Chapter IV

REVIEW OF LITERATURE

4.1 This chapter is an elucidation of literature relating to the flow of credit from various organised and unorganised sources of housing and real estate finance. The aim of such a perusal is to have a bird's eye view of the concurrent and corresponding issues and problems related to the present study.

The first part deals with the flow of credit from organised institutions to various sectors like manufacturing industry, private corporate sector and various other industrial concerns. Studies on the institutional flow of credit in Kerala are also discussed. The unorganised sector consisting of indigenous financial agencies is enumerated in the next part.

Understanding the operation of and the potential for housing finance is important, since in many developing countries 'housing' policy is about establishing new and more innovative finance policies.

4.1.1 The banking system in India comprises of the Reserve Bank of India, Commercial banks and cooperative banks and credit societies. The commercial banks are the premier institutional structure of the
banking system. The principal function of these institutions is to satisfy simultaneously the portfolio preferences of the borrowers on one side and the lenders on the other. They mobilise resources from the savers in the form of deposits and extend credit facilities to borrowers in the form of loans, advances and securities. Loans and advances provided by these institutions can be categorised into short-term funds and long-term funds. The latter are advanced for purchase of plant and machinery while the former are provided for purchase of raw materials, stores, spare parts and the like. However following the traditional British banking practice, commercial banks provide more short term funds to the investors in industry and trade than long term loans. The pattern of credit disbursement has undergone substantial changes since 1950.

4.1.2 Commercial banks extended credit to commerce and trade to a larger extend than to manufacturing industry until 1958. Since the commencement of the second five Year Plan, which laid emphasis on rapid industrialisation, the pattern of credit flow took a new turn in favour of medium and large industry. As a result, the share of industry, in public and private sectors in total bank credit increased from 34.8% to 67.5% during the period 1954 to 1968. Since nationalisation of 14 major commercial banks in July 1969, the Government of India assigned new priorities to commercial banks with regard to the flow of credit to hitherto neglected sectors, called
"priority sectors." The emphasis thus shifted from industry to the priority sectors. Further the supply of credit was controlled through statutory regulations and monetary regulations.

4.1.3 On the other hand the demand for bank credit has also undergone substantial increase. Factors such as, large growth in the number of industrial units, diversification of existing units, increase in industrial and agricultural production, increasing needs of short and long-term funds to maintain the increased levels of production, pushed up the demand for bank credit.

4.1.4 Gupta¹ and Ambegaokar² observed that the use of funds from banks by the private corporate sector had exceeded its inventory formation. Gupta, has argued that a small portion of such finance should have gone to meet fixed investment. Further, he found the growth rate of physical assets to be more directly and closely related to security issues than bank credit. Hence, he argued that the fast growing firms relied heavily on security issues than the use of bank credit. Ambegaokar found that the rate of rise in bank credit exceeded that of inventory, sales and output. Further he observed

that its dependence on banks for working capital had increased, accompanied by a decline in reliance on other financial institutions.

4.2 Shetty\(^3\) assessed the dimensional changes in credit deployment during the first five years of nationalisation in relation to changes in output and prices. The rationale for his analysis was the fact that, in any accepted model of demand for money, one common variable is the gross national product or some other variant of it in real terms. Consequently, he hypothesised that credit for any sector or industry over a period has to have some relationship with its performance in real terms, particularly output. He observed a declining trend in the credit extended by banks to industries since nationalisation, though it was higher than other sectors. On finding that the share of manufacturing sector in bank credit is higher than its share in Net Domestic Product (NDP) he concludes that increase in bank credit has occurred far in excess of increase in output during the years 1968/69 to 1973/74.

4.2.1 In his other paper, Shetty\(^4\) observed that the share of medium and large industry in total bank credit had declined due to priority


sector lending. Another observation in line with his earlier finding was that growth in bank credit had always been disproportionate to growth of their physical output, especially in industries like cotton textiles. His observation particularly for the years 1975-76 and 1976-77 revealed:

(a) Increase in average bank credit had been higher than the growth of NDP originating in registered manufacturing sector even at current prices

(b) An appreciable increase in the rate of short-term bank credit to inventories; and

(c) Relatively higher reliance on trade credit.

In line with these observations, he suggested policies to scrutinise credit claims vigorously and relate credit to the genuine production requirements so that funds are not tied up with these large borrowers.

4.2.2 K.S.R. Rao carried out an econometric exercise on the determinants of demand for bank credit of some selected industries for the period between 1970-71 and 1984-85. He observed that output of these industries was the most important factor in determining its demand for bank credit whereas, interest rate of

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banks and relative rate of interest of other sources of borrowing played only a secondary role. Price of output was also found to have affected the demand for credit significantly. The relative interest rate variable was significant with respect to industries like textiles, engineering and total manufacturing, while it was not significant for industries like sugar and other food products and chemicals.

