost sight of by the development banks of today.

12) As already described, Gerschenkron rightly pointed out in his historical perspective, the role of St. Petersburg banks as instrument of industrialisation, were suitable to the 'new stage of backwardness' in Russia in the years 1912-14 - in other words, development banks must be modified or new ones are to be created to adapt to different stages of economic development.

Our attempt here, in enumerating different aspects of development banking (points 1 to 13) as a result of experiments made in different countries, is to emphasise that India could draw upon those experiences gained elsewhere, especially in developed economies. India has no doubt adopted this varied and rich experience of development banks in different countries, in the constitution and objectives of its own development banks. The adaptation was primarily to suit the process of India's economic development at different stages, as we shall describe in Section (II) of this chapter. Before this, it is necessary to take an overview of the pre-independence organization of Industrial Finance in this country so as to appreciate the special need for the creation and development of special financial institutions.
Section (II) : Development Banking in India

II.16 Evolution of Commercial Banking

It made its beginning only during the second half of the 19th century with the initiative of British and European entrepreneurs, who needed these banks for their foreign trade and for the transmission of funds to their home country as these entrepreneurs reaped higher profits in India than at home through the exploitation of natural resources in this country. These banks were modelled on the lines of the British Banking system and there were branches of English banks too. The English investors ploughed back their earnings into business, and banking facilities were needed by them for transfer of foreign exchange and meeting short term credit needs arising out of orders placed and payments to be made, credit to pay the farmers for the cash crop before processing for further use in manufacturing, to finance the shipment of the finished products to the market, were the purposes for which short term funds were needed and the banks maintained their typical English character as institutions for the supply of short term credit. With this beginning the Indian banking system throughout its history confined its operation to financing just the short term requirements of industries.

There were two distinct periods when Indian commercial banks showed interest in long term finance. The Swadeshi movement of 1906-13, gave impetus to Indian owned joint stock banks for fostering indigenous industries. There was a rapid growth of joint stock banking during these years, with the new banks undertaking various types of business with a view to provide long term finance to industry. These Swadeshi banks indulged in various methods of investment banking and subscribed to shares and debentures of industrial company but in reckless manner and frenzied speculation. This resulted in large number of bank failures and a severe banking crisis in 1913-15. Nearly 34 per cent of total paid-up capital of Indian joint stock banks, were lost during 1913-17. Huge advances given to industrial ventures were not recovered. Every known principle of investment banking was violated as these banks which were primarily deposit banks locked up almost the whole of the resources in long term industrial investments resulting in disastrous consequences.

II.17 Industrial Banks

At the end of the First World War the idea of forming 'Industrial banks' caught the imagination of our countrymen. This came in the wake of the success

of Japan and Germany in industrial progress, where such specialised banks had played their part. Even in May 1917, when the Government appointed an Indian Industrial Commission for the development of industries in India, it felt the lack of financial facilities as the stumbling block to the industrial development of the country and favoured the establishment of an institution modelled on the lines of the Industrial Bank of Japan. The Government, however, erred surprisingly in recommending that a large portion of its business be confined to the provision of working capital only, which in fact would defeat the very purpose for which it was to be started viz, long term industrial finance.

The Tata Industrial Bank, The Calcutta Industrial Bank, The Indian Industrial Bank, The Mysore Industrial Bank, The Industrial Bank of Western India, were some of the banks, which made their appearances in the country. Amongst these the Tata Industrial Bank was the earliest and the largest, with an authorised capital of 2.12 crores, of which more than two crores were fully paid up by September, 1922. However, the failure of the Tata Industrial Bank, can be attributed to the following:

a) The Bank combined commercial banking with investment trust business but did not follow the norm

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that only long term funds should be invested in industrial units - it merely wanted to transplant the German model on Indian soil, without following the norms of the German banks;
b) It did not issue debentures for financing its long term investments, which as we saw earlier, brought about the downfall of the French Credit Mobilier;
c) Considerable holding of shares by the bank, on permanent basis, especially of doubtful concerns;
d) The ignorance and inexperienced management of the bank hastened the crisis;
e) Like the French Credit Mobilier it tried to achieve rapid success in a short period, which led to its downfall. The Tata Industrial Bank was controlled by European employers and the rights of Indians were ignored. This led to the unpopularity of the management and the alienation of the sympathy of the Indians.

Like the Tata Industrial Bank the other industrial banks also failed in their attempts, as they did not follow the basic principle of separating short term and long term finances. Heavy funds were invested in doubtful concerns, which happened to be 'pet concerns' of the directors, the directors themselves taking heavy loans without having any intentions of repaying. Within four years of their
start, all these industrial banks disappeared in quick succession.

II.18 **Indian Central Banking Enquiry Committee**

The problem of long term industrial finance was taken up by this Committee in 1931, in yet another attempt at the formation of special institutions for this purpose.

The majority of the Committee members felt the need for the establishment of 'Provincial Institutions', although some urged for the establishing of an all-India institution. The majority was carried away by the recommendations of a number of Provincial Banking Enquiry Committees for setting up industrial banks to cater exclusively to the needs of the provinces. Any attempt in the setting up of a central institution was feared by the provinces, as it might then dominate the provinces and ignore their local interests. However, at the same time, certain economists made a strong plea for the establishment of an all-India Industrial Bank, besides those at the provincial level. Nothing concrete emerged in this direction.

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41. Ibid., pp. 333-337.
until July 1948, when the first development bank, the Industrial Finance Corporation was set up.

A short description at this stage on the investment climate and capital market, that prevailed in India at the time of setting up of the first development bank, is required so as to focus on and perceive the tasks to be faced at the time of independence, by this bank and other specialised institutions that followed it.

II.19. Indian Capital Market:

It has been, since time immemorial, underdeveloped and devoid of institution like issue houses and investment banks, a situation now redeemed to the extent of the creation of a couple of all-India development banks and state financial institutions after independence. Insurance companies, unlike in other developed countries, where they have played a significant role as an institutional investor in industrial development, invested their funds in Government and semi-Government securities. Debentures, a hot source of industrial finance, were never popular in India and the Indian Central Banking Enquiry Committee, 1931, also pointed out that industrial concerns which issued debentures, did not evoke the support of the banks. Indian investors were shy and reluctant to invest in industrial

securities and preferred to invest in tangible assets, like land and house property, or in government and municipal securities or postal savings schemes. Investment in gold and jewellery, above all, has always been a dominant trait in the character and pride of Indians. 43.

George Rosen's observation 44 on investment habits in India, is relevant and worth mentioning here. He says that the interest rates earned on money lending in the rural sector in India are high (a minimum of 16 and the maximum varying between 30 and 100 per cent at times). This results in the landed money-lender being least bothered about investing in industry. There is also ignorance and fear of investment in industry and urban activities on the part of landed money-lender to whom, moreover, industrial investment will not be attractive by itself, in the initial stages of industrialisation. To him, other investments than in agriculture or money lending, will be attractive only in a situation when his returns from the present investment diminish as a result of reforms initiated by the government in agriculture and in socio-economic structure.

The capital market and the money market are inter-dependent, with a relative rise in the rate of interest in the money market increasing the demand in the capital market, and any increase in the rate of


interest in the capital market being felt in the money market - the process through which long term capital is formed cannot ignore the money market. The money market in India is bedevilled by an unorganised section comprising indigenous bankers and money-lenders, and there is an absolute lack of inter-connection between the organised and the unorganised market. Interconnections within the unorganised market are also lacking due to which a free flow of loanable funds, from areas where they are in plenty to areas where they are scarce, is hampered. This results in the rate of interest being unusually high in some centres and low in others. Even the organised section is no better and there prevails unsatisfactory conditions for both long and short term capital.

The ill-developed capital market is attributed to: 45.

i) agriculture, constituting the main occupation, did not lend itself to the floatation of securities;

ii) foreign business enterprises, which accounted for a major part of industrial concern in the past, were dependent on the London capital market rather than on the Indian market.

iii) the managing agency system was also responsible for the non-development of capital (we have given below some details of the working of the managing agency system).

iv) government securities accounted for more than half of the total volume of issue in the capital market and ordinary shares were the predominant type of security, while debentures and preference shares, whose price movement usually showed a close co-relation with those of government securities, occupied a limited place;

v) the restrictions imposed on investment patterns of the various financial institutions, circumscribed the capital market even during the 1950s: while the institutional investors were primarily interested in government securities, the speculators were mostly concerned in short list of speculative shares; the class of investors was very narrow and continuous dealings in a large range of securities was conspicuous by its absence.

II. 20. Managing Agency System:

Some elaboration of the role played by the managing agents is essential for our study since the system successfully mobilised available resources into the field of industries and induced the public to subscribe and invest their savings in enterprises.

The system came into existence in the second half of the 19th century and promoted new companies, provided finance through equity, preference shares, debentures, loans and deposits to the companies, besides acting as guarantors of loans, advanced by
commercial banks. In the early days due to the absence of large classes of investors most of our large scale industries like, cotton, jute, textiles, iron and steel and plantations, had to depend on this system. The promotion of The Tata Iron & Steel Company speaks for its importance in pioneering and experimenting work in industrial ventures. A number of other prosperous and flourishing industries of today owe their existence to the managing agents. These agents even retrieved many companies from bad shape and liquidation. In fact if it were not for them many an industry of significance would have been lost to the country, with shareholders losing everything. They provided management and supervision in both factory and field including technical services, developed markets for the finished products, not only domestically but also overseas through arrangement of shipping services and finance.

They provided long term funds for extension and reorganisation purposes. They attracted funds not only from their friends and relatives but as underwriters they could mobilise huge funds from the public. The response to Tatas in 1912, when £1,630,000, was secured

46. Dr. P. S. Lokanathan, 'Industrial Organisation in India', p. 33.
within three weeks time, the entire amount contributed
8000 Indians is a well known fact.

Dr. RaI K. Nigam, Prof. Basu and the NCAER have
provided useful statistical data in respect of managing
agents. For instance, Prof. Basu has shown that out of
Rs. 215 crores of the paid-up capital of 1720 companies,
the managing agents subscribed Rs. 20 crores, 14 per cent
of the total paid-up capital. Their share in loans and
advances was 24 per cent. The average holding of Indian
managing agency houses was found to be 42 per cent, as
compared to only 10 per cent in the case of European
houses.

The NCAER study shows that direct loans from
managing agents formed only 1.3 per cent of the total
loans in case of large companies but the same was 7
per cent in the case of smaller companies, which shows
that in smaller companies the managing agents played
a more important role. In the case of guarantee of
loans, companies with paid-up capital between Rs. 20 and
Rs. 30 lakhs, were favoured with 77 per cent of their
total loans being guaranteed by the managing agents.
All the loans of those companies with paid up capital
above Rs. One crore, were necessarily guaranteed by the
managing agents.

49. S. K. Basu, The Managing Agency System - In
Prospect & Retrospect, (Data relates to
1951-52)

As per the enquiry conducted by the Research and Statistics Division of the Department of Company Law Administration, there were 3944 managing agencies including incorporated firms, private and public companies at work during 1954-55. These agencies managed 5955 Joint Stock Companies out of a total of 29625 companies at work in that year. In other words, roughly one out of every six joint stock companies at work in India was managed by the managing agents and in terms of paid up capital managing agencies covered nearly 48 per cent paid up capital of the entire corporate sector. Again, while 40.7 per cent accounting for 66.3 per cent of the paid up capital of total number of public joint stock companies at work were managed by managing agencies, 4.9 per cent private companies accounting for 8.6 per cent of the paid up capital of all private companies were covered by them. 51.

