CHAPTER - V

DEVELOPMENT BANKING AND INDUSTRIAL FINANCE :
THE PROCESS OF EVOLUTION

Transfer of financial savings from the surplus spending units to the deficit spending units takes place through the mechanism of financial system. "A system is a set of inter-related parts working together to achieve some purpose. Conceptually, the term financial system includes the complex of institutions and mechanism which affects the generation of savings and effects its transfer to those who will invest."¹ As such, the financial system of an economy comprises financial institutions, financial instruments and financial market.

DEVELOPMENT OF FINANCIAL SYSTEM

Development of financial system, in the modern sense, started everywhere in the world with the emergence of the banking system. In the initial stages of development, the banks were used extensively for payment services only. They came to be looked upon as the intermediaries between savers and investors. In Treatise on Money, Keynes² noted that banks supplied substitutes for State-money and money transfer services and, at the same time, acted as

middlemen for lenders and borrowers.

In order to meet the requirements of industrial development, in course of time there emerged other financial institutions. "Banks emerged as the dominant intermediaries, although in the process of development other financial institutions appeared and in many cases, after a point, grew at a faster pace than banks. Such processes were accompanied by rising complexities in the financial structure."³ Gurley and Shaw⁴ thought Banking to have become a relatively declining industry as soon as the institutionalisation of saving and investment ceased to be confined to the monetary sector and became a kind of product differentiation in the field of finance.

Development of financial system in different countries did not follow a uniform course. In the industrial countries of the West, the development took place in an environment vastly different from that of the developing countries. Till the depression of 1930s, State intervention, either in the field of macro-economic management or in that of financial sector, was never dreamt of. As a result, a wide variety of both specialised and general purpose financial institutions emerged. In the industrially developed West, the Anglo-Saxon countries developed commercial banks for supplying both short-term and long-term credit for financing trade and commerce only; whereas,

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in Germany, there developed universal or multipurpose banking in the eighteenth century for supplying both short-term and long-term finance to trade, commerce as well as industry. Not only that, the German banks also maintained close association with the borrowers for ensuring proper utilisation of finance provided by them.

In the developed economies of the world, specialised saving and investment institutions of different types also evolved through the normal process of market pressure and acquired the requisite level of perfection and development according to the needs of the particular economy. In general, the need for such institutions in the developed economies arose from the twin needs of channelling the small savings of innumerable sources and minimising the risk of investment by distributing the investible fund among a wide range of profitable avenues.

PROBLEMS OF DEVELOPING COUNTRIES

In the developing countries, on the other hand, the pressure of poverty was so severe and the need for development so urgent that the emergence of specialised institutional agencies for finance and other strategic inputs could not be left to the process of slow evolution. In such countries, whatever saving was there was not available for investment in industries. In many of the less developed
countries, even though capital in general is in very short supply, a certain amount could in fact be made available to industry if suitable machinery existed for the purpose.  

Savings tend to be shy of investment in developing countries since industrial development implies investment of savings outside the traditional areas where they are generated. "The problem of mobilizing savings is particularly serious where new forms of economic activity are involved, as in the expansion of industry in an underdeveloped country, for savings tend to move within the sector in which they are generated. The industrial sector, by definition small and incapable of producing quickly the resources it needs, must look elsewhere, particularly to the commercial sector."  Hence, in such countries "every encouragement should be given to institutional development parallel to industrial development." 

INSTITUTIONAL FINANCING OF INDUSTRY: EARLY EXPERIENCES

The origin of institutional financing of industries dates back to early nineteenth century when the first institution of its kind was established.

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7. United Nations, op.cit., p.36
kind, the Societe - General de Belgique, was founded in Belgium in 1822. After a lapse of exactly thirty years, Credit Mobilier was founded in France as the second specialised institution for supply of industrial finance. The Societe - General was established to promote new industrial companies, to subscribe to industrial shares and to establish subsidiaries for holding industrial shares. The Bank promoted a number of companies for opening up coalfields and construction of railways and other public utility services. For extending the horizon of operation, the Bank also opened a few subsidiaries. But, as the only institution of its kind, the Bank had no example before it and in course of time it was found that a considerable portion of its assets had been locked up in unrealisable security holdings. Thus, after the establishment of the Banque National de Belgique in 1851, the Societe - General was required to modify its course of business and increasing attention had to be devoted to ordinary deposit banking.

The Credit Mobilier of France, enriched by the experience of its predecessor, the Societe - General de Belgique, was designed exclusively for financing industries. It promoted a large number of public utility companies in France and in other parts of Europe. As

9. ibid, p.244
the first industrial financing institution of its kind in the world, Credit Mobilier attained considerable success both in terms of financial performance and the horizon of operation. "Ever since its establishment by the Pereire Brothers in 1852, the institution had engaged the earnest attention of economists and bankers throughout the world." Experiment of Credit Mobilier was a short-lived one; the end came after a brief career of 15 years in 1867. But the concept of industrial banking brought into operation by the Credit Mobilier in 1852 continued to remain the only experiment of its kind till the end of the century. "Throughout the nineteenth century, the Credit Mobilier attracted considerable attention. It provided a great appeal to all those countries which were desirous of achieving a rapid industrial progress; and Japan chose it as the model, when she founded her Industrial Bank in 1902 for the purpose of financing her industrial development."^12

Industrial Bank of Japan was an ambitious experiment in investment banking. Founded at the dawn of the present century, it continued to illuminate the horizon of industrial banking till the depression of 1930s. The Japanese experiment in the field of industrial banking enthused economists, bankers and politicians of both developed and developing countries around the world to set up such institutions. "It made a profound appeal to the Indian Industrial

11. S.K. Basu, Industrial Finance in India, op.cit., p.245
12. ibid, p.247
Commission of 1916 who were mainly responsible for popularising the idea of forming an "industrial bank" in India on the model of the Japanese institution.  

