Importance of finance in the modern industrial set up:

Finance is the process of conversion of accumulated funds to productive use. It comprises financial planning, raising the needed funds and financial analysis and control.

Industrial Finance involves an analysis of the various means of securing money for industrial enterprises and the administration of this money by individuals, voluntary associations and corporations.

Finance is the sine-qua-non of industrialisation. It procures the necessary funds for the industry. It entails a decision-making after analysing the alternative uses and sources of funds. It covers financial planning, forecasting of cash receipts and disbursements, the raising of funds, use and allocation of funds and financial control.

The finance function includes judgements about whether an industry should hold, reduce or increase investment in various assets.

Finance determines how large and how fast a company should grow; in what specific forms should it hold its assets and what should be the composition of its liabilities?

Finance functions comprise of two groups: executive finance function and incidental finance function. Executive finance function requires administrative skill in planning and execution and the incidental function covers routine work.
which is necessary to carry into effect financial decisions at the executive level.

Financial need includes decisions of marketing executives involving the carrying of inventories of finished goods and customer credit policy. It takes into consideration the carrying of inventories of raw materials and factory supplies, the purchase or renting of building, machinery and equipment. It is the prime responsibility of financial management to see that an adequate supply of cash is on hand at the proper time for smooth flow of operations of the industry. Financial manager likes to match the inflow of cash to the outflow of cash so that after providing enough cash to meet current obligations, there would be no idle cash balance earning nothing for the company. Cash inflows are not precisely predictable. They generally offset one another. The financial manager has to keep a cash balance on hand to pay his bills in time. Now, the more he protects his company against risks associated with inability to pay bills in time, the more he loses returns that might have been gained from investment of the idle cash. This is the dilemma of liquidity vs. profitability.

Problems of financing the small scale and medium size industries

Small scale industries form an integral part of Indian economic structure. It is closely related with
agriculture on one hand, and with large scale industry on the other.

A small industrial unit is defined as an undertaking engaged in manufacturing and processing whose investment of a capital nature like land, building, plant and machinery etc. does not exceed Rs. 5 lakhs. This limit has been extended up to Rs. 10 lakhs in the case of certain ancillary industries.

The problem of financing small industries cannot be studied in isolation. The problems of small industries together form a vast complex; and the various issues regarding raw material, production, quality-control, finance and marketing etc. cannot be solved separately. The problem of financing can be tackled only as a part of the whole programme.

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1. Under the Credit Guarantee Scheme of the Government of India, the definition of small industry has been revised in 1967 so as to treat any concern as small industry where investment in plant and machinery only does not exceed Rs. 7.5 lakhs.
The financial requirements of these industries can be studied under two heads:— (1) Equity Capital; and (2) Borrowed Capital. Loan capital can further be subdivided into two types: (a) long-term loans, and (b) short-term loans.

Adequacy of equity capital is the prime requisite for the proper equipment and management of small industries. It helps in increasing their earning capacity. Again, the maintenance of interest in the enterprise and intensification of efforts for improving its efficiency are sustained by the sufficiency of equity capital. Equity capital is dependent on two postulates: (i) the general atmosphere for conducting business should be favourable, and (ii) the venture capital should have a fair chance to give reasonable net profits to the investor as compensation for the risks taken by him.

Equity Capital:

Initial investment should necessarily be provided by the proprietor of the small business since a reasonable amount of venture or equity capital is always a primary condition before requesting credit. Mentioning the financial position of small industry in India, the International Team of Experts (1955) observed that in most of the workshops visited real finance did not seem to exist at all.
There was a severe lack of capital as well as credits. The small factories in traditional industries, such as the brass industry in Moradabad, the lock industry in Aligarh or the shoe industry in Agra, to a great extent rely on dealers for buying raw materials and also for marketing their products. They have little money for adopting independent business methods of their own. They are compelled to sell every day's or week's production to buy raw material in small quantities at retail price, and to work according to the order of the dealers because of shortage of capital. Their earnings are meagre and do not allow them to procure new implements or machines for more or better production. The low productivity and over-population in many small industries account for the scarcity and absence of capital.

Loan Capital:

In addition to the Equity Capital, long and short-term loans are required by small industries. Long-term loans are taken to finance the expansion and modernisation schemes or the purchase of the fixed assets while short-term loans are required for keeping the enterprise operating, for meeting current expenses, and for re-stocking and re-equipment of machines and inventory. The sound principle of finance is that the fixed assets should largely be financed by owned capital and reserves. Long-term loans
should only supplement rather than supplant the risk capital. The borrowed capital should in no case exceed 50% of the total capital requirement of enterprise. Thus a reasonable amount of owned capital is always a primary requisite before requesting credit from others. The negligence of this basic fact introduces a fundamental weakness in the financial structure of our small industries.

Need for establishing State Financial Corporations in our Country:

Industrial development of our country, depends to a large extent upon the financial resources can be made available. This industrial finance has got some of its own peculiarities. They may be stated as under:-

(1) It is generally required for long term.

(2) It is a production cost and helps to produce further capital or in other words, it is self-generating.

(3) It is provided by a third party named as entrepreneur or industrialist and not by worker or labour.