The system was to be abolished due to prevalence of several malpractices such as: 52.

1) The practice of inter-investment of funds - the surplus funds of one unit were invested in the shares and debentures of another under the same managing agency and loans raised under the name of one concern.

were lent to another under the same agency. This led many a time, to the doom of several inter-connected firms merely because of mismanagement and failure of one or two firms in the group under the same managing agency;

ii) Yet another big defect was the speculative activities of the managing agents, which resulted in several cases, in heavy losses, suffered in shares and especially in cotton speculation and even though many of the mills were intrinsically sound in themselves, their financial position suddenly became precarious as the banks withdrew their cash credits because the agents had become weak; Th. 6643

iii) Due to the control of a number of companies being vested in a single managing agency, there resulted a great strain on its financial resources and often the agents failed to provide adequate finance to an industry, driving it to crisis. There was no reference in their agreements to provide the requisite finance or to any penalty in case they fail to do so; which made it easy for the agents to escape from and shirk their responsibilities in times of financial crisis of the firms under them;

iv) They perpetuated their tenure and hold on companies by various manipulations though it could have been terminated if the shareholders desired so. Any removal of managing agents could be done only by a special resolution to be passed by three-fourths
or four-fifths majority, which was rather an impossible task; heavy compensation was to be paid in the event of the removal;

v) They took away a very high percentage of net profits - their remuneration was disproportionately high and was a heavy burden on companies earnings, which in many cases could not be borne;

vi) Auditors were ineffective in preventing the misappropriation of funds by the managing agents, since they were appointed in effect by the managing agents themselves, though the formal approval was with the shareholders. The agents also decided their remuneration. This reduced the impartiality and independence of the auditors. All kinds of obstacles were often placed by the managing agents in the working of the auditors in respect of detailed examination of accounts;

vii) Directors of a company were always at the mercy of the managing agent.

Thus the managing agency system was extolled as a masterpiece of human ingenuity by its admirers but on the other hand on more important grounds it was condemned as an instrument of knavery and fraud by its critics. 53 No doubt in the pre-Independence days industrial entrepreneurship in India was a closed-circle of a few already established firms controlled and

53. N. Das, Banking and Industrial Finance in India, p.163.
concentrated in the hands of a few managing agents.

The discussion so far is only to project the scenario of socio-economic setting in this country at the time of independence, wherein the financial system - a semi-organised and narrow industrial securities market devoid of issuing institutions and intermediary financial institutions for long term financing of industry, which had no choice but to depend on internal savings alone, was not conducive for industrial investment and the sustenance of a high rate of industrial growth so essential for the country's rapid economic development as envisaged in the planning era that followed.

II.21. Post-independence socio-economic goals

The basic economic and social goals of the country were reflected in the Constitution adopted in 1950, wherein the Directive Principles of State Policy, directed the State 'to promote the welfare of the people by securing and protecting, as effectively as it could, a social order in which justice, social, economic and political, shall inform all the institutions of national life'. To achieve such an order it was enjoined that the State shall direct its policy, inter-alia, towards securing that the citizens, men and women equally, have the right to an adequate means of livelihood: that the ownership and control of the material

55. L.C. Gupta, Ibid., pp.8-10.
resources of the community are so distributed as best to subserve the common good; that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

Further the objective of a socialist pattern of society adopted in India and emphasised in the Second Five Year Plan, implied that the basic criterion for determining lines of advance must be not private profit, but social gain, and that the pattern of development and the structure of socio-economic relations should be so planned that they result not only in appreciable increase in national income and employment but also in greater equality in incomes and wealth. Major decisions regarding production, distribution, consumption and investment and in fact all significant socio-economic relationships must be made by agencies informed by social purpose.

We have accepted the philosophy of planning with the launching of First Five Year Plan in 1951, with its connotation of a mixed economic system in which the public and private sectors are to play equally important roles as parts of a single mechanism, with both sectors supporting each other. The financial system has to bear the brunt of fulfilling these basic socio-economic objectives. The financial operations of different institutions, especially development banks and commercial banks have to go hand-in-hand and must be attuned to achieve

56. Second Five Year Plan, p.22.
the priorities laid down in Government's economic policy. As Edward Nevin rightly pointed out that in a monetary economy it is essential, when a development programme is attempted by the government of a territory, that allocation of resources between sectors is backed up by adequate and sufficient funds to the producers in the sectors concerned, as otherwise it would be futile to draw up a development programme in a particular way, without ensuring that the financial resources were distributed according to a corresponding pattern.57.

Rightly, the financial mechanism has now practically came into the hands of public control in toto, either through the nationalisation of private institutions or through the creation of new institutions in the public sector - the nationalisation of the Reserve Bank of India, (1949), the Imperial Bank of India (1955), and the life insurance offices (1956), and 14 major commercial banks (1965); new and giant institution in IDBI (1964) and other special purpose financing institutions in IFCI (1948), ICICI (1956) and a series of variegated institutions at the state level.

II.22. Committee on Finance for Private Sector: (Shroff Committee)

The Reserve Bank of India on October 5, 1953, appointed a committee of experts under Shri A.D. Shroff

as its Chairman (popularly known as Shroff Committee), which gave its findings in respect of (A) Factors inhibiting investment in the private sector, and (B) Institutions and agencies of the capital market.

Under (A) while dealing in circumstances affecting expectation of enterprises called 'economic climate', it felt that an increase in supply of finance by itself may not bring about an increase in investment - 'cheap or plentiful credit cannot per se be an incentive'. Only if there is an expectation of reasonable compensation for the risk undertaken, will private investment come forth. The investor's expectations depend upon purely economic factors like demand and costs, and also on political, social and psychological factors, which build up the environment in which he has to operate.

As regards (B) the committee pointed out the lacunae in the structure of the Indian capital market, in the absence of issue or underwriting houses or investment trusts for placing shares or debentures issues on the capital market, and pointed out that the then existing financial institution could only partly meet the requirements of industrial finance. Hence the necessity to devise new agencies for attracting long term capital to both large scale and small scale industries. In the context of industrial expansion, the committee felt that more specialised institutions would help to build up confidence in investors, marketability
of shares and debentures, attracting thereby new private investors as the industrial expansion gathers momentum. Besides as the operation of units which are at present organised on proprietary, partnership or private limited company basis grow in size, the tendency to convert into public limited companies will be strengthened. This means an increased resort to the capital market for procuring long term finance, a situation in which several types of agencies have to strive hard to mobilise investable resources and promote further growth.

The Committee envisaged a greater role for commercial banks in providing finance to industry by way of advances of a medium or long term character, within the limits of the resources available to the banks, provided individual banks are satisfied in their own judgement that such advances are for moderate amounts in consonance with ordinary banking prudence and maintenance of liquidity.

According to this committee banks should contribute in an indirect manner, more funds to private industries in any one or more of the following ways:

a) by taking up shares and debentures of first class industrial concerns in greater volume; b) by making larger advances to approved parties against such shares and debentures; c) by subscribing substantially to the shares and bonds of the industrial and state financial corporations. Further, it prescribed that banks with the
cooperation of insurance companies should form a consortium or syndicate for the underwriting of or investing in new issues of shares and debentures of industrial companies, wherever they are satisfied about the soundness and prospects of the projects. The Committee did not favour any radical departure from the then existing policies of the commercial banks. 58.

It is now time to consider the salient features of the various development banks that have been set up from time to time. Here we intend to present only the object and scope, type of assistance, and financial resources of these banks; the financing operations and promotional activities are to be discussed in detail in the next chapter (chapter III).

II.23. Industrial Finance Corporation of India

This is the very first of its kind to be established in this country. Originally, Sir Archibald Rowlands was to have introduced the bill for the setting up of an industrial finance corporation in the budget session of 1946. Only by the passing of the Industrial Finance Corporation Act, 1948 (XV of 1948) the Corporation came into force on July 1, 1948.

Objects & Scope: The purpose of the Corporation in terms of the preamble of the Act, is one of making medium

and long term credit more readily available to industrial concerns in India, particularly in circumstances where normal banking accommodation is inappropriate or recourse to capital issue methods is impracticable.

As per the IFC Act an industrial concern has been defined to mean any limited company - private, joint or public sector or co-operative society, incorporated by an Act of legislature and registered in India, engaged in the manufacture, preservation, or processing of goods or in shipping, or in mining, or in hotel industry, or in the generation of electricity or any other form of power.

It has strictly to adhere to the objectives laid down in the five year plans of the country. It gives priority to dispersal of industry, industrial development in backward areas and growth of industries in the co-operative sector with special emphasise on the following categories of projects, viz, those:

a) promoted by new entrepreneurs and/or technologists;
b) located in less developed areas;
c) based on indigenous technology and/or aimed at exploring new areas of technology;
d) having prospects of earning foreign exchange or which would result in substitution of imports;
e) providing inputs for increasing the agricultural production as fertilizers, pesticides, agricultural

f) fulfilling the increased demand for essential consumer goods like textiles and sugar, which meet the basic need of the people.

**Type of assistance:** In terms of Section 23 of the Act, later amended in 1952, the Corporation was authorised to transact only the following kinds of business:

a) guarantee of loans raised by industrial concerns;
b) underwriting the issue of stocks, shares, bonds or debentures by industrial concerns;
c) granting loans or advances to or subscribing to debentures of industrial concerns repayable within a period not exceeding 25 years;
d) acting as agent for the Central Government and/or with its approval, for the IBRD in respect of loans sanctioned by them to industrial concerns;
e) extending guarantee in respect of deferred payment by importers, who are able to make such arrangement with foreign manufacturers.

By further amendment of Section 23 of the IFC Act, 1960, 1) The Corporation was enabled to guarantee:

a) loans raised by industrial concerns from scheduled banks or State co-operative banks;
b) deferred payments due from industrial concerns in connection with their purchase of capital goods both within and outside India;
c) with the prior approval of the Central Government, loans raised from the credit arrangements made with any bank or financial institution in any country outside India by industrial concerns in foreign currency;

ii) The Corporation was empowered to subscribe directly to the stocks or shares of an industrial concern and also to convert, at its option, the loans granted or debentures subscribed to by it into stocks or shares of the concern. By an important amendment recently, the loans granted by it or the debentures subscribed by it will be convertible, at the option of the Corporation, into stock or shares of industrial concerns within the period the loans or debentures are repayable. Any shares, bonds or debentures that the Corporation had to take up in fulfilment of its underwriting obligations, as per its original Act, were to be disposed of as early as possible, within seven years in any case - however, the amendment Act of 1955, removed this limitation and now with the Central Government's permission, can hold stocks, shares, even beyond a period of seven years whenever necessary.

The Corporation cannot grant loans nor guarantee advances unless it is fully secured by tangible assets and a minimum margin of 50 per cent is generally insisted upon.

