CHAPTER III

THE CONSTITUENTS
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The strength of a money market, like that of a chain, depends upon the strength of the constituents - the links which form it. Obviously, if the constituents are well-knit, properly organised and responsive to dynamic changes, the money market as a whole will operate successfully.

Spadling has compared the mechanism of a money market with that of a wheel. His observations, though primarily dealing with the London Money Market, are universally applicable. According to him, "It is not too much to say that the Bank of England is the axle on which the wheel of the Money Market's business turns. The axle, however, is of very little use without the constituent parts of the wheel, each is reliant on the other for its strength, the hub of the wheel is represented by the joint stock banks, the spokes by the other banks of the country, the rim by the discount houses and to make the wheel complete the boss may be taken to represent the bill brokers, the stock brokers, and the finance houses, the paint being left to indicate the public. The supply of funds, to carry the simile further, is the greatest necessity to lubricate the wheel of the money Market". 1

As a bicycle without a wheel or with an incomplete wheel is unimaginable or is unable to move, so is the money market without the constituents. The stronger and more efficient are the constituents, the more will be the capacity of the money market to play its proper role in the financial mechanism of the area it serves.

Before evaluating the role of the different constituents of the money market, it must be kept in view that they are not necessarily similar everywhere. Their importance and development in different money markets varies in relation to the economy of the country, its historical growth, local conditions and traditions and the financial mechanism, operating in the country where the money market functions. In fact, the money market responds to the economic development of a country. It is static if the economy is backward. It is progressive and responsive if the economy is advanced. For instance, in advanced countries, the chain of the money market is not only complete, continuous, co-ordinated and regular but also strong enough to face stresses or strains. It is so comprehensive as to provide funds for different maturities, ranging from a day, a week, a fortnight or a month and above. Conversely, in the case of backward countries, the chain has many missing links and those available are generally composed of loosely knit units divided into isolated segments, which are not only uncoordinated to each other but also isolated in their respective spheres often following independent policies, which might sometimes clash and weaken the entire monetary structure of that country.
These constituents may conveniently be classified and studied under two groups: (a) the constituents of the money market, i.e., those which supply short-term funds and (b) those of the Capital Market, i.e., those which supply long-term funds. In countries where reliable statistical data is available and where all the links are complete and play their due role, the trend is towards unison. But in countries where such conditions are lacking, the traditional study still appears to be better. The present study is, consequently, more or less confined to the money market proper, including the constituents which play a joint or composite role.

This study of constituents therefore, includes:

(A) The main constituents of the money market, viz. Commercial Banks, Co-operative Banks, Discount Houses, Acceptance Houses, Post Office savings Banks etc., as they operate in Karnataka.

(B) The subsidiary constituents representing the unorganised sector of the money market such as the Indigenous Bankers and Money lenders.*

(C) Institutions, which contribute greatly in providing liquidity and elasticity to the money market, viz. Clearing Houses.

(D) Specialised Markets, which do not actually supply cash or credit, but provide investment facilities and help in the mobilisation of savings, e.g., Stock Market and Bill Market.

* Indigenous Bankers and Money Lenders do occupy an important position as the subsidiary constituents of the money market of our State. But it is very difficult to assess their contribution to the financial flow as their transactions are veiled in secrecy. Therefore, no estimate of their resources is possible in the absence of reliable statistics about their private wealth, business transactions or working capital available. For this reason we do not study them and present study does not include their contribution.
Specialised Agencies, which help in collecting and disseminating information to trade, industry and commerce and thus indirectly help in the organisation of the money market, e.g., Chambers of Commerce, Trade Associations.

Of course, all these institutions and agencies work in coordination and under the direction of the Central Bank of the country - The Reserve Bank of India.

The principal features of the main constituents of the Bangalore Money Market are briefly indicated below:

A. The Main Constituents

(1) Commercial Banks *

Commercial banks constitute the most important link in the chain of financial mechanism all over the country. They serve as shock absorbers and effective feelers on the one hand and circulators of funds in the arteries and veins of the money market on the other. They serve as the reservoirs of savings, distributors of credit, stimulators of discount houses, bill brokers, stock brokers etc., collectors and disseminators of financial information, financiers of foreign trade, mobilisers of funds in different areas, regions and sectors.