4.3 Divatia and Shankar⁶ in their paper discussed the role of internal and external sources of funds and their components in financing capital formation of the private corporate sector. The study was based on the RBI company finance studies relating to medium and large public and private limited companies and covered the period 1961-76. They also discussed the trends and patterns of financing for four individual industries, viz, cotton textiles, jute, sugar and cement.

4.4 S. Adve⁷ had some interesting findings in his article "Financial Practices in Indian Corporate Sector," based on the RBI company finance data. He underlined the rising dependence on borrowed capital in relation to the total capital employed in the


Indian corporate sector. Trade credit was pointed out to be important sources of capital when the bank credit was squeezed. Making an industry-wise analysis, the author came to the conclusion that the industries with large profit margins and those with large depreciation and development rebate reserves had a relatively lower order of overall indebtedness and many of them also had a lower order of bank borrowings in relation to overall indebtedness. Industries with high profit margin such as silk and rayon textiles, aluminium, basic industrial chemicals and medicine and pharmaceutical preparations had lower proportion of borrowed funds as compared to the average of the medium and large public Ltd. companies.

4.5 L.S. Gupta\(^8\) from the extensive study viewed that the growth of institutional finance emerged in India due to structural change for industrial financing system with wide change of socio-political situations in India. He attempted to measure overall impact of financial institutions on capital formation in the organised private sector as also the allocative efficiency of financial system. He observed that during the first plan financial assistance rendered by special institutions represented only 4.1 per cent of gross fixed investment in private industry, which rose to 7.9 per cent in the second plan and further to 18.1% in the third plan period. He also

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found that commercial banks remained the most important single agency for financing the private corporate industry and LIC was the single largest purchaser of industrial securities and the underwriter of new issues of large and established companies.

4.6 M.S. Joshi\(^9\) examined the role of financial intermediaries in providing finance to large-scale industries in the private sector. After analysing the contribution of each important intermediary towards industrial development in India, he estimated that these intermediaries have participated with 17\% of investment in various industries against 39\% in share capital of public Ltd. companies.

4.7 Studies on Institutional Credit in Kerala

Among the studies on the state of Kerala, few have looked at the inter-regional development of banking. The study conducted by the Travancore-Cochin banking enquiry committee\(^10\) was the first of its kind in the post-Independence era. The report traced the development of banking in the two regions of Travancore and Cochin. It noted that in terms of the average number of people per bank office, they had the smallest figure in the whole of India. It was noted that the expansion of commercial banks in the rural areas is more pronounced than in any other state.

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\(^10\) Gok (Various Years) *Kerala Economic Review*, Thiruvananthapuram.
4.7.1 M.A. Oommen\textsuperscript{11} historically reviewed the expansion of commercial banking in the Travancore-Cochin region prior to the period of planning. He noted some of the salient features of banking in Kerala: their community or sectarian origin and ownership, the rural areas bias, over extension of credit and predominance of small accounts. He noted the presence of a special concentration of banking in Tiruvalla and Trichur.

4.7.2 The Kerala Planning Board (1982) too made an effort to understand the performance of commercial banks in Kerala after nationalisation. This study was confined only to a quantitative assessment of the performance of nationalised banks and looked at the mobilisation of deposits, trend in credit expansion and the sectoral distribution of bank advances. Even though the number of bank offices in the state is more than that of other states, some districts like Malappuram and Idukki lacked banking infrastructure. Ernakulam was found to be the best-banked district in the state followed closely by Trivandrum. It accounted for 22 per cent of the deposits and 30 per cent of the credit disbursed in the state. Idukki, Malapuram and Palghat were way behind.

4.7.3 Among the more recent studies, Sunanda’s\textsuperscript{12} study of institutional agricultural credit in Kerala highlights the inter district disparity. She reviews the socio-economic background for the origin and growth of banks in Kerala (performance of commercial banks and co-operatives only) and concentrates on the agricultural credit disbursed by them. In credit per hectare, Ernakulam and Trichur stood highest while Palghat ranked the lowest. Regional disparity of agricultural credit from commercial banks decreased between 1974/75 and 1985/86 while that of co-operatives increased. She has used Principal Component Analysis to explain the variation. Three sets of variables are used for explaining the variation of credit per hectare from commercial banks and co-operatives viz, Banking variables, Asset variables and Productivity variables.

4.7.4 The book ‘Reminiscences’, written by Shri. K.C. Mammen Mappilai\textsuperscript{13} throws some light on the banking developments that took place in Kerala prior to independence and also the role played by the Christian community in developing the banking system in the state. It also contains the history of the National Quilon Bank, which was the premier bank at that time and explains the reasons for its failure.


