CHAPTER II

HISTORY OF CREDIT

Introduction

Banking system occupies an important place in a nation's economy. It plays a pivotal role in the economic development of a country and forms the core of the money market in an advanced country. Commercial Banks in India were in the private sector working with share capital and deposits from the public. Till 1960s it may be said that short-term deposits constituted the major portion of Commercial Bank's deposits. Being motivated by profit consideration, Commercial banks in India like their British counterparts, concentrated on giving short-term loans to trade and commerce as that ensured liquidity and profitability of Commercial banks. Although Commercial banks opened branches at taluka places or in bigger villages, they mostly concentrated on short-term loans to commerce and industry in those areas.

In India, although the money market is still characterised by the existence of both the organised and the unorganised segments, institutions in the organised money market have grown significantly and are playing an increasingly important role. Amongst the institutions in the organised sector of the Money Market, Commercial banks and Co-operative banks have been in existence for the past several decades. The unorganised sector, comprising the money lenders and indigenous bankers, caters to the credit needs of a large number of persons especially in the countryside.

For extending credit to agriculture and allied activities in the rural areas, though co-operative credit societies and Central
Co-operative banks have been participating since long, commercial banks started participating actively only after nationalisation of major banks in 1969. Upto late sixties, commercial banks were mainly engaged in financing organised trade, commerce and industry. After nationalisation, they are actively participating in financing agriculture, small business and small borrowers, also. Because of the absence of institutional agencies like commercial banks in the pre-nationalisation period, money lenders have played an important role in providing finance to the agricultural sector and thus they were acting as bankers to the areas where branches of banks were not opened. The money lenders still continued to play that role even after the country became independent and even after steps were taken to put a number of restrictions on their activities.

Money lenders

A brief discussion of the activities of money lenders and indigenous bankers are given in the following pages—

Broadly a money-lender may be defined as one whose primary business is lending of money or giving loans. Money lenders may be classified into two categories, namely, (1) professional money lenders and (2) non-professional money lenders. It may be said that while in the case of professional money-lenders, money lending is the primary business, in case of non-professional money-lenders, economic activities other than money lending (For example, trading, agriculture, running a small workshop etc.) are primary activities and money lending is carried on as a side business or as a subsidiary activity. In this way money lenders were extending credit facilities to nearly 70% of the country's
population extending over 5.6 lakhs villages. "Thus in 1950-51, it was observed that money lenders accounted for nearly 70% of the total borrowing by cultivators and about 23% being accounted by relatives, landlords, traders etc. and the remaining 7% to others". After banks nationalisation, even in 1980, according to the estimate of the fifth plan, nearly 43% of the rural credit is provided by non-institutional sources of which money-lenders in rural areas happen to be the most important constituent part.

Money-lenders generally give short term loans for various purposes, such as — to meet some urgent consumption needs, to meet expenses on social and religious functions and to meet short-term needs of cultivators in respect of agricultural activities. Money-lenders generally grant loans on the security of property like houses in the village, agricultural land or gold, silver and jewellery. Money-lenders who have been carrying on money-lending business for generations have fairly adequate knowledge about the credit worthiness of each borrower. What is significant and what distinguishes money-lenders from institutional sources of lending is that since money-lenders know borrowers personally, the later can approach money-lenders directly, easily and at any time of the day without any formalities that characterise lending activities of institutional agencies both in rural and urban areas. Money-lenders adopt either rigid or flexible attitude in respect of lending business depending upon the borrowers about whom they possess adequate knowledge.

Rate of interest changed by money-lenders

It is revealed from the reports of the Provincial Banking Enquiry Committees that in most cases money-lenders charged interest rates varying between 12% to 37%, depending upon the nature of security offered, amount of loan granted, personal relation between the money-lender and the borrowers, existence of alternative lending agency in the area. Money-lenders, because of their strong socio-economic position in villages and also because of comparative absence of alternative lending institutions of organised type, specially in rural areas, are in a position to resort to various objectionable practices in their financial dealings with their clients. Some of the commonly found objectionable practices resorted to by money-lenders are obtaining the thumb impression of borrowers on blank papers with the dubious objective of entering bigger figures than the amount lent, manipulating of accounts demanding or deducting advance interest etc. However, there are some money lenders who are considered as "friends of the farmers, the traditional guardians of their property and ever-present helpers in times of need.

Various enactments have been passed to remove or reduce the vigour of the above objectionable practices of money-lenders. But to what extent the money-lenders have discarded several objectionable practices is difficult to say. "Attempts were made to regulate the money-lenders by passing the Agricultural Loans Act (1879) and the Usurious Loans Act (1918). The Punjab Government passed the Regulation of Account Act in 1930. Other provinces passed similar Acts later on. As the cultivators were poor and illiterate, they could not take advantage
of these Acts. The main provisions of these Acts may be summarised as follows:

(1) Licensing and Registration of money-lenders

(2) Fixing of maximum rates of interest

(3) Furnishing of receipts and periodical statements of accounts to debtors

(4) Maintenance of accounts in prescribed forms

(5) Protection of debtors from intimidation and harassments; and

(6) Provision of penalties for violation of provision of the Acts".  