Inspite of the various financial resources available in our country, industries have to face grave difficulties in getting adequate and timely finance and often they are starved of capital. Investing public is still
averse to invest in shares and securities of joint stock enterprises. Managing Agents, at one time, were the main stream for finance. They gradually withdrew from this field on account of unhealthy atmosphere, and have, by now, been completely wiped out by the Indian Companies Act. Banks in India are carrying on simply short-term credit operation and not long-term credit finance as in Germany and Japan. Banks abroad form themselves into a constorium and freely underwrite and purchase the shares of industrial concerns and grant long-term advances. Commerce Banks are more inclined to advance to commerce rather than to industry. Central and State Governments finance to a very little extent only. Our indigenous bankers have been put to control by various manufacturing Acts. Foreign Capital is not coming freely to our country for fear of nationalisation. The result is that our industries are facing dearth of finance. Thus the problem of provision of finance comes to the forefront. Commercial Banks have built a high development credit structure in our country. They have always been prepared to accommodate industries in respect of their requirements of working capital to the extent it is possible within the limits of their commitments on deposits. It was, however, outside their normal jurisdiction to invest in long-term investment. Shroff Committee too cautioned them not to change the essential pattern of their lending operation.
The establishment of special institutions in western countries served as an object lesson for India. The two British institutions set up in 1945 attracted the greatest measure of attention. A vital absence of well-developed capital market and the dearth of issue houses and underwriting firms intensified efforts in this direction. Re-conversion of war-time to peace time basis, equipment to war shattered industrial plant and machinery, rationalisation and expansion of existing units and establishment of new industrial enterprises under the planned economy further served to motivate the idea.

The Government came to the conclusion that if provision for industrial finance is to be met consistently with the rapidly increasing pressure of demand for it, one effective way to do it was to encourage the establishment of industrial finance.
Study of various Financial Institutions, which provide finance to industries in general and small scale and medium industries in particular in U.K., U.S.A., U.S.S.R., Germany, Japan and Canada.

United Kingdom

The problem of providing special facilities to industries in U.K. for obtaining new capital was given serious consideration in the early thirties. The Macmillon Committee (1930-31) which examined in detail the problem of industrial finance, reported that there was a gap in the existing arrangements for the provision of credit owing to the absence of financial machinery specifically designed to provide:

(a) business with temporary finance in anticipation of an issue of capital and with medium term finance in connection with contracts, and

(b) smaller and medium-sized business with long-term capital, where the amounts involved would not justify or possibly permit of a public issue. The Committee recommended the creation of a special institution to fill this gap. One step towards bringing the gap had been taken in June, 1934 with the founding of Charter House Industrial Development Company. It was established with a capital of £5,00,000 by the Charter House Investment Trust in connection with the Prudential Assurance Co. and two of the big five Loyds and the Midland. The Company has played an
important part in the special sphere of industrial finance.

The recommendation of the Mac-Millan Committee was not implemented until the abnormal conditions following the termination of World War II lent new urgency to the problem. In 1945 two Corporations viz. The Industrial and Commercial Finance Corporation (ICFC) and the Finance Corporation for Industry (FCI) were established along the lines suggested by the MacMillan Committee.

**Industrial and Commercial Finance Corporation:**

The object of the Industrial and Commercial Finance Corporation is to provide finance for small and medium sized industrial units and commercial business where existing facilities provided by banking institution and the stock Exchanges are not easily or readily available. The Corporation may also extend its facilities to new enterprises whose functions and prospects are commercially sound.

**Capital Structure:**

The resources of Corporation were provided by a consortium of the Bank of England and the Joint Stock Banks of Great Britain. Of its authorised capital of 15 million pounds, the Bank of England took up £ 5 lakhs as 'token subscription' and the balance was subscribed by the clearing
(1) The amount required and the purpose for which it is required.

(2) Existing Capitalization of the business.

(3) Financial records.

(4) Prospectus.

**Business Operations:**

Quite a large variety of industries have been financed by the Corporation. Mechanical Engineering including agricultural machinery, printing and paper making machinery, textile machinery, cooking heating and ventilating machinery, have absorbed by far the largest single proportion of the total advances. Other industries assisted are agriculture, iron and steel, cement, lime, bricks, chemicals, electrical engineering, ship building, cutlery, handlooms, watches, textiles, leather, clothing, food, drink, scientific instruments etc. Transport, distribution, hotel and catering, laundering, dyeing and other services also figure as important items.

The assistance furnished by the Corporation takes the form of debentures and secured loans, unsecured loans, redeemable shares, non-redeemable preference shares, participating preference shares and ordinary shares. The particular situation of the customers is taken into account and
facilities which would just suit their cases were devised. The Corporation has frequently been asked to provide resources for new developments or new enterprises involving considerable risks, or to provide resources which constituted a substantial part of total funds. In such cases the Corporation prefers to stipulate for some part of the equity either in ordinary shares or by way of participation attaching to the preference shares.

