Karnataka State Open University
Manasagangothri, Mysore - 570 006

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ಮಾನಸಗಂಗೋತ್ರಿ, ಮೈಸೂರು - ೫೭೦ ೦೦೬

COURSE:5 **M.A.(PREVIOUS)**

MONEY-BANKING AND FINANCIAL MARKETS

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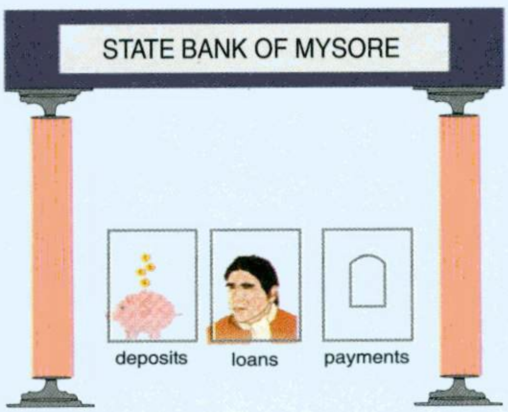

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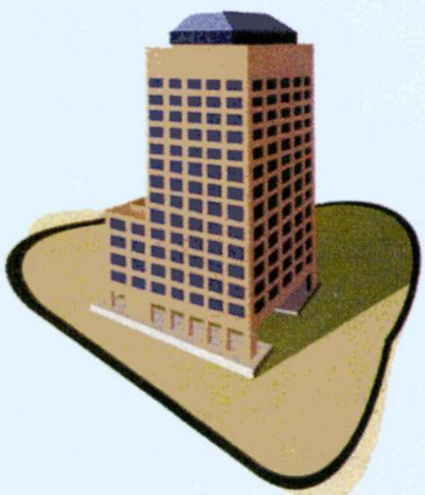
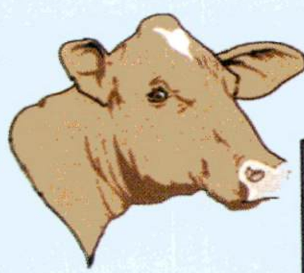


SHARE MARKET
BOMBAY



SHARE MARKET

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Economics
Course 5

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7

Introduction

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COURSE V BLOCK VII

BLOCK INTRODUCTION

Block VII comprises Units 28, 29 and 30. You will be introduced to the following in those three units:

Unit	28	Indian commercial banking system. You will also be introduced to State Bank of India and the Reserve Bank of India.
Unit	29	Development Banking in India. You will know some important development banking institutions of the country.
Unit	30	Similar to unit 29 here the emphasis is on some important investment institutions.

UNIT 28 COMMERCIAL BANKING

Structure

28.0 OBJECTIVES

At the end of this unit you should be familiar with the

- evolution of commercial banking in India
- the significance of social control over commercial banks
- the subsequent nationalization and progress and
- the main features of SBI and RBI

28.1 INTRODUCTION

It hardly needs any special emphasis to say how important commercial banks to our daily living. All of us-whether individuals as householders, businessmen and traders or as industrialist-depend on them in some way or the other. The significance of banking system (meaning commercial banking system) has greatly expanded after Independence and more so after the Nationalization of 14 top commercial banks in 1969.

The introduction of Economic Reforms in 1991 included financial sector reforms as well. One of the elements of this is the reform of the banking sector also. Therefore it is only in fitness of things that we take a close look at this sector to assess the various dimensions of its development. In what follows, you will be introduced, first to the nature and evolution of commercial banking in India. The second part examines two specific institutions, namely the State Bank of India and the Reserve Bank of India.

28.2 EVOLUTION OF COMMERCIAL BANKING IN INDIA

The origin of modern banking in India dates back to 1770 when the first joint stock bank, named the Hindustan Bank was started by the English agency house of Alexander and co., in Calcutta. The bank was however, wound up in 1932.

Modern joint stock commercial banking in India started during the beginning of the 19^{th} century. The earliest commercial banks were known as Agency Houses and they were started by the employees of the East India Company. They were established mainly to cater to the needs of the colonial economy. The bank offices were confined to the port cities of Bombay, Calcutta and Madras. The Agency Houses were mainly trading concerns and they combined banking with trading functions. Several banks were established on unlimited liability basis, mainly by the English Agency Houses. Most of them failed during the crisis of 1829-33 due to speculation and mismanagement.

In 1860 an Act was passed permitting the establishment of banks on limited liability basis. Soon afterwards came the American Civil War which caused a boom in India's cotton trade with England. Banks speculated heavily and participated in the cotton trade on a fairly large scale. All of them failed in a short time and this destroyed the confidence of the public in the stability of banks.

From 1865 till the end of the 19th century, the creation of joint stock banks was very slow. A few banks were started during the last quarter of the 19th century such as the Allahabad Bank, the Oudh Commercial Bank and the Punjab National Bank.

The Swadeshi movement of 1906 gave a stimulus to the starting of Indian banks. During the period 1906 to 1913, several banking institutions came into existence. A number of small banks were established during this period. Some of the present nationalized banks like Bank of India, Indian Bank, Bank of Baroda and Central Bank of India were established only during this period.

The boom in bank opening was followed by a banking crisis during 1913-17. As many as 87 banks failed and their failure completely shattered the public confidence in joint stock banks. There was a brief respite in bank failures during 1918-1921. The latter part of the First World War gave an impetus for the starting of banks. But again from 1928, the number of failures increased mainly due to economic depression. Between 1922-1932 as many as 373 bank failures were recorded. During 1937-48, 620 more banks failed. Most of the failures were in respect of small banking institutions. Thus the development of joint stock banks in India has been characterised by a crop of bank failures.

The Central Banking Enquiry Committee (1929) traced the following major causes of bank failures in India.

1. Insufficient paid up capital and reserves
2. Poor liquidity of assets
3. Combination of non-banking activities with banking
4. Irrational credit policy causing reckless and injudicious advances
5. Favouritism by the directors and their vested interests
6. Incompetent and inexperienced directors
7. Mismanagement
8. Dishonest management
9. Creation of long term loans on the basis of short term deposits
10. Indulgence in speculative investments
11. Ignorance if the people about banking business
12. Lack of coordination among joint stock banks
13. Absence of a Central bank for overall supervision and control
14. Lack of suitable banking legislation for regulation of banks

The shattered public confidence in banks may be accounted for the failure of many Indian commercial banks over time.

Another event of bank failure took place in 1946-47 with the crash of the A.B.C Bank, the Exchange Bank of India and Africa and the Nath Bank.

Eventually at the time of independence India inherited an extremely weak banking structure with urban-orientation comprising 544 small non-scheduled banks and 96 scheduled banks, giving bulk finance to the trading sector. Further, only a few of them possessed an all India character, while most of them had limited geographical coverage in their business.

Post independence period

After independence the Govt of India launched economic planning in 1951. It has since then seen drastic transformation through several important developments/reforms and policy measures.

One of the important developments refers to liquidation and amalgamation of banks. Due to this, the number of scheduled banks declined from 92 in 1951 to 73 by end of June 1969 and that of non-Scheduled banks from 474 to 16 in the same period. [scheduled banks are those that are included in the Second Schedule of RBI Act 1934. Consequently, the banks that are excluded from this category are called non-scheduled banks. As per the RBI Act 1934 a commercial bank to qualify for inclusion in the Second Schedule must satisfy the following conditions:

1. It must have a minimum paid-up capital and total reserves of Rs.5 lakh
2. It must be a company as defined in Sec.3 of Indian Companies Act 1956 or a corporation or a company incorporated by or under any law in any place outside India, or an institution notified by Central Govt in this behalf, or a state cooperative bank.
3. It must also satisfy the Reserve Bank of India that its affairs are not being conducted in a way detrimental to the interest of its depositors]

A more detailed analysis with regard to social control and nationalization of commercial banks in India is presented in the following few sections. Suffice it is to say at this juncture that after the Economic Reforms initiated in 1991, private sector banks and foreign banks have entered the commercial banking system in a big way.

28.3 SOCIAL CONTROL

Though after independence commercial banking expanded its operations significantly, yet it was pointed out that bulk of bank advances was directed to large and medium sized industries, where agriculture is the main occupation of the people. Changes in the structure and functioning of commercial banking were considered necessary and one of the measures introduced by the Govt is the introduction of 'Social Control' which ultimately resulted in the nationalization of 14 top commercial banks in 1969.

The scheme of social control over banks was initiated by the Govt in December 1967 by amending the Banking Laws (Amendment) Act 1968 which came into force on 1st Feb 1969. The main features of this enactment were

- Not less than 51% of the total number of members of the board were persons having special knowledge or practical experience in the fields of economics, law, cooperation, agricultural and rural economy, banking, finance, small scale industry etc.
- Every bank was to have a whole time chairman who is not an industrialist but is a professional banker and has special knowledge and practical experience of banking, financial, economics or business administration.
- The RBI was vested with the powers of appointment, removal or termination of the services of not only the chairman, but also any director, the chief executive officer or employee of a bank, when circumstances require.
- The banks were prohibited from making loans to their directors or concerns in which their directors were interested.
- Provision was included in the Act for the nationalization of any bank even without resorting to legislation.

28.4 NATIONALISATION OF COMMERCIAL BANKS

Nationalization or state take-over of a private enterprise is no more an issue as far as commercial banks in India is concerned. It is nearly 34 years that 14 top commercial banks were nationalized on July 19, 1969 followed by nationalization of another six on April 15, 1980. As such there are 20 nationalised banks in the public sector since 1980. The scheme of social control over commercial banks hardly lasted six months. Since the issue of nationalization of commercial banks at present is only of historical relevance, only a few arguments both in favour and against are presented here.

28.4.1 Arguments for Nationalisation

The following arguments were put forth in favour of nationalization:

1. Banks profits would become revenue to the Govt which can be used to finance the five year plans.
2. Nationalisation would promote and safeguard the interest of depositors.
3. Concentration of economic power and the creation of industrial or business monopolies can be avoided.

4. Bank credit can be deployed to productive purposes instead of speculative ventures.
5. Misuse of bank funds for the benefit of directors of banks can be avoided.
6. A judicious allocation of bank finance and evolving a credit policy that is relevant to Indian economic development can be made a reality.
7. The banking sector could diversify its lending for the benefits of priority sector like small farmer and small scale industrialists.
8. Bank branches in rural areas can be expanded.
9. The RBI can implement its monetary policy more effectively.
10. Profit motive can be replaced by service motive.
11. Commercial banks can act as public utilities.