THE TWO WORLD WARS AND THE EMERGING SCENARIO

The course of evolution of specialised institutions for industrial finance was greatly influenced by the political and economic changes that started taking place in different parts of the world since World War I. In the war devastated countries of Europe, long term fund was urgently needed for reconstruction. Re-organisation, modernisation and expansion of old industries of these countries also called for massive investment on long and medium terms. "The type of machinery that was generally chosen to solve this financial problem was provided by the device of the industrial mortgage bank." In the countries of Europe, there existed at that time developed commercial banking and developed capital markets for meeting the usual requirements of trade, commerce and industry. So, in order to have the demand for additional capital satisfied, the industrial mortgage banks, with funds raised by the issue of bonds, were looked

upon as the most suitable institutions. The mortgage banks used to extend term loans against mortgage of real property; mainly capital assets of the borrower industries. "The largest of these banks were the Industrial Mortgage Bank of Finland Ltd., the National Hungarian Industrial Mortgage Institute Ltd., and the Provincial Mortgage Bank of Saxony."15

Before the scars of World War I healed up and before the industrial mortgage banks could be reasonably successful, came the depression of 1930s. The financial systems of the industrial economies were thrown out of gears by the depression. Thus, the institutions which evolved in the post-depression period had to adjust themselves to suit the needs of the emerging situation. Accordingly, the institutions established in the post-depression era and also those formed before the depression had to widen the range of operation by including underwriting and even holding of new issues of capital within their purview. Underwriting and holding of new issues were combined with the business of long-term lending with the definite objective of developing the capital market, the new issue market in particular.

The third and the most significant phase in the process of evolution of institutional development of industrial financing began with the end of World War II. Demand for institutional development

15. Ibid., pp. 5-6
during the period came both from the developed and developing countries.

The devastation caused by the war necessitated massive investment of fund for rehabilitation of economies in Europe. To meet these requirements of fund, specialised financial institutions were set up even in Great Britain and other developed countries of the Commonwealth, such as Canada and Australia. Institutions were also set up for regional and sectoral developments as well as for social purposes. Setting up of the International Bank for Reconstruction and Development (IBRD) in 1945 and attaching greater emphasis to the reconstruction of the war-torn economies of Europe lent additional support to the initiatives of those countries in this direction. The institutions set up in the years after World War II in those countries combined the business of mortgage lending with that of merchant banking in a general way. "In sharp contrast to the pure industrial mortgage banks of the period after World War I, and the hesitant policy of the post-depression industrial credit companies there could now be witnessed a remarkable trend in favour of a combination of the business of mortgage lending with that of underwriting and, in several important cases, participation in the equity capital of industrial companies as well."\(^{16}\) Beginning from 1944 there evolved machinery for financing and promoting industries in those countries of

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the industrially developed world that so long remained beyond their purview. "The Industrial Development Bank of Canada (1944), the Finance Corporation for Industry Ltd. (F.C.I.) and the Industrial and Commercial Finance Corporation Ltd. (I.C.F.C.) of Great Britain (1945), and the Industrial Finance Department of the Commonwealth Bank of Australia (1946) are important instances of such machinery being established in developed countries."17

Historically, the financing of industrial and economic development in Europe and North America has been a function of the growth of capital formation. The foundation of industrial development in those countries was laid down by a process called Industrial Revolution which had spread over a period of nearly a century or so and, naturally, the rate of growth was not very fast. But the developing countries of Asia, Africa and Latin America, liberated from imperialism during and after World War II, found themselves far behind the developed countries in terms of standard of living and industrial production. The process of development, however, envisages a developed capital market which was totally absent in these countries, nor was it possible to have developed capital markets overnight. Naturally, the developing countries had to establish development financing institutions for the supply of long-term finance, more or less similar to those established in Europe and North America. "... these institutions are in fact a reflection of the growing

17. ibid., p.9
urge for rapid economic development and of the search for machinery to use where development does not appear to be proceeding of itself with the desired speed. This was the position of continental Europe, as it looked on Britain in the middle of the nineteenth century; it is the position of most of the nations of Latin America, Asia and Africa today, as they look on Western Europe and North America.  

From the process of evolution of institutional development of industrial financing depicted above it now transpires that the establishment of Societe-General de Belgique in 1822 marked the beginning of the quest for such institutions. The evolution took place in several distinct phases. In the countries of Europe and North America, in general, these institutions were looked upon as the suppliers of long-term fund for re-organisation, modernisation and reconstruction. On the other hand, in the developing countries, these institutions are considered the agents of development; hence, the development banks.

THE DEVELOPMENT BANKS

Though the specialised financial institutions, the forerunners of development banks, appeared and existed since early eighteen twenties, the emergence of development banks or development

18. William Diamond, op.cit., p.5
### TABLE - 5.1

**EVOLUTION OF DEVELOPMENT BANKS**

<table>
<thead>
<tr>
<th>Year of Establishment</th>
<th>No. of Development Finance Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1920</td>
<td>3</td>
</tr>
<tr>
<td>1920 - 1925</td>
<td>-</td>
</tr>
<tr>
<td>1926 - 1930</td>
<td>1</td>
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<tr>
<td>1931 - 1935</td>
<td>2</td>
</tr>
<tr>
<td>1936 - 1940</td>
<td>2</td>
</tr>
<tr>
<td>1941 - 1945</td>
<td>6</td>
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<td>1946 - 1950</td>
<td>11</td>
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<td>1951 - 1955</td>
<td>12</td>
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<td>1956 - 1960</td>
<td>19</td>
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<td>1961 - 1965</td>
<td>35</td>
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<tr>
<td>1966 - 1970</td>
<td>22</td>
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<tr>
<td>1971 - 1975</td>
<td>24</td>
</tr>
<tr>
<td>1976 - 1980</td>
<td>2</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>139</strong></td>
</tr>
</tbody>
</table>


Finance institutions is mostly a post-World War II phenomenon. Table-5.1 indicates that as much as 82 per cent of such institutions were established after 1950. It also appears that before 1920 there existed only three development banks, whereas, till the end of World
War II, that is, upto 1945, there were only fourteen such institutions. "In the early 1940s the need to reduce the gap between the standards of living of the developing countries in Africa, Asia and Latin America on one hand and those in Europe and North America on the other, brought about more conscious promotion of economic development by means of development financing institutions." 19

Another feature connected with the evolution of development banks is that in most cases such institutions were the products of direct initiative and enterprise of State, unlike their counterparts in Europe and North America. Magnitude of State ownership of the institutions, however, differed widely. Only in cases of twentythree out of one hundred thirtynine such institutions in 1980, State ownership was totally absent; whereas, in as many as ninetytwo institutions the extent of State ownership was above fifty per cent, out of which sixtyfour such institutions were totally owned by the State. The reasons behind State ownership of such magnitude was attributable to the fact that in those countries the development banks were looked upon as the agents of change in the overall context of their development plans. Moreover, involvement of World Bank in setting up development financing institutions also brought about closer involvement of Government in both the formation and evolution of development financing institutions.