* In England they are referred as "Joint - Stock Banks" and in the U.S.A. as "Member Banks".
The relative role played by the Commercial Banks in different spheres varies from market to market. In underdeveloped money market, they primarily mobilise small atomised savings, pool them up and make them available to trade and industrial activities. In developed money markets, they serve not only as mobilisers of savings and distributors of credit but also render numerous subsidiary services.

So far as Bangalore money market is concerned, commercial banks have focussed their attention on the primary function of savings mobilisation and credit distribution. Some of these banks have their head offices in Karnataka while others are controlled from the head offices located outside the State. At the end of 1975 the number of scheduled banks maintaining their head offices in Karnataka came to only six*. Their total paid-up capital and reserves were of the order of Rs. 17.91 crores and they had deposits of Rs. 670.38 crores. Thirty two banks have their head offices outside the State of Karnataka and maintained 679 branches and their total resources estimated at the rate of Rs. 81.61 lakhs per branch came to about Rs. 60.59 crores. ** Thus the total resources of scheduled commercial banks operating in Karnataka at the end of 1975 came to Rs. 759.28 crores.***

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* Canara Bank, Karnataka Bank, State Bank of Mysore, Syndicate Bank, Vijaya Bank and Vysya Bank.

** The financial resources of All-India Banks (excluding banks of Karnataka origin) had total resources (includes paid up capital + Reserves + deposits) of Rs. 1427199 lakhs with 18325 branches all over the country. This would give an average of Rs. 81,64 lakh per branch. 32 banks had maintained 679 branches in the State of Karnataka which would give us the total of their resources of Rs. 60,59 crores.

*** Foreign exchange bank with its head office abroad had only one branch operating in Karnataka at the end of 1975. The resources of this branch were estimated to be about Rs. 67.50 lakhs. This has been excluded for finding the average resources of banks of outside origin.
It may be mentioned here that the average resources of the banks of Karnataka origin are small. The average per capita deposit of banks of Karnataka origin at the end of 1975 came to only Rs. 229 as compared with Rs. 569 for Maharashtra and Rs. 411 for West Bengal. The percentage contribution of banks of Karnataka origin to All-India Scheduled Banks' Deposits on the above date came to 4.9% in contrast with 21.0% for Maharashtra and 13.3% for West Bengal. These figures suggest that, despite their dominant position in Bangalore money market and their recent uptrend in deposits, resources of banks of Karnataka origin cannot be said to be adequate (Vide Appendix 'B' Table No. 1).

So far as distribution of loans by commercial banks in Karnataka is concerned the total amount advanced came to Rs. 696 crores, of which 2/3rd was sanctioned for Industry and Commerce and the remaining 1/3rd for agriculture and other purposes (Vide Appendix 'B' Table No. 2). The total amount of productive Capital employed in Karnataka at the end of 1975 came to Rs. 9895 crores*. Of this, Rs. 2332 crores comprised working capital and Rs. 7562 crores fixed capital. Even if we leave out the fixed capital component of total resources invested in the State industries, we find that the contribution of commercial banks to the total working funds used in the State Industries comes to less than

10% (Vide Appendix 'B' Table No. 3). The deficiency of resources of the banking system in the State is thus self-evident even on the basis of advances given to industries. As against this, the commercial banks have concentrated more than two thirds of their advances — and this inspite of a marked increase in industrial advances during the last five years.

So far as agriculture and other sectors of the economy are concerned the total advances granted to them at the end of 1975 came to less than Rs. 200 crores. The minimum of requirements of short-term credit to agriculture are estimated at Rs. 200 crores on the basis of population of Karnataka. Since the density of population in Karnataka is low and the scope of agriculture expansion relatively higher the estimate based on Rural Credit Survey Review must be revised upwards to a minimum of Rs. 500 crores, if break-through in agriculture is to be achieved.* The contribution of commercial banks towards this

* The All India Rural Credit Survey estimated the annual borrowings of the country at Rs. 750 crores in 1951-52 and Shri B.Venkatappiah estimated them at Rs. 1000 crores in 1959-60. The demand for Rural Credit is much larger today than in 1959-60 and is bound to expand rapidly as a result of the near phenomenal development now taking place in agriculture and enormous rise in prices. The growing need is not only for short-term credit to purchase inputs such as fertilisers and pesticides but also for medium-term and long-term credit for purposes such as land levelling, minor irrigation and rural electrification. Further, attention is also to be drawn to the credit needs of areas not well endowed by nature and classes of farmers not well equipped to take advantage of the new techniques, special measures have to be decided. Thus credit needs for the country as a whole may be placed at Rs. 8000 crores for the year 1975 and Karnataka's share in the requirement for funds on the basis of its population may be estimated to be about Rs. 500 crores approximately.
estimated short-term needs of agriculture comes to hardly 15%. This reinforces the argument of deficiency of the banking system to meet the requirements of finance even in the basic sector of the economy.

