INTRODUCTION
CHAPTER I
INTRODUCTION

Immediately after the world war, many underdeveloped countries turned their attention towards economic growth. Their objective was to foster a higher level of growth in a relatively short period of time. In their bid to achieve high growth, they have confronted diverse problems stemming from such factors as shortage of capital, limited technological capacity and inadequacy of institutional arrangement. To meet these problems, centralized planning had been adopted in some countries. In this connection, Indian planning commission had said, "the central objective of public policy and national endeavor in India since independence has been promotion of rapid and balanced economic development.... The programme of development incorporated in the plan was calculated to strengthen the economy at the base and initial institutional changes which would facilitate more rapid advances in the future."¹ This clearly indicated the nature and direction of economic change contemplated through planning which emphasizes institutional changes – social, political and economic. The present study represents an effort to describe and evaluate the experience of India in the establishment and use of development banks to foster rapid growth of the economy of India.

Economic Development

The study of economic development attracted the attention of economists right from Adam Smith down to Marx and Keynes. They were mainly interested in the problems, which were essentially static in nature and related to western European framework of social and cultural institution. It was however; during the forties of the twentieth century, especially after the Second World War, that the economists started devoting their attention to analyzing the problem of underdeveloped countries.

¹ Government of India, Planning Commission, Second five Year Plan, GOI Press, 1956, p.3.
'Economic Development' refers to the problem of development of underdeveloped countries and 'Economic Growth' refers to that of developed countries. Madison made the distinction between the two terms when he wrote, "the rising of income levels is generally called Economic Growth in rich countries and in poor ones it is called Economic Development."²

Hicks pointed out that the problems of underdeveloped countries are concerned with the development of unused resources even though their uses were well known, while those of advanced countries were related to growth, most of their resources were already known and developed to a considerable extent.³

Economic growth is a complex process, which includes social, political, economic and institutional factors. Industrialisation can be an important path to economic development. This fact accounts for the considerable emphasis that is placed on rapid industrial growth in underdeveloped countries.

Successful industrialization depends, among other things, on such factors as quality of entrepreneurship, access to modern production techniques, competent management, technicians, skilled personnel, markets and availability of capital. Suitable agencies must exist or be established to acquire, mobilize, and develop resources, given a favourable social, political and economic climate. Development Banks enter the picture at this juncture.

**Development Banks**

During the post war period, many underdeveloped countries established special institutions in a bid to increase supply of some ingredients of industrialization. In many cases, such institutions were and are wholly owned by the state. In some other cases, they

² A. Maddison, Economic Progress and Policy in Developing Countries, 1970
³ U.Hicks, "Learning about Economic Development", O.E.P., February 1957
are jointly owned by the state and private interest and in others, exclusively owned by the private interest. Although these institutions are diverse in form and activities, they are generally known as Development Banks.

Given the non-economic factors, the key determinants of the rate of economic growth, according to Indian planning commission are; a. The rate of population growth. b. The proportion of current income devoted to capital formation. c. The return by way of additional output on the investment i.e., productivity of capital.4

**Development Banks and Population:**

One has to consider population growth as a factor in the theory of economic growth since it affects national income as well as percapita income by size and productivity. Population growth depends on many factors – social, economic and demographic over which development banks exercise little influence. Labour productivity can be affected by some of the activities of the development banks. Besides fostering technological advance and resource discovery, it is possible for the development banks to affect labour productivity indirectly through capital accumulation, better labour management techniques and provision of training facilities. Increase in labour productivity induces even greater increase in capital productivity.

**Development Banks and Capital Accumulation:**

In the words of Nurkse "The low level of productivity is the result of the small amount of capital used in production, which in turn may be caused by the small inducement to investment."5 The main task before these countries was to raise by deliberate effort the level of their investment from approximately 5 per cent to 10 to 15 per cent of their national income to get themselves out of the hard ring of the vicious

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circle of poverty. In the light of the above statement, the improvement role of development banks stands out in bold relief. The allocation of resources by development banks may break the vicious circle by increasing the K factor and thereby increase the pace of additional investment. It should be pointed out that these banks were channels through which foreign capital and skills flow into national economy.