Development banks play an important role in the economic development of the developing countries. In these countries, development banks are in operation and they help and assist the authorities in achieving the targets of development by providing finance and other services. "A development bank is primarily a financing agency, providing medium and long-term capital, generally to the private sector of the economy, but it is not wholly so, a wider role being envisaged for it, such as acting as a catalytic agent in promoting development, by initiatives and services in other spheres too, such as discovery of investment projects, undertaking preparation of project reports, provision of technical advice and management services and finally, on rare occasions, establishment and management of industrial units."^20

Being two dimensional in operation, the development banks occupy a very critical position. "As their name suggests, development banks are both development institutions and banks. .... Therefore, as banks they are obliged to apply sound financial criteria in their activities. But, as development institutions they share in the responsibility of the country's development effort, both social and economic. It is the fulfilment of this role which places unusual demands on the project promotion and financing activities of development banks. Yet, without fulfilling this role, a development

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bank would lose its reason for existence." Thus, success of a development bank depends upon harmonious and purposeful combination of the twin responsibilities.

FUNCTIONS OF DEVELOPMENT BANKS

Provision of medium and long-term finance for productive investments is the primary function of most of the development banks. This function is mainly intended to bridge the hiatus between the creation and the financing of productive projects.

A development bank has to shoulder the tasks of both 'development' and 'financing'. It has also to ensure that an optimal mix of the two is achieved. "Lending, as such, is a dismal activity, cold-blooded in character and requires that hard-headed quality which is not usually associated with development. The passion needed for development is different in kind from the quality which generally goes with financing activity. To blend the two requires craftsmanship and an idealist's vision." 22

Though we have taken a look at the broad functions of


development banks, it would be a difficult task to pinpoint all their activities in view of the diversity in their coverage in different countries. This diversity stems from the versatility in the socio-economic background and size of the economy, banking and financial infrastructure of the country, political philosophy of the Government and the stage of development of the country. Therefore, all we can do is to have a glimpse of the principal functions of development banks under the following two major headings, viz., financial functions and development functions.

FINANCIAL FUNCTIONS:

The more customary function of provision of finance takes on many complexions.

Secured loans are provided by development banks both in national and foreign currencies. Usually, they provide medium and long-term loans, leaving the provision of working capital in the hands of other financial institutions.

Participation in the equity capital of companies is another way of financing by development banks. The degree of such participation, "will depend on the circumstances of the country and the degree of development of its capital market." They also subscribe to the bonds and debentures of companies.

Nearly all development banks render the service of

23. William Diamond, op.cit., p.53
underwriting of industrial securities. Through this, the incipient companies get over the initial hurdle of raising the required capital and the existing companies get the needed finance without any hindrance.

Sometimes, development banks become purveyors of financial assistance through the provision of guarantees of loans taken by industries. These cover loans raised both from within the country and from abroad. Other types of financial assistance include, inter alia, guaranteeing deferred payments for import of machinery.

A more recent financial function, though not in the nature of provision of financial assistance, is the deposit-taking function. But this activity is confined to accepting only large institutional and personal deposits.

DEVELOPMENTAL FUNCTIONS:

There is more to development banking than the provision of financial assistance. Financial assistance alone does not dispel all the impediments of development and so, development banks have to take on developmental functions also; the important ones among them are discussed hereunder. The first of them is, the fostering of Capital Markets. Mostly in developing economies, development banks have to play the role of boosting up a sluggish capital market. This
is done in many ways such as selling their own shares and bonds, underwriting industrial securities and issuing securities from their own portfolios. "Portfolio sales represent both the culmination and the beginning of a cycle of activities in which the bank participates, as a developer first of securities and later of markets for these securities once they have become seasoned." 24

It has been observed that, "A development bank, if it is to assume its true responsibilities and fulfil its proper role, has inevitably to take a great deal of interest in new ventures. It has to pioneer and experiment in new fields of industrial activity..." 25 Keeping in view the above observation, we find the various aspects of involvement of development banks in new projects. The first aspect is the identification and appraisal of projects. Despite the investment ideas arriving in from the clients, development banks have themselves to identify the projects that are in consonance with their objectives of development. They also have to make a probing appraisal of every phase of the chosen projects. The second aspect is the assistance in project preparation. While preparing projects, clients of development banks, in many cases, require technical and advisory services. Development banks provide these services through their expertise and know-how. The third aspect is project promotion. Development banks are invited to be engaged in project promotion in the cases marked by

25. S.K. Basu, op.cit., p.46
lack or deficiency of entrepreneurial drive. Project promotion includes giving a start to an entrepreneur. This also includes the activity of taking part in project management in the construction and operating period.

"The provision of capital and initiative is not always sufficient to create effective enterprise. Entrepreneurs may need technical advice on the preparation of projects and on their execution and management." Therefore, development banks help many projects with their technical assistance by virtue of their specialisation in mobilisation, management and allocation of resources and in supervision of projects.

Many aspects of industrialisation are out of the reach of development banks, still, they assist Governments in solving these problems. These include the aspect of technology-transfer. Technology divisions have been opened by many development banks and Governments of many countries are acting hand in hand for development of these technology departments.