28.4.2 Arguments Against Nationalisation

The following are the main arguments against nationalization:

1. The assumption of Govt earning huge revenues is not borne by facts.
2. Private banks were involved in malpractice is not true.
3. Creation of industrial monopolies is due to the economic especially industrial policy of the Govt and not due to the operation of private banks.
4. Board of Directors of banks have vast powers to use funds as per their discretion is far from true.
5. Banks could finance only those ventures which were profitable.

28.4.3 Progress of Nationalised Banks

A banking revolution occurred in the country during the post nationalization era. The commercial banks, especially public sector banks, have drastically changed from their traditional money dealing business to innovative banking and subserved their operations to the needs of nation building activities and socio-economic upliftment of the Indian masses. It is rightly said that Indian banking has changed from class-banking to mass-banking or social-banking. Look at some of these:

1. The total number of commercial bank branches in the country was 8262 at the time of nationalization which went up to 66,239 by June 2002. This means there has been an increase of 57,977 bank branches between 30.6.69 and 30.6.02
2. The number of rural branches was 32,459 or 49% of all bank branches.
3. The priority sector advances which accounted for 14.6% of all advances, reached 43.7% of

total advances (Priority sector includes the following: Agriculture, small scale industries, setting up of industrial estate, small road and water transport operators, retail trade, small business, professional and self-employed persons, education, consumption loans, state sponsored corporations/organisations for on-lending to other priority sector, state sponsored organisation for SC/ST for purchase and supply of inputs and marketing of inputs, housing loans, advances to self-help groups, advances to software industries, advances to food and agro-processing sector, investment in venture capital and a half of funds provided to RRBs. Please see Economic Survey 2002-03 P.S-57)

28.5 STATE BANK OF INDIA

Hitherto you were initiated to the banking system in general with special reference to the social control and nationalsation of commercial banks. New a very special type of commercial bank is being introduced to you. It is the State Bank of India or SBI for short.

The SBI, the biggest commercial bank was formed on 1st July 1955 with the passing of the SBI Act 1955 by taking over the assets and liabilities of the Imperial Bank of India.

28.5.1 Organisation and Management

At present the State Bank Group consists of the SBI and its seven subsidiaries namely, the State Bank of Bikaner and Jaipur, the State Bank of Indore, the State Bank of Hyderabad, the State Bank of Mysore, the State Bank of Partiala, the State Bank of Saurashtra and the State Bank of Travancore. These subsidiaries are now described as "Associate Banks"

The SBI has an authorised capital of Rs.20 crore and an issued capital of Rs.5.6 crore. Over 92% its shares are held by the RBI.

The SBI however holds 100% share capital of the State Banks of Hyderabad, Patiala and Saurashtra. In the case of other associate banks, the SBI owns between 58-93% of their share capital. The SBI thus, resembles a 'holding company'. But the State Bank and its associate banks in practice work like members of a group. Indian economists therefore describe it as the SBI Group. Each associate bank possesses full autonomy in its routine business and only general policies are laid down by the SBI Management. The SBI is managed by the Central Board of Directors in accordance with the SBI Act.

The Central Board of Directors of the SBI consists of:

1. A Chairman and a Vice-chairman both of whom are appointed by the Govt of India in consultation with the RBI. Their term of office, not exceeding five years is fixed by

the Govt.

2. Two Managing Directors appointed by the Central Board of Directors with the approval of Govt of India.

3. Six Directors to be elected in the prescribed manner by the shareholders other than the RBI.

4. Eight Directors to be nominated by the Govt of India in consultation with the RBI to represent territorial and economic interests in such a manner that not less than two of them have special knowledge of the working of the cooperative institutions and of rural economy and the others have experience in commerce, industry, banking and finance.

5. One Director to be nominated by the Central Govt and

6. One Director to be nominated by the RBI.

Besides the Central Board, there are local boards at Kolkata, Mumbai, Chennai, New Delhi, Kanpur, Hyderabad, Ahmedabad, Bhopal and Patna. Each local board consists of the members of the Central Board residing in its area and directors not exceeding four elected by shareholders whose names appear in the branch register. To keep the management free from politics, the Act stipulates that no member of the Central or State Legislatures shall be appointed as Director of the State Bank.

28.5.2 Functions

Section 33 of the SBI Act stipulates the functions of the Bank. The major functions may be summarized as follows.

1. **Agent of the RBI:** The SBI acts as an agent of the RBI at all places in the country where there are no branches of the Banking Dept of the Reserve Bank. At such places instead of the RBI it pays, collects and remits money, bullion, securities on behalf of the Govt and also transacts other business entrusted to it by the RBI.
2. **Advancing and lending:** The SBI advances and lends money and open cash credits against the security of (a) stocks, funds, other securities (except immovable property) in which a trustee is authorised to invest trust money; (b) debentures or other securities issued by or on behalf of a district board, muncipal board, other local board or committee, under the authority of law; (c) debentures of companies with limited liability; (d) hypothecation of goods to the State Bank; (e) Bills of exchanges and pro-notes etc.
3. **Dealings in bills of exchange:** The SBI undertakes the business of drawing, accepting, discounting, buying and selling of bills of exchange and other negotiable securities.

4. **<u>Investment:</u>** The investing of the funds of the bank in any specified securities and the conversion of the same into money.
5. **<u>Remittances:</u>** The issuing of demand drafts, telegraphic transfers and other remittances.
6. **<u>Deposits:</u>** Receiving of deposits and keeping cash accounts.
7. **<u>Dealings in gold/silver:</u>** The buying and selling of gold and silver.
8. **<u>Underwriting:</u>** The underwriting of the issues of any stocks, shares, debentures etc.
9. **<u>Agent of cooperative banks:</u>** Acting as agent of any registered cooperative bank.
10. **<u>Agent of the Govt:</u>** Acting as agent of the Central and any State Govt in implementing any scheme for financing the construction of dwelling houses.
11. **<u>Borrowing:</u>** The borrowing of money for the purposes of business of the State Bank.
12. **<u>Administration of estates:</u>** The administration of estates for any purpose as an executor, trustee or otherwise.
13. **<u>Liquidator and consolidator of the banking system:</u>** The Banking Regulation Act has authorised the SBI to act as the liquidator of a banking company in the event of its winding up by acquiring its assets and liabilities, if such an application is made by the RBI. In this way, it helps in consolidating and strengthening the banking system.
14. **<u>Dealing in foreign exchange:</u>** The SBI serves as a major authorised dealer of foreign exchange in the country. It also finances the foreign trade of the country.

Above all with the passing of the State Bank Laws (Amendment) Act, 1973 the SBI renders all normal banking functions an par with the other commercial banks of the country.

28.5.3 Progress

The Govt of India prescribes the general policy for the course of banking activity of the SBI, but it does not interfere in its day-to-day functioning. The remarkable progress made by this institution can be ganged by the following facts:

(i) The number of branches of SBI and Associates, which was a more 2462 in June 1969, has gone upto 13,454 by the end of June 2002 of these 41% are rural branches.

(ii) SBI is in the forefront of financing, both directly and indirectly, to the cooperative institutions of the country. It indirectly helps primary agricultural societies by providing short term assistance to State and Central Cooperative banks against govt securities at a concessional rate of interest. It also finances Central Land Development Banks which is a primary of source of long term funding to farmers.

(iii) The SBI with its country wide network has been providing cheap and quick remittance facilities to State and Central Cooperative Banks.

(iv) It has been financing warehousing and agricultural marketing activity.

(v) It has been providing direct finances to agriculturists as well.

(vi) It has been an important source of finance to small scale industries in the country.

28.6 THE RESERVE BANK OF INDIA

The RBI is the apex financial institution of the country's monetary system. The RBI, as India's Central bank, was established on 1.4.1935 under the RBI Act 1934. Originally the Reserve Bank was constituted as a shareholders bank based on the model of a leading foreign Central bank of those days. The bank's fully paid up share capital was Rs.5 crore divided into shares of Rs.100 each. This has remained unchanged even today.

However realizing the need for a close integration of the monetary and credit policies of the Bank and the macro-economic policies of the Govt the notion of state ownership was raised and justified from time to time. After Independence, the Govt of India took the decision to nationalize this institution. The Reserve Bank(Transfer to Public Ownership) Act, 1948 was passed and the Govt took over the RBI from private shareholders by paying adequate compensation to them. On 1.1.1949 the RBI started functioning as a state-owned central banking institution.

28.6.1 Organisation

The RBI is a corporate body. The Ministry of Finance, however, owns the Bank by directive right. The Bank has special powers and obligations for serving the national interest.

As per the RBI Act the organisational structure of the Bank comprises (i) Central Board and (ii) Local Boards.

Central Board: The Central Board of Directors is the leading governing body of the Bank. It is entrusted with the responsibility of general superintendence and direction of the affairs and business of the Reserve Bank.

The Central Board of Directors consist of 20 members as follows:

(i) One Governor and not more than 4 Deputy Governors appointed by the Central Govt.

(ii) Four Directors nominated by the Central Govt, one from each of the Local Boards.

(iii) Ten Directors nominated by the Central Govt. They are experts from the fields of business, industry, finance and cooperation.

(iv) One govt official (the Secretary, Ministry of Finance) is usually nominated by the Central Govt.

The Governor is the Chairman of the Central Board. The Central Board of Directors exercises all the powers of the Bank. The Central Board should meet at least six times in each year and least once in three months.

Local Boards: The RBI is divided into four regions-the Western, the Eastern, the Northern and the Southern areas. For each of these regions, there is a Local Board with headquarters at Mumbai, Kolkata, New Delhi and Chennai.

Each Local Board consists of 5 members appointed by the Central Govt for 4 years. They represent territorial and economic interests of cooperative and indigenous banks in their respective areas.

The Local Boards carryout the functions of advising the Central Board of Directors on such matters of local importance as may be generally or specifically referred to them or performing such duties which may be assigned to them. Generally a Local Board deals with the management of regional commercial transactions.

The Central Office of the Bank is located at Mumbai. At present the Central Office comprises 18 departments. The Bank has local head offices and branches at several places for its two major departments, namely, the Issue and the Banking Departments. In places where there is no office of the Reserve Bank, the SBI Group represents it as agents/sub-agents.

28.6.2 Functions

The functions of the RBI may be generally classified into two types: (i) Traditional functions and (ii) Developmental functions. A brief summary of these two is provided below.

(i) **Traditional functions:** As a Central Bank it performs the following functions which are typical of all central banks.