By the end of first accounting period (20th July, 1945 to 30th September, 1946) the Corporation had called up £1.5 million of its £15 million capital and also begun to call up the loan facilities which the share-holder banks had undertaken to provide. An analysis of the assistance provided by the Corporation upto March, 1954 shows that debentures and secured loans have accounted for the largest proportion varying from 34 to 40 percent of the total. Preference share accounted for 27 to 37 percent. The importance of unsecured loans has been diminished in recent years from 31 percent in the beginning to 21 percent. The investments in ordinary share rose to 8% in 1950 to 10% in 1954. The Corporation has, briefly, sanctioned two-thirds of assistance in the shape of subscription to shares. The outstanding advances and investment covered British Government Securities of £1,01,000 Debentures and secured loans £57,91,000, Redeemable participating preference shares £53,35,000, Non-redeemable participating preference shares
of £ 3,19,600, Ordinary shares £ 27,41,000.

The financial results of the Corporation showed a loss of £ 3,41,200 during the first four years of its operation. In the subsequent five years of its working, it made profits which enabled the Corporation to declare a dividend of 4% which was slipped up to 5% in the sixth and seventh year. By the year ending March 1955, the net profits of the Corporation after tax was £ 7,18,550.

It has over 600 customers by the year ending 1958 and it has established branches in Birmingham, Leeds, Manchester and Edinburgh.

The Corporation's customers are principally private companies of small and medium size, engaged for the most part in industry. Here again the Corporation deals essentially with the developing sector of industry with companies which are expanding, and to a certain extent with new concerns.

In its lending policy, it has been guided by the directions given to the Capital Issued Committee by the Chancellor of the Exchequer from time to time and the priorities laid down by the Govt. Departments. Its rates have been modelled on these prevailing in the capital market with a preference for the low rather than for the high side of the market.
Comments and Criticism:

It is said that the Corporation may become the 'dustbin' into which all the undesirable business will be dumped. But Lord Piercy claims that fears are unreal as it is not the Corporation's policy to carry financial lame-ducks but help-ducks that can serve.

The Corporation has further been accused of adopting an unduly conservative policy. "It has outbanked the bankers", so runs the slogan. But the institution is unjust not only to the Corporation but to the bankers as well. The fact is combined with prudence and a maximum of usefulness according to its lights, the object being to increase the accessibility of permanent or quasi-permanent capital to eligible borrowers.

Again, there can be no question of competition between the Corporation and the banks. The relationship is rather one of co-operation. This co-operation will be in the interest of the customers as well as of the Corporation and of the banks themselves. Applications for assistance have followed steadily. These will increase with increasing tempo of re-stocking, re-conversion and restoration of physical equipment. It seems certain that there will be a lasting demand for the facilities provided by the Corporation.
Finance Corporation for Industry Ltd.:

The large British institution is the outcome of a more ambitious and potentially more significant idea. "The purpose of the FCI Ltd." in the words of Sir John Anderson, "is the provision of temporary and longer period finance for industrial businesses of the country with a view to their quick rehabilitation after war and development in the national interest, thereby assisting in the maintenance and increase of employment."

As Industrial and Commercial Finance Corporation is concerned with small and medium sized industries, the FCI's main interest is in large scale industries. The types of business envisaged are those which show prospects of financial success but cannot be immediately financed through normal channels e.g. the banks or by capital issue.

Capital Structure:

The Finance Corporation for Industry Ltd. is wholly owned by Consortium of Insurance Companies, Trust Companies and the Bank of England in proportions of 40%, 30% and 30% respectively. The Authorised Capital amounts to £25 million, divided into 25,000,000 shares of £10 each, the Issued and Called up Capital being only 2% or £50,000,000. The object of retaining a large reserve of
uncalled Capital was two-fold: first, to enable the Corporation to work at fine rates; and secondly, to afford a very good cover for the borrowings from the Banks by which the business of the Corporation will be chiefly financed. The bulk of its resources are provided by the exercise of its borrowing powers amounting to four times the amount of capital i.e. of £100 million. This would be chiefly provided by deposits from clearing Scottish Banks. It will not itself accept any deposits from public.

Methods of Finance:

As in the case of ICFC, the peculiar needs of every customer have determined the form in which the accommodation is provided. The final decision rests with the Board of Directors except in those cases which clearly fall outside the purview of the Corporation. Negotiations are conducted with applicant company through correspondence or by interviews with their representatives. An important consideration for the Board is that whether the project seeking assistance would contribute towards the objective of the Corporation through modernisation, expansion or development of the industry concerned. If the Board is satisfied on this point and there are reasons to believe that there are prospects
of financial sources, the money is provided on terms as little burdensome as possible during the development period. When the advance is made, the permanent capital structure of the company is taken into consideration and the security received by the Corporation has often attached to it conversion rights into Preference Shares, Redeemable or Irredeemable, and even Ordinary Shares.

Working:

The FCI made a disappointingly slow start. Though partly due to difficulties of initial organisation at some experimental stage, it was mainly attributable to the slow progress of reconversion in a large variety of industries the repercussion of the Government's nationalization programme. The spectre of uncertainty must have held back from it a great deal of prospective business.

The slow start cannot, however, be regarded as any real guide to the Corporation's future. During the subsequent accounting periods the business of the Corporation had steadily increased. In the Balance Sheet as at March, 1947, the Corporation's Investments (at cost) stood £ 18,62,351 which was made up of Debentures and Secured Loans £ 12,13,600, Unsecured Loans £ 5,25,250,
Redeemable Preference Shares £ 95,917, and Ordinary Shares £ 27,584.