There are other issues as well, such as, joint technological research activities, regional industrial co-operation, joint financing of regional strategic industries and promotion of multinational industries. Development banks, both national and regional, will have to share the onus of responsibility with the Governments.

26. William Diamond, op.cit., p.57
Apart from the principal functions stated above, development banks have also to perform numerous other functions, such as, management consultancy, leasing, merchant banking, industrial estates and factory development, etc.

The effectiveness of development banks is dependent on their developmental and economic performance and achievements. So these institutions should have the ability to render diverse services, be it singly or in co-ordination with others.

**SOURCES OF FINANCE**

The financial resources that the development banks mobilise are of mighty proportions. It has been pointed out that "development banks may represent 100 per cent of the available supply of long-term loan funds in the smaller and least developed countries and as much as 25 per cent in the more advanced economies...."\(^27\) The chief source of finance of a development bank is domestic capital; Government, Central Bank, institutions or individuals, all may have their contributions to it.

A question that crops up is whether the resources of development bank should be constituted mainly of equity capital or

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loan capital. At the initial stages with little earnings, it is not practicable for development banks to turn to any source except the sponsoring Government for mobilisation of loan capital. Evidently, at this stage, more and more equity in proportion to loan capital is desirable. At later stages, the capital structure needs a higher proportion of loan capital as the potential earning power of equity base will thereby be greater. Though deciding between equity capital and loan capital is a difficult task, it can be said that a strong equity base acts as a buffer against probable defaults, especially when borrowing is from private sources and there is no governmental guarantee. Still, it should be pointed out that a reasonable leveraging of debt is important for profit-maximisation.

Development banks also mobilise resources by selling their own financial instruments. This is the easiest and cheapest means of raising funds. "In fact besides the paid up share capital the main source of funds for their operation comes from the proceeds of their bond issues and borrowings." 28

Foreign capital participation, both equity capital and loan capital, is another method of financing of development banks. This has the advantage of the development banks being shielded from local political pressures. 29 This also brings in foreign technical expertise


29. Shirley Boskey, op.cit., p.28
and knowhow. Such finance is not an unmixed blessing - a negative fluctuation in the foreign exchange rate might not augur well for the development banks. "A problem that faces development banks which have obtained loans from abroad directly and have to make repayments in foreign exchange is that of the possible risk of depreciation in the rate of foreign exchange."  

Development banks obtain funds through retained profits also. Despite being undertakers of developmental activities, development banks sometimes amass sufficient reserves out of profits.

Repayment of loans from borrowers is also a source of development banks' funds. Though the inflow of funds through repayment is usually expected, overdues, defaults and bad debts sometimes impede it.

In some cases, development banks are made agents for the management of public funds, on a fee basis. This source of fund through agency arrangement is totally free from risk of loss as development banks disburse these loans only as agents.

Governments of some countries have set up rediscounting facilities for loans of development banks and thereby enabled them to procreate new liquidity from their portfolios. Government funds also fill development banks' coffers in the form of direct grants.

30. S.K. Basu, op.cit., p.22
31. Shirley Boskey, op.cit., pp.33-34
subsidised loans, etc.

The more vital factors that help mobilise finance from others is the reputation and creditworthiness of development banks. These are measured by their capital, sponsorship, and primarily, by their performances.

Our analysis revealed that the financial institutions paving the way for the flow of fund for investment in industries, by whatever name they are known or identified, evolved and came to exist in different parts of the world since early twenties of the last century. Evolution of such institutions, however, continued to remain confined within the boundaries of the developed countries almost till the end of the World War II. In the developed countries such institutions were mainly looked upon as the suppliers of fund for reorganisation, reconstruction and rehabilitation of war-torn and depression-ridden economies. The developing countries, on the other hand, modelled such institutions as the agents of change and vehicles of development by bringing under the same umbrella the functions of entrepreneur and manager and called them the development banks.

INDUSTRIAL FINANCING INSTITUTIONS IN DIFFERENT COUNTRIES

Having analysed the process as well as the circumstances leading to the emergence and development of industrial financing
institutions in different countries of the world, developed and developing, we now venture to have a glimpse at the network of such institutions obtaining in some of those countries. For the purpose of this probe we have selected four developed countries of Europe and America and seven developing countries of Asia, including Japan, Africa and South America. The countries are in the different stages of development with different social and political systems. Such differences profoundly influence the range and magnitude of operation of the specialised industrial financing institutions.

FRANCE

The banking system of France dates back to the period of Renaissance but it came to maturity in the early nineteenth century when the private banks for the elite people came up. These were commonly known as haute banque or 'high banks' and were under the supervision of the Bank of France. This was followed by grande banque or 'popular banks'. Owing much to the industrial revolution, they spread progressively and surpassed the high banks by a great margin. Thus, towards the middle of the nineteenth century, commercial joint stock banks started to be set up. The first of such banks was the Comptoir National d'Escompte de la Ville de Paris, established in 1848. 32

The French banking system has undergone various reforms. The Acts of 13 June, 1941 and 2 December, 1945 have contributed in big ways in the field of credit control. The Act of 1945, inter alia, differentiated between banques de depots (deposit on commercial banks), banques d'affaires (merchant banks) and banques de credit a long et a moyen term (banks for long and medium term credit). Banking reforms of 1966-69 aimed mainly at paving the way for deposit banks to go into investment-financing in a bigger way. Moreover, the limit of participation of the deposit banks and the banks for long and medium-term credit in industrial and commercial organisations was raised to 20 per cent from the previous limit of 10 per cent. The limit of total participations was also raised to 100 per cent of their own capital from the former limit of 75 per cent. The banques d'affaires were also permitted to accept deposits with maturities of two or more years over and above their former functions of investing in share capital of companies and accepting deposits for less than two years. Consequently, many long and medium-term credit banks have been set up since 1965, most of them under the ownership of major financial institutions. In the field of investment-financing in France, the banques d'affaires and the long and medium-term credit banks play vital roles as intermediaries.