(a) **Currency authority:** The RBI has the sole right to issue currency notes, except one rupee which is issued by the Ministry of Finance. The RBI follows the minimum reserve system in the note issue. Initially it used to keep 40% of gold reserves in its total assets. But, since 1957, it has to maintain only Rs.200 crore of gold and foreign exchange reserves of which gold reserves should be of the value of Rs.115 crore. As such India has adopted the "managed paper currency standard".

The Bank has established 14 offices of the Issue Department for the discharge of its currency functions. The currency requirements are met by the Bank through currency chests. Currency chests are maintained by the Bank with the branches of the SBI group, Government Treasuries and sub-treasuries and public sector banks.

(b) **Banker to Government:** As banker to Government the RBI provides the following:

- Maintaining and operating of deposit accounts of the Central and State Governments.
- Receipts and collection of payments to the Central and State Governments
- Making payments on behalf of the Central and State Governments.
- Transfer of funds and remittance facilities to the Central and State Governments.
- Managing the public debt and issue of new loans and treasury bills of the Central Governments.
- Providing ways and means advances to the Central and State Governments to bridge the interval between expenditure and flow of receipts of revenue. Such advances are to be repaid by the Government within threee months from the date of borrowing.
- Advising the Central and State Governments on financial matters such as the quantum, timing and terms of issue of new loans. For ensuring the success of Government loan operations, the RBI plays an active role in the gilt edged market.
- The Bank also tenders advice to the Government on policies concerning banking and financial issues, planning as well as resource mobilization. The Government of India consults the Bank on certain aspects of formulation of the country's Five Year Plans, such as financing pattern, mobilization of resources, institutional arrangements regarding banking and credit matters. The Government also seeks Bank's advice on policies regarding international finance, foreign trade and foreign exchange of the country.
- The Bank represents the Government of India as a member of the IMF and World Bank.

(c) **Bankers' Bank and Supervisor:** The RBI serves as a banker to the scheduled commercial banks in India. All the scheduled commercial banks keep their accounts with the Reserve Bank. As per the amendment made in 1962 to the Banking Companies Act of 1949, 3% of the total liabilities should be kept as reserve requirement.

The RBI serves as a clearing agent for commercial banks. It provides clearing and remittance facilities to the scheduled commercial banks at centers where it has offices or branches.

The RBI also serves as a lender of last resort by rediscounting eligible bills of exchange of commercial banks during the period of credit stringency. The Bank can however, deny rediscounting facility to any bank without assigning any reason therefor.

Apart from being the bankers' bank, the Reserve Bank is also entrusted with the responsibility of supervision of commercial banks. In this capacity, it performs the following functions:

i) Licensing of banks
ii) Approval of capital reserves and assets of banks
iii) Branch licensing policy
iv) Inspection of banks
v) Audit
vi) Control over management and methods of operation
vii) Control over amalgamation and liquidation
viii) Deposit insurance
ix) Training and banking education

(d) Exchange Management and Control

Under section 40 of the RBI Act, it is obligatory for the Bank to maintain the external value of the Rupee.

The RBI is the custodian of the country's foreign exchange reserves. It has authority to enter into foreign exchange transactions both on its own and on behalf of the Government. It is obligatory for the Bank to sell and buy currencies of all the member countries of the IMF to ensure smooth and orderly exchange arrangements and to provide a stable system of exchange rates.

(e) Controller of Credit:

In line with all central banks throughout the world, the RBI also is entrusted with the responsibility of implementing monetary policy by regulating credit availability. You are aware how there are both quantitative and qualitative controls. The quantitative controls include the bank rate policy, the open market operations and the variable reserve ratio. The qualitative controls include selective credit control and moral suasion. Please refer to a standard text to know the mechanism of operation of these methods.

(f) **Collection of data and publications**:

The RBI collects statistical data and economic information through its research departments. It compiles data on the working of commercial and cooperative banks on balance of payments, company and govt finances, security markets, price trends, and credit measures.

Some important publications of RBI are:

- RBI Bulletin (monthly) and its weekly statistical supplements.
- Report on the Trend and Progress of Banking in India
- Report on Currency Finance.
- Banking Statistics
- Statistical Tables relating to Banks in India.
- Banking and Monetary Statistics of India and its supplements.

(ii) **Developmental and Promotional Functions:**

The functions of the RBI are multidimensional. The Bank performs a number of developmental and promotional functions. Apart from credit regulation, the Reserve Bank effectively channelises credit, especially to priority sectors, such as agriculture, export, transport operations and small-scale industries. It makes institutional arrangements for rural and industrial finance. For instance, special agricultural credit cells have been set up by the Bank. The Industrial Development Bank if India has been set up to solve the allied problems of industries.

The Bank also assists the Govt in economic planning. The Bank's credit planning is devised and coordinated with the 5 year plans of the country.

The RBI in order to improve the Indian money market introduced two Bill Market Schemes in 1952 and 1971.

The Bank has also established the Discount and Finance House of India in 1988.

In order to provide security to depositors with the Bank and thereby promoting the growth of banking in the country, the RBI took initiative to set up the Deposit Insurance Corporation of India in 1962.

The RBI has also assisted the emergence and growth of development banking and other term-lending institutions such as the Unit Trust of India.

The RBI appoints adhoc committees/expert groups, from time to time, to enquire into specific money/banking problems and make recommendations to solve them.

28.7 LET US SUM UP

- The significance of banking in India hardly needs any emphasis and since the nationalization of commercial banks, several fundamental changes have occurred in the banking structure of the country.
- The origins of modern banking in India can be traced back to 1770 when the Hindustan Bank was started by the English agency house of Alexander and Co., in Calcutta.
- The earliest commercial banks were known as Agency Houses.
- Banking failures were a common feature during the early period
- At the time of Independence an extremely weak banking system was inherited.
- Liquidation and amalgamation of banks was an important feature of post-independence banking development in the country.
- Social control ovre commercial banks was introduced to alter the lending policy of these banks. But this policy did not last long.
- Nationalization of 14 top commercial banks was first effected on 19th July 1969 followed by another 6 in 1980.
- Since nationalization the structure and character of commercial banks have changed.
- State Bank of India was earlier known as the Imperial Bank of India.
- SBI group at present consists of SBI and seven subsidiaries.
- It performs a number of functions including these as agent of RBI
- It has been playing a significant role in rural finance as well.
- RBI is the Central Bank of our country.
- It was originally a shareholders bank which was nationalized in 1948.
- It performs not only the traditional functions associated with a central bank but also promotional/developmental and supervisory functions.

28.8 FOR FURTHER READING

(i) Please refer to the Home Pages of both SBI and RBI to keep abreast of latest development

(ii) Mithani.D.M: the Anatomy of Indian Banking

(iii) RBI: Functions and Working of the Reserve Bank of India

(iv) Vasudevam S.V : Theory of Banking

2.5 REVIEW QUESTIONS

1) Briefly trace the growth of commercial banking in India.
2) How far the goals of nationalization have been achieved?
3) Explain the main functions of State Bank of India.
4) "Reserve Bank of India is not only a traditional central bank but also is a development promoting institution". Examine this statement.

UNIT 29 DEVELOPMENT BANKING IN INDIA

Structure

29.0 OBJECTIVES

At the end of this unit you should be able to

- Know in brief the evolution of development banking in India;
- Some important development banking institutions and their progress.

29.1 INTRODUCTION

The concept of development banking is basically a post independence period phenomenon as far as India is concerned. In the Western Countries, however development banking had a long period of evolution. The origin of development banks may be traced to the establishment of 'Societe Generale Pour Favouriser 1 'Industrie Nationele' in Belgium in 1822. But the notable institution was the 'Credit Mobiliser' of France, established in 1852 which acted as an industrial financier.

In 1920, Japan established the Industrial Bank of Japan to cater to the financial needs of its industrial development. In the post war period, the Industrial Development Bank of Canada (1944), the Finance Corporation for Industry Ltd., and the Industrial and Commercial Finance Corporation Ltd., of England (1945) etc., were established as modern development banks to provide term loans to industry. In 1966 the U.K Government set up the Industrial Re-organization Corporation.

A global financial institution, the World Bank or the International Bank for Reconstruction and Development (IBRD) was established in 1945. In most countries development banks were started during the post war period. Thus, development banking is essentially a post war phenomenon.

In India, the first development bank called the Industrial Finance Corporation of India was established in 1948.

Definition of a Development Bank: There is no precise definition of development bank. William Diamond and Shirley Bosky consider industrial finance and development corporations as 'development banks'. Fundamentally a development bank is term lending institution.

Development bank is essentially a multi-purpose financial institution with a broad development outlook. A development bank may thus, be defined as a financial institution concerned with providing all types of financial assistance (medium as well as long term) to business units and promotional activities-economic development in general and industrial development in particular.

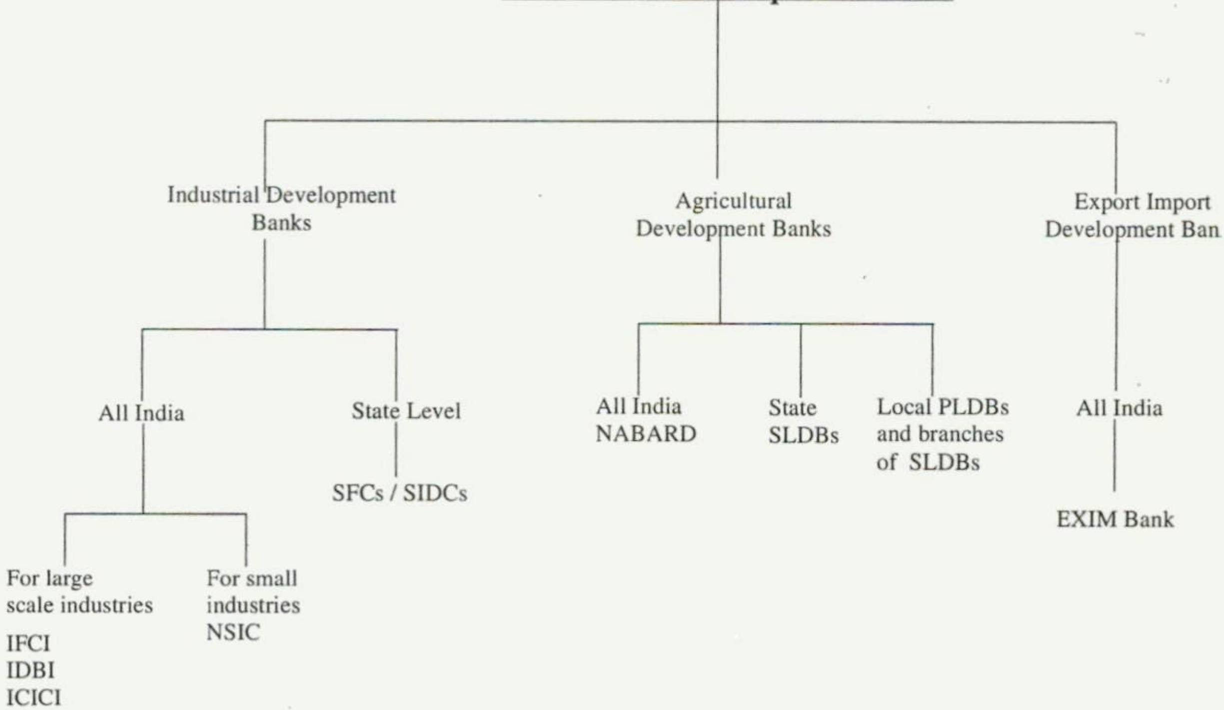
The main characteristics or the main features of a development bank are -

- It is a specialized financial institution.
- It provides medium and long-term finance to business units.