On 31st March, 1948, the Investments stood at £ 47,37,801, made up of Debentures and Secured Loans at cost, less written off £ 24,89,350; Unsecured Loans at cost £ 21,25,000; Redeemable Preference Shares at cost £ 95,917; Ordinary Shares at cost £ 27,534. The investments of the Corporation representing the cost of loans and participations amounts written off have steadily risen from £ 10.9 million to 32.7 millions in 1950 and 54.5 millions in 1951. In 1952 there was a slight decline, the amount being £ 52.8 millions.

The total loans and participations and forward commitments made by the Corporation showed a steady rise since its inception in 1945 and stood at £ 77.2 million at the end of March, 1964. Out of this sum 76.3% related to investments by way of loans and participations and 23.7% to forward undertaking to participate or to make further loans. As at the end of 31st March, 1958, the enterprises assisted by the FCI are concerned with a variety of products e.g. steel, oil, chemicals, shipping, diesel engines and the electrical components.

The object of the Finance Corporation for Industry has been to assist in the creation of new
enterprises and the expansion and modernisation of existing ones which will contribute to the advancement of the national economy by providing finance when it cannot be obtained through the ordinary channels. In carrying out this task the Board of Directors has interpreted its charter in the widest manner and has not even hesitated to provide finance required for projects whose activities are not conducted within the United Kingdom.

**Comments and Criticism:**

An impression that the Corporation will be competitive with existing sources for the provision of capital will be wholly erroneous. As in the case of ICFC, it is merely intended to supplement and not replace the existing channels through which industrial finance is procured. In fact, there have been several instances where the Directors have declined business on the ground that in their view the applicants should attempt to find the money through the usual channels. The Corporation will particularly operate when the circumstances make normal banking accommodation inappropriate, or where the amount required or the extent and character of the necessary enquiries put the operation for a time outside the scope of a normal capital Issue Market.

According to the Chairman of the Corporation, its
activities to-date have justified the view that it was necessary to provide a mechanism for mobilising the credit resources in order to finance schemes of Post-War modernisation and re-equipment which could not be handled appropriately through the normal financial channels. The recent working of Corporation confirms the view that it is destined to provide an essential element in the financial structure of the country's economy.

Indeed it can look forward to play quite a useful part in the rehabilitation and maintenance of British Industry. Industrial development has taken place throughout the world. As a result of these developments, the markets for Britain are likely to be considerably reduced. To replace these markets, British Industry will have to keep ahead of its rivals in specialisation, modernisation, utilisation of science and in the application of modern technique. All this will call for an adequate and continuous flow of new capital. It is in the provision of this capital, that the FCI can play a valuable part.

**Commonwealth Development Finance Company:**

This company was established early in 1953. Its purpose is to finance non-governmental development schemes
in the British Commonwealth. The Authorised and Issued Capital of this Company is £ 10 million, which is held by the Bank of England and by 91 industrial, mining, shipping and banking companies and firms; £ 4.2 million of the Capital has been paid up. The Company is empowered to borrow up to twice its issued capital.

During its first year of operation it invested about £ 5 million mostly in secured debentures in three major enterprises; Electricity Generation and Cellulose Pulp Production in the Union of South Africa and Natural Gas Development in Pakistan. In the second year it financed six undertakings in six different countries viz. India, Pakistan, Canada, Newzealand, South Africa, Rhodesia and Nyasaland. Investments made during the financial year 1954-55 totalled £ 4.3 million and net profit for this year was £ 25,016 compared with £ 8,424 in 1953-54. At the end of March 1958, the Company had entered into commitments totalling £ 14.6 million.

United States of America

The Reconstruction Finance Corporation:

During the World War I, federal funds were advanced to business by an agency called the War Finance Corporation. The lending powers of this Corporation were
used to Bolster banks in distress after the War. In 1929, the Corporation was liquidated. On January 22, 1932, Congress authorised formation of a Corporation as an agency of the Federal Government and modelled on the lines of the War Finance Corporation to provide financial aid to banks, rail roads and other business suffering from the effects of the drastic decline in business, then under way. The new agency was named the Reconstruction Finance Corporation. The life of this Corporation was originally limited to five years. The renewal of the charter has been seriously challenged from time to time, particularly in 1948 and again in 1951.

**Capital Structure:**

At the outset the RFC received capital of 500 million Dollars from the Government and was authorised to borrow upto 1.5 billion dollars. Subsequently, the borrowing authority was increased. In 1947, the limit on borrowing was placed at 14.1 billion dollars for general purposes and 10 billion dollars for certain specific purposes, and restricted amounts were named for certain other specific purposes designed by Congress. The Government's investment in the Corporation was reduced to 325 million dollars in 1948. The huge capacity of this
agency to acquire and lend money has had great influence, absolutely and psychologically, on the business in this country.