**Development Banks and Productivity of Investments:**

To understand the role of development banks in improving the productivity of capital, one has to consider the ingredient that can accomplish the task. It is responsible to state that increases in capital stock and technological progress, and an efficient managerial cadre are some of these ingredients. In underdeveloped countries where these are in short supply, development banks can be used to provide some of them.

**Development Banks and Savings:**

In the poverty ridden areas of the world the supply of capital is determined by the ability and willingness of the people to save. Saving as a function of income is low in underdeveloped countries and subject to the vicious circle of poverty. By adding ingredients of industrialization like investment and entrepreneurship and management, the development banks can prove to be a direct instrument for increasing income and thereby increasing savings. Further, by pooling funds from other institutions that collect funds from different sources they can act as conduits for the flow of savings into productive investments.

**Role as a Catalyst:**

If the top management of a development bank is dynamic, active and development-oriented, it will try to influence and modify the aspect of policy

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environment and framework that are not in tune with its basic objectives. A development bank can serve as a catalyst in several ways in initiating a process of capital market integration.

1. It can make a rational case to the policy-making authorities for a change in the interest rate policy.

2. If possible, it can undertake some commercial bank functions. It will thus mobilize more resources and raise effective interest rate on lending.

3. If it cannot assume commercial bank functions, it can still induce commercial banks to provide part of the credits for projects it had appraised and selected for finance.

4. Similarly it can induce social security institutions and other similar institutions to purchase the bonds/equity of projects that it had selected for finance.

5. It can reduce its own transaction costs and at the same time improve the project design and formulation of new enterprises by establishing of its own or in participation with other financial institutions a technical consultancy service centre.

6. Similarly it can reduce its transaction cost relating to project supervision by establishing management consultancy service centre.

7. With such reduction in transaction cost it can improve its own profitability and this can make it possible to issue its own bonds at attractive interest rates in the security markets and mobilize additional resources to some extent.

8. It can serve as a catalyst for promotion of small enterprises by inducing the promoters of large enterprises, who seek assistance to provide management, technical and financial assistance to small enterprises that are ancillary to their own projects.
Development banks are unique financial institutions in developing countries, specializing in the provision of high risk, long term financing for the purpose of industrialization. These banks are expected to provide not only long-term finance but also play a catalytic promotional role, a development role – in setting in motion a widely diffused viable process of industrialisation.

**Place of Industrialisation in Economic Development.**

Industrialisation plays a crucial role in the economic development of all the underdeveloped countries. It is viewed as a means to economic development and is considered as being identical with economic development. Industrialisation encourages economic development in various ways.

Statistical substantiation demonstrated that in developed countries, manufacturing industries have made enormous contribution to the gross national product and in such countries the per capita income is much higher than that in the under developed countries. The income per head generated in manufacturing is by and large, higher than in agriculture. Hence it was argued that if a country desires to raise its national or per capita income it should give top priority to industrialisation.

It is a recognized fact that underdeveloped countries are afflicted with extensive unemployment in urban areas and equally large disguised unemployment in the rural areas. Thus the spreading out of industrial sector is advocated for absorption of surplus population from agriculture. When this superfluous population is more lucratively employed in industry, the national output would indeed go up.

Carrying with it the benefits of increasing returns and economics of scale, industrialization sponsors economic development and affluence. Hence investments in industries are more remunerative. Consequently industrialisation brings about the most
advantageous utilization of the undersupplied financial and other resources. The industrial sector has, admittedly, a relatively higher competence to save and invest. It thus lends an authoritative support in accomplishing the goal of a self-sustaining economy.

As industry spreads out, more and more people in the country turn out to be enterprising and vibrant. Such temperament is considered indispensable for economic development. Unless people became modern in attitude, the process of growth could not go very far. The industrial milieu encourages adjustment and progress. It fabricates a category of dynamic entrepreneurs who give an enormous thrust to economic growth.