As for the special financial institutions, the first one to be set up in France was the Crédit Mobilier established in 1852. This

33. ibid., p.58
had aroused much greater interest throughout the World as a pioneering effort towards building up an institutional structure of industrial finance.\textsuperscript{34} It mainly financed public utility undertakings. After a bright performance spanning one and a half decades, it had to close down in 1867.

Among the special financial institutions that are at present in operation in France, the Crédit National (National Credit) is involved in industrial investment credit. It was set up in 1919 to provide financial support to the work of repairing the damages caused by the First World War and restoring the war-damaged industrial organisations. Later, it started functioning as the chief supplier of medium and long-term credit to industry. It also helped the French industry by refinancing medium-term credit provided by the banks. At present, the Crédit National is involved in many activities. In the first place, it provides long-term finance for construction work, purchase of materials, licencing, establishment of branches, purchase of fixed assets and so on. Secondly, it grants loans to finance French industrial investments in foreign countries. Thirdly, through a lengthy process, it mobilises medium-term credits that other banks grant. The process includes analysis by the Crédit National of the applications for their creditworthiness, but for which the loans would not qualify to be rediscounted by the Bank of France. Fourthly, Crédit National

\textsuperscript{34} S.K. Basu, Theory and Practice of Development Banking, op.cit., p.2
provides financial assistance to metallurgical, tourism and hotel industries and for scientific research to financially unsound enterprises out of a special fund called FDES (Fonds de Developpement Economique et Social). Numerous other activities like export counselling and assistance, leasing, etc. are undertaken by the Crédit National.

It is to be noted that Crédit National finances only large organisations, the medium and smaller ones being taken care of by other institutions.

The Crédit National procures funds chiefly through issue of long-term bonds and from other important financial institutions and insurance companies. The bank also keeps at its disposal public funds meant for particular purposes.

Another institution worth mentioning is the Institution for Industrial Development. It was set up in 1970 to give fillip to the growth rate of the French industries, especially those in the priority sectors.

JAPAN

Towards the end of the nineteenth century, Japan was already blessed with a central bank and a foreign exchange bank but there was no long-term credit bank. A dire need for such a bank was

there for industrial advancement. "Since Japan had no large middle class with financial resources to invest in industrial securities, there was a great need for such banks ready to accumulate the savings of the community and channel them into new industrial enterprises."

It was in 1896 that the first long-term credit bank Nippon Kangyo Ginko (The Hypothec Bank of Japan) was set up. It provided unsecured loans to public authorities, agricultural co-operatives and fishing guilds and also provided loans secured on immovable properties. It secured resources primarily through the sale of its own debentures.

Between 1898 and 1900, Agriculture and Industrial Banks were set up one in each of the 46 prefectures. These institutions were regional in nature and provided long-term loans against securities of real estates for agricultural and industrial developments. Such institutions could raise funds through issue of debentures also.

Still the need to set up a bank to provide purely industrial finance was there and by the promulgation of a law in 1900, the Industrial Bank of Japan (Nippon Kogyo Ginko) was established in 1902. With the development of modern industries, the lending of this bank increased progressively. The bank provided loans mostly for

37. ibid, p.18
newly established large industries, especially for ship building companies, iron and steel factories and public utilities. "Further, in the recession after the First World War it made relief loans to the chemical, silk and other industries..."\(^{38}\) During the Second World War, all financial institutions, especially the Industrial Bank of Japan, provided funds for the expanding munition industry.\(^{39}\)

After the Second World War, the system of special banks was abolished in Japan in 1950 under the policy of the General Headquarters of the Allied Forces and the Industrial Bank of Japan was also transformed into a commercial bank. The Long-term Credit Bank Act was enacted in 1952 and the former special banks were revived. The long-term credit banks were so established as to make a distinction between long-term and short-term lending activities in order to relieve the commercial banks of the load of long-term finance.

The chief difference between the pre-war special banks and the post-war long-term credit banks are that, "unlike the special banks in the pre-war period, the present banks under the new Act are private institutions."\(^{40}\)

At present, 3 long-term credit banks, viz., the Industrial

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39. ibid., p.40
40. Cees F. Scheffer, *op.cit.*, p.281
Bank of Japan, the Long-term Credit Bank of Japan and the Hypothec Bank of Japan, are there in Japan. Interest on loans constitute the chief source of their income and the largest part of their expenses is the interest on their debentures.

Under the Japan Development Bank Act, the Japan Development Bank (Nippon Kaihatsu Ginko), the State-owned long-term credit bank, was formed in 1951. It was established "to supplement and encourage financing by private institutions for economic reconstruction and industrial development." It provides financial assistance through granting loans for investment in equipments, subscribing to industrial bonds and guaranteeing financial obligations.

UNITED KINGDOM

Although the British banking system is one of the oldest in the world, there has never been any development bank to provide industrial finance. "The British, Canadian and Australian institutions cannot however be characterised as true development banks in the strictest sense of the word as understood in relation to underdeveloped countries. They were specialist machineries [sic] set up in countries already in an advanced stage of economic development..." The reason

41. ibid., p.284
42. S.K. Basu, Theory and Practice of Development Banking, op.cit., p.10
behind that may be traced in the fact that there was no dearth of
industrial finance. ".... in Britain, the development of commerce had
preceded the development of industry so that a developing industry
had access to a developed money market and a developed stock
exchange market."43

Starting from the middle of the nineteenth century, we
observe that industrial capital was plentiful. "Upto the late Victorian
or Edwardian era, there was abundant capital as the middle class
expanded..... This middle class had money and was willing to risk it
to make more."44 Although in the later years there was a tendency of
savings to be invested abroad rather than in domestic industries, the
London capital market played a vital role in keeping the position of
British industrial finance intact."... the supply of British capital
was sufficient in the period up to 1938 ... the London capital market,
while hardly favouring the domestic investment, did not inhibit it,
given its willingness to convert private to public companies, to raise
large amounts of capital for new industries started large, and the
availability of other capital for industry in the provinces....."45

The Macmillan Committee on Finance and Industry in 1931
opined that while short-term credit to industry was being supplied by

43. Moeen A. Qureshi, Banking and Credit Institutions in Pakistan,
1947-1952, University Microfilms International, Ann Arbor,
Michigan, 1987, p.112.