- Unlike commercial banks, it does not accept deposits from the public.
- It is a multi-purpose financial institution.
- It is essentially a development-oriented bank
- It provides financial assistance to not only the private sector but also public sector.
- It aims at promoting the saving and investment habit in the community.
- It does not compete with normal channels of finance. It is a gap-filler.
- Its motive is to serve public interest rather them to earn profits.

The Indian Development Banks: At present, India is well-served by a network of development banks both at the national and state levels. The following chart gives an idea about the structure of development banks in India.

Structure of Development Banks



In what follows, you will be introduced to a few of these development banks of the country.

29.2 THE INDUSTRIAL FINANCE CORPORATION OF INDIA LTD (IFCI Ltd)

At the time of Independence in 1947, India's capital market was relatively under developed. Although there was a significant demand for new capital there was a dearth of providers. Merchant bankers and underwriting firms were almost non-existe1nt. And commercial banks were not equipped to provide long-term industrial finance in any significant manner.

It is against this backdrop that the government established the Industrial Finance Corporation of India (IFCI) on July 1, 1948 as the first Development Financial Institution in the country to later to the long-term finance needs of the industrial sector. The newly established DFI was provided access to low-cost funds through the central banks statutory liquidity Ratio or SLR which in turn enabled it to provide loans and advances to corporate borrowers at concessional rates.

Liberalisation-conversion into Company, 1993: This arrangement continued until the early 1990s when it was recognised that there was need for greater flexibility to respond to the changing financial system. It was also felt that IFCI should directly access the capital markets for its funds needs. It is with this objective that the constitution of IFCI was changed in 1993 from a statutory corporation to a company under the Indian Companies Act 1956. Subsequently the name of the company was also changed to "IFCI Limited" with effect from 1999.

Focus: IFCI has fulfilled its original mandate as a DFI by providing long-term financial support to all segments of Indian industry. It has also been chiefly instrumental in translating the Govt's development priorities into reality until the establishment of ICICI in 1956 and IDBI in 1964, IFCI remained solely responsible for implementation of the govt's industrial policy initiatives. Its contribution to the modernization of Indian industry, export promotion, import substitution, entrepreneurship development, pollution control, energy conservation and generation of both direct and indirect employment is noteworthy. Some sectors that have directly benefited from IFCIs disbursal include-

- Consumer goods industry (textiles, paper, sugar)
- Service industries (Hotels, hospitals)
- Basic industries (iron and steel, fertilizers, basic chemicals, cement)
- Capital and intermediate goods industries (electronics, synthetic fibers, synthetic plastics, miscellaneous chemicals) and
- Infrastructure (power generation, telecom services)

IFCI's Economic Contribution: IFCI's economic contribution can be measured from the following:

1. Cumulatively, IFCI has sanctioned financial assistance of Rs.452 billion to 4,871 projects and disbursed Rs.440 billion since inception.
2. In the process, IFCI has catalyzed investments worth Rs.2,585 billion in the industrial and infrastructure sectors.
3. The direct employment generated as a result of its financial assistance is estimated at almost 1 million persons.
4. IFCI has played a pivotal role in the regional dispersal of industry – 47% of IFCI's assistance has gone to 2,172 units located in backward areas.

5. IFCI's contribution to exchequer by way of taxes has been substantial.
6. IFCI has played a key role in the development of cooperatives in the sugar and textile sectors, besides acting as a nodal agency in both sectors.
7. IFCI has promoted Technical Consultancy Organisations (TCOs) primarily in less developed to states to provide necessary services to the promoters of small and medium-sized industries in collaboration with other banks and institutions.
8. IFCI has also provided assistance to self-employed youth and women entrepreneurs under its Benevolent Reserve Fund (BRF).
9. IFCI has founded and developed prominent institutions like
   - Management Development Institute (MDI) for management training and development.
   - ICRA for credit assessment rating.
   - Tourism Finance Corporation of India for promotion of the hotel and tourism industry.
   - Institute of Labour Development (ILD) for rehabilitation and training of displaced and retrenched labour force.
   - Rashtriya Gramin Vikas Nidhi (RGVN) for promoting, supporting and developing voluntary agencies engaged in uplifting rural and urban poor in east and northeast India.
10. IFCI along with other institutions, has also promoted-
    - Stock Holding Corporation of India Ltd., (SHCIL)
    - Discount and Finance House of India Ltd., (DFHI)
    - National Stock Exchange (NSE)
    - Over the Counter Exchange of India (OTCEI)
    - Securities Trading Corporation of India (STCI)
    - LIC Housing Finance Ltd.,
    - GIC Grih Vitta Ltd., and
    - Bio-tech Consortium Ltd (BCL)
11. IFCI has also set up Chairs in reputed educational/management institutions and universities.

29.3 NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT (NABARD)

An important development banking institution in the field of agriculture is the National Bank for Agriculture and Rural Development, NABARD for short. The following sequence of events indicate the background for setting up of this institution.

- The RBI, established in 1935, has, among other things, a mandate to establish a

iv. Undertakes monitoring and evaluation of projects refinanced by it.

NABARD's refinance is available to State Cooperative Agriculture and Rural Development Banks (SCARDB'S) State Cooperative Banks (SCBs), Regional Rural Banks (RRBs), Commercial Banks and other financial institutions approved by RBI. While the ultimate beneficiaries of investment credit can be individuals, partnership concerns, companies, state owned corporations or cooperative societies, production credit is generally given to individuals.

OFFICES: NABARD operates throughout the country through its 28 Regional Offices and Sub-offices, located in the capitals of States/Union territories. It has 336 district offices across the country, one sub-office at Port Blair and one special cell in Srinagar. It also has six training establishments.

PROGRESS: The following are the highlights of this institution during 2002-03

(1) Credit Operations

Short Term Credit Limits:

(a) For SCBs, RRBs – seasonal agricultural operations Rs.7,926.88 Cr.

(b) For RRBs – other than seasonal agricultural operations Rs.153.42 Cr.

(c) For SCBs – financing weavers cooperative societies Rs.550.93 Cr.

(d) Credit limits aggregating Rs.493.47 Cr were sanctioned to 5 SCBs for conversion of short term loans into medium term loans on account of damage to crops due to natural calamities.

(e) Long term loans sanctioned to 12 state govts for contribution to the share capital of cooperative credit institutions aggregated Rs.60.55Cr

(f) Investment refinance to commercial banks SCARDBs, RRBs and SCBs and other eligible institutions Rs.7418.71 Cr.

(2) Kisan Credit Card Scheme (KCC):

The KCC scheme was introduced in 1998-99 as an innovative scheme to facilitate access to short term credit by farmers. In order to educate the card holders to use the cash credit facility more optimally and efficiently the NABARD has formulated a model scheme to channelise its financial support out of its Cooperative Development Fund (CDF) by way of one time grant to all SCBs and DCCBs. The scheme for personal insurance cover for accidental death or permanent disability announced in 2002-03 budget for the KCC holders (upto maximum amount of Rs.50,000 and Rs.25,000 respectively) has been operationalised by a number of banks. During 2002-03, 76.10 lakh cards were issued by cooperative banks, RRBs and commercial banks. Since inception in 1998-99, 3.13 Crore cards have been issued.

special Agriculture Credit Department (ACD) with expert staff.

- The ACD initiated different measures to develop a healthy rural credit structure and provided guidance to State Governments and cooperative credit structure.
- Agricultural Refinance Corporation (ARC) was established in 1963 to support investment credit needs for agricultural development.
- Consequent to undertaking development and promotional functions, ARC was renamed as Agricultural Refinance and Development Corporation (ARDC) in 1972.
- RBI at the instance of Govt of India appointed a committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) in 1979 (Sri B.Sivaraman Committee)
- The CRAFICARD reviewed the need for integrating short term, medium term and long term agriculture credit structure.
- The CRAFICARD recommended the establishment of National Bank for Agriculture and Rural Development (NABARD)
- National Bank for Agriculture and Rural Development Act 1981 was passed by the Indian Parliament and NABARD was established on 12th July 1982 with an initial capital of Rs.100 crore. The capital is enhanced to Rs.2000Cr subscribed by Govt of India (Rs.550 Cr) and RBI (1450Cr).

Objectives: NABARD is established as a development Bank, in terms of the Preamble of the Act, " for promoting and regulating credit and other facilities for the promotion and development of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing of prosperity of rural areas and for matters connected therewith and incidental to".

Functions:

i. Serves as an apex financing agency for institutions providing investment and production credit for promoting the various developmental activities in rural areas.

ii. Takes measures towards institution building for improving absorptive capacity of the credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, training of personnel etc.

iii. Coordinates the rural financing activities of all institutions engaged in developmental work at the field level and maintains liaison with Govt of India, State Governments, RBI and other national level institutions concerned with policy formulation and

(3) Rural Infrastructure Development Fund (RIDF):

The RIDF, the contribution to which received by NABARD from scheduled commercial banks against their shortfall in priority sector agricultural lending during the preceding year has a cumulative corpus of Rs.28,500 Cr. At present under tranches I to VIII total sanctions and disbursements under various tranches of RIDF amounted to Rs.29,475.50 Cr and Rs.17145.08 Cr respectively at the end of March 2003.

(4) **Self-help Groups (SHGs):**

The concept of SHGs promoted by NABARD for financing the poor by formal institutions and the non-formal institutions, made a beginning in 1991-92 by linking SHGs with the formal credit agencies. This is the largest micro-credit programme in the world. Cumulatively, till 31st March 2003, 7.17 lakh SHGs were provided bank loan aggregating Rs.2048.70 Cr and benefiting an estimated 78 lakh poor households.