A highly industrialized country produces, a wide assortment of commodities. Industrialisation enhances the purchasing power of the people engaged in the industrial sector. It leads to enlargement of market for all other commodities.

The industrial pattern of India on the eve of economic planning showed: a) high proportion of household enterprise and relatively insignificant position of large factories; b) low capital intensity; and c) the predominance of consumer goods in the composition of domestic manufacturing as related to producer goods.

**Industrial Development under Five Year Plans:**

The industrial pattern in India had undergone a distinct change as an upshot of the Five-year plans, especially since the beginning of the Second Plan. (1955-61) The number of bigger industrial establishments have proliferated and the proportion of producer goods in the composition of manufacture have registered a remarkable increase. Several new products have come to be manufactured and several new materials have come to be used. Heavy and basic industries have come to occupy an important place in the industrial structure of India.
First Five-Year Plan (1951-56)

The first five-year plan did not create any big provision for industrial development. It merely aimed at building up basic services like power and irrigation, so that industrialisation might be facilitated. The public sector outlay on power and transport and communication and industry were Rs. 260 crores, Rs. 520 crores, and Rs. 120 crores respectively.\(^7\)

The overall production improved by 39 per cent per annum, production of capital goods by 70 per cent, of intermediate goods, mostly industrial raw materials by 34 per cent and that of consumer goods by 34 per cent during the period of First Five year Plan.

Several new products came to be manufactured for the first time. A number of new industries were established, e.g., petroleum refining, ship building, manufacture of aircraft, railway wagons, penicillin and D.D.T. Several public sector undertakings were set up. But, on the whole, the pace of industrialisation during the first plan was sluggish.

Second Five-Year Plan (1956-61)

The Second Plan had been truly called the industrial plan. It aimed at laying the very foundation of industrial development in the country by building up a number of important heavy and basic industries. The investment in the public sector an organized industry was estimated at Rs. 870 crores. The private sector investment in the industrial sector was to the tune of Rs. 675 crores.\(^8\)

A spectacular achievement of the Second Plan was the remarkable expansion of iron and steel industry, appreciable expansion of heavy industries like heavy engineering and heavy chemical industries, the machine - tool industry and expansion of the installed capacity of essential producer goods industries like cement and fertilizers. Manufacture

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\(^7\) Planning Commission: First Five Year Plan (1951-56)

\(^8\) Planning Commission: Second Five Year Plan (1956-61)
of new industrial items like boilers, motorcycles, and scooters was another achievement. In short, the Second Plan was regarded as the first long-term planned initiative of the public sector to build up the base for the industrialisation of the economy.

Third Five-Year Plan (1961-66)

The emphasis in this plan was laid on machine building and on the acquisition of related skills and technical know-how and designing ability. The objective was to make the economy self-sustaining and self-reliant, so that during the subsequent plan periods it might not depend on external assistance. The public sector outlay on the industrial development was Rs. 1,970 crores, the private sector investment in the industrial sector was about Rs. 1,300 crores.\(^9\)

Substantial additions to capacity were made for the manufacture of machine tools, coal-mining machinery, steel-making machinery and cotton machinery. Several industries increased their output, several new items were manufactured and several raw materials, which used to be imported, began to be manufactured. But progress in several crucial sectors was far from satisfactory. In short, during the Third Plan a vast base for future industrialisation emerged as a result of completion of projects in areas of heavy machines, heavy electrical and heavy chemicals and steels.

Fourth Five-Year Plan (1969-74)

The Fourth Plan emphasized the need for the achievement of self-reliance in industry. Accordingly, it proposed a faster expansion of industries producing capital equipment, petroleum products, chemicals and metals. Its second main aim was to develop indigenous technologies, design and engineering skills and to reduce the import of foreign technology. Besides, it laid particular stress on the development of industries in the backward areas and on preventing further concentration of industrial activity in the

\(^9\) Planning commission: Third Five Year Plan (1961-66)
existing urban centre. The public sector on the industry was actually Rs. 3,630 crores. The private sector investment was around Rs. 2,250 crores. The actual performance during the Fourth Plan in the industrial sector was very disappointing. Its average annual growth rate was hardly 5 per cent.