Financial Resources: As per Section 4 of IPC Act, 1943, the authorised capital of the Corporation
is Rs. 10 crores, divided into 20,000 shares of Rs. 500/- each. A distribution of shares prior to and after the creation of IDBI is given below:

<table>
<thead>
<tr>
<th>Percentage of Shares</th>
<th>As on 30.6.1964 (prior to creation of IDBI)</th>
<th>As on 30.6.1976 (after creation of IDBI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Central Government</td>
<td>20.0</td>
<td>--</td>
</tr>
<tr>
<td>2. Reserve Bank of India</td>
<td>20.7</td>
<td>--</td>
</tr>
<tr>
<td>3. Commercial Banks</td>
<td>24.3</td>
<td>20.0</td>
</tr>
<tr>
<td>4. Life Insurance Corporation</td>
<td>25.3</td>
<td>22.0</td>
</tr>
<tr>
<td>5. Co-operative Banks</td>
<td>9.7</td>
<td>8.0</td>
</tr>
<tr>
<td>6. Industrial Development Bank of India</td>
<td>--</td>
<td>50.0</td>
</tr>
<tr>
<td></td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: The IFC Annual Reports.

With the creation of IDBI, shares held directly by the Central Government and the RBI have been transferred to it.

The authorised capital of IFCI is now Rs. 20 crores. As per Section 21 of the IFC Act, 1948, amended in 1957, it is authorised to augment its resources by the issue of bonds to the extent of ten times the amount of paid-up capital and reserves.
Again as per Section 22 of the Act (1948), yet other method of augmenting the resources is that, it can accept deposits from public repayable after the expiry of a period of not less than five years. The maximum limit of such deposits can be 7.10 crores at a time.

As per IFC (Amendment) Act, 1952, it was authorised to borrow moneys from the Reserve Bank against securities of the Central Government or a State Government, payable on demand or for fixed periods not exceeding 90 days. It has also been authorised to borrow moneys from RBI against bonds and debentures issued by the Corporation, maturing and repayable within a period not exceeding 18 months, provided the amount at any time borrowed does not exceed 7.3 crores in the aggregate. Limitations on borrowings that are applicable to IFC to borrow in terms of the provisions of IFC Act, are as under:

(i) the total amount of bonds issued and outstanding, and of the contingent liabilities of IFC in the form of guarantees and underwritings is not to exceed 10 times the amount of paid-up share capital and the reserves;

(ii) the total borrowings of IFC from the Central Government, IDBI and the Reserve Bank of India together with the amount of bonds and outstanding is not to exceed 10 times the amount of the paid-up capital and the reserves.

The borrowings from the Central Government 61.

60. See Section 21 of IFC Act, 1948 amended in 1957.
61. The IFCI Amendment Act, 1955. It came into force on Sept 18, 1955. Also see Sec. 21(4) of the IFC Act (as amended).
represent interest differential funds under KfW line of credit. The IFC (Amendment) Act, 1952 empowers the IFC to borrow in foreign currency and since 1960, it has borrowed limited amounts from foreign agencies. It obtains lines of credit in foreign currencies from AID (USA), KfW (West Germany), BPEE (France) and ODA (UK) for granting sub-loans to industrial units for import of machinery from abroad.

For augmenting resources, the existing policy of IFC is to depend more on the borrowings from the market by way of bonds rather than on borrowings from the central government, which enables it to be in constant touch with the investors and the capital market. The bonds issued by the IFC are guaranteed by the government and in terms of Section 20 of the Indian Trust Act they are deemed to be central government securities and are eligible securities for investment of Provident Funds.

For instance, for appreciation of different sources of funds, we give below the details as of 30.6.1977:

(\text{\textup{\textsterling}, in crores})

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid up Capital</td>
<td>10.00</td>
</tr>
<tr>
<td>Reserves</td>
<td>26.37</td>
</tr>
<tr>
<td>Borrowings from Central Govt.</td>
<td>11.81</td>
</tr>
<tr>
<td>Borrowings from market by issue of Bonds</td>
<td>227.03</td>
</tr>
<tr>
<td>Special Govt. grants</td>
<td>1.27</td>
</tr>
<tr>
<td>Borrowings from IDBI</td>
<td>5.00</td>
</tr>
</tbody>
</table>
Foreign credits 50.08
Repayment of Rupee loans, sale of investment etc. 207.21

Total: 639.87

The maximum limit for loans to a single concern was 5.50 lakhs or 10 per cent of the paid-up share capital, whichever was larger but in 1952, this was amended, and the limit was raised to 3.1 crore. In case of loans larger than 3.1 crore, the Corporation needed Government of India approval.

Management of IFCI: The Board of Directors is the supreme authority. It consists of 13 Directors as follows:

1. four directors nominated by the Central Government;
2. two directors nominated by the Central Board of Reserve Bank of India, now nominated by IDBI;
3. two directors to be elected by the scheduled banks;
4. two directors elected by the insurance companies;
5. investment trusts and other financial institutions;
6. two directors elected by the co-operative banks; and
7. one stipendiary chairman to be assisted by a general manager.

Now the Central Government nominated two directors and IDBI four, of which three outsiders are experts in the area of industry, labour and economics, while the fourth nominee is the general manager of the IDBI.
The IFCI also has Standing Advisory Committees for six major groups of industries, reconstituted from time to time with the Chairman as the ex-officio Chairman of all these committees. They include a few Directors of the Corporation and outside experts besides officers of the Government mostly from DGTD.

The Headquarters of IFCI is at New Delhi and it has 17 offices all over the country including a separate office at New Delhi. The Management at the headquarters recommends to the Board of Directors all cases for sanctions, however, a lot of delegation of work is entrusted to the branch offices, like follow-up, disbursals, recoveries etc. It also has Local Advisory committees at branch offices to advise management on matters like industrial opportunities in the respective areas.

II. 24 Industrial Credit & Investment Corporation of India:

This was the second all-India development bank to be set up at the initiative of IBRD, for promoting investment in the private sector. It was registered in January 1955, as a private limited company. By the end of 1953, discussions were held by the representatives of Government of India, the Foreign Operations Administration of the United States Government and the IBRD, for establishing this privately owned investment corporation for assisting private industry. As a sequel to this, a
three man mission of the World Bank visited India. Their findings were favourable in setting up of such an institution. A steering committee of leading industrialists of the country met again with the World Bank representatives to complete the arrangements and the Government of India encouraged the move by providing an interest free loan.

**Objectives:**
1. To assist in the creation, expansion and modernisation of private enterprises;
2. to encourage and promote participation of private capital both internal and external in such enterprises;
3. to encourage and promote private ownership of industrial investment and expansion of investment markets.

**Functions:**
1. to provide finance in the form of long or medium term loans or equity participation;
2. to sponsor and underwrite new issues of shares and securities;
3. to guarantee loans from other private investment sources;
4. to make funds available for reinvestment by revolving investments as rapidly as prudent; and
5. to furnish managerial, technical, and administrative advice and assist in obtaining managerial, technical and administrative services to Indian industry.

Provision of foreign exchange loans and greater
emphasis on underwriting are the matter of the institution.

**Eligibility for assistance:** Any limited liability company in the private sector is eligible for assistance as already observed, this institution was conceived to cater exclusively to the requirements of the private sector. It has not found it practicable to assist proprietary or partnership enterprises. Its scope of assistance has now been extended to include joint sector, public sector and co-operative projects also.

Again since 1969, the Corporation has started providing foreign currency loans to proprietary and partnership concerns either directly or in association with state financial corporations and banks.

Though there are no firm limits on the size of the enterprises, the ICICI is prepared to assist, nor any maximum or minimum limit on investment that the corporation will make, in practice Rs.5 lakhs has been deemed to be the lower limit for an investment.

The maximum period of repayment of loans is 15 years.

**Resources:** The authorised capital of the Corporation is Rs.25 crores, of which Rs.5 crores were originally issued and paid-up. This consisted of Rs.1.5 crores subscribed by foreign institutions and
individuals and \text{¥.3.5 crores contributed by institutions and individuals in India.}

This was supplemented by an interest-free loan of \text{¥.7.5 crores from the Government of India and an advance of $10 million in foreign currency by the World Bank.}

These resources were further augmented by further rupee loans from the Government of India and IDBI, lines of credit extended by the World Bank, and credit by USA, West Germany and Britain.

It entered the foreign capital market for the first time in 1973 by issuing bonds of Swiss Francs in the European capital market.

It has expanded its rupee resources by increasing its capital base by right issues and by the issue of debentures to public.

The total resources of ICICI, net of repayments and cancellations, as on 31st December 1977, was \text{¥.490 crores of which ¥.307 crores (62.7 per cent) in foreign currencies and ¥.183 crores (37.3 per cent) in rupees.}

This means that the mainstay of the Corporation has been foreign currency credit, especially that of the World Bank. Recently, issues of debentures in rupees are gaining more ground. Loans from KfW (Germany) are also playing a big role next only to World Bank, in respect of foreign currency, followed by sterling loans from the UK Government, IDBI and the Government of India have also been important sources of borrowings.
Thus borrowings has constituted the biggest source of funds (92 per cent).

Management: This is vested in a Board of Directors consisting of not less than five or more than 10 persons, excluding the Directors, appointed by the Government of India, or by debenture holders, if any. The Board is to have a Chairman elected from amongst the Directors. Until October 1958, it had a non-Executive Chairman and a whole time General Manager.* From October 1958, it started having an Executive Director was created, who was also a Deputy Chairman, who later on was elevated to the Chairman's post from January, 1972.

From January 1976, the ICICI has reintroduced the post of a non-Executive Chairman again, as before. Unlike IFCI and IDBI, the ICICI does not have any Advisory Boards.

ICICI's Head Office is located in Bombay. It has the special advantage of having the World Bank's guidance in all these years and for a year or two in the beginning experts from the World Bank (including the well known banker Mr. William Diamond) helped the ICICI in advice and guidance for its improvement in the working and better appraisal of projects.

II.25 Industrial Development Bank of India:

This is the most important of all the development

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* The first General Manager was a Bank of England official, who was for some time secretary of RBI. The first Indian General Manager to succeed him was Shri H. T. Parekh.
banks in this country, as a wholly-owned subsidiary of the Reserve Bank of India and as an apex agency in the field of development finance.

It came into existence from July 1, 1964. The already existing institutions at that time, as we described above, were contributing their mite to the growing financial needs of the changing industrial structure of the country.

Nevertheless, considering the dimensions of rapid industrialisation during the Third Five Year Plan, need was acutely felt for an institution with wider functions and larger resources, since it was felt that the totality of the contribution of the then already existing institutions, was not adequate in terms of magnitude, range and pattern of financing for rapid and diversified growth.

The already existing institutional framework lacked an effective mechanism to coordinate and integrate the working of diverse institutions. Where a long term view is necessary and a certain amount of risk has to be taken, the existing institutions tend, by reason of their statutory obligations and traditions, to be conservative and cannot be very helpful.

As a coordinating machinery, the IDBI could establish a working relationship with other institutions

62. As per Public Financial Institutions Laws (Amended) Act, 1975, it has been delinked from RBI.

63. The Finance Minister’s speech at the time of introduction of the IDBI Bill in the Lok Sabha on April 31, 1964.
and build a pattern of inter-institutional co-operation that "facilitates the evolution of a rational and cohesive structure of financial institutions adapted to changing needs of emerging industrial structure with its growing complexity of inter-relationships. A central development institution was essential to provide dynamic leadership in the task of promoting a widely diffused and diversified, but viable, process of industrialisation."