Table 2.1
Prescribed rates of interest for money-lenders

<table>
<thead>
<tr>
<th>State</th>
<th>Simple rates of interest on secured loans</th>
<th>Simple rates of interest on unsecured loans</th>
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<tbody>
<tr>
<td>Madras</td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td>Punjab</td>
<td>12</td>
<td>18</td>
</tr>
<tr>
<td>Bihar</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>Orissa</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>Assam</td>
<td>9½</td>
<td>12½</td>
</tr>
<tr>
<td>M.P.</td>
<td>12</td>
<td>18</td>
</tr>
<tr>
<td>U.P.</td>
<td>12</td>
<td>24</td>
</tr>
<tr>
<td>Bengal</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>9</td>
<td>12</td>
</tr>
</tbody>
</table>

Source: Desai S.S.M. Money-Lenders & Agril. Finance, p. 175

Although the rates of interest was prescribed as stated above, in some cases the rates of interest charged by professional as well as agricultural money-lenders were often as high as 50% or even more in many provinces.

**Legislative measures to check money lenders**

The legislative measures undertaken to restrict objectionable practices of money-lenders and to put limit on usurious rates of interest on loans, proved to be only a sort of palliative. These legislative measures created serious problems for borrowers in obtaining credit facilities from them. Money-lenders were hesitating to lend money to potentially troublesome borrowers, but were lending to old and trusted borrowers. These legislative measures thus resulted in making credit non-available to many needy borrowers. In the absence of alternative source of credit, this resulted a great hardship to many potential borrowers. Also evasion of the provisions of these legislative measures was very common. The money-lenders were able, without much difficulty to evade almost all important provisions of these enactments because of the inadequacy of the supervising machinery, absence of alternative source of credit and the compelling nature of borrowers' requirements.

It is obvious that these legislative measures did not prove successful. These preventive measures would not be successful until and unless alternative institutional arrangements are made to meet credit requirements of borrowers cheaply and efficiently.
Decline of money-lenders

Since independence and especially in recent years i.e. after the nationalisation of the 20 major commercial banks in the country, the importance of money-lenders appear to be declining due to the following factors:

(1) Various legislative measures are passed mainly to protect the borrowers that have increased the difficulties of money-lenders as they find it difficult to recover their loans from borrowers. The Land Alliennation Act, the Usurious Loans Act and various other Acts appeared to discourage money-lenders in carrying on money-lending activities as before.

(2) Moreover, money-lenders are getting difficulties to secure repayment of their debts. Civil proceedings are expensive and time consuming and the courts appear to be in favour of giving maximum protection to borrowers. This has naturally discouraged money lenders.

(3) Various factors such as spread of literacy, increasing awareness among the borrowers regarding exploitative nature of the money-lenders have stained the relationship between borrowers and money-lenders.

(4) Increase of credit institutions such as Co-operative Societies and recently commercial banks and Regional Rural Banks have become helpful in satisfying the credit needs of the people.

Increasing opportunities in trade, commerce and industry are now available to the money-lenders. They now prefer to open a hotel or a shop or an industrial establishment which may often offer more
attractive returns than money lending. Since Independence, the state has been assuming increasingly important role in the sphere of finance, especially agricultural finance and supply of credit to people in rural areas. The state is, therefore, making efforts to establish alternative financial institutions for the supply of credit to the needy people with a view to reduce the importance of private money lenders and if required, eventually to supplant them by alternative public financial institutions. Regarding existencies of money-lenders, one class of people believes that there should not be place at all for private money-lenders and they should be completely supplanted by financial institutions like co-operative and commercial banks. There are other class of people who believes that since financial agencies will take long time to reach each & every villagers, it would be better not to demolish the existence of money-lenders totally. They also feel that money-lenders have substancial financial resources, personal knowledge about every potential borrower and his credit worthiness, hereditary connections with borrowers, local knowledge and experience.

Rehabilitation of money-lenders

Money lenders must not be thrown away simply because some black sheep among money-lenders exploited debtors in the past or continue to exploit them even at present. Proposals have been made from time to time to link the money-lenders with the organised sector of money market to enable them to play a more vital role, especially in rural reconstruction. One proposal is to entrust some well established and reputed money-lenders with agency function of modern commercial banks. Another proposal is to transform such reputed money-lenders into regular
branches of commercial banks or partners of commercial banks as that would help to avoid heavy expenses and possible losses in opening new branches of commercial banks, particularly in villages. Yet another proposal is that in case reputed money-lenders are ready to specialise in banking business by separating their banking from non-banking activities, to link them directly with the Reserve Bank of India which should make available to them rediscounting facilities on the same terms and conditions as offered to commercial banks.