Fifth Five-Year Plan (1974-79)

The Fifth Plan assigned a very important place to the development of industries with a view to achieving self-reliance and social justice. The development programme in the industrial sector in the Fifth Plan included: rapid growth of iron and steel, non-ferrous metals, fertilizers, mineral oils, coal and machine building, called the core sector industries; rapid diversification and development of industrial exports; substantial increase in the production of mass consumption goods; development of backward areas and rapid development of small industries.

Sixth Five-Year Plan (1980-85)

The Sixth Plan aimed at 7 percent average annual growth in industrial production. This target was designed to be achieved through optimum utilization of existing capacities along with substantial enhancement of capacities in a wide range of industries both in the public and private sectors. The emphasis was also laid on the dispersal of industries to develop backward regions. The actual investment on public sector industries was Rs. 15,200 crores.

Seventh Five-Year Plan (1985-90)

The Seventh Plan envisaged an annual growth rate of 8.7 per cent in industrial production. The total investment of Rs. 19,708 crores was expected to be invested in the

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10 Planning Commission: Fourth Five Year Plan (1969-74)
11 Planning Commission: Fifth Five Year Plan (1974-79)
12 Planning Commission: Sixth Five Year Plan (1980-85)
13 Planning Commission: Seventh Five Year Plan (1985-90)
public sector to promote industrial development. This target was sought to be achieved through increase in efficiency, productivity and upgradation of technology. This plan emphasized the need for ensuring adequate supply of wage goods and article of mass consumption. It is heartening to note that the Seventh Plan is deemed to have achieved the targeted industrial growth rate of 8.5 per cent. It was possible because of adequate infrastructure and liberalisation policies on the part of the government.

Eighth Five-Year Plan (1992-97)

The Eighth Plan envisaged an annual growth rate of 8.0 per cent in the industrial production. The first year of the eighth plan witnessed 2.3 per cent growth in the industrial production, which increased to 4.1 per cent in the second year of the plan. During 1992-93 and 1993-94 the industrial growth rate fell short of the targeted growth rate. It was due to the industrial sector having been in the grip of recession. However, industrial growth rate sharply picked up to 8.0 per cent in the third year (1994-95) of the plan. The Eighth Plan allocated a total investment of Rs. 38,083 crores for industry and mineral production.¹⁴

The progress of industrialisation during the last 50 years since 1951 had been a striking feature of Indian economic development. The process of industrialisation, launched as a conscious and deliberate policy under the Industrial Policy Resolution of 1956 and vigorously implemented under the five-year plans, involved heavy investment in building up capacity over a wide spectrum of industries. As a result, over the last 50 years industrial production went up by about five times, making India, the tenth most industrial country of world. The industrial structure had been widely diversified covering broadly the entire range of consumer, intermediate and capital goods. The rapid stride in the industrialisation had been accompanied by a corresponding growth in technological advancement.

¹⁴ Planning Commission: Eighth Five Year Plan (1992-97)
and managerial skills for efficient operations of the most sophisticated industries and also for planning, designing and construction of such industries. Industrial growth, however, had not been uniform since 1951. After a steady growth of about 8 per cent during the initial period of 14 years (1951-1965), there was a fluctuating trend since then—near stagnancy during 1966-68, a high level of 9.5 per cent during 1976-77, and a minus 1.4 per cent in 1978-80. In the sixties (1961-70) the average growth rate of industrial output was put at 5.5 per cent and in the seventies (1971-80) the average growth rate was about 4 per cent per annum. Even during 1980-85, the growth rate of industrial production was 5.5 per cent per annum. The basic fact was that the rate of industrial growth had been slowing down. During the Seventh Plan (1985-90) the growth rate had picked up to an average of over 8 per cent per annum and in the Eighth Plan it had declined to 7.3 per cent per annum.