4.7.5 Shri. A.K. Seshadri's "A Swadeshi Bank from South India"\textsuperscript{14} gives an account of the banking crisis that occurred in the state in 1930 due to the failure of the National Quilon Bank and that in 1960 consequent upon the liquidation of the Palai central Bank, Palai.

4.7.6 The Indian Banks Association\textsuperscript{15}, Bombay published a book 'Kerala's Banking Profile' in 1987. This book contains a quick review on the banking and the economic scenario in Kerala from 1969 to 1987 and also has dealt with the impact of the non-banking private financial institutions on the banking system in the state. It also contains a quick analysis of the role of the NRI sector in the growth of the commercial banks in Kerala. Though the book contains information regarding deposits, advances, number of branches, net state domestic product, per capita income, per capita deposits etc, it does not make any attempt to analyse these factors and to find out whether any relation exists between these factors. In 1992 Canara Bank, the convener of State Level Bankers' Committee Kerala had brought out a brochure on Kerala's banking profile. This book contains a review of the district and state wise performance of the commercial banks during the 3 year period from 1989 to 1992. But this does not contain certain vital information like

\textsuperscript{14}A.K. Seshadri (1982). A Swadeshi Bank from South India, Indian Bank, Madras.
\textsuperscript{15}Indian Banks Association (1987). Kerala: A Banking Profile, Bombay.
classification of deposits and advances according to population group wise, a review on the productivity of banks in Kerala etc.

4.8 Indigenous Financial Agencies

The availability of literature on indigenous financial system is scarce. The Central and Provincial Banking Enquiry Committee Reports give comprehensive information regarding the working of the agencies. But even such information appears to have become outdated in many respects as the enquiry was conducted more than 55 years ago. The Rural credit survey and Central banking Enquiry Committee attempted to obtain quantitative information, including capital invested in the business from the agencies but failed in their task. Hence as far as the quantitative aspect is concerned, it is impossible to collect correct information from these agencies as their nature of business is selective and also as their exact number is not known.

4.8.1 G. Karkal\(^6\) brings out some of the problems of indigenous banking in India in the present context of economic development. He attempts a scientific definition of the term 'agencies' and points out how the earlier definitions were defective. Karkal's book estimates the magnitude of capital involved in the unorganised

market through the help of data regarding 'Hundi' sales. With the help of available data the study points out the nature of the interest rate in the various rural-urban regions. It indicates the trend of and effect of the contact between the two markets viz., the organised money market and unorganised financial sector. Again the study discusses the methods of strengthening the 'Agencies.' Here it pleads for the recognition of the 'hundi' as a liquid asset - at least in the case of trusted indigenous bankers, thereby giving an impetus to the unorganised sector to encourage the bill business.

4.8.2 B.A. Prakash\textsuperscript{17} provides an interesting account of the functioning of private financing firms in Kerala. The study based on a survey of the private financing firms in Trichur town seeks to examine the factors, which contributed to the emergence of these institutions, the method of their functioning and their importance as a parallel banking system. However he is silent on questions such as types of borrowers, total amount of uncounted money generated by the private financing firms, safety of depositors' money and so on.

4.8.3 D. Rajasekhar\textsuperscript{18} based on a survey of 8 private financing firms in Bellary town in Karnataka tries to probe the factors

responsible for the growth of private financing firms. It also
documents and analyses the functioning of private financing firms
and critically examines the type of borrowers, the use pattern of the
borrowings and also tries to estimate the black money generated by
the private financing firms.

4.9 Housing Finance

A strong relationship between levels of urbanisation and
wealth has been demonstrated both theoretically and empirically in
numerous studies.\(^{19,20}\) Traditionally, faced with other development
priorities, governments and international agencies have been
reluctant to encourage investment in housing, which has often been
seen as an item of consumption (UNCHS 1991).\(^{21}\) Moreover, many
of the first waves of housing finance institutions were poorly
managed and contributed to macro-economic disruption.\(^{22}\) Even by
the late 1980s Renand\(^{23}\) was able to observe that 'few aspects

\(^{19}\) S. Malpezzi (1990). “Urban Housing and financial markets: Some
international Comparisons”, Urban Studies, 27, 6: 971-1022.


Housing Finance into the National Finance Systems of Developing Countries:
Exploring the Potentials and the Problems”, Nairobi: UNCHS.

\(^{22}\) R.M. Buckley et al. (1989). “Housing policy in developing economies:
evaluating the macroeconomic impacts”, Review of Urban & Regional
Development Studies, 2: 27-47.

of economic development remain as unexplored and poorly analysed as the potential to induce financial development and ways to improve the financing of housing.'