**Powers of the Corporation:**

The best description of the powers of the RFC is contained in the legislation:

"To aid in financing agriculture, commerce, and industry, to help in maintaining the economic stability of the country and to assist in promoting maximum employment and production, the Corporation within the limitations hereinafter provided, is authorised:

1. To buy obligations of or lend to any business.

2. To lend to any financial institution.

3. To buy securities of or lend to any government or agency to facilitate a project.

4. To lend not more than 35 million dollars in event of flood or catastrophe.

No financial assistance shall be extended unless the financial assistance applied for is not otherwise available on reasonable terms. All securities and obligations purchased and all loans made shall be of
such sound value and so secured as reasonably to assure retirement on repayment and such loans may be made directly or in co-operation with banks or other lending institutions through agreements or participate or by purchase of participation or otherwise."

**Business Operations:**

The RFC has furnished capital, served as a rediscount agency, and provided a market for debit instruments of many other federal agencies, such as federal forms and home credit agencies.

The RFC was a temporary institution intended to be liquidated upon the fulfilment of specific purpose. It was to cease its operation with the passage of financial crisis. But World War II created a pressing need for its services. A number of subsidiaries were formed under this Company like Defence Plants Corporation, Rubber Reserve Company, Metal Reserve Company and War Damage Corporation, in order to expedite the production and distribution of goods for military purposes. From 1932 to December, 1945, just after the close of World War II, the RFC and its subsidiaries disbursed 34584 million dollars in loans, purchase of securities, construction of defence plants, purchase of strategic materials,
production of synthetic rubber, payment of subsidies and for other purposes.

Advances to rail roads, to other industries and to financial institutions have been large, although at present they are relatively small. The losses incurred upto March 31, 1947 amounted to 23 million dollar or 0.2% of the total funds advanced. The problem of its liquidation resumed its importance in the subsequent years after the World War II. But it is still continuing and is performing very significant services to the small business. It has supported a number of state and Municipal Development Projects.

As on 30th June, 1950, the consolidated assets of RFC amounted to 2,103 million dollars and it had surplus and reserves of 264 million dollars. It reported income after the provision for losses amounted to 27 million dollars for the financial year ended June 30, 1950, and during the same year it approved 5506 loans for 593.6 million dollars. The RFC also provides working capital to these concerns which cannot obtain credit by usual sources and on acceptable terms.

**Criticism**

Criticism of the operations of RFC led to hearings
before Senate Committee in 1957. Testimony indicated that political pressures and favouritism influenced lending operations of the agency. Some critics urged the abolition of the RFC. More moderate critics recommended substitution of a one man administrator in lieu of a board on the theory under a single operating hand responsibility is more easily placed and favouritism should be minimised. The latter action was taken.

**Development Credit Corporation:**

Corporation is being entertained from banks, insurance companies and other business organisations in these states and with some individuals in establishing and financing the state-wide institution known as Development Credit Corporation or Business Development Credit Corporation.

It would be too early to warrant any judgement against the usefulness of these agencies keeping in mind the brief history of their existence. The first of the development corporations was formed in May, 1949 and similar institutions are in active operation in New Hopshire, Rhode Island, Massachusteetts and Connecticut. The principal object before the formation of such corporations is to fill a financial gap that seems to have
been created in past, at least by heavy taxation. In recent years, a high and steeply progressive tax rates on individual incomes, combined by Capital Gains Tax have tended to dry up the traditional sources of outside Capital for small business.

The Development Corporation endeavours to meet this problem by applying the time-honoured investment principle of diversification of risk, which is achieved by polling many small contributions into a substantial funds, which is then distributed among a number of borrowers. The Credit Corporations raise their funds by issuing Stocks and borrowing from member institutions, which are not necessarily stock-holders and are drawn from business community.

U.S.S.R.

The Soviet Union possesses a developed, modern socialist credit system. All its institutions belong to the state, i.e. they are the property of the people as a whole. It is used, together with other economic levers, to strengthen and develop the socialist economy and to raise the living and cultural standards of the people. The modern Soviet credit system is based on a planned and rapidly advancing socialist economy and therefore operates according to plan. The credit system is a state
monopoly. The structure and activities of the credit system are determined and guided by state plans. The main form of credit in the Soviet Union is bank credit.

Short-term bank credit to enterprises and organisations enables them to maintain circulating assets necessary for the uninterrupted production and sale of products, and the successful fulfilment of production targets. Such credit accelerates the circulation of the assets of enterprises and makes for their economical and rational use. It also helps to extend cost accounting principles and to develop and strengthen the economic ties of industry and agriculture. By granting long-term credits to construction and agricultural co-operatives the state and renders them considerable financial help.

The credit system is at present operated by the U.S.S.R. State Bank (Gosbank), the Bank of Foreign Trade (Vneshtorgbank), the All-Union Bank for Capital Investments (Stroibank), the state savings banks subordinated to the State Bank, and the state pawn-shops.

The U.S.S.R. State Bank is the only centre for the issue of currency. It provides credit to all fields of the national economy. It issues currency and regulates money circulation in the country; grants short-term and partly long-term loans; accumulates the temporarily
idle money resources and funds of enterprises and institutions; organises and effects transfer payments for goods, other material values and services; affects transactions to provide cash for enterprises, economic organisations and institutions; and exercises financial control over the economic and financial activities of enterprises and organisations. All enterprises, organisations and institutions in the Soviet Union keep their money in their special and current accounts at the branches of the State Bank. When an enterprise has to pay a debt to another enterprise the Bank is authorised to debit the account of the debtor-enterprise and to credit the account of the creditor-enterprise.