Unfortunately no serious attempts have been made so far to reform the institution of money lenders and link it with the organised money market. The stalemate is just allowed to continue. The institutional credit in the rural area increased sharply from 7.3 per cent to 80.4 per cent during 1951 to 1991, whereas the non-institutional credit declined from 92.7% to 19.6% during the same period as shown in the table below.

Table 2.2
Rural Credit Structure (in percentage)

<table>
<thead>
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<tbody>
<tr>
<td>Institutional Credit</td>
<td>7.3</td>
<td>18.4</td>
<td>31.7</td>
<td>62.6</td>
<td>80.4</td>
</tr>
<tr>
<td>Non-institutional</td>
<td>92.7</td>
<td>81.6</td>
<td>68.3</td>
<td>37.4</td>
<td>19.6</td>
</tr>
</tbody>
</table>

Source: SSM Desai, Rural Banking in India
Indigenous Bankers

Besides money-lender, there are indigenous bankers who provide finance to traders and industrialists. Indigenous bankers may be differentiated from money-lenders on the grounds that the indigenous bankers' scale of operation is generally larger; deposit from the public constitute a sizeable portion of their funds. Their accounts are kept more systematically than those of money-lenders. They maintain closer links with the modern sector of banking (namely, the State Bank of India and other commercial banks). They do not provide consumption loans as money lenders often do. The Banking Commission (1972) estimated that the number of indigenous bankers in India is around 2,000. Indigenous bankers hail from certain communities in India and carry on business in a hereditary way. They provide credit out of the deposits received from public. In recent years the deposits from the public with indigenous bankers are declining because the customers feel that their deposits with commercial banks are more secure as they also get attractive rates of interest (especially after 1960). Indigenous bankers provide finance to traders and small industrialist and have thus indirectly enabled agricultural and industrial products produced in rural areas to move to markets. They do not provide financial accommodation to large-scale industries.

Mode of operation of Indigenous bankers

The usual method of indigenous bankers of lending money is with the aid of written demand promissory notes. In the case of loans involving large amount, such promissory notes are generally attested by surities in the absence of which generally higher rates of interest are
charged. Another method adopted is giving loans against bonds written on a stamped legal paper and duly executed. In rural areas another method adopted by indigenous bankers while giving loans is lending money on the mortgage of land or houses or such other form of property. The mortgage may be ordinary in which case possession and enjoyment of the property is left with the mortgagors. The mortgage may be usufructuary in which case the possession of the property is with the indigenous banker (mortgagee) who enjoys the property or lets out to another, the income therefrom being considered as interest on loan given to the mortgagor. In the case of usufructuary mortgages a condition may be laid down that if the loan is not paid by a certain fixed date, the transfer of property to indigenous banker will become absolute and unredeemable. When such condition is not stipulated, borrower can recover the property at any time (or at the stipulated time) by repaying the loan to indigenous banker.

A very important and distinguishing function which indigenous bankers undertake is discounting of 'hundis' which is the indigenous bill of exchange. Hundis are classified as (1) Finance Bills and (2) Trade Bills. Finance bills are drawn by merchants who are in need of money, on their agents or firms with whom these merchants have made previous arrangements regarding acceptance etc. or these finance bills may be drawn by merchants just for remittance of money from one place to another. On the other hand, trade bills are drawn by the seller who sells goods on the purchaser who purchases the goods and promises to make payment for the goods purchased (plus stipulated amount of interest) on a stipulated day in future because he is not in a position
to make cash payment for goods purchased immediately. Hundis can be discounted and rediscounted any number of times until the date of maturity written on the bill.

Rate of interest charged by indigenous bankers

Indigenous bankers usually charge rate of interest varying between 6 and 18 per cent on secured loans given by them, depending upon the nature of the security, and the prevailing conditions in the money market. In the case of unsecured loans (i.e. loans not backed by any property or eligible security), indigenous bankers charge rates of interest varying between 18 and 37 per cent, depending upon the credit worthiness of the borrower and his relations with the indigenous banker.

Defects associated with Indigenous Bankers

Though indigenous bankers occupy an important place in the unorganised sector of money market in India, and in spite of the fact that they have been playing an important role in rural areas from times immemorial, certain serious defects have come to be associated with the institution of indigenous bankers. The following defects are the important ones.

1. Majority of indigenous bankers combine indigenous banking business with some other activities such as trading, agriculture, speculation, running of oil mills or other industrial units, brokerage and so on, so that very often capital used in banking cannot be distinguished from that used in non-banking activities.