Functions: As an apex bank the types of assistance extended by IDBI are more varied in character and quantum than those provided by other development banks. The IDBI may transact the following kinds of business:

a) Grant loans and advances to:

   i) the Industrial Finance Corporation, any State Financial Corporation or any other financial institution notified by the Central Government on its behalf by way of refinance of any loans and advances granted to industrial concerns by these institutions which are repayable within a period of three to 25 years;

   ii) any Scheduled Bank or State Co-operative Bank by way of refinance for loans and advances made to industrial concerns for a period of three to 10 years.

   iii) the aforesaid institutions by way of refinance of any loans and advances granted by them for the export

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of capital goods, commodities or merchandise from India and repayable within a period of six months to 10 years;
b) to accept/discount or rediscount bills of exchange and promissory notes of industrial concerns;
c) to subscribe to or purchase stocks and shares, bonds and debentures of the Industrial Finance Corporation, any State Financial Corporation or other notified financial institutions;
d) to grant loans and advances to any industrial concern or subscribe, purchase or underwrite the issue of stocks, shares, bonds or debentures of any industrial concern;
e) to guarantee deferred payments due from any industrial concern;
f) to guarantee loans raised by industrial concerns from notified financial institutions;
g) to guarantee the obligations of notified financial institutions in connection with underwriting the issue of stocks, shares, bonds or debentures of any industrial concern;
h) to undertake research and surveys for evaluating or dealing with marketing or investments and undertakings or carrying on techno-economic studies in connection with the development of industry;
i) to provide technical and administrative assistance for promotion, management or expansion of industry;
j) to plan, promote and develop industries to fill up gaps in the industrial structure in India;
k) to form or conduct subsidiaries for carrying out its functions;
k) to do any other kind of business which the central government on the recommendation of the Reserve Bank may authorise. Thus we find that the IDBI performs a multiplicity of functions of varied character, from the granting and guaranteeing of loans to the planning and promoting of industries and the conducting of research and surveys.

In backward districts and regions, the IDBI is organising techno-economic surveys and establishing agencies for the provision of technical consultancy services, especially to small and new entrepreneurs. The promotional activities are initiated by the IDBI and the collaboration of other financial institutions and that of the Central and State government are also sought. The Kerala Industrial and Technical Consultancy Service Organisation (KITCO), the North-Eastern Industrial and Technical Consultancy Organisation (NEITCO) and the Bihar Industrial and Technical Consultancy Organisation (BITCO), and the three institutions established to organise facilities for technical assistance, with joint sponsorship of all-India development banks, state level financial institutions and leading commercial banks. These three namely, KITCO, NEITCO and BITCO are registered as public limited companies under the Companies Act.

Resources: The authorised capital of IDBI, before its delinking from RBI in February 1975, was fixed at 5.50 crores, but with previous approval of the Central
Government, it is allowed to increase such capital to ₹1,100 crores and now after the delinking from RBI, it can be increased to ₹200 crores by the Government of India. The entire paid-up capital at the time of formation was subscribed to fully by the RBI.

The paid-up capital of the IDBI as of June end 1977 was ₹50 crores as outstanding amount, after the share capital of the IDBI was transferred from RBI to Government of India, as per Public Financial Institution Laws (Amendment) Act, 1975, which constituted 2.4 per cent of its cumulative assistance.

The original Act provided for the Central Government to advance: (a) an interest-free loan of ₹10 crores repayable in 15 equal annual instalments. The repayment shall commence on the expiry of a period of 15 years from the date of the receipt of the loan; (b) such further sums on such terms and conditions as may be agreed upon.

To augment its resources the Development Bank was authorised to:

a) issue and sell bonds and debentures with or without the guarantee of the Central Government;

b) borrow money from the Reserve Bank of India;

c) borrow money from any other institutions approved by the Central Government;

d) accept deposits for over 12 months;

e) borrow foreign currency from any bank or financial institution in any country;
f) receive gifts, grants, donations or benefactions from government or any other source.

Besides the above the repayment of past assistance by borrowers constitutes the most important source of funds to the IDBI.

To attract deposits from the companies so as to increase the resources of IDBI, the Government of India, since 1976, has exempted, under the Companies Deposits (Surcharge on Income-Tax) Scheme, companies from payment of surcharge on income-tax provided the companies deposit with the IDBI is an equivalent amount repayable after five years.65.

Special Fund and General Fund: As per Section 14 of the Act, it can establish a special fund called 'Development Assistance Fund'. The resources of the fund would consist primarily of amounts received by way of loans, gifts, grants, donations, etc., from Government and other sources. Any profit or loss arising out of the use of these resources would also be credited or debited to the Fund. Assistance provided from the Fund requires approval of the Central Government. The Fund can be utilised for granting loans and advances to industrial concerns or for subscribing to or purchasing or underwriting the issue of stocks, shares, bonds etc., for guarantee of deferred payment, for guarantee of loans raised or for guarantee of the obligations.

65. The Scheme was discontinued since April, 1978.
of the Industrial Finance Corporation, the SFCCs, other financial institutions, commercial banks, and state co-operative banks. However, the main purpose of the Fund is to provide assistance to industries, which for various reasons, like heavy investment involved or low anticipated rate of return on capital, may not obtain funds in the normal course but may nevertheless be of such importance as to justify special assistance.

There is the General Fund, apart from the above Fund, to which all other receipts are credited. The IDBI transfers the entire net profit after making necessary appropriations in respect of Bad & Doubtful debts, Depreciation, Provisions, etc, to the Reserve Bank of India. This practice continued till February, 1975, when the IDBI was delinked from RBI.

This Development Bank has recourse to loans from the Reserve Bank for 90 days accommodation against trustee securities as in the case of IFC and SFCCs. Even on the security of bonafide commercial bills or promissory notes bearing two good signatures the Bank is accommodated for periods up to five years. The RBI has created the National Industrial Credit (Long Term Operations) Fund similar to the National Agricultural Credit (Long Term Operations) Fund and the IDBI is entitled to borrow on the long term from this Fund. The National Industrial Credit (Long Term Operations) Fund has been initially credited by RBI with
Rs.10 crores and annual contribution of Rs.5 crores commencing with the year ending on June 30, 1965, however this annual contribution can also be reduced, if circumstances so warrant. This Fund is utilised for granting loans to the Industrial Development Bank for the purpose of acquiring shares, bonds or debentures of other specified financial institutions or for the purpose of any other business of the Development Bank.

The entire business assets, liabilities, rights, interests, privileges and obligations of the Refinance Corporation were transferred to IDBI and compensation to the shareholders of the Refinance Corporation was paid by IDBI - equal to the paid-up capital of the Corporation.

The magnitude of the principal sources of funds of IDBI can be appreciated from the break-up of sources given below:

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Value (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Increase in paid-up capital</td>
<td>50.0</td>
</tr>
<tr>
<td>2. Borrowings from Govt. of India</td>
<td>100.0</td>
</tr>
<tr>
<td>3. Borrowings from RBI</td>
<td>527.4</td>
</tr>
<tr>
<td>4. Against lodgment of usance bills</td>
<td>136.0</td>
</tr>
<tr>
<td>5. Borrowings by way of bonds</td>
<td>247.4</td>
</tr>
<tr>
<td>6. Deposits from companies in lieu of surcharge</td>
<td>49.9</td>
</tr>
<tr>
<td>7. Repayment of assistance</td>
<td>715.7</td>
</tr>
</tbody>
</table>

The Refinance Corporation for Industry was registered on June 5, 1958, as a private limited company to provide medium term credit facilities to the medium sized industrial units in the private sector.
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>17.4</td>
</tr>
<tr>
<td>2.</td>
<td>160.6</td>
</tr>
<tr>
<td>Total:</td>
<td>177.4</td>
</tr>
</tbody>
</table>

Source: IDBI Annual Reports.

**Management:** The Industrial Development of India was originally conceived as a wholly owned subsidiary of the Reserve Bank of India, with its Head Office at Bombay and was authorised to establish offices, branches, or agencies at any other place in or outside India.

The Board of the Bank consisted of the same persons who held office as Directors on the Central Board of the Reserve Bank of India with the Governor and Deputy Governor of the Reserve Bank of India as the Chairman and Vice-Chairman respectively. There was, however, a separate Executive Committee for the IDBI for administrative purposes to look into the matters like recruitment, salary and financial sanction.

With effect from February 16, 1975, the IDBI has been delinked from RBI, with an independent Chairman appointed by the Government of India and is managed by a separate Board of Directors comprising representatives of financial institutions and public sector banks and experts in different fields.

For a variety of reasons, the IDBI was set up in the beginning as a wholly owned subsidiary of the Reserve Bank. Firstly as the Reserve Bank of India, the
IDBI was to act as the lender of the last resort in respect of term finance, as RBI in the field of short term finance. Secondly the IDBI’s operations were visualised so as to assume greater dimensions, thereby requiring regulation within the framework of proper monetary and credit management under the aegis of RBI, which would bring together under one unified set-up the entire range of financial and credit institutions so as to effect a unified and integrated approach in the field of financial system. A national credit policy to suit the pace and pattern of investment activity is indeed a must under the responsibility of RBI. Thirdly the Reserve Bank had all along been associated in helping Central and State governments in evolving an appropriate structure of financial institutions.

However the primary objective of delinking was to enable the RBI to concentrate on the proper discharge of its central banking functions on the one hand, and on the other to enable the IDBI to meet independently, the challenges of the ever growing financial needs of industries. It now has considerable operational flexibility to undertake all types of financing and developmental roles and it can finance all types of concerns engaged in manufacture, or processing of goods, mining, transport, generation and distribution of power, both in private and public sectors. There are also no restrictions in respect of the nature and type of
security to be offered by Industrial concerns, nor any maximum or minimum limits prescribed for assistance or for the size of the unit itself.

Thus IDBI occupies a pivotal place in development banking and is elevated to a position similar to that of the RBI in this country. Its role is unparalleled by any other institution of its kind in the world today and can be described as a development bank par excellence - as an apex institution, coordinating and supplementing the activities of other financial institution, as a provider of huge capital for large projects or for those in less developed areas or those exploring new areas of technology. It also acts as an Export-Import Bank of the country, as an underwriter and direct subscriber to industrial concerns as also as a major subscriber to shares and securities as a promoter of developmental or technical consultancy activities, and as an institution with considerable operational flexibility to undertake all types of financing and developmental role.

II.26. Industrial Reconstruction Corporation of India:

Yet another all-India development financial institution set up in April, 1971 is the IRCI, with its Head-quarters at Calcutta. This is established as a Company under the Indian Companies Act. As a sequel to the recession accompanied by adverse factors, like, mis-management, unsatisfactory labour relations, critical raw material position leading to closure or 'sickness'
of many industrial units, especially in West Bengal, the RBI took the initiative at the instance of Central Government in setting up this Corporation in the task of reviving and revitalising sick and closed industrial units.

It does not function merely as an institution providing finance, but also as an agency for diagnosing and removing the shortcomings which were responsible for the sickness or closure of units. This has meant, restructuring management, providing technical and managerial guidance either through its own staff or by helping and procuring suitable personnel from the market, and acting as a catalyst in securing assistance from other banks and financial institutions and Government agencies.

It insists on the restructuring of the financial base of the companies assisted, and smooth labour-management relations, as pre-conditions for providing assistance. It provides advice to the management and makes a close follow-up of the course of reconstruction of the units.