The State Bank issues cash to enterprises, organisations and institutions to enable them to pay wages, to pay out pensions and to pay for business trips and various administrative and overhead expenses. It exercises financial control over the economic and financial activities of enterprises and organisations. It checks that loans issued to them are properly secured and used for designated purposes. It sees to it that enterprises use their own and borrowed funds correctly and controls the expenditure of the wage fund, the fulfilment of the profits plan, and of contracts. The Bank is also obliged to see that the enterprises carry out their financial,
credit, cash and payments transactions in accordance with established procedures.

For Capital Investments, there is Stroibank. It is the All-Union Bank. It finances capital investments in all branches of the national economy, except agriculture. It issues short-term credits to building contractors and building projects and long-term credits to enterprises of the local industry and municipal enterprises to finance the production of consumer goods and to set up various welfare enterprises. It marshals the monetary resources of enterprises and organisations for planned capital investments, and also of other resources used for the short-term crediting of contractors and building projects, and financial control of the progress made in construction and in the lowering of costs.

In its capital investments, Stroibank is guided by the "Rules for the Financing of Construction" endorsed by the U.S.S.R. Government. It checks the designs and estimates of projects, sees that the resources earmarked for capital investments are spent for designated purposes, controls the expenditure of the wage fund by the organisations, enterprises and projects financed or credited by it, checks that they observe the established quotas for overhead and administrative expenses, and that the funds of enterprises and organisations earmarked for the financing
of capital investments are paid into the bank in time and in full.

Stroibank applies a differentiated approach in its financing and crediting transactions. Projects and building contractors who fulfil their plans for the construction and commissioning of productive capacities and fixed assets, are granted privileges by the bank. Conversely, the bank imposes fines for defaults, demands clearance ahead of time, refuses further finance etc., to projects and organisations which do not fulfil plans and targets.

Stroibank has a statutory fund, a reserve fund, a fund of fixed assets and a depreciation fund. The statutory fund is used for the crediting of enterprises and building projects, and the reserve fund to cover possible losses connected with the bank's transactions.

There are Stroibank offices in every republic, region and territory. In regions where large-scale building is carried out Stroibank sets up a department, or else has a representative at the branch of the State Bank. At present, it finances the building of various amenities, and communal and industrial projects.

At present Soviet State enterprises receive from the U.S.S.R. State Bank short-term credits for the purchase
of seasonal stocks of raw and other materials, fuel, semi-finished and finished products and for other temporary needs arising in connection with the over-fulfilment of plans or with other money shortages arising through no fault of enterprises, for the introduction of new equipment, and for the organisation and expansion of consumer goods production.

Enterprises receive credits for the purchase of seasonal stocks and stocks of material values over and on seasonal expenditure above the quotas envisaged in the plan if this expenditure cannot be covered by their own established circulating assets.

In issuing loans the State Bank takes care not to allow the spending of money on goods of low quality, or on excessive or unnecessary materials, it also takes care not to issue credits on stocks of goods produced in excess of plan targets and not easily marketed.

When issuing credits to enterprises the State Bank checks that they are secured by inventories. It checks that the value of the inventories is correctly shown in the books, and that they are properly stored. This is done to prevent enterprises from using credits to cover losses.
Loans for temporary needs are a form of financial help extended to enterprises when they experience temporary financial difficulties in fulfilling production and goods turnover plans. The need for such credit arises in connection with the irregular receipt by enterprises of materials necessary to expand production or to improve the quality of products. Sometimes, an enterprise needs such credit because a superior body changes the quarterly or monthly production plan, or because suppliers have shipped to the enterprise inventories against funds allocated for the next quarter. Enterprises are entitled to credit if their stocks of goods in process exceed the quota because of delays in the delivery of planned co-operated supplies.

In recent years an ever greater number of enterprises, especially heavy industry enterprises, are using a specific kind of credit, which has become known as credit on the turnover of material values. Under that scheme the State Bank supplements the enterprise's own circulating assets. Thus, both the enterprise's own funds and the bank's resources go to pay for the material values acquired under the scheme. The State Bank participates in the payment for the material values and production costs to the extent of 40 to 50 percent.

Should the enterprise accumulate sums in excess
of payments it has to make under this scheme, these sums are deposited in a special account in the State Bank. The money in it is used by the bank for the issue of short-term loans. No interest is charged for this type of credit.

When the bank grants credits on the turnover it pays all the bills of suppliers and twice monthly adjusts accounts with the enterprise.

Study of various financial institutions which provide finance to industries in general and small scale and medium industries in particular in U.K., U.S.A., U.S.S.R., Germany, Japan and Canada.

The German System:

In Germany the chief characteristic system of banking is its close connection with industry. In the first place this connection arises out of the current account maintained by an industrial firm with its bank. It is different from the current account opened by our businessmen with their bankers in this country. In the ordinary current account relationship the customer is sometimes in debt to the bank and sometimes has a balance to his credit. Many claims thus arise on both sides.
which are not settled individually but are settled periodically, usually every six months. On the other hand, the current account advances were used by the average German firm not only for the purpose of providing itself with working capital but also for supplying block capital for extension in anticipation of recourse to the investment market. The Industrial Current Account was the pivot of all transactions between banks and industry, promotion and issue transactions, direct participation in industrial undertakings and cooperation in management through boards of supervisors.