2. Indigenous bankers have failed to establish stable and workable business relations with organised sector of banking.
3. Indigenous bankers have not paid adequate attention to develop deposits of their business. Neglect of deposit side has meant that indigenous bankers have to work with limited funds than would have been possible with the increase of deposits. This has meant failure to mobilise potential savings particularly in rural areas which could have been invested for the development of rural resources and reconstruction of rural economy. Continuance of unorganised sector of money market comes in the way of effective implementation of monetary policy of the government as in the absence of links with the organised sector of money market, indigenous bankers happen to be outside the purview and control of the Reserve Bank of India.

**Accommodation of indigenous bankers**

Indigenous bankers whose names are on the approved list of State Bank of India and Commercial Banks can obtain cash-credit from them. Indigenous bankers, if they are on the approved list of commercial banks, can also discount hundies with them drawn by traders and endorsed by indigenous bankers upto a certain limit which a commercial bank assigns to each indigenous banker on consideration, such as their financial standing. However in normal circumstances, indigenous bankers prefer to borrow from each other at a lower rate of interest and also to avoid all sorts of inquiries which are conducted when borrowing from commercial banks. Indigenous bankers donot publish their accounts nor publish their balance-sheet for which commercial banks get difficulties to determine their true financial status and standing and the extent of trust which they (commercial banks) should put in them. Thus, commercial banks refuse to honour cheques drawn on indigenous bankers or
endorsed to them. But it must be admitted that commercial banks and the State Bank of India have occasionally treated indigenous bankers of repute without sympathy, insisting on observance of formal rules and procedures.

Decline of Indigenous Bankers

Some provisional banking companies pointed out that the volume of banking business conducted by indigenous bankers was on the decline. This decline in the volume of business and importance of indigenous bankers have continued with rather accelerated speed after independence and especially after the nationalisation of the 14 major commercial banks in the country in 1969. This is due to reasons that —

(1) The State Bank of India, Commercial banks and Co-operative banks are making heavy in roads into the banking business of indigenous bankers in rural areas. Indigenous bankers are finding it more difficult to stand in competition with them or even to retain their traditional financial business. Thus they are finding it difficult to compete with commercial banks in regard to business of giving loans and advances.

(2) Big business firms engaged in India's export trade are opening branches in the interior and providing finance for the movement of goods from the interior to port towns, thus depriving indigenous bankers of their traditional valuable business.

(3) There is a fairly heavy stamp duty on hundis and thus is hampering considerably their hundi business.

Indigenous bankers supply valuable banking facilities to merchants, traders etc. who, for all practical purposes, are almost
entirely dependent upon indigenous bankers, especially in rural areas. India has 5.6 lakh villages which cover nearly 80% of the country's population and carries on their various economic activities. It will certainly take a very long time for the commercial banks, State Bank of India and Co-operative banks or other modern financial institution to make arrangements for the provision of credit facilities to millions of traders and small industrialists who are carrying on their day to day business. Indigenous bankers have established sound business contacts as they have been carrying on banking business in hereditary way. They can bring about integration not only of organised and unorganised sectors of economy in rural areas but also of banking in rural and urban areas. It must be admitted that within limits their functioning has been satisfactory and the rates of interest by indigenous bankers donot compare unfavourably with those of commercial and co-operative banks.

**Reserve Bank of India and Indigenous Bankers**

In May, 1937, the newly established Reserve Bank of India, made an attempt to bring about some reforms among indigenous bankers. Reserve Bank of India was also ready to consider any practicable scheme for organising indigenous bankers with a view to providing them direct credit. The conditions imposed on indigenous bankers were that they must be a self-contained legal entity with resources and deposits equal to those stipulated by Reserve Bank of India for scheduled commercial banks, must maintain separate account of their banking business and the account must be properly audited, should not enter into speculative business. Pending the establishment of such an organisation of indigenous bankers, the Reserve Bank of India suggested a provisional
scheme whereby the Reserve Bank would provide advances against bonafide trade bills originating with a merchant or agriculturist and endorsed by an indigenous banker and discounted with an indigenous banker with a possible second signature and discounted by a scheduled commercial bank. The indigenous bankers were not in favour of this scheme of the Reserve Bank of India which proposed indirect linking between Reserve Bank of India and indigenous bankers. They felt that the Reserve Bank had unnecessarily exaggerated the difficulties of establishing direct link between itself and indigenous bankers.

It is unfortunate that more than 60 years after the establishment of the Reserve Bank of India, the important matter (which would establish a link between the unorganised sector of rural banking and organised money market) is still hanging fire and that no satisfactory solution to the problem could yet be found.