44. Charles P. Kindleberger, Economic Growth in France and Britain
1851-1950, Harvard University Press, Cambridge, Massachusetts,

45. ibid., p.67
the banks, new institutions were needed for the provision of (a) intermediate credit for all sections of industry and (b) long-term credit for small and medium enterprises which were unable to procure finance through new issues. The financial gap which the Macmillan Committee recommended to bridge was called the "Macmillan gap".

It was later in 1945 that two special financial agencies, Finance Corporation for Industry (FCI) and Industrial and Commercial Finance Corporation (ICFC), were established. FCI was formed to supplement the long-term capital provided by the capital market to larger companies and ICFC was formed with an intention to fill the "Macmillan gap" by providing long-term finance for the small and medium-sized companies.

The formation of these two brought forth interesting changes in the capital market. "One of the most significant influences on the new issue market in post-war years has been the growing importance of institutional investment and the decline of direct investment by private savers."46

FCI and ICFC merged in 1973 and a holding company named Finance for Industry (FFI) was formed. The two subsidiaries went on with their former tasks. FFI establishes new policies, raises funds for its subsidiaries and provides managerial and accounting services for

the group. At present, FCI provides medium-term loans to manufacturing companies and not supplementary finance only. ICFC now finances small and medium-sized organisations with each financial proposal tailor-made for the particular requirement. An expansion of the capacity and work of FFI has come into effect from January, 1975.47

Rapid developments mark the British financial system since the early 1970s. In 1976, Equity Capital for Industry (ECI), a private sector intermediary, was formed by various large financial institutions to "fill a gap in the provision of equity finance for small and medium sized firms."48 National Enterprise Board (NEB) was formed in 1975 in order to finance sick firms through loan and equity.

In U.K., a number of specialist financial intermediaries are now there each catering to a particular class of borrowers. These institutions procure funds mostly from the banks. Quite a few of them are subsidiaries of banks. However, their finance functions vary widely. One of the most reputed intermediaries is 3i, formed under official pressure to help fortify Britain's post-war industrial and commercial foundation. It is a holding company for a number of institutions. Major U.K. clearing banks and the Bank of England hold its equity.49

47. Gees F. Scheffer, op.cit., pp. 400-401
A special feature that separates German banking system from that of the other advanced nations is its tradition of universal banking. Commercial banks have, for long, indulged widely in investment financing and in the recent past they have also extended their operation to include merchant banking activities. The industrial development in Germany owes much to the commercial banks. This has produced a strong interconnection between the financial system and the large-scale industries. It has been observed that, "...if, in the early stages of German industrialisation, it was the banks who took the lead in promoting industrial concentration, it is equally clear that during the twentieth century growing concentration in industry has often stimulated and/or compelled growing concentration in the finance sector."  

Besides the universal banks, the German industrial credit sector also has the special credit institutions, most of which were formed to cater to the post-war recovery activities. The largest of these institutions is The Reconstruction Loan Corporation [Kreditanstalt fur Wiederaufbau (KfW)] set up in November 1948. Its main function was to provide medium-term and long-term loans for the purposes of reconstruction, chiefly towards basic industries. "... in its first few

years of operation, the coal and steel industries and the public utilities were almost entirely dependent on it for their capital funds. KfW's resources came mainly from the European Recovery Program (ERP) funds. As time passed, KfW took on diversified activities, e.g., long-term export financing started in 1953. KfW also provides loans to medium and small industrial organisations for different objects. Moreover, public funds have been supplied to backward areas at low interest rates through KfW. Funds of KfW come mainly from budgeted Government funds, ERP funds, direct loans from financial institutions, issuance of bonds and notes and sometimes from international financial organisations.

Another major long-term credit institution is the private Industriekreditbank-Deutsche Industriebank formed through the merger of two institutions, the Industriekreditbank and the Deutsche Industriebank. Primarily, the bank provides medium-term and long-term loans to industrial organisations. It also renders various consultancy, planning and market research services and participates in medium-term loans authorised by other banks. It raises funds mainly through the issues of debentures and also through short-term obligations and medium and short-term loans from insurance companies and banks.

52. Cees F. Scheffer, op.cit., p.254
UNITED STATES OF AMERICA (USA)

In consonance with the theory that a developed financial system hardly requires a separate development bank, USA does not have one, though many kinds of financial institutions have their existence in the system. The U.S. financial system is bound by many regulations.

It is the commercial banks which are the major sources of finance for the industry in USA. They grant direct medium-term credit and provide long-term financial assistance through purchase of government and industrial securities. The large banks also provide advisory services to business enterprises on amalgamation, take-over, divestiture and several other financial problems including managing private placements for corporate clients.

The Banking Reform Act of 1933 precludes commercial banks from indulging in investment-banking activities like underwriting and security dealings. ⁵³

The other kinds of institutions assisting in the industrial finance are the Investment Banks. These banks underwrite new issues of securities and also deal in them.

⁵³ ibid., p.430
SOUTH KOREA

It was the Japanese who brought modern banking system to Korea to help their own business which they had set up there by forcing the Kanghwa Agreement on the Koreans in 1876.\(^{54}\)

Before the formal Japanese annexation of Korea in 1910, there existed two important institutions relevant for our purpose. The first was the Agriculture-Industry Bank, set up mainly to finance Japanese business, and the second was the Oriental Development Company, which helped develop new investments and enterprises in collaboration with the Agriculture-Industry Bank.

At the end of the Second World War and the liberation of Korea in 1945, the financial institutions in Korea had slumped due to many adverse factors. After the Korean War, the reconstruction programme of the war-ravaged economy was launched. This necessitated a good flow of long-term funds but that was in short supply in the economy. Thus, the Korean Development Bank (KDB) was established in 1954 to supply medium and long-term loans to industry. The KDB took over a part of the previous Industrial Bank which had originated from the Agriculture-Industry Bank of the Japanese period. The importance of KDB grew so quickly that, "by the end of 1955, after only 21 months of operations, the KDB accounted for over 40 per cent of the

total bank lending." 55

After the initial purpose of reconstructing industries was fulfilled, the KDB turned its objectives to serve development projects and, at present, it specialises solely in catering to the priority industries and infrastructural projects that are essential for the economic development.