(5) **Financial highlights:**

- Total assets of Rs.50,885 Cr of which owned funds were Rs.21,469 Cr.
- Net profit before tax stood at Rs.1,524 Cr.
- A high capital adequacy ratio of 39.05% at against a minimum of 9% stipulated by RBI.
- Non performing assets (NPA) as low as 0.0017% of advances as on 31.3.2003.

29.4 THE INDUSTRIAL DEVELOPMENT BANK OF INDIA (IDBI)

The IDBI was established on July 1st, 1964 as a wholly-owned subsidiary of the RBI under an Act of the Parliament. In view of the manifold increase in its activities and diverse responsibilitie's the ownership of IDBI was transferred to Govt of India in Feb 1976 and it was made the principal financial institution for coordinating the activities of institutions engaged in financing, promotion or development of industry in the country as also for providing credit and other facilities for the development of industry.

The evolution of this development bank can be assessed if we look at the following chronological events:

July 1964: Set up under an Act of Parliament as a wholly owned subsidiary of RBI.

Feb 1976: Ownership transferred to Govt of India. Designated Principal Financial Institution for coordinating the working of institutions at national and state levels engaged in financing, promoting and developing industry.

March 1982: International Finance Division of IDBI transferred to Expert-Import Bank of India, established as a wholly owned corporation of Govt of India, under an Act of Parliament.

April 1990: Set up the small Industries Development Bank of India (SIDBI) under SIDBI Act as a wholly-owned subsidiary to cater to specific needs of small scale sector. In terms of an amendment to SIDBI Act in Sept 2000, IDBI divested 51% of its share holding in SIDBI in favour of banks and other institutions.

Jan 1992: Accessed domestic retail debt market for the first time with innovative Deep Discount Bonds.

Dec 1993: Set up IDBI Capital Market Services Ltd., as a wholly owned subsidiary to offer a broad range of financial services.

Sept 1994: Set up IDBI Ltd., in association with SIDBI as a private sector commercial bank subsidiary, a sequel to RBI's policy of opening up domestic banking sector to private participation as part of overall financial sector reforms.

Oct 1994: The IDBI Act amended to permit public ownership upto 49%

JULY 1995: Made Initial Public Offer of Equity and raised over Rs.2,000 Crore thereby reducing Govt share to 72.14%.

March 2000: Entered into a joint venture agreement with Principal Financial Group, USA, for participation in equity and management of IDBI Investment Management Co., Ltd., previously a 100% subsidiary.

March 2000: Set up IDBI Intech Ltd., as a wholly-owned subsidiary to undertake IT-related activities.

August 2000: Became the first All-India Financial institution to obtain ISO 9003: 1994 certification for its treasury operations. Also became the first organization in Indian financial sector to obtain ISO 9001:2000 certification for its forex services.

March 2001: Set up IDBI Trusteeship Services Ltd., to provide technology-driven information and professional services to subscribers and issuers of debentures.

2002: Associated with select banks/institutions in setting up Asset Reconstruction Company (India) Ltd., which will be involved with the strategic management of non-performing and stressed assets of financial institutions and banks.

2003: The Industrial Bank (Transfer of Undertaking and Repeal) Bill 2002 to repeal IDBI Act 1964 is under consideration of parliament. The Bill is aimed at bringing IDBI under the companies Act of investing it with the requisite operational flexibility to undertake banking business.

FUNCTIONS OF THE BANK:

Chapter 4 Business of the Development Bank of the IDBI Act lays down the following functions.

1. It shall function as the principal financial institution for coordinating the working of institution in financing, promoting or developing industry and assisting the development of such institutions.
2. It has to carry out the following kinds of business:
    (a) Granting loans and advances to IFCI, any SFC by way of refinance of any loans or advances which are repayable within a period of 25 years.

(b) Any schedule bank or cooperative bank by way of refinance repayable within a period not exceeding 15 years.

(c) Export finance to any scheduled bank or state cooperative bank or industrial finance corporation repayable between 12 and 15 years.

(d) Accepting, discounting or rediscounting bills of exchange and promissory notes made, drawn, accepted or endorsed by industrial concerns selling capital goods manufactured by one industrial concern to another industrial concern.

(e) Subscribing to or purchasing stocks, shares, bonds or debentures of the Indian Finance Corporation or any other financial institution, whether within or outside India which may be approved by the Board in this behalf.

(f) Granting lines of credit or loans and advances to the IFC or any SFC or any other financial institution which may be approved by the Board.

(g) Granting of loans and advances to any industrial concern or under writing the issue of stocks, shares, bonds or debentures of any industrial concern.

(h) Granting of loans and advances to any person exporting products of industrial concerns.

(i) Guaranteeing deferred payments.

(j) Guaranteeing loans raised by industrial concerns, scheduled banks or state cooperative banks.

(k) Providing consultancy services in or outside India.

(l) Undertaking research and surveys in connection with the development of industry.

(m) Providing technical, legal, marketing and administrative assistance.

(n) Planning, promoting and developing industries to fill up gaps in the industrial structure in India.

(o) Acting as agent of Central Govt and RBI.

(p) Issue and sell bonds and debentures with or without the guarantee of the Central Govt and borrow money from the RBI.

PROGRESS: The IDBI has played a pioneering role particularly in the pre-reform era (1964-1991) in catalyzing broad-based industrial development in the country in keeping with its development banking character. IDBI's activities were not confined merely to long term project lending to industry, instead, these covered a host of services undertaken in pursuit of broader development goals aligned to Govt of India's varied socio-economic objectives in the field of industry. The latter included balanced industrial development through development of backward areas, modernisation of specific industries, employment creation, identification and encouragement to new entrepreneurs.

A number of financial sector reforms undertaken by Govt since 1992 aimed at domestic deregulation and greater global integration posed new challenges.

Cumulative assistance sanctioned and disbursed by IDBI since its inception upto end March 2003, stood at Rs.2,25,000 Crore and Rs.1,70,000 Crore respectively. Total assistance sanctioned under all categories by IDBI during 2002-03 amounted to Rs.2889 Crore.

The capital base as represented by capital adequacy ratio (CAR) based on the calculation of risk-weighted assets was 18.7% by end March 2003. This is against the RBI stipulation of 9%.

29.5 STATE FINANCE CORPORATIONS (SFCs)

On the lines of the Industrial Finance corporation Act, 1948 the State Financial Corporation Act, 1951 was enacted to finance medium and small scale industries which fall outside the ambit of operation of the Industrial Finance Corporation of India. As per the statement of Objects and Reasons, the "intention is that the State Corporation will confine their activities to financing medium and small scale industries and will, as far as possible consider only such cases as are outside the scope of the Industrial Finance Corporation". The main features of State Finance Corporation Act 1951 are the following:

(1) State Govt may establish a financial corporation for the State.

(2) The share capital shall be fixed by the State Govt and shall not exceed Rs.2 Crore. The issue of the share to the public will be limited to 25% of the share capital and the rest will be held by the State Govt, the RBI, scheduled banks, insurance companies, investment trusts, cooperative banks and other financial institutions.

(3) The corporation is authorized to issue bonds and debentures.

(4) The corporation can accept deposits from the public.

(5) The Corporation can make long term loans to industrial concerns and to guarantee loans raised by industrial concerns, which are repayable within a period not exceeding 25 years.

(6) The Corporation is authorized to underwriting the issue of stocks, shares, bonds or debentures by industrial concerns.

Several amending Acts have been passed, the last one being the Delegated Legislations Provisions (Amendment) Act, 1985.

There are 18 SFCs operating in different States and Delhi. The SFCs are under the diarchical control of the State Govt and the IDBI.

The financial assistance provided by these corporations does not show any clear trends. For example the amount sanctioned and disbursed amounted to Rs.2190Cr and 1537 Cr respectively in 1991-92 which reached a high of Rs.4188Cr and 2961Cr in 1995-96 which has fallen to Rs.2076Cr and 1762Cr in 2001-02.

29.6 SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA (SIDBI)

SIDBI was established on April 2, 1990. The Charter establishing it, the Small Industries Development Bank of India Act, 1989, envisaged SIDBI to be " the principal financial institution for the promotion, financing and development of industry in the small scale sector and to co-ordinate the functions of the institutions engaged in the promotion and financing or developing industry in the small scale sector and for matters connected therewith or incidental thereto".

Shareholding: The entire issued capital of Rs.450 Crore has been divided into 45 Crore shares of Rs.10 each. Of the Rs.450 Crore subscribed by IDBI while setting up of SIDBI, 49% has been retained by it and balance 51% has been transferred/divested in favour of banks/institutional insurance companies owned and controlled by the Central Govt.

Objectives: Four basic objectives are set out in the SIDBI Charter. They are:

- Financing
- Promotion
- Development
- Coordination

for orderly growth of industry in the small scale sector. The SIDBI activities now meet almost all the requirements of small scale industries which fall into a wide spectrum constituting modern and technological lift superior units at one end and traditional units at the other.

Operational Emphasis: SIDBI in its operational strategy emphasizes the following:

- Enhancement in the flow of financial assistance to SSIs and
- Enhancement in the capabilities of SSIs at all levels with focus on adoption of improved and modern technology.

The small industries sector in India is dominated by a large number of small units. These micro-enterprises require special nurturing. SIDBI has been operating schemes like Single Window Scheme and Composite Loan Scheme to ensure that financial assistance is made available to such units on easy terms and with hassle-free procedures. SIDBI as a matter of policy identifies areas of gaps in credit delivery system and fill them through devising appropriate new schemes and implementing them.

SIDBI's assistance now covers:

- Equity
- Term loan (domestic and foreign currency)
- Working Capital
  - for inventory
  - for raw material

- through finance against bills receivable and for intangibles.

The purposes for which SIDBI's assistance is provided include new projects, expansion, diversification, technology upgradation, modernization, quality improvement, environmental management, marketing (domestic and international) and rehabilitation of SSIs.

Promotional Orientation: Besides financing, SIDBI provides development support services to SSIs under its Promotional and Development (P & D) Schemes. The focus of such assistance is to ensure:

- Enterprise promotion
- Human Resource Development
- Technology Up gradation
- Environmental and quality management
- Information dissemination and
- Market promotion

The P & D initiatives of SIDBI have crystallized over the years and are now oriented to serve rural entrepreneurs and youth, particularly women through programmes to empower them and motivate them to undertake entrepreneurial ventures.

Progress: SIDBI has been one of the top 30 Development Banks in the World. SIDBI is ranked 25th both in terms of capital and assets. The amount of financial assistance sanctioned and disbursed have been showing a continuously increasing trend. For example in 1991-92, it sanctioned and disbursed a sum of Rs.2846 Cr and Rs.2027 Cr. respectively. It is provisionally estimated at Rs.9025 Cr and Rs.5919 Cr respectively during 2001-02.