Recommendations of the Banking Commission

The Banking Commission (1972) in its report made a number of recommendations to bring about reform and modernisation of indigenous banking in the country. The commission suggested that the indigenous banker (i.e the private banker) should obtain a certificate of authorisation from the government for continuation of his banking business and any change in the constitution of the firm of the indigenous banker should first secure the approval of the appropriate authority. The Banking Commission, therefore, recommended that the best course would be controlling activities of indigenous bankers through commercial banks. The Reserve Bank of India should lay down guidelines for commercial banks dealing with indigenous bankers. This

would mean indirect control of the Reserve Bank of India over the indigenous bankers.

The Banking Commission recommended that there should be some understanding between indigenous bankers and commercial banks regarding level of interest rates charged by them to their respective customers. It was recommended in this connection that the Reserve Bank of India should indicate from time to time the adequate spread of interest rates. For example, in case where indigenous bankers have lent money to priority sector, they should get from commercial banks a concessional discount rate for their hundis and bills but at the same time carefully ensuring that this concession granted to indigenous bankers by commercial banks is adequately passed on by them to borrowers in the priority sector through appropriate lower rates of interests. Commercial banks should verify on random sample basis rates of interest charged by indigenous bankers to their borrowers of different categories. Any indigenous banker found misusing concessional rates of interest charged to him by commercial bankers should be refused financial accommodation by commercial banks in future.

Banking Commission Report

It might be said that according to the Banking Commission report, indigenous bankers have been playing a very useful financial role as they make credit available to those sectors which are productive and which due to some reason or other find it difficult or impossible to get financial assistance from organised sector of banking, namely, Commercial banks and co-operative credit societies. Though nationalised commercial
banks have been trying to meet the needs of the neglected sectors and small borrowers, the Banking Commission was of the opinion that these commercial banks would hardly be in a position to undertake all the banking business done at present by indigenous bankers and thus completely displace them. This may take long time, if it ever takes place at all. This implies that indigenous bankers, in the Indian economy as a whole, in extending credit should be considered as complementary to commercial and corporate banking institutions in the organised sector of money market and as such (with funds, accumulated experience, knowledge of local conditions, personal contacts and flexible methods of operation) they should be considered as a necessary part of the banking system, especially in rural areas as their complete displacement, even granting that it were desirable, is practically impossible for quite some time.

Co-operative Credit

The Era of Co-operative movement in India started with the passing of the first Co-operative Societies Act in 1904 by the Government of India. The idea behind the Co-operative Movement was defensive and protective of the interest of the peasants. A vast number of peasants were then caught in the clutches of unscrupulous private money lenders.

Under the Act of 1904, a number of Co-operative Credit Societies came to be established. This was followed by Co-operative Societies Act of 1912. The Act of 1912 recognised, along with co-operative credit societies, co-operative societies engaged in other activities like marketing, farming, distribution etc. The situation in the sphere of
rural credit and indebtedness necessiated a complete and through review of the whole question of rural credit or agricultural finance.

**Agricultural Finance Sub-committee**

The Agricultural Finance Sub-committee (1945) under the chairmanship of D.R. Gadgil examined the whole question throughly and comprehensively.

The Gadgil Committee analysed all aspects of the problem of rural credit or agricultural finance and the committee recommended that it was necessary to establish an agency alternative to private money-lenders for providing adequate finance for all reasonable purposes and on reasonable terms.

Although the Agricultural Finance Sub-committee headed by D.R. Gadgil recognised co-operation as "the best and most lasting solution for the problem of agricultural credit", the committee felt that the co-operative societies as they existed then could not be solely relied upon to meet the needs of rural credit fully or substantially. The committee, therefore, recommended the creation in each province of an autonomous Agricultural Credit Corporation. Though the last recommendation of the committee was not given effect to, it marks an important stage in the evolution of policy in regard to co-operative movement in the country.

The next step in the evolution of co-operative movement in the country was the appointment of two committees, the Co-operative Planning Committee appointed by the Government of India in 1946 with R.G. Sariya as the chairman and the Agricultural Credit Organisation Committee
appointed in 1947 by the Govt. of Bombay under the chairmanship of Manilal Nanavati. 4 While both the committees opined that co-operatives are the most suitable agency for providing agricultural credit, the Saraiya Committee also made the important recommendations that the village level co-operative credit societies should be made multipurpose. Government should contribute to the share capital of Central Co-operative banks and the Apex Banks, and also recommended for the Governments' association in their management with a view to enable them to provide adequate institutional credit to all credit-worthy agriculturists. It may be noted that the recommendations of the Saraiya Committee were subsequently accepted by the Government. 5

The most important landmark in the history of co-operative movement in India after independence was the appointment by Reserve Bank of India of the committee of Direction to conduct an All-India Rural Credit Survey. The report of the All India Rural Credit Survey Submitted in 1954 marked a historical landmark in the evolution of policy of co-operative movement in India. The report of the All India Rural Credit Survey opined that co-operative credit which provided (in 1951) only 3% of the total borrowings of the agriculturists had proved thoroughly inadequate to meet the financial needs of agriculturists. But the Survey Committee was convinced that in the Indian context, the co-operative society was the most suitable agency to provide credit to agriculturists.