The per capita advance — another index of assessing the adequacy of banking system works out at Rs. 229 for Karnataka as contrasted with Rs. 300 for West Bengal and Rs. 490 for Maharashtra. This also suggests that the loanable capacity of Karnataka Banks is comparatively poor. The only redeeming feature would appear to be a slight improvement in the ratio of total advances by Karnataka banks to the total advances of All-India Scheduled Banks from 6.4% in 1971 to 6.7% in 1975 as contrasted in the ratio from 16% to 13% in case of West Bengal and 28.3% to 24.5% in case of Maharashtra in the same period (vide Appendix 'B' - Table No. 4).

2. Co-Operative Banks

Besides commercial banks, co-operative banks serve as an important link between those who save and those who invest. While the commercial banks focus their attention on relatively larger industrial and commercial houses, co-operative institutions seek to serve agriculture and industrial entrepreneurs. Like Commercial banks, Co-operative banks mobilise the savings of men of small means through allotment of shares and acceptance of deposits. They also advance loans for short-term
requirements of both small scale industrialists and agriculturists.
Although the area of their activities is fairly wide, covering credit,
marketing, house construction, land improvement, irrigation etc., the
major function of these banks is to provide credit facilities particularly
for periods ranging from six months to one year.

Unlike the commercial banks, the co-operative institutions have
their federations. With primary societies at the base, central banks
at the district level, and apex banks at the state level, they have
also links with the Reserve Bank of India.

So far as Karnataka State is concerned, it had 8309 agricultural
credit societies at the end of 1974-75 covering about 53% of agriculturists
families. The total amount of deposits of these societies at the end of
1974-75 came to Rs. 5.69 crores. In addition, there were also 1524 non-
aricultural credit societies with total deposits amounting to Rs. 32.04
crores. There were also 6 State Co-operative Banks with total deposits of
Rs. 26.93 crores. There were 356 Central Co-operative Banks with total
deposits of Rs. 50.77 crores. Thus the total deposits of co-operative
institutions in the State at the end of 1974-75 came to about Rs. 115 crores.

The total loans advanced by the Primary Agricultural Credit
Societies, Non-agricultural credit societies, Central Co-operative Banks,
and State Co-operative Banks stood at Rs. 80.30 crores, Rs. 37.90
crores Rs. 53.07 crores, Rs. 121.03 crores respectively. Thus the total
loans advanced came to approximately Rs. 291 crores. Considering the
facts that the advances from higher co-operative institutions were granted to their federating units, we might place the net loans granted to agriculturists and industrial workers at Rs. 150 crores at the minimum.

From the above figures it would appear that co-operative institutions have contributed significant amount of credit, particularly to the agricultural sector, and as such, deserve a special encouragement, if the deficiency noted in the loan operations of commercial banks is to be made good. A closer look at the figures would however, shows that the funds mobilised under credits granted by co-operative institutions do not compare as favourably with other States as one might expect. The total working capital of central co-operative banks at the end of 1975-76 came to Rs. 166.97 crores for Karnataka as compared with Rs. 454.60 crores for Maharashtra. The working capital of State co-operative banks similarly came to Rs. 91.04 crores for Karnataka as compared with Rs. 324.79 crores for Maharashtra. In the case of primary agricultural credit societies, the total working capital amounted to Rs. 179.06 crores for Karnataka as compared with Rs. 360.99 crores for Maharashtra. The position of loans advanced during 1975-76 was no more encouraging. In the case of central co-operative banks the amount came to Rs. 154.54 crores for Karnataka as against Rs. 585.71 crores for Maharashtra. In the case of State Co-operative banks the amount came to Rs. 104.31 crores and Rs.
345.49 crores for Karnataka and Maharashtra respectively. In the case of primary agricultural societies, the amount came to Rs. 91.15 crores and Rs. 182.96 crores for Karnataka and Maharashtra respectively. What is more significant, the contribution of deposits to the total working funds of co-operative institutions was much less significant than the relative contribution of their borrowings. Deposits constituted less than one third of total working funds in the case of central co-operative banks (vide Appendix 'B' - Table No. 5).