These practical and conceptual difficulties notwithstanding, during the 1990s housing finance moved to the top of the urban agenda. Under pressure to reform urban management, governments have made important legislative and institutional reforms to enable private institutions and non-governmental organisations (NGOS) to have a greater role in the provision of housing finance. The lead of the World Bank has been especially important in making the shift from housing projects towards the delivery of housing finance\textsuperscript{24} from 1983 to 1988. Bank lending for housing finance exceeded the total for sites and services from 1972 to 1988, and by 1989 almost one-half of all Bank urban lending was for housing finance programmes.\textsuperscript{25} This reorientation went beyond the need to deliver more and better housing, to make urban policy compatible with macro-economic management, particularly in the context of structural adjustment programmes in which control of foreign exchange risks and fiscal policy have been paramount.


4.9.1 S. Chant\textsuperscript{26}; K. Datta\textsuperscript{27} and Miraffab\textsuperscript{28} argue that formal finance institutions are rarely willing to assist with the purchase of land, especially where the tenure, is insecure, to provide assistance with improvements to the rental housing stock or to support non-conventional household arrangements such as sharing of multiple-family compounds. These limitations have implicit gendered consequences, as rental and shared housing are of particular importance to low income women who often lack the means to become homeowners.

4.9.2 M.M. Valenea\textsuperscript{29} summarizes the conditions of Brazil’s housing finance system by the 1980’s as one of ‘crisis, chaos and apathy.’ Notoriously inadequate fund collection and loan enforcement rates exemplified these conditions. This condition of public-sector housing finance institutions was accentuated by political manipulations that passed these institutions from one ministry to another at short intervals. Valenea points out that as the economic crisis of the 1980s deepened, the fall in the real value of payroll


deductions with rising unemployment, the diversion of revenue sources to fund higher priority areas of the government budget and the withdrawal of savings from negative interest rate bearing accounts left many public sector housing finance institutions short of capital.

4.9.3 David Isaac\(^3\) provides an introduction to property finance, bringing together the professional disciplines related to finance and property investment and development. The book establishes the basic concept of finance, examines the applications of these concepts in practice and gives an overview of the market, its history and position as of 1993.

4.9.4 R.M. Buckley\(^3\), K.H. Kim\(^3\) and N. Munjee\(^3\) have pointed out that the declining effectiveness of housing finance institutions coupled with economic and fiscal crises, have made governments more aware of the need to promote savings, reduce subsidies and mobilize domestic resources and motivate the involvement of

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\(^3\) N. Munjee (1994). "Housing finance in development: is there an emerging paradigm for developing countries in Asia": *Housing Finance International*, 8.4: 6-10.
private financial institutions. Many of the most restrictive practices operating in housing finance markets, such as institutional entry requirements and liquidity limits, have been lowered, loan/value ratio made more flexible and a wider definition given to the terms of collateral. The optimistic view was that private institutions would be able to deliver larger quantities of finance more efficiently and with a greater chance of sustainability.

4.9.5 T.H. Malik argues that even though new private finance companies have been set up, a few lower-income households qualify for loans because the eligibility criteria require proof of five years full employment, imposing a start-up fee equivalent to three months salary and taxes to approximately 25% of the loan value.

Similarly USAID points out that in Eastern Europe despite the establishment of DIMs in Poland, building certificates in Russia and indexed credit systems in Bulgaria, the bottom 80 per cent of the income profile has not been reached.

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4.9.6 Thomas Klak and Marlen Smith\textsuperscript{36} in their article, 'The Political Economy of Formal Sector Housing Finance in Jamaica' explore the organisation and performance of the National Housing Trust (NHT), the state's main housing agency in distributing finance in the context of the struggle for basic needs such as shelter, state socio-economic interventions. By examining the NHT's funding base, expenditures and beneficiaries they outline the scale of the financial resource diversions that effectively restrict low-income households from obtaining NHT housing assistance. They point out that a greater share of NHT's massive financial assets could be directed towards serving the housing needs of low-income people if the Trust were organised differently.

4.9.7 Kuame Addae-Dapeeh\textsuperscript{37} in his article 'Formal Housing Finance and the elderly in Singapore' aims to assess the effectiveness of recent policies in resolving the housing finance crisis facing the elderly in Singapore. He critically reviews the housing policies which have appeared to provide Singapore with


enviable housing conditions, but which have created limited housing options for the elderly and have led to a widening housing finance gap.

4.9.8 Robert M. Buckley\textsuperscript{38} in his book 'Housing Finance in Developing Countries' examines the way various changes have affected the financing and delivery of housing in developing and reforming economies. A framework for analysis as well as applications of the framework in case studies is presented in this book. A main emphasis throughout is the demonstration of the gains that can be realised from overcoming the often-blurred distinctions between fiscal and financial policies for housing. The book concludes with the evolution of the World Bank supported projects in this sector and a summary of some of the principles of effective housing finance systems.

\textsuperscript{38}R.M. Buckley (1996). \textit{Housing Finance in Developing Countries}. Basingstoke: Macmillan.