Resources: The authorised capital is ₹25 crores of which paid-up capital amounts to ₹10 crores. This has been subscribed by the IDBI, LIC, ICICI, SBI and the 14 nationalised banks (initially IDBI's subscription was held by IDBI pending amendment to IFC Act). It is also supplemented by an interest free loan of ₹10 crores from the Central Government repayable in 15 equal annual
Instalments commencing after the expiry of period of 15 years from the date of receipt of the loan by the Corporation. It has access to the RBI and the IDBI for its borrowings.

The IRCI has been empowered to issue bonds to meet its requirements.

Management: The IRCI is managed by a Board of Directors consisting of representatives of financial institutions including banks, the LIC and the Ministry of Industrial Development. An Executive Committee comprising some of the directors, has been constituted for expeditious dispersal of reconstruction assistance and other related matters. This Committee has powers only unto 5.50 lakhs to be granted to any individual unit and the total reconstruction loans accorded by it should not exceed 5.50 crores at one time. Routine matters are looked after by the Managing Director assisted by two General Managers and a team of technical, financial and legal staff.

The IRC takes up first on priority basis, those units passing through a crisis and facing imminent closure; this is followed by those cases which are capable of cutting down cash losses early, if only their use of relatively modern machinery and techniques receive adequate financial support; these are followed by cases where there are chances of regaining economic viability through a process of reconstruction over a period of years. However, units which are comparatively
labour intensive receive top consideration. The IRCI pursue different lines of action for control of the operations of the assisted units, while assisting in reconstruction, as the nature and extent of past deficiencies of the units assisted differ from unit to unit.

The IRCI generally requires the transfer of 51 per cent of the shares to itself and appoints its nominees to the Board of Directors of the assisted companies.

The IRCI has concentrated a major part of its activities in West Bengal, where a little over 75 per cent of its sanctions and disbursals, is extended, with hardly 10 per cent being given in Maharashtra. Hence we have not included this Corporation for our further study and analysis from the point of view of purvey of credit to different districts in Maharashtra, as we have done in respect of other all-India development banks.

II.27. Agriculture Refinance & Development Corporation:

Agriculture Refinance Corporation, as it was known originally was constituted by an Act of the Parliament passed in 1962. The Corporation commenced its working from 1st July, 1963. For a long time the need for an institution to direct and supervise by an apex institution in respect of agricultural finance was acutely felt. It was to fill-up this gap in the then
existing credit system that the Agricultural Refinance Corporation was conceived. Agriculture means not only production achieved from land but also include other vital allied activities, such as, live stock, dairy, fishery, poultry etc.

Term lending for agricultural development has been built largely in the co-operative sector which received considerable patronage from the Central and State governments and above all from the Reserve Bank of India. The cooperatives have built up a good deal of tradition, policy and procedure but lacked in innovative finance to meet the growing requirements in agriculture. To large they function more like a limb of the Government than as development banks. To encourage commercial banks and other eligible financing institutions to take more active interest in financing agriculture, it was considered necessary to provide a scheme under which refinance could be made available in respect of advances to agriculture in all deserving cases, thereby eliminating strain on the liquidity of the sources of these institutions. With the nationalisation of commercial banks they were expected to play more active role alongside the State Bank of India in the field of agriculture finance. There are different activities in which the Co-operatives were not well-suited or have not involved themselves in any way, such as farm-mechanisation,

poultry, dairy and plantations and commercial banks can play a big role here and thus act as complementary and not competitive to Co-operatives. A bigger role is thus envisaged for ARDC to push through its refinance scheme.

Resort to institutional resources for developmental activities implies that the technical and economic feasibility of the schemes should be well established and that the credit provided is principally in the nature of supervised credit. Here again the ARDC can play an important role as development bank.

Thus the objectives of the ARDC can be summarised as follows:

1) to assume an effective role as a development bank;
2) to increase participation in the productive lending and in the fulfilment of the targets in Five Year Plan;
3) to penetrate into backward and underdeveloped areas for correcting regional imbalances;
4) to diversify the types of lending for achieving a broad based growth in the economy;
5) to provide assistance to small farmers in an increasing scale;
6) to strengthen the intermediary lending institutions both operationally and financially so as to enable them to handle business in innovative and increased manner;
7) to stress the need for technical consideration in the formulation of projects;
viii) to orient the commercial banking sector for greater participation in the investment in agriculture;

ix) to provide assistance to governmental agencies in the formulation of viable projects;

x) to translate the agricultural development programmes especially during Fifth Five Year Plan and after, into bankable propositions.

Since 1970 the Corporation has involved itself into a more developmental role and for that matter the name was also changed from Agricultural Refinance Corporation to Agricultural Refinance & Development Corporation.

Functions:

(1) To provide refinance in respect of medium and long term loans given by the financing institutions for development of agriculture including land reclamation, soil conservation, levelling and preparation of land under the command of major irrigation projects, construction of tube wells, minor irrigation projects. The financing institutions also get refinance for their financing of plantations such as, coffee, rubber, cardamom, coconut, grapes, and areca-nuts. Finance provided for the purchase of heavy machinery, such as, tractors, power tillers are also eligible for refinance besides the finance given for animal husbandry, poultry farming, dairy development, pisciculture (fisheries), horticulture. Since 1969-70, the
Corporation provides refinance for construction of godowns, and for the storage of agriculture produce. In the recent years, market yards, agriculture aviation, gobar gas plants, electrification programmes of the Rural Electrification Corporation, have been given more encouragement through refinance facilities.

The Corporation prepares guidelines to help the financing banks and state governments especially in respect of schemes under minor irrigation, development of plantation.

Sources of Funds: The Corporation started with the authorised capital of ₹25 crores and paid-up capital of ₹5 crores. Its main shareholders are: the Reserve Bank of India, Central Land Development Banks, State Co-operative Banks, Life Insurance Corporation, a number of scheduled commercial banks - 59 per cent shares contributed by the Reserve Bank of India and 27 per cent shares purchased by the Central Land Development Banks, and State Co-operative Banks.

In terms of Section 5(5-A) of the ARDC Act, 1963, the Government of India approved the proposal to increase the authorised capital of the Agricultural Refinance Development Corporation from ₹50 crores to ₹100 crores, of which paid-up capital is ₹47.50 crores. The reserves and surplus was ₹2.23 lakhs as on 30.6.1971 which increased to ₹10.30 crores as on 30.6.1978.

As per Section 6 of the Act, the Corporation's shares are guaranteed by the Central Government in respect
of repayment of principal and of payment of minimum
annual dividend @ 4\% in the case of first issue. The
shares are treated as trustee securities.

Section 19 of the Act, enabled the Government of
India to give an interest free loan of ₹5 crores to
the Corporation, the repayment of which commenced only
after 15 years, that is from 1978.

It is permitted to borrow through issue of
debentures to the public, with the payments of interest
and capital being guaranteed by the Central Government.
The borrowing power of the Corporation is restricted to
20 times its paid-up capital and reserves under Section
20(2) of the ARDC Act.

The Corporation has received assistance from the
International Bank for Reconstruction & Development (IBRD)
and its affiliate the International Development Associa-
tion (IDA).

The Corporation accepts deposits for periods of
12 months and above, from Central Government, State
governments, local authorities, state land development
banks, State Co-operative Banks, Scheduled Commercial
Banks. The maximum borrowing power of the Corporation
was fixed at 20 times its paid-up capital and reserve
fund.

The Corporation’s main sources of funds as on
30.6.1978.

1. Authorised capital ₹100.00 crores
2. Issued & Paid-up ₹47.50 crores
3. Reserves & Surplus ₹ 10.38 crores
4. Special deposits ₹ 3.87 crores
5. Bonds & Debentures ₹ 20.34 crores
6. Loans from Central Government ₹ 427.61 crores
7. Other borrowings - R.B.I. ₹ 16.80 crores
8. Fixed deposits ₹ 4.63 crores

The Corporation is managed by Board of nine directors with Dy. Governor of RBI as ex-officio Chairman.

Main channels for refinance: Land Development Banks, Scheduled commercial banks and State Co-operative banks are the main channels through which refinance is provided. The Central Land Development Bank obtained the bulk of refinance facilities during the first decade after its establishment, however, the share of the scheduled commercial banks is on the increase in the last few years.

Terms & conditions: Medium term finance is granted for 3 to 5 years, while long term is over 5 years but not more than 15 years and in exceptional cases upto 20 years. The minimum amount that can be considered for refinance was fixed at ₹ 1,00 lakhs in the case of scheduled commercial banks and the state co-operative banks, while in the case of Land Development Banks it was fixed at ₹ 5 lakhs. Refinance is provided upto 75% of the amount advanced and in exceptional cases this can exceed 75 per cent.
Rate of Interest: As on 15th March, 1979.

<table>
<thead>
<tr>
<th>Minor irrigation &amp; land development</th>
<th>To banks</th>
<th>To ultimate borrowers</th>
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<tbody>
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<td></td>
<td>6.5</td>
<td>9.5</td>
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</table>

Diversified purposes:

(a) Small farmers | 6.5 | 9.5 |
(b) Others | 7.5 | 10.5 |

Security: The financing institutions, under the scheme approved by the Corporation, grant loans to their constituents against sub-mortgage/sub-hypothecation or even against government guarantees. Refinance is provided to the extent of 50 per cent of the value of the security. The refinance to land mortgage banks is by way of subscription to the Special Development Debentures floated by them against mortgages collected and these debentures are required to be guaranteed by the State governments.

Technical feasibility and economic soundness:

The Corporation satisfies itself that the scheme submitted by the financing institutions for refinance are:

a) technically feasible; b) economically sound; and c) commercially viable. The Corporation also satisfied itself that adequate working capital is arranged for and that proper marketing organisation exists.

II. 28. State Financial Corporations:

The Parliament passed the State Financial Corporation Act on September 28, 1951, empowering State
Governments to establish financial corporations for their respective regions. Under the Act, SFCs, as specialised state level institutions were set up to provide term finance exclusively to small and medium enterprises. The Madras Industrial Investment Corporation, now Tamil Nadu Industrial Investment Corporation (TIIC) is the oldest. This was established even before the enactment of the 1951 Act. All the States, except Nagaland, Manipur, Tripura and Meghalaya have now set up SFCs. The area of operation of a SFC, though confined normally to one State/Union territory, the activities of some of the SFCs have spread to the neighbouring states/union territories, as in the case of Maharashtra State Financial Corporation, which covers even Goa, Daman & Diu.

Objective: It was envisaged that these corporations should supplement the activities of the Industrial Finance Corporation; while the IFC helps larger industries the SFCs are set up to cater to the needs of small and medium scale industries so that a balanced development of both kinds of industries can take place. To demarcate the functions of IFC and SFCs, the former has to entertain loans for amounts exceeding ₹10 lakhs, whereas the latter were to sanction only up to ₹10 lakhs. Further, the IFC assists only public limited companies, while SFCs cover not only public limited companies but also private companies, partnerships and proprietary concerns too.
Functions: SFCs are authorised to provide different types of assistance:
1) granting loans or advances for periods not exceeding 20 years; ii) subscribing to debentures repayable within 20 years; iii) guaranteeing loans raised by industrial concerns either in the public market or from scheduled or co-operative banks and repayable within 20 years; iv) guaranteeing deferred payments due from any industrial concerns for purchase of capital goods in India; v) underwriting of the issues of stocks, shares, bonds or debentures; and vi) subscribing to stocks, shares, bonds or debentures of industrial concerns from the 'Special Capital' contributed by the State government and the RBI at the instance of Romanum Committee Report, which does not carry any obligation to pay a minimum dividend, as it has been specially created for promoting developmental activities even including granting of soft loans to the weaker sections in the small scale sector; vii) the SFCs also act as the agent of the Central Government, State government, the IDBI and IFCI.