4. Desai, S.S.M. Rural Banking in India, page 201
5. Desai, S.S.M. Rural Banking in India, page 201
Establishment of National Agricultural Credit Fund

The Report of the All India Rural Credit Survey also recommended for the establishment of the National Agricultural Credit (Long-Term) Fund, and the National Agricultural Credit (Stabilisation) Fund, by the Reserve Bank of India. Both the Funds were established in the year 1955.

The objective of the National Agricultural Credit (Long-Term Operation) Funds were as follows:

(i) Giving loans to State Governments for a period of not exceeding 20 years to enable the State Governments to subscribe to the share capital of co-operative institutions, (ii) Providing medium term loans to the State Co-operative Banks (i.e. the Apex Banks) for enabling them to provide finance for agricultural and allied activities and (iii) Providing loans for a period of not exceeding 20 years to State Governments for the purpose of purchasing of debentures of Central Land Development Banks. ⁶ The objectives of the National Agricultural Credit (stabilisation) Fund were — providing fund to the State Co-operative Banks (the Apex Banks) for converting short-term loans due from the State Co-operative Banks to the Reserve Bank of India into medium term loans when repayment of short-term loans becomes impossible due to factors beyond their control, namely, floods, famines etc. ⁷

Appointment of Committee on Co-operative Credit

In 1959, the Government of India appointed a committee on co-operative credit under the chairmanship of V.L. Mehta, the doyen of co-operative movement in India. The Mehta Committee also recommended

⁶,⁷ Ghosal, S.N. Agricultural financing in India, Asia Publishing House, 1966
that the primary society should admit all types of cultivators for providing credit and that all short-term and medium-term loans upto Rs. 500/- should be given to agriculturists without the mortgage and of landed property. The committee has recommended for state participation in the share capital of primary agricultural co-operative credit society to the extent of Rs. 5000/- per society and there should be liberalisation of credit limits in the case of Central Co-operative banks (at the district level) to enable them to obtain larger funds from the Reserve Bank of India so that they in turn can provide larger funds to primary societies which in turn would be enabled to give more loans to needy cultivators. The Government of India accepted the recommendations of the Mehta Committee practically. Therefore, after 1960 attention came to be given more to the reorganisation of primary societies and ensuring sufficient credit to all types of cultivators with special emphasis on the financial needs of small and medium class cultivators.

Formation of Rural Credit Review Committee

When Indian agriculture is getting increasingly mechanised and commercialised, naturally financial or credit needs of cultivators are continually rising. To meet the increased credit needs of the cultivators, the Reserve Bank of India appointed in 1966, the Rural Credit Review Committee (under the chairmanship of B. Venktappiah) to review the entire question of supply of agricultural credit in the light of technological changes that have been taking place in the agricultural sector in India.

The Review Committee submitted its report in 1969. According to the report of the Review Committees, in the last year of the Fourth Five
Year Plan (i.e. 1973-74) credit needs of the agricultural sector were estimated at Rs. 2500 crore. Out of this, it was estimated that Co-operative Societies would be in a position to provide only about 750 crore. This would leave a gap of Rs. 1750 crore in the requirement of agricultural credit for the year 1973-74.

Multi Agency Approach

Clearly in the changed circumstances of increasing mechanisation and commercialisation of Indian agriculture, it was realised that co-operatives alone would not be able to meet adequately the increasing credit needs of Indian agricultural & rural sector. The Review Committee thus recommended for the Multi-Agency Approach to fill up the gap to agricultural and rural credit provision instead of entrusting the task only to co-operative societies.

Meanwhile the social control over commercial banks came to be introduced in 1968. But it was soon found that social control was inadequate for channelising funds at the disposal of the commercial banks in an appropriate manner. This was because all along commercial banks in the country as a rule had kept themselves away from agricultural and rural credit provision and commercial banks had concentrated on providing short-term credit only to trade and industry as they ensured commercial banks both liquidity and profitability. Commercial banks which were in the private sector and were motivated by the consideration of maximisation of profit, found it difficult to change quickly their mode of functioning. And, therefore, in 1969, 14 major commercial banks in the country came to be nationalised. The Review Committee, therefore laid emphasis on provision of increasing
amount of agricultural and rural credit by co-operative as also by commercial banks and re-orientation of loaning policy of commercial banks with emphasis on meeting the credit needs of the agricultural sector, especially of small and marginal farmers.