Indian Experience

In India the shyness of capital to move into the new and untried ventures resulted in lopsided industrial growth. This ill balance in industrial structure of India failed to provide any base for further and self-sustaining growth. Here a device, in the form of development banks was found to remove this shyness and mobilize capital to new basic sectors. They were made a tool for mobilizing investment in the priority sectors in a planned economy. Thus the Industrial Finance Corporation was established in 1948. SFCs Act was passed in 1958 and finally IDBI as apex bank started functioning since July 1964. Subsequently, other development banks like ICICI were started in the year 1955 respectively to give a fillip to industrial development.

A well-integrated structure of financial institutions have evolved in the country comprising 11 institutions at the national level and 46 at the state level. These institutions provide a variety of customized financial products and services to suit the varied needs of
the corporate sector. The national level institutions comprise 5 All India Development Banks (AIDBs) and three specialized financial institutions (SFIs) and three investment institutions (IIs). At the state level, there are 18 state financial corporations (SFCs) and 28 state industrial development corporations (SIDCs). The AIDBs are Industrial Development Corporation of India (IDBI), Industrial Finance Corporation India Ltd (IFCI), Industrial Credit and Investment Corporation of India Ltd (ICICI), Small Industries Development Corporation of India (SIDBI) and Industrial Investment Bank of India Ltd (IIBI). The SFIs comprised Risk Capital and Technology Finance Corporation Ltd (RCTC), ICICI Venture Ltd (erstwhile TDICI Ltd) and Tourism Finance Corporation of India Ltd (TFCI). The investment institutions are Life Insurance Corporation of India (LIC), Unit Trust of India (UTI) and General Insurance Corporation of India (GIC). For the purpose of our analysis the above institutions together with SFCs and SIDCs are grouped as All Financial Institutions (AFIs)

In tandem with the emerging need of the industry in the liberalized environment, these institutions have reoriented their policies and assistance structure with much sharper customer focus, by developing and introducing a variety of products and services. In the post reform period AFIs have setup several subsidiaries/associate concerns for offering a wide range of such newly developed products and services as also for capital market infrastructure development, covering areas such as commercial banking, investment banking, non-banking finance, investor servicing, broking, venture capital financing, infrastructure financing, custodial services, electronic trading in stock exchanges, capital market regulation, registrars and transfer services and credit rating.

Statement of the Problem

Economic Development has a direct relationship with industrialisation. The industrial development of a country not only helps in optimizing the utilization of its scarce
resources but also in diversification of its economy. It is hoped that industrialisation brings social transformation, social equality, higher level of employment, and more equitable distribution of income and well balanced regional development. However historically speaking the process of industrialisation tends to be concentrated only in certain industrial areas, which poses serious social economic and political problems. Therefore a balanced growth of all regions is the *sin qua non* for enabling every region to share the benefit of development. In this process institutional finance has to play a crucial role. Schumpeter was the first to recognise a definite link between economic development and financial institutions. "Capital is nothing but a lever by which the entrepreneur subjects to his control the concrete goods which he needs, nothing but a means of diverting the factors of production to new uses, or of dictating a new direction to production." In fact, with a view to giving a fillip to development for all, a number of development banks are set up to foster industrialisation of the country in general and its backward areas in particular. By law, the development banks might not have been charged with specific task of industrial development of backward areas, but they are certainly expected to fill up the gaps in industrial structure and plan, promote and develop industries from that point of view.

Uniform advancement through all the states in India has been an important objective of our economic planning and policies. Development banks initiated several promotional measures in this regard. Although these banks catered to the financial needs of industries, they played a vital role in the industrial development of all the states.

Keeping in mind these related facts, the present study has been undertaken to review and evaluate the performance of All India Development banks in the industrial promotion of various states in India.
Objectives of the study

The following are the major objectives of this study.