KDB's function comprises the provision of financial assistance through granting of loans, investment in equity capital, bonds and debentures, underwriting assistance, provision of guarantees, etc. It also renders, inter alia, services like engineering and statistical survey and market research.

In 1967, with the help from the World Bank, the Korean Development Finance Corporation (KDFC) was set up "to assist in development and creation of private enterprises by providing medium and long-term industrial financing and equity participation as well as technical and managerial consulting services." 56 Apart from the aforesaid purposes, KDFC aims at developing the capital market. It grants medium-term and short-term loans, participates in the equity capital, underwrites new issues of shares and debentures, provides guarantees and renders managerial and technical services.

55. ibid., p.52
ISRAEL

In the period before 1957, manufacturing industry in Israel was financed from Development Budget and foreign funds. Until 1957, such industry received 12 per cent or less of total budget allocations. 57

In 1957, the Industrial Development Bank of Israel (IDBI) was set up with the special purpose of providing medium and long-term industrial credit. Israel was in need of such a broad-based institution for long-term lending that would not act as a mere governmental apparatus of administration of loans but would mobilise resources from the private sector and use it for industrial development. It was also intended for IDBI to have the concomitant ability to help in the formation of projects.

IDBI provides medium and long-term credits, issues long-term guarantees and issues "commitments for the opening of documentary credits in connection with others by its clients for industrial equipment from abroad." 58 IDBI has a subsidiary, the Investment Company of the IDBI, to manage the portfolio of its equity investments, and another subsidiary in the sphere of industrial equipment leasing.

IDBI obtains its resources through issues of debentures and

58. Cees F. Scheffer, op.cit., p.357
preference shares. It has also obtained long-term loans from the U.S Government, World Bank, Export-Import Bank of the U.S. and many American and European sources.

NIGERIA

After it became free from the British rule, Nigeria embarked upon developing its banking and financial sector. The Central Bank of Nigeria was set up in 1958 and since 1960 a money market had started to accord short-term loans for commercial and industrial purposes. But it was the universal problem of procuring long-term finance that led Nigeria into setting up development banks. "Traditionally, commercial banks in Nigeria, and indeed in other countries, lend out money only on a short-term basis and mainly to activities of a commercial nature. They do not provide long-term financial accommodations. It, therefore, became necessary for the government to establish specialised credit institutions to provide long-term capital."\(^{59}\)

In 1959, the Investment Company of Nigeria (ICON) was established, incorporated "as an industrial development finance company."\(^{60}\) Its share capital was 1 million pound and among its

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60. ibid., p.247
shareholders were several Nigerian and foreign companies, firms and individuals. Other than providing loans to or buying equities of private industries, ICON also "actively participated in the formation and running of the Lagos Stock Exchange..." 61

Through reconstruction of ICON, the Nigerian Industrial Development Bank Limited (NIDB) was established in 1964 with the assistance from the International Finance Corporation. 62 Its initial objective was to act as a conduit for the savings of the household sector and private capital from abroad to flow into the Nigerian industrial sector for its development. NIDB accords financial assistance to domestic companies that have predominantly Nigerian ownership. The assistance is rendered through medium and long-term loans and equity investments. In 1970, it expanded its operating policy to encompass Government-sponsored projects that act independently on commercial basis. 63

Another institution, The Nigerian Bank for Commerce and Industry, started functioning in 1973. It was formed "to help local businessmen and institutions to acquire small and medium-sized alien-owned business, by providing both equity capital and loans." 64 It is

62. Cees F. Scheffer, op.cit., p.374
63. ibid., p.375
primarily State-owned with the Federal Government of Nigeria holding 60 per cent of its shares, the Central Bank of Nigeria holding 20 per cent and the rest are held by the commercial banks.

BRAZIL

In the nineteenth century, when the Brazilian industrial sector was at its infancy, the Brazilian Government attracted investors at home and abroad to invest in certain enterprises by guaranteeing interest on the investment made by them. Direct loans by the Government and the Bank of Brazil along with loans from several other Government-controlled agencies also helped the industries.  

The First World War helped the growth of Brazilian industry by precluding competitors from abroad to reach the Brazilian market; but after the Second World War, the Brazilian industry really boomed. "It was only after the Second World War that Brazil engaged upon a deliberate, all-embracing, and sustained industrialisation drive which markedly altered the structure of the economy."  

Out of the necessity to meet the long-term credit needs of


the booming industries was born the National Economic Development Bank [Banco National de Desenvolvimento Economico (BNDE)]. It started as an autonomous institution allied to the Ministry of Finance and having the main purpose of supplying long-term finance to enterprises which invested in infrastructural activities and development of core industries. Its funds came from both domestic and foreign sources. "Over the decade prior to 1964 the BNDE derived about one-third of its resources from foreign and two-thirds from domestic resources."^{67}

In 1964, BNDE became absorbed in the financial system following a reform. It now functions mainly as an executor of the Government's development finance policy and as a channel for Government investment into high-priority development projects and thus works towards augmentation of the private sector, economic development, exports and regional development banks. It provides financial assistance through direct loans, investment in shares and underwriting. It is now the largest and the chief development bank of Brazil.

There are also the regional development banks, the Bancos de Desenvolvimento Estaduais (sometimes Interstaduais) Regionais which are under the control of State Governments and follow the guidelines of the Central Bank. They perform all the functions of development banks especially long-term operations "to provide fixed assets on turnover

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capital, through the application of capital accounts or third party resources for the economic and social development of the respective areas of operation. 68

There are some investment banks in Brazil which also provide medium and long-term credits for fixed and working capital and are of considerable importance in the Brazilian economy.