The Government accepted the recommendations of the Review Committee. Instead of a single agency approach namely co-operative societies — it is at present multi-agency approach which is being followed, a number of different types of credit agencies trying to meet credit needs of the agricultural and rural sector in an integrated manner, special attention being concentrated on small and marginal farmers, poor rural artisans and the other neglected sectors of the rural community.

Credit Monitoring

With increased economic activities, arising out of increase phase of industrial growth as also due to post-nationalisation, the demand mounted up from various other sections of the society and the available credit has become a scarce commodity. Moreover, with a view to achieve the socio-economic goals, it was necessary to pass on the credit to the sectors which needed them most to improve the economic standard of the people in general. Earlier, the credit facilities were being granted basically on individual assessments of the companies or the management and there have been instances in the past where the total credit limits sanctioned were more than total deposits of the bank and it was found that such feature was virtually alarming. With a view to give a realistic approach to the credit monitoring, the credit plan is done at the central bank level i.e. by Reserve Bank of India. Similarly,
each bank has its credit planning exercises not only on year to year basis but on a long term range. This ensures flow of credit not only to a single sector of economy but to various types of industries.

Credit monitoring has become more necessary when credit restraint policy is continuously followed-up by the banks in consultation with or under the guidance of Reserve Bank of India. Credit is monitored in several ways namely, by assessing the needs of large or medium scale industrial units. The assessment is made on the basis of financial statement and the needs forecast. Similarly, the flow of credit is monitored through quarterly operating data of the unit and the borrower is questioned for any undue holdings/lock-up of finance under inventories or receivables or if the levels of current liabilities are higher than what is forecast. This ensures that no undue credit facilities are extended to any sector.

Amongst the banking institutions in the organised sector, the commercial banks are the oldest institutions having a wide network of branches, commanding utmost public confidence and having the lion's share in the total banking operations. Initially, they were established as corporate bodies with share holdings by private individuals, but subsequently there has been a drift towards state ownership and control. Today 28 banks constitute the strong public sector in Indian Commercial banking. Upto late sixties, they were mainly engaged in financing organised trade, commerce and industry, but since then they are actively participating in financing agriculture, small business and small borrowers also.
Credit to Agriculture

The commercial banks are financing agricultural sector, broadly in two ways (i) Direct finance of agriculture and (ii) Indirect finance of agriculture. Direct financial assistance is rendered to agricultural sector in three different ways, namely, (1) Short-term finance, (2) Medium-Term Finance and (3) Long-term finance. Indirect Agricultural Finance is provided in the following ways— (a) Financing distribution of seeds, fertilisers, pesticides, insecticides etc. (b) Granting loans to State Electricity Boards for rural electrification, (c) Granting loans to warehousing corporation for the purpose of construction of warehouse facilities, (d) Granting loans to servicing organisations/individuals who spray pesticides, insecticides etc. on the agricultural crops, (e) Granting credit to dealers/service people of tractors, hull dozers, ball-bearing equipment and pump set suppliers/dealers.

Under indirect agricultural finance, commercial banks also grant loans to Agro-Industries Corporation and agricultural credit corporations at the state levels as also to Agricultural Finance Corporation and Land Mortgage Banks. Under the twenty point programme of the Government of India, Commercial banks have made a good headway in financing marginal farmers and their agencies thereby contributing to the improved socio-economic structure and better standard of living. Basic projects financed by commercial banks are generally refinanced by the Agricultural Refinance and Development Corporation (ARDC). Foreign Commercial banks are the branches in India of the joint stock banks incorporated abroad. These banks, besides financing the foreign trade of the country, under-take banking business within the country as well.
Long term credit needs

For meeting the long-term credit requirement of industry, Industrial Development Bank of India (IDBI) has been set-up in 1964, as the apex bank in financing industry. Besides direct financing of big industrial projects, it undertakes refinancing of term loans granted by other financial institution including the commercial banks. IDBI provides assistance to financial institution by way of subscriptions to their shares and bonds. The financing of exports was also undertaken by the Industrial Development Bank of India till the establishment of Export Impert Bank of India in March, 1982. IDBI raises the bulk of its funds from (i) market borrowings by way of bonds, (ii) the borrowings out of National Industrial Credit (Long Term Operations) Fund of the Reserve Bank of India. It also takes short-term advances from the Reserve Bank of India against lodgement of usance bills. There are two prominent all India institutions in the field of industrial finance namely, the Industrial Finance Corporation of India (IFCI) and the Industrial Credit and Investment Corporation of India (ICICI).

The Industrial Finance Corporation of India (IFCI) was the first development bank established in India in the year 1948 for providing financial assistance to industry. Its primary objective was to assist industry especially when accommodation from traditional sources of finance for the creation of fixed assets was felt inadequate or when recourse to capital market was difficult.