3. Other Agencies:

Besides the Commercial and Co-operative Banks briefly described above, an organised money market is also characterised by the presence of several other specialised institutions which either supplement the operations of the above dominant constituents or indirectly assist them in their day to day operations. Discount houses, Acceptance houses, Post Office Savings Banks, Clearing houses, Stock Exchange, Chambers of Commerce and Trade Associations to name some of them — play a significant role in extending the boundaries of the money market. These agencies impart liquidity and elasticity in its operations and in meeting the specific needs of special categories of borrowers/savers.

So far as the Bangalore Money Market is concerned, most of these agencies do exist, but they do not operate in a satisfactory manner. There are no Discount Houses or Acceptance Houses worth the name throughout the State. The Post Office savings banks had deposits
of only Rs. 19.33 crores at the end of March 1975 (vide Appendix 'B'
Table No. 6). The State also had a central clearing house at Bangalore
with membership of 23 at the end of 1974-75, five other clearing
houses working in other regional centres. The total amount of cheques
cleared during 1975 at the central clearing house located at
Bangalore stood at Rs. 1994.16 crores as against Rs. 24,830.86 crores
for Bombay and Rs. 11,136.40 crores for Calcutta. Unless the number
of members of the central clearing house at Bangalore is increased by
granting facilities to co-operative banks and other financing agencies,
and the amount of minimum balance to be kept by the member institutions
is reduced significantly the total amount of clearings cannot be
increased (vide Table No. 8.2)

The only Stock Exchange in the State located at Bangalore with
a membership of only 25 and a nominal capital of Rs. 25,000 divided
into 250 shares of Rs. 100/- each. It has been approached by 140 companies
under its "listing" regulations for purposes of price quotations. The
inadequacy of this Stock Exchange would be evident when compared with
a total membership of 660 for Calcutta, and 504 for Bombay Stock Exchange,
with their listed securities coverage numbering 1115 and 963 respectively.
(Vide Table 9-1 in Chapter IX)

* Mysore, Mangalore, Davangere, Hubli, Shimoga.
So far as other specialised agencies are concerned, the State had 12 Chambers of Commerce, with three located in Bangalore. It had also 86 trade associations with 52 located in Bangalore*. In most cases, their membership is poor and unstable, their finances are in a state of doldrums and the operations and efficiency, for variety of reasons are at a very low level. A developed bill market is yet to come into existence.

Bangalore Money Market - An Overall Appraisal.

The foregoing portrayal of the Bangalore Money Market and its principal features clearly bring out two facts; first, its inadequacy to meet the growing demand for funds required for development of agriculture, industry and other ancillary activities, second, its operational inefficiency.

The dominant position in the market is occupied by commercial banks and, to some extent, by co-operative banks. They enjoy this position to the utter neglect of other specialised agencies which lubricate the wheels of the Money Market e.g., Stock Exchange, Bill-Market, Discount and Acceptance Houses, Chambers of Commerce and Trade Associations and Clearing Houses etc. etc. Certain priority sectors of the economy of the State have been neglected due to lack of suitable financing agencies 'tailored' to meet their specific needs. In the absence of institutional credit, the indigenous bankers, noted
for their malpractices, may be enjoying certain measure of supermacy.

So far as operational efficiency is concerned, the Bangalore money market lags far behind expectations. The Call Money Market has not developed so far. Financing through collaterals is still the most popular method adopted by the banks. "Creditworthiness" alone continues to play a significant role in the disposal of loan applications even when viable projects are put forward for consideration of advances. From the personal enquiries made with a couple of constituents we have come to know that the recommendations of the Tandon Committee have not been taken by the banks binding. There is no nexus, whatever between the bank rate on the one hand and the market rate of interest on the other. The difference between the two is fairly wide even in the organised sector of the money market. So far as the unorganised sector is concerned, interest rate variation extends over a wide range from 18% to sometimes as high as 36% per annum. To sum up, it may be brought on record that there is hardly any co-ordination between the different constituents of the money market despite the efforts of the R.B.I. to achieve integration between them.


* Vide Chapter VII.