Scope of activities: As said earlier, the SFCs have a wider scope in financing multifarious units, as compared to the IFC, yet they are prohibited, per the SFCs Act, in certain respects, like from subscribing directly to the shares or stocks of any company having a limited liability (now amended in
1972 with the creation of 'Special Capital' as said above), except for underwriting purposes and from granting any loans on the security of their own shares. Further, no single concern can get assistance exceeding 10 per cent of the paid-up capital of the Corporation or ₹ 30 lakhs wherever is less. The maximum amount of financial assistance of ₹ 30 lakhs is in the case of limited liability companies and cooperative societies only, whereas this limit is only ₹ 15 lakhs as per recent amendment, for all other borrowers. To restrict SFC's assistance to small and medium scale industries, they are now prohibited from granting assistance to units whose paid-up capital and free reserves together exceed ₹ 1 crore.

Moreover the aggregate contingent liabilities arising from guarantee and underwriting arrangements of the SFCs, should not ordinarily exceed twice their paid-up capital and reserves. This can even go up to three times with prior approval of government. A SFC's holding of a company's share capital should not exceed 30 per cent of the subscribed capital of that company or 10 per cent of its own paid-up capital and reserves whichever is less. A SFC is also prohibited from entering into a business with a concern in which any of its directors is proprietor, partner, director, manager, agent, employee, or guarantor or in which one or more directors together have substantial

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63. Originally the limit was ₹ 10 lakhs for all types of borrowers, which in 1962, was raised to ₹ 20 lakhs for public limited companies and Co-operative societies, amended again in 1972 by which the limit was raised to ₹ 30 lakhs for companies & co-op societies.
interest - substantial being defined as holding of share capital of ₹5 lakhs or 5 per cent whichever is less.

The policies and functioning of all the state financial institutions are in terms of the SFCs Act, 1951 with the state government and the Reserve Bank of India/IDBI shaping all these policies through mutual consultations.

Amendments of the Original Act, 1951:

The Original Act of 1951 was amended in 1956. The amendment of the Act widened the scope of the Corporation's activities. It also placed them on a firmer footing. The important provisions of the amending Act related to:

1. Establishment of Joint Financial Corporations by two or more States or extension of jurisdiction of an existing Financial Corporation to other States.
2. Inspection of the working of the Financial Corporations by the Reserve Bank of India.
3. Instructions to be issued by State Governments to the Financial Corporations on questions of policy, in consultation with the Reserve Bank of India.
4. Granting of accommodation by the Corporations against the guarantee of the State Government, a scheduled bank or a State Co-operative Bank.
5. Empowering the Corporation to act as agents of the Central or State Governments or the Industrial Finance Corporation of India in respect of loans or
advances granted by them.

6. Authorising the Corporations to borrow moneys from the Reserve Bank of India.

It may be seen from these amendments that the activities of the State Corporations were widened in various directions. The area of jurisdiction of the Corporations can now be extended to include another State; the Corporations can now grant accommodation not only against fixed tangible assets but also against guarantees given by the State Governments, scheduled banks and the State Co-operative Banks; the Corporations may now act as agents of the Central or State Governments or of the Industrial Finance Corporation of India in respect of the loans and advances granted by them; and the Corporations can borrow funds from the Reserve Bank of India for expanding their business and for covering short-term needs in respect of loans sanctioned.

The State Financial Corporation Act was again amended in March 1962. The Amendment Act:

1. empowered the State Financial Corporations to guarantee:

(a) loans raised by industrial concerns from scheduled banks or State Co-operative Banks; and

(b) deferred payments due from any industrial concern in connection with the purchase of capital goods within India.
2. enhanced the limit of accommodation to public limited companies and co-operative societies from ₹10 lakhs to ₹20 lakhs.

3. enlarged the scope of the definition of industrial concern so as to include hotel and transport industries and also concerns engaged in the development of contiguous area of land as an industrial estate.

4. empowered the Corporation to borrow from the Reserve Bank in addition to the amounts borrowed, for periods not exceeding 90 days, for periods upto 18 months, against certain specified securities, provided such amount does not, at any time, exceed 60 per cent of the paid-up share capital of the Corporation.

5. empowered the Corporations to borrow from the State Governments in consultation with the Reserve Bank, and also from any notified financial institution with the prior approval of the Reserve Bank, on such terms and conditions as may be agreed upon.

6. enabled the Corporation to act as agents of any financial institutions notified by the Central Government in respect of loans and advances granted or debentures subscribed by such institution.

7. empowered the Corporation to accept from the respective State Governments or, with the prior approval of the State Government and the Reserve Bank, from a local authority or any other person, deposits
repayable after a period of twelve months, instead of five years.

2. enhanced the borrowing limit of the Corporation from five times to ten times their paid-up share capital and reserve fund.

It is clear that these amendments have further enlarged the scope of the activities of the State Financial Corporations. At the same time the amendments have made healthy provisions for augmenting their resources to meet the burdens of added responsibilities.

Resources: The State Government fixed the capital structure of a state financial corporation with a minimum of Rs. 5 lakhs and maximum Rs. 5 crores.

The resources can be further increased by issuing bonds and debentures, which together with contingent liabilities in the form of guarantees or underwriting agreement should not exceed 10 times their paid-up capital and reserves.

Subscription to share capital is done by:

a) public to the extent of 25 per cent; b) state government; c) Reserve Bank; d) Scheduled banks; e) Co-operative banks; f) Insurance companies and other financial institutions. The proportions of (b) to (f) are determined by the State government in consultation.


70. This is distinct from IFCI where public is not allowed to contribute to the share capital.
with the Central Government. The shares other than those subscribed by the public, are not transferable except to the state government, the Reserve Bank or any financial institution on behalf of state government. According to the Public Financial Institutions Laws (Amendment) Act, 1975, the share capital of the SFCs held by the RBI was transferred to the IDBI.

**Reserve Funds**: These consist of: (i) General Reserve Fund; (ii) Special Reserve Fund; (iii) Special Reserve Account; (iv) Reserve for Bad & Doubtful Debts; and (v) Reserve for Bad Investments.

Under the SFCs Act, 1951, a SFC has to establish a General Reserve Fund. Until the fund becomes equal to its paid-up capital and the guarantee sums provided by the State Government are repaid, dividend in excess of the guaranteed dividend cannot be paid. But on account of their limited profits, the SFCs have been able to transfer only insignificant sums to the general reserves. To overcome this deficiency, the SFCs Act was amended in 1962, providing for the establishment of a Special Reserve Fund - the dividends paid to the State Government, RBI (later IDBI) now credited to this Fund, as they have agreed to forgo the dividends. But the total amount in this Fund was not to exceed 10 per cent of the paid-up capital, but by an amendment to the SFCs Act, the 10 per cent limit was raised to 25 per cent, however since 1975, in terms of the Public Financial Institutions Laws (Amendment) Act, the RBI is out of this arrangement, for
future transfers.

There is also provision for a Special Reserve Account. In terms of the Finance Act 1961, 10 per cent of profits of a SFC are exempted from tax if set apart in a Special Reserve Account. The Mitra Committee\textsuperscript{71} recommended that this limit should be raised to 25 per cent with which the Ramanujam Committee subsequently, not only agreed to but carried even a step further by suggesting that the SFCs might be compelled by a statute to transfer 40 per cent of their profits each year to the Special Reserve Account. The exemption limit was enhanced to 25 per cent after 1964 and further raised from April, 1975 to 40 per cent with the ceiling of 5.3 crores on paid-up capital for eligibility for the maximum concession, raised to 5.5 crores later on.

There are also two other funds, one for bad and doubtful debts and another for bad investments, the contributions to which have been rather negligible.

**Fixed Deposits**: The SFCs can also accept deposits from the state governments or with the approval of state government and the RBI and the IDBI, from local authority or the public. These deposits are guaranteed by state

\textsuperscript{71} The RBI appointed in June 1962, a Working Group under the Chairmanship of Shri K.C. Mitra, Chief Officer of the RBI's Industrial Finance Dept, and again in April, 1970, yet another group under the Chairmanship of Shri K.N.R. Ramanujam, also Chief Officer of the Bank's Industrial Finance Department, to study the functioning of SFCs and make recommendations on resource mobilisation, profitability etc. See appendix II.
governments and are accepted for periods not less than 12 months. The total amount of deposits is not to exceed the paid-up capital of SFCs.

**Bonds**: Issue of bonds constitutes a major source of funds for SFCs. They are authorised to issue bonds and debentures in the markets, guaranteed by the state government in respect of repayment of principal along with interest done in consultation with the RBI which determines quantum of bond issue by the SFCs. They have normally a maturity of 10 years to 12 years and they are subscribed to mostly by LIC, State Bank of India, and other commercial banks. The RBI always steps in and lends its support, if there is a shortfall in the subscriptions so as to ensure that an SFC is always assured of requisite funds. Hence SFCs prefer to raise resources by way of bonds to the maximum possible limit.

**Borrowings from the RBI**: As per the Act, the SFCs can borrow from the RBI in two different ways:

a) loans repayable on demand or within 90 days against trustee securities or eligible bills and promissory notes;

b) loans for longer periods repayable within 18 months against Central or State government securities or its own debentures maturing within 18 months - this type of loan however, was not to exceed 60 per cent of the paid-up capital of the SFCs till 1972, which has now been raised to 90 per cent.
From State Government: The SFCs can also borrow from the State Governments and also from any financial institution notified by the Government of India. But borrowings from State Government are very small in the aggregate.

Refinance from the IDBI: This innovative method has emerged as a major source of funds for SFCs at concessional rates. This source has also acted as incentive to SFCs to increase their assistance to the small scale sector and to units in backward districts. This constitutes normally a little over 25 per cent of the total resources of funds in the recent years. There are no statutory limits on the amount of assistance the IDBI can provide by way of refinance. However to effect certain control, the IDBI has stipulated that the outstanding refinance assistance to a SFC should not exceed thrice the paid-up capital and reserves of the latter at any point of time. There have however been occasions when SFCs have had to borrow more, up to four times the paid-up capital and reserves which IDBI agreed to, only for temporary periods.

The procedure for availing of refinance has been considerably simplified so that the funds are replenished immediately. In the beginning the scheme was restricted to refinance of loans extended to industrial estates for the construction of sheds, but the scope has now been widened to cover development of land and provision of infrastructure also. Small scale industries and small road transport operators receive preferential treatment.
under this scheme and in the recent years more and more newer types of industries/services have been made eligible under this scheme.

Management: The Board of Directors is the supreme authority and is assisted by an Executive Committee and a Managing Director.

The Board of Directors consists of 10 directors - 3 nominated by state government, one each by RBI and IDBI, 3 elected to represent scheduled banks, co-operative banks and other financial institutions, one elected by non-institutional shareholders and the Managing Director.

In a recent amendment, the Board now comprises 12 persons as the State Government and the IDBI can nominate an extra Director each. One of the directors, other than the Managing Director, is the Chairman nominated by the State Government, who holds office for two years and who is eligible for renomination.