The second important point was in respect of promoting companies and supplying them the necessary capital. As soon as the plans for the formation of a new company had been prepared and approved by a bank, a 'Consortium' was formed. It was a sort of temporary association of banks and private persons. The promoters were the members of the Consortium. They took over the entire capital of the company. Later on it was placed on the market. Whenever industrial companies wished to procure new capital, whether from existing shareholders or by issue of new shares or debentures in the general market, they arranged the transaction with the bank with which it was in permanent banking relations. Thus the banks played
the part of the middlemen only. They held the securities only for a short period of time. It was not their general policy to have lasting participation in industrial undertakings.

In the third place, they had banks' representatives on the Board of Supervisors of the industrial undertaking. This board came in between the Executive and the general meeting of shareholders. It exercised considerable influence over both. It was not the same thing as the British Board of Directors. It was a Board of Supervision and not of Direction.

This intimate relationship between banks and industry was a historical necessity. About the middle of the nineteenth century, Germany sponsored schemes of industrialisation in competition with Britain. There was scarcity of capital. In order to assist national industry German banks had to undertake granting long term loans and promotion of joint-stock companies. Again the capital that was available, was generally misdirected. Those who had the necessary funds were neither willing nor fitted to become progressive entrepreneurs themselves, nor would they entrust their money to others who had the required qualities. Thus there was need of an agency which could win the confidence of the investing classes and direct the capital towards sound industrial undertakings. The banks
filled this gap in Germany.

German banks were, of course, fully aware of the dangers of locking up short-term advances. They knew well the dangers of extensive and permanent participation in the concerns which they brought into existence. Their function was not so much to call great branches of industry into existence through large-scale participation on their own account as to induce the capitalists of the country, by the authority of their recommendations, to apply idle capital to undertakings which, properly planned according to real needs and equipped with expert management offered prospects of reasonable profits. It was in accordance with the responsiveness of the capital market that they assisted in the promotion of new undertakings or in the conversion of private into public limited companies. If the public was not willing to supply the industrial company with the required capital, banks did not take the place of the public and would not themselves furnish the industrial company what the investing public was not prepared to provide. The banks never desired to hold their securities in their own hands. German credit banks never tried to have lasting participation in industrial enterprises.

Again, the German banks had adopted the method of
self-balancing each line of activity. The short-term deposits were used for short-term credits. Long-term loans were based on such resources as could safely be locked up for long periods. The capital and reserve resources of the bank usually covered the total of liquid assets. Sometimes a certain amount of 'locking up' of depositors' funds became necessary. The risks, at such times, were mitigated either by diversifying their interests or by maintaining secret reserves. These banks had vast resources, large reserves and elaborate and methodical organisation. It gave them power and strength.

The German banking system came to a crisis during the depression of nineteen-thirties. It was modified substantially in subsequent years. As a matter of fact, this system completely broke down as a result of the crisis of 1931. A Commission of Investigation was set up in 1934. The German Credit Act of December, 1934 was passed as a result of its investigations. Under this Act, banks were called upon to maintain a fairly high standard of liquidity. They were asked to limit their holdings of real estate and speculative investments. Permanent participation and investment in property and buildings were not to exceed the capital and reserves of the credit institution concerned. In 1948, a programme
of currency and credit reform was carried out to suit the requirements of post-war industrial reconstruction. Accordingly, the Bank Deut Scher Laendar acquired extensive regulating powers over all banks. Two specialised institutions KFW and IKB were founded in 1948 and 1949 respectively. They were meant to provide long term industrial finance. Thus the idea of German banking is only of theoretical importance to India.

The Japanese System:

The French Credit Mobilier was famous during the nineteenth century as a special institution to provide industrial finance. It attracted attention of all those countries which aimed at rapid industrialisation. Japan was one of those countries which adopted this method of financing industries. The first Industrial Bank in Japan was founded in 1902. Prince Matsukata enunciated the principle that district groups of banks should be established to fulfil different functions. After establishing a Central Bank and an exchange bank, he started banking institutions to facilitate the grant of long-term loans to industry and agriculture. Hypothetic Bank for agricultural credit and the Industrial Bank for industrial finance were started. Japanese Industrial Bank served as a model
of specialised bank to finance industry. In India, there was industrial awakening during the inter-war period. She was influenced by the industrial finance system of Japan. Indian Industrial Commission of 1916 was impressed very much by the Japanese method. It popularised the idea of forming an 'industrial bank' in India on the model of the Japanese institution. The witnesses, who appeared before the Banking Enquiry Committees, Central as well as Provincial, were very much inspired by it. It was also favoured by many of the Indian economists and publicists.

The Industrial Bank of Japan was established with a Government subsidy under Government Control. It was chartered for 50 years and the charter was to be renewed at the option of the Government. The Government guaranteed a 5% return on the shares of the bank for the first five years, provided the amount of the subsidy did not exceed 5% of the paid-up capital. It was under the direct superintendence of the Finance Minister. He appointed a Controller to supervise the business and management of the Bank.