1. To analyse the sanction and disbursement of assistance of All India Development Banks
2. To analyse the proportion of assistance provided to different states by All India Development Banks.
3. To examine the various types of assistance provided to different industries by the Development Banks
4. To assess the growth of assistance during the period of study.
5. To estimate the per capita assistance and extent of diversification of assistance in various states in India.

Hypotheses

The following were the Null hypotheses formulated.

1. There is no association between loan disbursed and the growth of number of factories, invested capital, number of workers, total inputs, value of output, and gross capital formation.
2. There is no association between the amount of loan disbursed and the population of the state.

METHODOLOGY

Nature of the study

As the study intends to analyze the function and working of All India Financial Institutions, it is both analytical as well as descriptive.

Period of study:

A period of nineteen years from 1981 to 1999 has been selected as the study period on the basis of the availability of relevant data.
Nature and source of the data

Only secondary data have been collected for the study. The required data have been collected from various issues of IDBI report on developing banking and annual survey of industries.

Selection of the institutions

All financial Institutions (AFIs) as categorised by IDBI have been taken for the study. The All India Development Banks are Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India Ltd. (IFCI), Industrial Credit and Investment Corporation of India. Ltd. (ICICI), Small Industries Development Bank of India (SIDBI), and Industrial Investment Bank of India Ltd (IIBI). The Specialised Financial Institutions comprised Risk Capital and Technology Finance Corporation Ltd. (RCTC), ICICI Venture Ltd (erstwhile TDICI Ltd) and Tourism Finance Corporation of India Ltd. (TFCI). The Investment Institutions were Life Insurance Corporation of India (LIC), Unit Trust of India (UTI) and General Insurance Corporation of India (GIC).

For the purpose of analysis the above institutions together with State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs) were grouped as All Financial Institutions. (AFIs).

Statistical tools used

Apart from the use of statistical tools such as descriptive statistics, correlation and regression techniques, the following model has also been used for analysing the data.

Quotients of assistance

To throw light on per capita assistance of each institution in various states in comparison to their per capita assistance in the whole country, quotients of assistance have been computed.
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\frac{\text{ASi}}{\Sigma \text{ASi}} \quad \frac{\Sigma \text{ASi}}{\text{Pi}} \quad \frac{\text{Pi}}{\Sigma \text{Pi}}
\]

Where \(\text{ASi}\) = Assistance sanctioned in the \(i\)th state, and
\(\text{Pi}\) = Population in the \(i\)th state

In a particular state if (a) \(Q.A. > 1\), it means that the state has a larger share in the
distribution of per capita sanctions as compared to the distribution of per capita sanction
in the whole country.  (b) \(Q.A. < 1\), it means that the state has a smaller share in the
distribution of per capita sanctions as compared to its share in the distribution of per capita
sanctions in the whole country.

**Scope of the study**

The study intends throw light on the functioning and financial activities of
All financial institutions (AFIs) It also tries to explain the quantum of loan sanctioned,
the type of industries benefited and distribution of funds to various states in the country.
The study also gives an account of the financial positions of the financial institutions
taken for study.

**Limitations of the study**

The study has used only secondary data. In the case of operations of All Financial
Institutions the data have been collected for 18 years from 1980-81 to 1998-99. The aggregate
data may not tally due to inter institutional flows and adjustments. The data for
consolidated annual financial statements were available only for All India Financial
Institution. Hence the analysis of financial statement was not made for State Financial
Institutions. These data were available only for 8 years from 1992-93 to 1999-2000.
Chapter scheme

The study is presented in seven chapters. The introductory chapter deals with the concept of development and under development and industrial development, meaning and role of Development Banks in industrial development, statement of the problem, methodology, scope of the study and limitations. Chapter two is related to the theoretical framework of industrial and economic development. Chapter three reviews important literature related to the present study. Chapter four deals with the description of the development banks chosen for study. Chapter five deals with sanctions and disbursement of assistance, state wise and component wise, provided by all the development banks. Chapter six deals with industry wise, sector wise and zone wise assistance provided by all the development banks. The last chapter summarizes the principal findings of the study along with suggestions relevant to policy makers.