Long-term Credit

Industrial Finance Corporation of India (IFCI) provides assistance to the industrial concerns in the following way —
(1) Long-term Loans— both in rupees and foreign currencies
(2) Underwriting of equity, preference and debenture issues,
(3) Subscribing to equity, preference and debenture issues,
(4) Guaranteeing the deferred payments in respect of machinery imported
from abroad or purchased in India, and
(5) Guaranteeing of loans raised in foreign currencies from foreign
institutions.

Financial assistance may be availed of by any limited company —
in the public, private or joint sector — or by a co-operative society in-
corporated in India, which is engaged or proposes to be engaged in the
specified industrial activities. Such financial assistance is available
for the setting up of new industrial projects and also for the
expansion, diversification, renovation and/or modernisation of existing
ones. The corporation also provides financial assistance on concessional
terms for setting up industrial projects in industrially less
developed districts in the States/Union territories notified by the
Central Government. The corporation raises its resources by way of (i)
issue of bonds in the market, (ii) borrowings from the Central
Government and (iii) foreign credit.

The Industrial Credit and Investment Corporation of India
(ICICI) was set-up as a joint Stock Company in 1955 as a private sector
institution with the objectives to channalise the World Bank funds to
industry in India and also to help build up a capital market. Initially
all its capital was held privately by companies, institutions and
individuals, but to-day a very large part of its equity capital is held
by public sector institutions such as banks, LIC,GIC and its subsidiaries,
as a result of subsequent nationalisation of these institutions.

The most significant feature of ICICI’s operations is the foreign currency loans sanctioned by it. Foreign currency loans sanctioned by it, since its inception, account for almost one half of its total disbursements. The major portion of its assistance has gone to the private sector, while it also lays emphasis on financing projects in the backward area. The ICICI has also contributed to the growth of the capital market by underwriting of corporate securities and by directly investing in such securities. It has built up a full-fledged merchant banking division, which provides advisory services in financial matters to the corporate sector.

The World Bank has been the single largest source of its resources. Since 1973, the ICICI has entered the International Capital markets also for raising foreign currency loans. The major portion of its rupee resources is raised by way of debentures in the capital market. The ICICI also borrows fund from the Industrial Development Bank of India and the Government.

State Financial Corporations

Besides the above industrial finance institutions, the State Financial Corporation (SFC) and State Industrial Development Corporation (SIDC) have been set up to meet the requirements of small and medium scale industries in the respective states. Industrial Reconstruction Corporation of India (IRCI) has been set up to bring back to normalcy the industrial units which fall sick. All these institutions engaged as they are in the task of development, are now designated as 'development
Development banking has had its genesis in the post-independence period in India, and has contributed significantly to the industrial growth of the country during this period.

At present 18 State Financial Corporation are functioning. Except the Tamil Nadu Industrial Investment Corporation, which was set up as a joint stock company in 1949, all other corporations have been set-up under the State Financial Corporations Act, 1951. These are the state level agencies established for the development of small and medium industrial units within their respective states. Thus they provide loans and underwriting assistance to industrial units having paid-up capital and reserves not exceeding Rs. 1 crore. The maximum amount that can be sanctioned to an industrial concern by State Financial Corporation is Rs. 30 lakhs. SFCs depend upon the Industrial Development Bank of India for refinancie in respect of the term loans granted by them. Apart from this, SFCs also resort to temporary borrowings from the Reserve Bank of India, borrowings from IDBI and by way of bonds.

**State Industrial Development Corporation**

The State Industrial Development Corporations have been set-up by the State Governments as companies wholly owned by them. State Industrial Development Corporations (SIDCs) are not merely financing agencies, but are intended to act as instruments for accelerating the pace of industrialisation in the respective states. Besides providing financial assistance to industrial concerns by way of loans, guarantees and underwriting of or direct subscriptions to shares and debentures, the SIDCs undertake promotional activities such as conducting techno-
economic surveys, project identification, preparation of feasibility studies, selection and training of entrepreneurs. They also promote joint sector projects in association with private promoters. SIDCs also undertake the development of industrial areas by way of construction of sheds and provision of infrastructural facilities and also the development of new growth centres. They also administer various State Governments incentive schemes. The IDBI grants refinance to SIDCs also against the term loans provided by them. SIDCs also borrow by way of bonds and from the Government and accept deposits to augment their resources.

To provide financial assistance to exporters and importers, the Export Import Bank of India (EXIM Bank) was set up on January 1, 1982 as the apex banking institution in India. It is also functioning as the principal financial institution for co-ordinating the working of other institutions engaged in financing of exports and imports of goods and services. It also provides refinance facilities to the commercial banks and other financial institutions against their export import financing activities. Broadly, it provides credit in the following ways —

1. Financing of exports from and imports into not only India, but also third countries, of goods and services.
2. Financing of joint ventures in foreign countries.