The Bank has been formed on the lines of a Joint Stock Company. The President as well as the Vice-President of the Bank are appointed by the Government from among the shareholders who possess more than 200 shares in the Bank.
Their term of office is five years. The appointment of Directors is made by the Government from among the members holding more than 100 shares in the Bank and elected in the general meeting of shareholders. Their tenure of office is three years.

The business of this Bank is to make loans on the security of national bonds, municipal loan bonds or debentures and shares of companies; to subscribe for and under-write national loan bonds, prefectural and municipal loan bonds or debentures of companies; to receive deposits of money on fixed, current or special account and undertake the custody of goods entrusted to it for safe keeping; to undertake trust business relating to secured debentures; to discount bills; to buy and sell clean and documentary bills of exchange; to make loans on mortgage of estates created by virtue of special laws; to make loans on mortgages of land and buildings belonging to factories; to make loans on mortgages of ships including those under construction; to make loans on the security of ship-building materials or equipments; to float national loan bonds, prefectural and municipal bonds and companies' shares and debentures and to receive payment for the same; to make loans on mortgages of lands and buildings in cities and towns designated by Imperial Ordinances, and
to subscribe for or accept shares of companies.

Thus it is a mixed banking institution. It has got a considerable amount of issue and mortgage business. It combines the functions of an issue-house as well as that of a mortgage bank. It is a monetary institution for industry but it cannot be characterised as a pure industrial bank in the sense that it is interested exclusively in industrial issue or mortgage business. As a matter of fact, in addition to its industrial business it frequently floats and underwrites Government and Municipal loan bonds. Besides, it also undertakes commercial banking business such as the discounting of bills and the receiving of deposits.

On a careful examination of the Japanese System, it was found that such a bank would not be suitable for India as the conditions here differ from those in Japan. The loans granted by the Bank are not truly long-term ones and there is no statutory provision for amortisation, except for ship mortgage loans. Such an institution would not be of great use in India to supply long-term industrial finance. Again a mixture of various kinds of banking functions was not considered desirable. Thus the Japanese system was not thought to be of great service in India.
Industrial Development Bank of Canada:

Industrial Development Bank of Canada (IDBC) was established on November 1, 1944 to supplement the operations of the existing institutions in providing intermediate and long-term credit for small or medium sized business units. Its purpose is to extend financial assistance to sound industrial concerns which are unable to obtain their requirements from other sources on reasonable terms and conditions. It intends to supplement rather than to compete with activities of Chartered Banks and other lending organisations and to operate chiefly in the medium and long-term field. The enterprises engaged in manufacturing, processing or refrigeration of any goods or the building of the ships or in the generation or distribution of electricity are eligible for assistance. In June, 1952, the Act was amended to take Commercial Air Transport Service eligible for loans from the banks.

The Bank has got an Authorised Capital of 25 million dollars and it has been empowered under the Act to issue debentures upto three times its paid up capital plus Reserve.
Under the section 25 (a) of the Act, any not currently required for business purposes have been invested in Securities of the Government of Canada. At present the entire issue of debentures amounting to about 8 million dollars is held by the Bank of Canada.

Circumstances prevail in deciding the method of extending financial aid by the Industrial Development Bank. In the great majority of cases, the Bank may lend directly, guarantee loans made by other institutions, and underwrite the issue of the securities. There are two limitations on the lending authority of the Bank. Firstly, the magnitude of its loans etc. outstanding should not exceed four times the aggregate of paid up capital and reserve fund. Secondly, in interest of small enterprises, it has been laid down that the total amount made available in individual amounts of more than 20 million dollars should not be more than 50 million dollars. It is always the matter of principle with the Bank to decide the method to be adopted but usually every effort is made to arrange finances suitable to the needs and interest of the borrower.

The Industrial Development Bank normally provides funds for financing fixed capital assets only, though
occasionally it has been supplemented the borrower's working capital. The length of term of loans depends on the Bank's estimate of prospects in the industry as a whole and on its judgement of the applying firm's situation. There is no limitation on the period of loans which Bank may make. The repayments of principal or interest are purposely made flexible and may be arranged on a monthly, quarterly, semi-annual or annual basis. The Bank is empowered to take any kind or form of security.

In the course of its ten years working 3,175 formal applications were received from eligible borrowers of which 1,323 were allowed, 983 were declined and 869 were withdrawn. In addition, 410 fresh applications were received from existing borrowers for financial assistance in further expansion, 86 percent of which were allowed. The total amount disbursed stood at 87 million dollars of which 46 million dollars have been repaid. Further loans granted by Chartered Banks have also been guaranteed though there has been no underwriting of issues so far. More than half of the credits granted by Bank were for the amounts of less than 50,000 dollars. The losses have been very low, the write-offs amounted to only 18,000 dollars on total disbursements of 87 million dollars.
It must be emphasised that an institution like IDB has to operate in a field where risks are greater and where operating costs are relatively high to the retained volume of business. In the ensuing years there will still be many problems of industrial finance of the kind that this Bank has been designated to tackle and the evidence indicates that it would continue to provide a useful service.