The post of Managing Director, who is a whole time Director, is for a term of four years, however eligible for reappointment.

The Executive Committee consists of Managing Director as Chairman and 3 other directors (one each from State Government, the RBI and the IDBI) and the elected directors. This Committee can deal with matters on behalf of the Board. Some of the SECs have constituted Advisory Committees/Regional Committees/Loans Sub-Committees.
II.20. Concluding Observations:

After the vicissitudes in the experimentation of institutional finance in catering to long term industrial needs, since the early years of the present century, development banking has at last come to stay in this country and is no longer in the stage of experiment.

In the present chapter we have traced the historical roots of the Indian development banks from the year 1872, when the earliest institution in Societe-Generale de Belgique was founded in Belgium, followed by the famous Credit Mobilier in France, founded in 1852. The mixed banking in Germany and the Industrial Bank of Japan established in 1902, served as prototypes to many countries along with Credit Mobilier of France.

The historical survey of development banking abroad has enabled us to enumerate different aspects of development banking as a result of experiments made there, which were of much relevance to our own experiments here.

Many countries associated their governments in the shareholding of the development banks for sound working. Public ownership was also achieved in some, by making the Central Bank of the country hold the shares of development banks as was the case in India. Control of

[72. See concluding observations at the end of Section(I) of this Chapter, page 75]
development banks by the government or public ownership proves effective as broad guidelines of policy and directions in consonance with development planning can be given.

While some of the development banks concentrated only on medium and small units, others assisted large and medium only - here too India took its cue in the formation of IFCI, ICICI and SFCs.

Different types of financial assistance are provided by way of direct subscription to the share capital or underwriting or direct loans or 'intermediate credit' (Macmillan gap) or rediscounting facilities or arrangements to finance the manufacturers, the distributors, the retailer and the individual buyer so that finance from one single source is made available to every link in the long chain from the producer to the ultimate consumer, which the IDBI in India, has followed with rich dividends as we will highlight in the next chapter.

We also observed that the development banks many a time concentrate on certain type of industries or activities, as for instance the Securities Management Trust in Britain played a leading part in implementing and financing industrial rationalisation schemes - in India the Industrial Reconstruction Corporation of India was created for reviving sick units, while Agriculture Refinance & Development Corporation concentrates on agriculture and allied activities.
Sources of funds for these development banks were:
Share capital and Reserves, Borrowings (largest source) through public bond issues, loans from provincial/state/central governments and the Central bank, deposits of governments and other institutions, budgetary allocation by government as agents, sale of investments from the portfolio and repayment of loans from time to time. For the Indian development banks, borrowings through public bonds, loans from government (state and central), and RBI/IDBI, together accounted for more than 70 per cent of the total sources of funds.

For successful working of a development bank, as we observed in the case of German banks, short term deposits were to be strictly used for short term credit, while the loans on long term basis were to be from such funds that could be locked up for long periods. This some of the early development banks, like the Societe-Genernal de Belgique or even the Credit Mobilier or our own Tata Industrial Bank failed to follow - a cue for development banks of today.

We saw it is essential to follow the basic principle of distributing risks and for the most efficacious, safe and sound use of the funds supplied by the development banks, it is necessary to foster close relations between the development banks and the industrial units even by participating in the management and accountancy of the aided enterprises,
to ensure the safety of the funds invested. Development banks must be modified or new ones created to adapt to different stages of economic development, as Gerschenkron pointed out while describing the role of St. Petersburg banks, in the years 1907-14 in Russia. Even in India the development banks are not lagging far behind the St. Petersburg banks, in adapting themselves to new stages of development.

We have in the present chapter traced in detail the background in which the different development banks, starting from IFCI in 1948, followed by SFCs, ICICI, IDBI were created. Now whether these development banks are truly dynamic institutions, continuously adapting themselves to the needs of the economy, especially in the development of backward regions, will be unfolded in the following chapters where we shall attempt to analyse in depth their role.
CHAPTER II
APPENDIX I

Regional Development Banks

Growing consciousness of regional economic growth resulted in the formation of regional economic blocks/organisations, which necessitated the establishment of regional development banks. The European Investment Bank, the Inter-American Development Bank, the African Development Bank and the Asian Development Bank are such banks.

The European Investment Bank formed in 1958, as an institution of the European Economic Community extended its area of operation initially to France, Italy, Germany and 'Benelux' countries and later extended to other member countries known as 'associated countries', which included Greece, Turkey, Eighteen African and Malagasy states, Nine French Overseas possessions and Four French Overseas Dependents. Its main objectives are to speed up development in the less developed areas of the community, to assist in the process of modernisation and conversion of enterprises besides promoting new activities and projects of common European interest.

The Inter-American Development Bank (IADB) established in 1960, by Latin America was the first to
take the initiative in under-developed regions, to establish a regional development bank. This was jointly set up by nineteen Latin American countries and U.S.A. It borrows from investors/institutions inside and outside the region and coordinates its efforts with local financial agencies to promote development projects for the economic and social development of Latin American countries. It also encourages foreign capital participation in developmental projects in Latin America.

The African Development Bank established in 1964, has similar objectives, viz., to accelerate the economic and social progress of its member countries individually and jointly.

The Asian Development Bank, a late starter in the field of development banking, came into operation in 1966 with headquarters at Manila.

Nineteen Asian and twelve non-Asian countries pledged $642 million and $341 million respectively towards the authorized capital of the Bank viz., $1000 million. According to its President Mr. Takeshi Watanabe, the purpose of ADB is to foster economic growth and cooperation in the region of Asia and Far

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East and to contribute to the acceleration of the process of economic development of the developing members in the region, collectively and individually. It assists in the attempt of the regional member countries economies to be mutually beneficial and complementary to each other and thereby promote their trade with each other.

Thus the main functions of the ADB are:

1. Giving loans for the development of the member countries;
2. Providing technical assistance for the preparation, financing and execution of development projects and programmes;
3. Promoting the investment of public and private capital for development purposes;
4. Meeting the requests of member countries for assisting in the coordination of the development policies and plans with a view to achieving better utilisation of their resources;
5. To cooperate with the U.N., its organs and subsidiary bodies which are concerned with the investment of development funds in the region in order to interest such institutions and

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74. *The Doors are open* Selected addresses by Mr. Takeshi Watanabe; President, A.D.B., Manila, March 1969, p.12.

75. S.I.N: Simha, Development Banking in India, p.328.
entities in new opportunities for investment and assistance; and (6) To undertake such other activities and provide such other services as may advance its purposes.

**Capital**

The initial capital of the Bank is $1,000 million — the Asian member countries subscribe 60 per cent of the capital while 40 per cent is subscribed by the non-Asian development countries. The $1,000 million capital is divided into 100,000 shares of $10,000 each — half of these shares or $500 million will be paid and half of this amount or $250 million is to be paid in gold or convertible currencies in five annual instalments, the balance of $250 million is to be paid in local currencies. An amount of $500 million will be made available as "callable" capital which will be called up by the Bank as and when required. The Bank would thus begin its operations with a capital of $500 million in gold or convertible currencies. As the lending operations became widespread the capital was to be increased to $2,700 million in the subsequent years.

**Financing Operations**

The Bank carries out its financing (1) by making or participating in direct loans from its
paid-in capital; (ii) by making or participating in direct loans with funds raised by the Bank in capital markets; (iii) by investment of funds under certain circumstances; (iv) by guaranteeing loans.

The Bank grants 'hard loans' to establish sound practices and endeavours to balance two objectives namely, that of attracting financial resources and that of lending money on conditions acceptable to borrowers.

It has special funds which are used for concessional loans — an Agricultural Special Fund, a Multipurpose Special Fund and a Technical Assistance Fund, all set up in 1968, through contributions made by the Governments of Canada and Japan. The Agricultural Special Fund was later merged with the Multipurpose Special Fund and a new Asian Development Fund was set up in April 1973, to eventually replace the Multipurpose Fund to assist specially non-oil developing countries of the region to overcome the oil crisis. It has approved many power development projects. The Bank has conducted regional surveys and studies — the Asian Agricultural Survey and South-East Asia Regional Transport Survey are two project oriented studies. The Technical Assistance unit assists development banks in the training of their staff.
The percentage-wise lending by ADB to different sectors, for instance in 1975, was:

(Percentage)

<table>
<thead>
<tr>
<th>Sector</th>
<th>No.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Agro Industry</td>
<td>28.1</td>
<td>22.8</td>
</tr>
<tr>
<td>Industry</td>
<td>17.5</td>
<td>22.0</td>
</tr>
<tr>
<td>Transport &amp; Communications</td>
<td>21.1</td>
<td>19.0</td>
</tr>
<tr>
<td>Public Utilities</td>
<td>31.6</td>
<td>35.1</td>
</tr>
<tr>
<td>Education</td>
<td>1.7</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Thus from the above, it is clear that the Bank's lending was for infrastructure projects.

Lending and Technical Assistance activities for the same year (as of December 31, 1975) were as follows:

(US $ million)

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Loans approved</td>
<td>251</td>
<td>2554</td>
</tr>
<tr>
<td>(i) Ordinary loans</td>
<td>150</td>
<td>1925</td>
</tr>
<tr>
<td>(ii) Special Fund Loans</td>
<td>101</td>
<td>659</td>
</tr>
<tr>
<td>Total technical assistance projects</td>
<td>186</td>
<td>30.8</td>
</tr>
<tr>
<td>(i) T.A. to member countries</td>
<td>156</td>
<td>25.3</td>
</tr>
<tr>
<td>(ii) Regional activities</td>
<td>30</td>
<td>5.5</td>
</tr>
</tbody>
</table>

76. S.L.N. Simha, op.cit., p.331.
The Bank has given assistance towards various developmental projects of different natures, like irrigation, fisheries development, power generation and distribution, industries, highways and feeder roads, ports and harbours, airports, railways, telecommunications, water supply, etc. Built-in technical assistance is provided for the preparation, financing and execution of development projects and programmes, specific project proposals and coordination of various technical assistance operations, which are being carried out in any member country. It has been fairly successful in promoting international cooperation and in harnessing the efforts of affluent countries towards the development of its poorer regional members. 

Management

All powers of the Bank are vested in a Board of Governors, with each member country appointing one governor and one alternate. The Board of Governors elect the Board of Directors. Out of the total of ten directors, seven directors should be from member countries in the region and three directors from non-regional members. The Board of Governors also elect a President of the Bank who should be a national of an

Asian country. He is the Chairman of the Board of Directors, the legal representative of the Bank and the chief executive of its staff. But he is neither a governor nor a director.

The World Bank

The historical survey presented in Chapter-II will be incomplete without a few words on the International Bank for Reconstruction and Development (IBRD), popularly known as the World Bank, a global development bank, which came into existence on December 27, 1945 and began operations from June 25, 1946. The Bank was created as a sequel to the United Nations Monetary and Financial Conference, held at Bretton Woods in July, 1944.

The Bank has two affiliates namely, the International Finance Corporation (IFC) and the International Development Association (IDA), all these institutions along with the International Monetary Fund (IMF) have played a significant role in the international economic and financial fields.

The main purposes of the World Bank include assistance in reconstruction and development of member countries and encouragement of productive resources in less developed countries; it promotes private foreign investment by guarantees or by participation in loans.
It also encourages long range balanced growth of international trade and maintenance of equilibrium in balances of payments by encouraging a long term international investment; it supplements private investment by providing finance out of its own capital, or funds raised by it or out of its other resources.