29.7 STATE INDUSTRIAL DEVELOPMENT CORPORATIONS (SIDCs)

In order to accelerate the pace of industrial development in their state many States governments have set-up State Industrial Development Corporations (SIDCs). A.P and Bihar were the first to set up SIDCs in 1960 followed by other states. There are 28 such SIDCs in the country. A common feature is that they are wholly owned by their respective state governments. They undertake a wide range of functions which include-

(a) Grant of financial assistance
(b) Provision of industrial sheds/plots
(c) Promotion and management of industrial concerns
(d) Promotional activities such as identification of project ideas, selection and training of entrepreneurs, provision of technical assistance during project implementation etc., and
(e) Provision of risk capital to entrepreneurs by way of equity participation and seed capital assistance.

As far as financial assistance is concerned, SIDCs provide assistance in the form of direct investment loans, extension of guarantee for loans and deferred payment, underwriting and subscription to the issue of shares, bonds and debentures. The financial assistance sanctioned and disbursed which was Rs.1009 Cr. and Rs.679 Cr. respectively in 1991-92, rise to Rs.1593 Cr and Rs.1717 Cr in 2001-02.

29.8 LET US SUM UP

- Development banking is basically a post-independence concept in India.
- The First Development Bank in India is the Industrial Finance Corporation of India established in 2948.
- There are development banks both at the State and National levels.
- The structure of development banks in India comprise industrial development banks, agriculture development banks and export-import bank.
- IFCI was establish in 1948 to cater to the financial needs of industrial sector.
- IFCI has contributed to the modernization of Indian industry, export promotion, import substitution, entrepreneurship development, pollution control, energy conservation and generation of both direct and indirect employment.
- The most important institution in the field of agricultural finance is the National Bank for Agriculture and Rural Development (NABARD).
- NABARD came into existence on 12th July 1982 with an initial capital of Rs.100 Cr that was raised to Rs.2000 Cr later.
- NABARD is the apex financing agency for institutional credit aimed at promoting the various development activities in rural areas.
- NABARD provides refinance to State Cooperative Agriculture and Rural Development Banks, SCBs, RRBs, Commercial Banks and other institutions approved by RBI.
- NABARD has introduced a number of innovative measures including Kisan credit cards scheme, Rural Infrastructure Development Fund, micro-finance to rural poor.
- IDBI is the apex agency as far as industrial finance is concerned and was established on 1.7.1964.
- IDBI is to come under the purview of companies Act 1956.
- It performs a number of functions including granting loans and advances by way of refinance.
- State Finance Corporations are similar to Industrial Finance Corporation, except that

SFCs are State level institutions.

- SFCs finance medium and small scale industries at the State level.
- There are 18 SFCs operating in different States and Delhi.
- The Small Industrial Development Bank of India was established on April 2, 1990.
- It is the principal financial institution for the promotion of financing and development of industries in the small scale sector and to coordinate the functions of the institutions engaged in the promotion and financing of small scale industries.
- State Industrial Development Corporations (SIDCs) have been established to accelerate industrial progress at the State level.
- SIDCs are wholly owned by their respective State governments.

29.9 FOR FURTHER READING

2. The following Home Pages are very useful.
   (a) www.ifcitd.com (b) www.nabard.org (c) www.idbi.com
   (d) www.sidbi.org
1. Govt of India : Economic Survey 2002-03
2. D.M.Mithani : An Anatomy of Indian Banking

29.10 REVIEW QUESTIONS

2. Examine the significance of Development Banks in India with special reference to industrial finance.
3. Explain the role of NABARD in India's rural development
4. Analyse the major State level development banks.

UNIT 30 : INVESTMENT INSTITUTIONS

30.0 OBJECTIVES

At the end of this unit, you should be able to

- understand the significance of investment banking institutions.
- the important investment banking institutions like the UTI, LIC of India, General Insurance Corporation of India and the Industrial credit and Investment Corporation of India, their main features and working.

30.1 INTRODUCTION

You were introduced in unit 29 to one type of financial institutions, namely, development banks. As the name suggests, the aim is to promote economic development in general, and agricultural and industrial development in particular, through the provision of adequate finance and other enabling services. This unit aims at looking at the other side of this.

It aims at analyzing the main features of investment banks in the country. You know there in substantial untapped house hold savings in the country which needs to be mobilized for investment in productive activities. Individuals by themselves cannot find profitable investment avenues due to their poor knowledge of the financial structure of the country. Under such circumstances, there is the need to establish specialized institutions which can take up this responsibility and the amount so mobilized can be invested in such a way that it not only brings a reasonable return to the savers in these institutions, but also promote the socio-economic objectives of the country.

An investment bank /financial institution is one which taps the savings of small investors and then invest in securities. This it aimed at affording the small investors a share in the overall development of the country.

30.2 UNIT TRUST OF INDIA (UTI)

It was on February 1, 1964 that Unit Trust of India (UTI), India's first mutual fund came into xistence as a statutory corporation under the Unit Trust of India Act, 1963 through an Act of Parliament and commenced its operations with effect from July 1, 1964, with a view to encouraging savings and investment and participation in the income, profits and gains accruing to the Corporation from the acquisition, holding, management, and disposal of securities. It was set up as an intermediary that would help fulfill the twin objectives of mobilizing retail savings and investing those savings in the capital market and passing on the benefits so accrued to the small investors.

Structure:

As a Trust without ownership capital and with an independent board of trustees, UTI represented a unique organizational innovation Under the provisions of the UTI scheme, Unit Scheme 1964, certain institutions were to contribute to the Scheme's initial capital, which is redeemable at the discretion of the Trust at such values as may be decided by the Government of India

The contributors to the initial capital of Rs.5 crore was the RBI, other financial institutions, LIC of India, State Bank of India and its subsidiaries and other scheduled banks including a few foreign banks.

In February 1976, the RBI's contribution was taken up by the IDBI. The institutions were provided representation on the Board of UTI. Under the provisions of the Act, Chairman of the Board in appointed by Government of India. The Board of Trustees overlooks the general direction and management of the affairs and business of UTI. The Board performs its functions based on commercial principles, keeping in mind the interest of the unit holders under various schemes.
Since UTI does not have any share capital, it operates on the principle of "no profit no loss" as all income and gains net of all costs and development charges, ultimately go back go investors of respective schemes.

Overview:

Since inception, UTI has played a pioneering role in the development and growth of the economy and the capital market. It has become a household name, providing avenues for investment to about 20.02 million uinit holders ranging from children to working professionals to women to retired people in a wide variety of 150 schemes / funds.

Individual household investors account for 99% of UTI's investor accounts and about 65% of unit capital of UTI schemes. It has a nationwide network consisting 54 branch offices, 3 UTI Financial Centres (UFCs) and representative offices in Dubai and London. In order to reach the common investors at district level, 18 satellite offices have also been opened in select towns and districts. There is a professionally qualified team to manage the funds of the trust. The UTI has implemented an integrated front office system for fund management activities. The system establishes a comprehensive system driven control to ensure adherence to regulatory and internal investment guidelines.

Associate Institutions:

To create a diversified financial conglomerate and to meet investors, varying needs under a common umbrella, UTI has set up a number of associate companies in the field of banking, securities trading, investor saving, investment advice and training. These include

UTI Bank Ltd (1994), UTI securities Ltd (1994), UTI Investor services Ltd (1993), UTI Institute of Capital Markets (1989), and UTI Investment Advisory Services Ltd (1988).

Institution Building:

UTI has helped promote / co-promote the following institutions:

- Infrastructure Leasing Financial Services (ILFS)
- Credit Rating and Information Services Ltd. (CRISIL)
- Stock Holding Corporation of India Ltd. (SHCIL)
- ICICI Venture Fund Co. Ltd.
- Over – the Counter Exchange of India Ltd (OTCEI)
- National Securities Depository Ltd.(NSDL)
- North Eastern Development Finance Corporation Ltd (NEDFCL)

UTI Reforms Package:

The Cabinet Committee on Economic Reforms (CCEA) under the Chairmanship of the Prime Minister granted approval to a UTI Reform Package on August 31, 2002. As per the package, UTI Act 1963 has been repealed and UTI has been bifurcated into 2 entities, UTI-I and UTI-II. This has been operationalised from 1st February 2003. In accordance with the Act, the undertaking specified in UTI-I has been transferred and vested in the Administrator of the specified undertaking of Unit Trust of India, who manages 20 assured return schemes along with US-64 and Special Units Scheme with a corpus of over Rs.30,000 crore. The Government has continuing obligations and commitments to investors, under this Scheme

Global Links:

UTI pioneered the offshore fund investment in Indian securities. UTI floated the India Growth Fund which is listed on the New York Stock Exchange. Besides the Columbus India Fund launched in 1994, UTI launched the India Access Fund, an Indian Index Fund (tracking NSE 50 index) in 1996.

UTI International is a 100% subsidiary of UTI, registered in the island of Guernsey. UTI International has an office in London to market UTI's offshore funds to institutional clients in UK, Errope and USA. To cater to various needs of NRI investors pased in the Gulf region, UTI has a representative office at Dubia.

In the recent past, UTI has extended its support to the development of unit trusts in developing countries like Sri Lanka and Egypt. UTI also participated in the equity capital of Unit Trust Management Company of Sri Lanka.

The nature of investment of LIC can be gauged by the following data.

TYPE OF INVESTMENT		INVESTMENTS UPTO (Rs. in crore)		
		31.3:1987	31.3.1997	31.3.2002
1.	Central Govt. Securities	4675	37330	109938
2.	State Govt. and Others	1683	8906	21463
3.	Electricity (SEBs)	2603	8214	13447
4.	Housing	1872	10967	19054
5.	Water supply and sewage	718	2028	4000
6.	State Road Transport Corp.	180	540	893
7.	Loans to industrial estates	37	45	45
8.	Loans to sugar co-operatives	37	37	37
9.	Development authority	1	1	1
10.	Roadways, Post, Railways	1	-	681
11.	Power Generation (private Sector)	-	-	3797
12.	Municipalities	-	-	4
	Total	11806	68068	173370

Source: www.licindia.com

It is clear from the data that bulk of LIC's investment has gone to finance central Government securities, followed by State Government and others. Housing also has been a major investment for the Corporation. It is also obvious that power generation has been getting the attention of LIC.
The amount sanctioned and disbursed in 1991-92 was Rs.1515 crore and Rs.1022 crore respectively, which went up to Rs.6741.5 crore and Rs.8914.9 crore respectively in 2001-2002

30.4 GENERAL INSURANCE CORPORATION OF INDIAN (GIC)

The entire general insurance business in India was nationalized by General Insurance Business (Nationalization) Act 1972 (GIBNA). The Government of India (GOI) through Nationalization took over the shares of 55 Indian insurance companies carrying on general insurance business.