THE PHILIPPINES

The financial system of the Philippines is a highly developed one. The development banking here can be said to comprise The Development Bank of the Philippines (DBP), the private development banks and the Private Development Corporation of the Philippines (PDCP).

The Government-owned Agriculture and Industrial Bank which was established in 1939 had been taken over by the Rehabilitation Finance Corporation (RFC) in 1946. Republic Act No.2081 was passed in June, 1958 for the formation of the DBP superseding the RFC and it began functioning in July, 1958 with the additional duties of establishing, sponsoring and promoting private development banks. The DBP's basic objective can be said to be the growth and development of the economy of the Philippines by providing necessary finance for

68. As quoted in Cees F. Scheffer, op.cit., p.229
industrial, agriculture and real-estate sectors. It also provides technical support to industries. Finance is accorded mainly through loans and also through equity participation and guarantees. "Loans are categorised into Peso loans and foreign currency ones."  

The lending programme of DBP includes various features such as collateral requirements and contingency allowances. As far as collateral requirements are concerned "DBPs lending programmes have been tailored so that in appropriate cases loan values get as high as 90 per cent or even 100 per cent of market values." Contingency allowances cater to the "speedy approval of cost-over-run loans up to a maximum of 15%. The aim is to facilitate project implementation."  

DBP mobilises funds by issuing bonds and capital stocks, obtaining foreign loans and accepting savings and time deposits.

The private development banks evolved in Philippines out of the function of DBP which was authorised by its formative Act to help establish and promote private development banks. The first such bank began to operate in 1959. The Private Development Bank Act of 1964 gave a further boost by authorising "the establishment of these

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70. Rodolfo D. Manalo, "Financing Small-Scale Industries in the Philippines" in Development Banking in the 1980s, United Nations, op.cit., p.130

71. ibid., p.130
development institutions in the different provincial areas..." The private development banks have three chief sources of funds: (1) Time and savings deposits, (2) Advances and rediscounts by the DBF and its subscription to the bulk of the banks' preferred shares. DBF also has time deposits in these banks, (3) Private capital subscription and surplus. They mainly provide long-term loans to agriculture and industrial sector.

Established in 1963 by prominent business and financial leaders, "the PDCP is basically a private development-investment corporation." With financial resources obtained from the World Bank, USAID, the Asian Development Bank and its own stock issues, it provides financial assistance mainly to private industries and projects in the form of loans of 3-15 years. Underwriting, guaranteeing and participation in equity capital also fall within the purview of its operation. Other activities include technical and management advisory services. As a whole, it helps new investment projects by functioning as a catalyst.

74. ibid., p.403
PAKISTAN

After the independence, the Pakistan commercial banks treaded the usual path and supplied finance mainly to trade and commerce and short-term and working capital needs of industry. Long-term finance was negligible in the economy. This vacuum led to the formation of long-term credit institutions. "Since facilities for the supply of long-term and intermediate-term credit to industry were inadequate after the partition, the Government decided to establish a specialized credit agency for the purpose of granting long-term and medium-term credit..."  

The Pakistan Industrial Finance Corporation (PIFC), established in July 1949, commenced operations in 1950. This was not a full-fledged bank but only a credit agency in character. It could grant loans to industrial concerns and subscribe to debentures of industrial companies, both for a maximum period of 20 years. PIFC was replaced by a development bank, the Industrial Development Bank of Pakistan (IDBP) which was established in July 1961. It was designed to supply term loans for the formation of new industrial concerns and also for modernisation and expansion of the existing ones. Unlike its predecessor, it can provide foreign currency loans. "The ability of this bank to make loans in foreign currencies enhanced its usefulness in

75. Moeen A. Qureshi, op.cit., p.116
76. S.A. Meenai, Money and Banking in Pakistan, Oxford University Press, Karachi, 1984, p.73
industrial development." It is the top financial institution of the country for the provision of medium-term and long-term loans not exceeding 20 years to the industrial concerns.

The Pakistan Industrial Credit and Investment Corporation (PICIC) was set up in 1957 to provide specifically for the long and medium-term finance and other assistance to private industrial sector. Besides granting loans in local and foreign currencies, PICIC participates in shares and debentures and underwrites public issues of industrial concern. It also provides and helps to procure technical and managerial advice to the private industrial concerns. Furthermore, it acts as a link between the foreign investors and local entrepreneurs and vice-versa. "Together with PICIC the IDBP functions as a vehicle for channelling the bulk of foreign loans obtained by the Government into the private sector." 78

The National Development Finance Corporation (NDFC) was formed in 1973 to provide all types of financial assistance to industries and enterprises owned or managed by the public sector which are "not financed through the development budget of the government..." 79 Its resources come mainly through private and corporate deposits and loans from international financial institutions.


78. Cees F. Scheffer, op.cit., p.84

79. S.A. Meenai, op.cit., p.85
Our probe into the institutional development of industrial financing clearly shows that every country, whether developed or developing, had to fall back upon some form of specialised financial institution or other for meeting the requirement of industrial finance and other specific needs under different circumstances. Among the countries of Europe, such institutions appeared first in those countries who were late-starters in industrial revolution and did not have the supply of merchant capital for industrial development. In France, for example, an ambitious attempt was made as early as in 1852. Subsequently, however, other specialised financial institutions evolved according to the needs of the situation and experience gained. In Germany, the commercial banks, from their very inception, financed the development of industries. Special credit institutions, however, emerged after the World War I to cater to the needs of reconstruction. In England, on the other hand, investible funds came from overseas trade which also led to the development of capital market. Need for specialised financial institutions was felt in England only after World War I when massive investment was called for reconstruction of industries and also for upgradation of technology. In the United States of America, the commercial banks themselves directly granted financial assistance from the early stage of development of industries and also made investment in industries and, as such, there did not exist development banks.
In the developing countries, the specialised financial institutions evolved during and after World War II, only as these countries became masters of their destiny. In these countries such institutions were so designed as to become partners in the implementation of the programme of development instead of becoming the suppliers of industrial finance alone.