Membership

A precondition to the membership of the Bank is the membership in IMF. The subscription of an applicant for membership is fixed after consultation between the Bank and the applicant and approved by the Bank's Board of Governors — it is based on the economic and financial strength of the member and is linked to the member's quota in the IMF. Individual members' voting power is fixed as per the size of their subscriptions.

Management

It consists in a three-tier authority: the Board of Governors, the Board of Executive Directors and a permanent staff headed by the President who is the Chief Executive. All powers are vested in the Board of Governors which consists of one Governor appointed by each member country. The Board of Governors have delegated their powers to the Board of Executive Directors — five of these are appointed by the five largest contributors and the remainder (15) are elected by other members.
The Directors choose the President of the Bank.

Resources

Most of the funds are raised through its own borrowings from investors who buy its obligations. Besides, repayments on existing loans, the amount of funds derived from net income after provision of a grant to IDA and sales by the Bank from its portfolio, are the other sources.

Lending Policies

It lends either to Government of member countries or to public and private organisations which can obtain the guarantee of the member Government.

The loan is provided for a specific project in a member country and the project must be technically and economically sound and of high priority. The loan covers the foreign exchange costs of the project and in special circumstances also covers local currency costs to some extent.

The Bank exercises rigorous control in appraising a project and after a loan is once sanctioned it exercises control on disbursements. The Bank sends a supervision team, from time to time, to assess the progress of each of its project. The Bank has regional offices in a number of places.

The Bank's lending focuses on basic infrastructure
and public utilities with lending for agriculture and education getting the next priority. In recent years the Bank is financing urbanisation, tourism and family planning programmes.

The Bank also provides technical assistance to member countries for identifying and preparing projects. It also helps the countries in various aspects of their development, like analysing their economies, formulating appropriate development policies, establishing effective development institutions, preparing investment programmes and undertaking feasibility studies of individual projects for which the Bank finances itself, either as a part of loan or credit or in the form of a grant.

The Bank has formed groups consisting of capital exporting countries and international and regional financial institutions, whose purpose is to coordinate the flow of development assistance to particular developing countries, and 16 such groups have been formed.

To encourage the flow of private foreign investment into developing countries, the Bank has sponsored the International Centre for Settlement of Investment Disputes (ICSID), in 1966, which provides a forum for conciliation and/or arbitration of disputes between member States and private foreign investors who are nationals of other member States. It has also formed
the Economic Development Institute (EDI) to provide training for senior officials in developing member countries.

**International Financial Corporation**

Membership to this institution is open only to Governments which are members of the World Bank. It was formed on July 21, 1956, with a view to furthering economic development by promoting private enterprises in its member countries especially in less developed areas. It endeavours to fulfil its objective of promoting economic development by (i) investing in productive private enterprises, in association with private investors and without government guarantee of repayment, in cases where sufficient private capital is not available on reasonable terms; (ii) serving as a clearing house to bring together investment opportunities, private capital (both foreign and domestic) and experienced management; and (iii) helping to create conditions conducive to the flow of private capital, domestic and foreign into productive investment in member-countries.

The enterprises eligible for financing from the International Finance Corporation are industrial, agricultural, financial, commercial and other private
It invests in association with either local or foreign private investors or both. It normally entertains investment proposals involving new investment of at least U.S. $500,000 and where the participation of the Corporation is involved, it is U.S. $100,000 or its equivalent.

It finances only private enterprises and does not invest in governmentally owned undertakings or where the government participates in the management. This does not preclude the Corporation from financing enterprises in which public funds have been invested if such enterprises are essentially private in nature.

**Forms and Methods of Financing**

It is authorised to make investments in any suitable form with the exception that it cannot invest in capital stock or shares. This was however, amended in October 1960, to enable it to invest in capital stock of private industries. The IFC can obtain convertible debentures, subscription warrants or similar rights to obtain capital stock or shares, which can be disposed of to private investors later on, so as to revolve its funds by sale of its investments.

The usual period of maturity of loans granted by the Corporation varies from five to fifteen years and
the amount is available in a lumpsum or in agreed instalments, and loans may be disbursed with or without security.

The IFC finances enterprises only when it is satisfied that the management of the enterprises are experienced and competent.

**International Development Association**

This came into existence on September 24, 1960 and the membership is open to the members of the World Bank.

Its object is to finance a wider range of projects than the World Bank because it is not strictly guided by revenue-yielding or directly productive projects. However, the project financed by it should be of a high development priority.

The Association can make loans to governments, government agencies, and individual industrial concerns; it is not necessary for it to obtain a government guarantee in respect of loans to individual industrial undertakings.

The Articles of Agreement provide that a member can make available to the IDA supplementary resources in the form of another country's currency which it may have acquired through aid programmes like the U.S. P.L.
scheme. To replenish hard currency holdings, the Articles provide for quinquennial reviews of the adequacy of the resources and for additional subscriptions, if necessary. For instance, as on June 30, 1975 four replenishments became effective and the total involved under the last replenishment agreement alone was about $4,500 million. The World Bank from 1964 to 1975, had transferred $1,025 million to it and its own net income on account of service charge of hardly 3/4 to 1 per cent on disbursed portion of credits and from interest on invested funds amounted to $70.4 million. 78

The IDA is regarded as a means of furthering the development activities of the World Bank and as a supplement to the Bank's activities and its projects are identified, appraised and supervised in the same manner as the World Bank projects are done. It has the same management and staff as the World Bank.

Region-wise more than half its assistance has gone to countries in South Asia.

78 S.L.N. Simha, op. cit., pp. 325-327.
CHAPTER-II
APPENDIX- II

Working Groups on the Functioning of SFCs

The RBI appointed two Working Groups, one in June, 1962 under the Chairmanship of Shri K. C. Mittra, Chief Officer of the Bank's Industrial Finance Department and another in April 1970, under the Chairmanship of Shri K. N. R. Ramanujam, also Chief Officer of the RBI's Industrial Finance Department. The terms of reference of the two Committees are given below:

Mitra Committee

(i) to review the working of the State Financial corporations in the light of the policies and procedure followed by them and to evaluate their role, in the financing of industries; (ii) to examine the organisational, legal, financial and other difficulties or factors impeding progress of the Corporations, with particular reference to their lending to small industries and to suggest appropriate remedies; and (iii) to suggest ways and means of improving the usefulness of the Corporations generally with a view to facilitating accelerated development of industries.
Ramanujam Committee

(1) to review the position of resources of SFCs and the cost of raising them and to suggest measures for augmenting the resources, having regard to the need for increasing and diversifying their business, particularly for undertaking underwriting obligations and participating in equity; (ii) to examine and suggest modifications, if necessary, to statutory provisions governing mobilisation of resources by SFCs; (iii) to study the profitability of SFCs with particular reference to their liability for payment of subvention, for payment of minimum dividend, taxes, stamp duty, registration charges on documents, etc, and make suggestions for improving their profits and reserves; (iv) to examine the statutory provisions regarding SFCs operations and suggest changes required, if any; and (v) to consider and make recommendations on other incidental matters.

Important Recommendations and Implementations

Reserve Fund

As per the SFCs Act, a SFC is required to establish a Reserve Fund. Until the Fund becomes equal to its paid-up capital and the guarantee sums provided by the State Government are repaid, dividend
in excess of the guaranteed dividend cannot be paid.

However, due to their limited scale of operations and low profits, the SFCs were able to transfer only insignificant amounts to the general reserves. Besides, another anomalous situation arose on account of the State Governments acceptance of dividends on their shares, which were paid by the SFCs by the subventions drawn from the states themselves. The SFCs were to transfer to the Special Reserve Fund a portion of the dividends fixed by agreement between the State Government and the Reserve Bank/IDBI, in any case not to exceed 10 per cent of the paid-up capital.

The Mitra Committee recommended that this limit should be raised to 25 per cent which was not accepted. However, the SFCs Act which was earlier amended in 1962, providing for the establishment of the aforesaid Special Reserve Fund, required the State Governments and the RBI to forgo their dividends which were to be credited to this fund. The Ramanujam Committee recommended that the IDBI too might forgo the dividend on its share-holdings for credit to the Special Reserve Fund. In 1972, by an amendment to the SFCs Act, the 10 per cent limit was raised to 25 per cent.

Again in terms of the Finance Act, 1961, a SFC's profits up to 10 per cent was exempted from tax
If set apart in a Special Reserve Account. The Mittra Committee recommended for an enhancement of the exemption limit up to 25 per cent, which was accepted. Later the Ramanulan Committee wanted the SFCs to transfer 40 per cent of their profits, each year, compulsorily by a statute, to the Special Reserve Account — the amount so transferred being eligible for income tax concession, with the then existing ceiling of Rs. 3 crores on paid-up capital for eligibility for the maximum concession to be raised to Rs. 5 crores, which was accepted and has come into effect from April 1, 1975.

**Underwriting and Investment**

The Mittra Committee brought forth the view reflected in the deliberations of SFCs Annual Conferences, that the SFCs were not enthusiastic in entering into the underwriting and investment field, which even the RBI and the Government, in fact did not encourage. The Mittra Group, however, was of the view that "in the first few years, SFCs would not be able to participate in equity to any significant extent as it is a risky undertaking; so long as they are not able to build up adequate reserves, the regular and minimum income generated by a loan portfolio would
naturally have a greater appeal to them than the delayed and uncertain returns on equity investment. The Mittra Group suggested that the SFCs should make a beginning by participating in equities of enterprises, which have already become seasoned and with which they have had satisfactory dealings as lenders for a fairly long time; after gaining a lot of experience in such riskless investment, SFCs were supposed to move on to the stage of subscribing to the equity capital of new ventures to fulfill their role of development banks.

Finally, the Mittra Group felt that a ceiling of something like 30 per cent of the capital and reserves up to which a SFC might engage in equity participation should be imposed.

The approach of the Ramanujam Group on this question of equity financing was practically similar to that of the Mittra Group. The Ramanujam Group felt that it is not at all advantageous for a SFC to subscribe to shares of a private company and that where a private limited company has potentialities for growth but the promoters do not have sufficient funds for the initial capital, the SFC might subscribe to redeemable cumulative preference shares which may have a redemption period of five years. But it is pointed out that preference shares, especially in case of new
companies, are inimical to the interests of the shareholders and that the Ramanujam Group's suggestion for SFC to subscribe to the share capital in the form of preference shares, is ill-conceived. The Ramanujam Group recommended that a SFC might subscribe both to equity capital and preference capital of public limited companies. It also gave norms regarding the extent to which subscription might be made to share capital and recommended that SFCs should follow a ratio of equity to loan assistance of 1:4 with a ceiling in the overall assistance by a SFC to a company, not to exceed 30 per cent of the company's paid-up capital or 30 per cent of the paid-up capital and reserves of the SFC, whichever was lower. This Group recommended the creation of a special class of share capital, for inducement to the SFCs to subscribe to shares, which is to be contributed by the State Government and the RBI/IDBI in agreed proportions, bearing no minimum dividend. The Group also recommended that the dividend earned out of the investment of this special category of capital and the capital gains thereon should be retained in the Special Capital Fund. It suggested special grants from the State Governments, for SFCs to undertake investment in equity capital.