The amount sanctioned and disbursed by this institution has been shawing a steady rise. While the sanctioned and disbursed amount was Rs.3814 Crore and Rs.2906 crore respectively in 1991-92,it has risen to Rs.6770 crore and Rs.4600 cr respectively in 2000-2001

30.3 THE LIFE INSURANCE CORPORATION OF INDIA (LIC of India)

The Life Insurance Corporation of India was set up in 1956 when the life insurance business was nationalized. It took over the assets and liabilities of 245 private insurers engaged in the transaction of life insurance business in India. LIC has its central office in Mumbai, 7 Zonal offices, 1000 divisional and 2048 branch offices spread throughout the country. Its zonal offices are at Mumbai, Kolkata, Chennai, Hyderabad, Kanpur and Bhopal. It has more than 15 crore policy holders, and employs 10,02,149 agents.

Objectives of LIC

The following are some of the objectives:

(1) Spread life insurance much more widely and in particular to the rural areas and to the socially and economically backward classes.

(2) Maximize mobilization of peoples savings by making insurance –linked savings adequately attractive.

(3) Bear in mind, in the investment of funds, the primary obligation is to policyholders, whose money it holds in trust, without losing sight of the interest of the community as a whole, the funds to be deployed to the best advantage of the investors as well as the community as a whole, keeping in view national priorities and obligations of attractive return.

(4) Conduct business with utmost economy and with the full realization the moneys belong to the policy holders.

(5) Act as trustees of the insured public in their individual and collective capacities.

(6) Meet the various life insurance needs of the community that would arise in the changing social and economic environment.

Lending Policy:

LIC has been providing assistance in terms of the following:

(i) Term loans

(ii) Underwriting and subscription in the form of (a) equity and preference shares and (b) debentures

(iii) Resource support to financial institutions. Because of LIC's efforts to earn sustained and guaranteed income for its policy holders, it has preferred investment in debentures over equity shares.

General Insurance Corporation of India (GIC) was formed in pursuance of section 9(1) of GIBNA. It was incorporated on 22 November 1972 under the Companies Act 1956 as a private company limited by shares. GIC was formed for the purpose of superintending, controlling and carrying on the business of general insurance.

As soon as GIC was formed, GOI transferred all shares it held of the general insurance companies to GIC. Simultaneously, the nationalized under takings were transferred to Indian insurance companies. After a process of mergers among Indian insurance companies, four companies were left as fully owned subsidiary companies of GIC. They are

(1) National Insurance Company Limited;
(2) The New India Assurance Company Limited;
(3) The Oriental Insurance Company Limited; and
(4) United India Insurance Company Limited.

The next landmark happened on 19th April 2000, when the Insurance Regulatory and Development Authority Act 1999 (IRDAA) came into force. This act also introduced amendment to GIBNA and the Insurance Act, 1938. An amendment to GIBNA removed all the exclusive privilege of GIC and its subsidiaries carrying on general insurance in India.

In November 2000, GIC is renotified as the 'Indian Reinsurer' and through administrative instructions, its supervisory role over subsidiaries was ended.

With the General Insurance Business (Nationalization) Amendment Act 2002 coming into force from March 21, 2002, GIC ceases to be a holding company of its subsidiaries. Their ownership was vested with Government of India. This in effect means that there is no GIC now.

The mission of GIC is

- To provide need-based low cost general insurance cover to the rural population keeping in mind their low premium paying capacity.
- To administer a crop insurance scheme for the benefit of farmers.
- To develop and introduce covers with social security benefits.
- To develop a marketing network throughout the country including areas with low premium potential, promote balanced regional development irrespective of cost considerations and make the benefits of insurance available to the master.

Through investments in the Government sector and socially oriented sectors, GIC has contributed to the nationals development. It is one of the largest financial institutions in the country. The other ventures initiated by GIC are GIC Mutual Fund and GIC Housing Finance.

THE NEW INDIA ASSURANCE COMPANY

This is the largest non-life insurer in India. The company was incorporated on 23rd July 1959 and commenced transacting business on 14th October 1919. Founded by the House of Tatas, Sir Dorab Tata set up this company to provide insurance protection to Indians.

Government of India took over the management of the company along with all other non-life insurers in the country. New India was subsequently reconstituted taking over 23 companies under the scheme of merger, following the nationalization of general insurance business in 1973. The company has overseas presence in countries like Japan, U.K, Middle East, Fiji and Australia.

UNITED INDIA INSURANCE COMPANY LTD.

United India Insurance Company Ltd., is one of he four public sector insurance companies, with its corporate office at Chennai. As at 2000, UI spans the country with a network of Head Office, 24 Regional Offices, 1 Regional Cell, 352 Divisional Offices and 742 Branch offices and a manpower strength of 21,116. UI has pioneered many innovative rural insurance covers.

NATIONAL INSURANCE COMPANY LTD.

The corporate office is at Kolkata. Since incorporation in the year 1906, National Insurance Company has been carrying out general insurance business under private management until 1972, the year of its nationalization.

In the same year 22 foreign 11 insurance companies were amalgamated with National Insurance Co. Ltd., as a subsidiar company of GIC of India.

THE ORIENTAL INSURANCE COMPANY LTD.

The oriental Insurance Company Ltd., earlier known as the Oriental Fire and General Insurance Co. Ltd, was incorporated at Bombay on 12th September 1947. The Company was a wholly owned subsidiary of the Oriental Government Security Life Assurance Limited and was formed to carry out general insurance business. The company was promoted by Sir Purushothamdas Thakurdas, Chairman of Oriental Government Security Life Assurance Co, Ltd., which was transacting life insurance business for nearly 75 years.

On nationalization of life insurance business in India in 1956, the company became a subsidiary of LIC of India. Subsequently, on nationalization of general insurance business in India in 1973, the company became one of the subsidiaries of GIC of India.

10 Indian and 12 foreign insurance companies merged with Oriental Fire and General Insurance Co. Ltd. The name of the Company was changes in the year 1984 to Oriental Insurance Co. Ltd.

The amount of financial assistance sanctioned and disabused by these four units is summarized below

	Name of the company	years	Sanctioned	Disbursed
1.	New India Assurance Co. Ltd	2001-02	Rs.526.3 Cr	Rs.423.4 Cr
2.	National Insurance Co. Ltd	2001-02	Rs.132.1 Cr	Rs.149.1 Cr
3.	Oriental Insurance Co. Ltd	2001-02	Rs.104.8 Cr	Rs.254.8 Cr
4.	United India Insurance Co.Ltd.	2001-02	Rs.324.1 Cr	Rs.330.4 Cr

SOURCE: Economic Survey 2002-2003, S.59.

30.5 INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI)

This institution is now known as ICICI Bank. ICICI in its original form was first formed in 1955 at the instance of the World Bank, the Government of India, and representatives of Indian industry. The main objective was to create a development financial institution for providing medium term and long-term project financing to Indian businesses. In the 1990s, ICICI transformed its business from a development financial institution offering only project finance to a diversified financial services group offering a wide variety of products and services, both directly and through a number of subsidiaries and affiliates like ICICI Bank. In 1999, ICICI became the first Indian company and the first bank or financial institution from non-Japan Asia to be listed on the New York Stock Exchange.

After consideration of various corporate structuring alternatives in the context of the emerging competitive scenario in the Indian banking industry and the move towards universal banking the managements of the ICICI and ICICI Bank formed the view that merger of ICICI with ICICI Bank would be the optimal strategic alternative for both entities, and would create the optional legal structure for the ICICI group's universal banking strategy. The merger would enhance the value for ICICI share holders as also ICICI Bank shareholders. Such a merger would increase the capital base and scale of operations as also entry into new business segments.

In October 2001, the Boards of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly owned retail finance subsidiaries, ICICI Personal Financial Services and ICICI Capital Services Ltd., with ICICI Bank. The merger was approved by share holders of ICICI

Bank in January 2002 by the High Court of Gujarat at Ahmedabad in March 2002, and by the High Court of Judicature at Mumbai and the Reserve Bank of India in April 2002. Consequent to the merger, the ICICI groups financing and banking operations, both wholesale and retail, have been integrated in a single entity.

The merger of ICICI with the ICICI Bank was the result of the recommendation of the Narasimham Committee-II. It had recommended that with the convergence of activities between bank and development financial institutions (DFIS) shovled over a period of time, convert themselves into banks paving the way for only two forms of intermediaries, namely, banking companies and non-banking financial institutions. RBI had advised financial institutions to chart a path for their evolution into universal banks.
The ICICI accounted for over 49% of sanctions and 45% of disbursements of all India financial institutions in 2001-2002. With its merger with ICICI Bank, the role of these institutions has come down further.

30.5 LET US SUM UP

- An investment bank / institution is one which taps the saving of small investors and then invest in securities.
- The important investment institutions are the UTI, LIC, GIC and the ICICI (now known as ICICI Bank)
- UTI, which came into existence on July 1, 1964 aims at encouraging savings and investment in securities.
- It was set up as an intermediary that would help fulfill the twin objectives of mobilizing small savings and investing these savings in the capital market and passing on the benefits so accrued to the small investors.
- UTI has created a number of associate companies in the field of banking, securities trading, investor servicing, investor advice and training.
- It has also promoted institutions like ILFS, CRISIL, ICICI Venture Fund Co,. OTCEI, NSDL and NEDFCL.
- As a result of a reform package, UTI has been bifurcated into two entities, namely, UTI-I, and UTI-II.
- LIC of India was set up in 1956 when the life insurance business was nationalized.
- LIC has been providing assistance in terms of term loans, under writing and subscription in the equity and preference shares and debentures. Debentures have been the preferred route of investment.
- Bulk of LIC's investment is in Central and State government securities.
- GIC was formed in pursuance of section 9(1) of General Insurance Business (Nationalization) Act 1972.
- It had four subsidiaries. They are the National Insurance Co., the New India Assurance Co., The Oriental Insurance Co., and the United India Insurance Co.

- The exclusive privilege of GIC was removed by an amendment to GIBNA
- With the general Insurance Business (Nationalization) Amendment Act, 2002, coming into force from March 21, 2002, GIC ceases to be a holding company of its subsidiaries, their ownership was vested with Government of India.
- Through investments in the Government and socially oriented sectors, GIC has contributed to the nation's development.
- GIC has initiated GIC Mutual Fund and GIC Housing Finance.
- ICICI after its merger with ICICI Bank is now called the ICICI Bank.
- Originally, ICICI was formed in 1955 at the initiative of the World Bank, the Government of India and representatives of Indian industry.
- The main objective was to provide medium term and long term project financing to Indian businesses.
- It diversified from a project finance institution into a diversified financial services group offering a wide variety of products and services.
- In October 2001, the Boards of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly owned retail finance subsidiaries (ICICI Personal Financial Services and ICICI Capital Services) with ICICI Bank.
- In 2001-2002 ICICI accounted for over 49% of sanctions and 45% of disbursements all India financial institutions.

30.6 FOR FURTHER READING

1. The following official websites are useful
www.uti.org
www.licofIndia.com
www.Insure 2bsecure.com
www.gicofindia.com
www.icici.com
2. Government of India: Economic survey 2002-2003

30.7 REVIEW QUESTIONS:

1) Explain the recent changes brought about to Unit Trust of India
2) Examine the significance of investment institutions in financing developmental activities of the country.
3) Examine the rationale behind the merger of ICICI with ICICI Bank.

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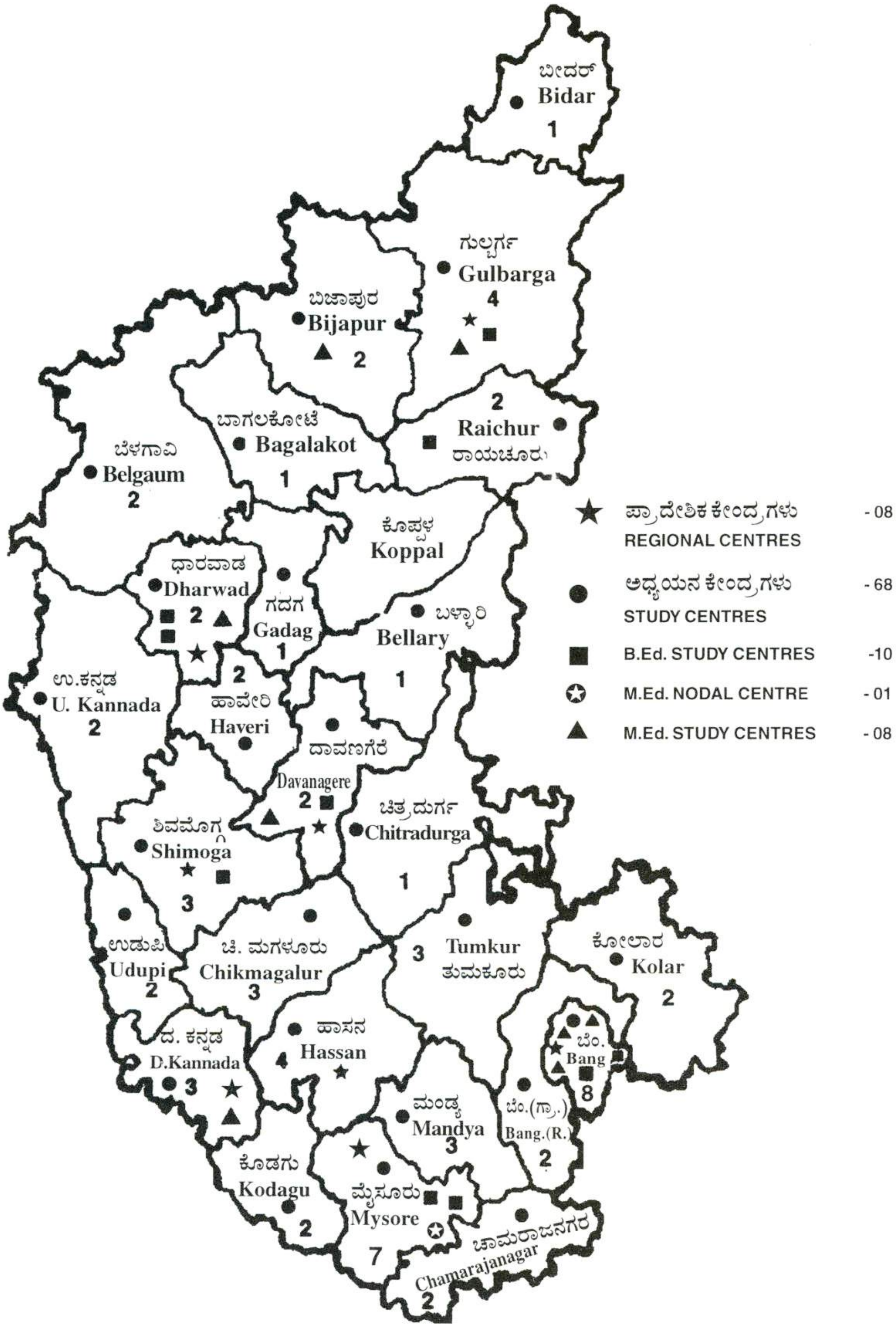
ಆದೇಶ ಸಂಖ್ಯೆ : ಕರಾಮುವಿ/ಸಿಪಾವಿ / 4/520/2006-2007 ದಿನಾಂಕ : 05-09-2006
ಒಳಪುಟ : 60 GSM MPM ವೈಟ್ ಪ್ರಿಂಟಿಂಗ್ ಪೇಪರ್ ಮತ್ತು ಹೊರಪುಟ : 170 GSM ಆರ್ಟ್‌ಕಾರ್ಡ್
ಮುದ್ರಕರು : ಪೂರ್ಣಿಮ ಪ್ರಿಂಟರ್ಸ್, ಬೆಂಗಳೂರು - 560 040. ಪ್ರತಿಗಳು : 1000, ಮುದ್ರಿಸಿದ ದಿನಾಂಕ : 07-09-2006

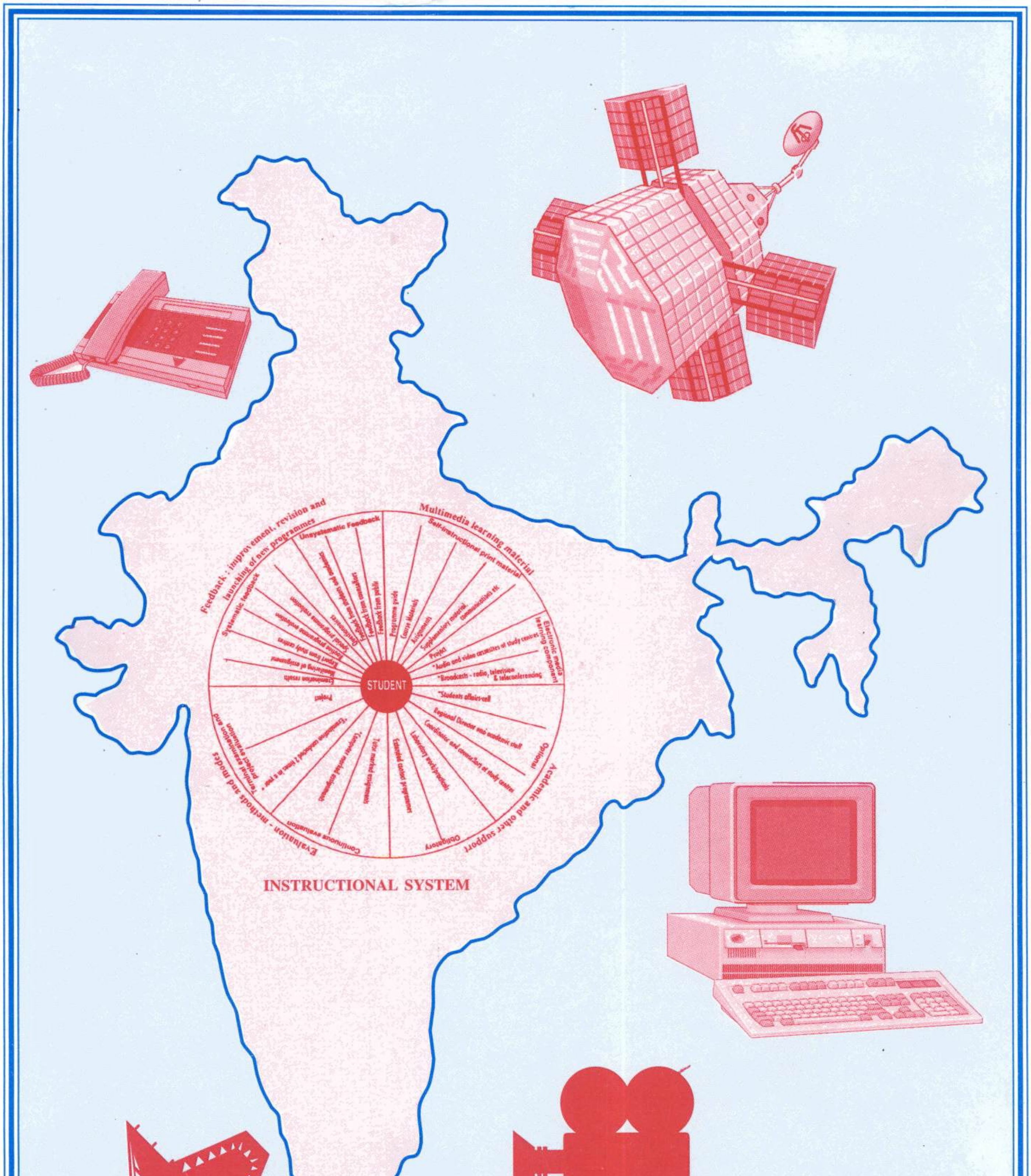
ಕರ್ನಾಟಕ ರಾಜ್ಯ ಮುಕ್ತ ವಿಶ್ವವಿದ್ಯಾನಿಲಯದ ಪ್ರಾದೇಶಿಕ ಹಾಗೂ ಅಧ್ಯಯನ ಕೇಂದ್ರಗಳು

Regional and Study Centres of Karnataka State Open University



(ನಮೂದಿಸಿರುವ ಅಂಕಿ - ಜಿಲ್ಲೆಯಲ್ಲಿರುವ ಒಟ್ಟು ಅಧ್ಯಯನ ಕೇಂದ್ರಗಳ ಸಂಖ್ಯೆಯನ್ನು ಸೂಚಿಸುತ್ತದೆ.)

The Number Indicate the Total Number of Study Centres Existing in that Districts.



INSTRUCTIONAL SYSTEM