CHAPTER III

NEED FOR INDUSTRIAL FINANCE.CORPORATION

PRE-INDEPENDENCE INDUSTRIAL PATTERN.

Introduction:

The rate of growth of an economy depends upon a multiplicity of factors among which differences in financial structure have been an important one. Industrial finance is one of the chief bottlenecks in the rapid industrialisation programmes of the developing countries. Finance is the life blood of industry. Adequate finance is absolutely necessary to oil the wheels of the Industrial machine, to ensure its smooth working and to prevent its break down. Lack of adequate and timely finance is one of the causes of slow development of industries in India.

This chapter deals with the study of pre-independence industrial pattern in India.

3.1 Commercial Banks and Industrial Finance in India.

Commercial Banks are the oldest and the most important financial intermediaries in India. The banks with, their deposits being unstable and of short term nature, struck, for a long time, to the function of providing working capital to industries on the basis of security of raw material and other floating assets. They neglected the need of industries for long term finance. Attempts were made to provide long term finance to industries on certain occassions, but all of them were short lived and ended in bank failures. In 1906-13, during the Swadeshi, Movement, a number of banks, mostly in Panjab, started participating in the provision of long term finance to

industries. During 1917-20, again, there was a wave of industrial banks, like Tata Industrial Bank and Calcutta Industrial Bank which were established for the purpose of promoting and providing long term advances to industries. But both these banks failed. During second World War, in West Bengal, number of banks met with failure mainly due to their activities in the field of long term finance to industries.

3.2 Thus because of all these reasons, the Indian banks were cautios in their lending operations and followed a conservative policy. However after independence, and particularly after the beginning of planning in India, there has been a remarkable change in the structure of our banking companies. The spectacular rise in the deposits, particularly time deposits, have made the position of banks vary sound, which is favourable for the extension of banks' activities in the long term financing of industries.

3.3 Another important development in recent days which facilitated the term loans by commercial banks was the formation of the Deposit Insurance Corporation. With the establishment of Refinance Corporation for Industry, it is expected that banks would take more active part in this field.

3.4 Thus commercial banks contribute to the industrial finance, by giving loans and advances short term as well as long term to industries and by participating in equities and granting advances against shares etc. Their investment in industries and advances against shares during the last few years have shown considerable progress and if the Reserve Bank adopts a

suitable policy by making necessary changes in its rediscounting facilities, they are bound to grow in future.

3.5 Since the beginning of the economic planning, commercial banks have been playing greater attention to industrial finance. The share of advances to industry in the total scheduled bank credit rose from 33.6% in March 1951 to 52.7% in April 1961 and to 67.57% in March 1968 However since bank nationalisation in 1969, with its emphasis on lending to priority sectors, the proportion of such credit to large and medium industry has come down.

3.6 Life Insurance and Industrial Finance (L.I.C.)

Life Insurance funds have aqui ed great importance in present days, for the mobilisation of sayings as well as their chanalization in proper direction. Their activities in the field of long term industrial Finance have been increasing consistently and in some places they have become the important source of finance for industries.

3.7 In India, in 1956, life insurance was nationalised and establishment of L.I.C. took place. Before nationalisation Life Insurance business was restricted to urban areas and rural parts of the country had remained more or less untouched. The LIC, therefore has a vast scope in increasing its business and thus mobilising larger amount of Savings from rural areas. Because of its government backing, the risk and uncertainly that goes with individual companies no more exists in case of the LIC. Since the Corporation does not face liquidity problem as such and can invest safely part of its funds in long term

securities, its role in long term finance for industries becomes very important. LIC is investing in shares and debentures of companies. The L.I.C. also indirectly contribute to the provision of industrial finance by holding shares etc. of specialised financial institutions like the Industrial finance Corporation, which directly finance the industries. The L.I.C. is playing an important role in financing public limited companies. With increasing activities in the field of genuine under writing, indirect contribution by investing in the stocks of other specialised financial institutions, and ambitious role in the provision of equity finance for industries, the LIC should be expected to play more important role in this field in future.

3.8 Indigeneous Bankers - In urban areas industries, especially medium sized industries, can obtain finance from the indigeneous bankers. But they charge exorbitant rates of interest which few industries can bear. Not many industries approach them now. Since the setting up of the state Financial Corporations this source of finance is, therefore, becoming less and less important.

3.9 Term lending Institutions.

When India became independent in 1947, the share of contribution of factory establishment was a meagre 6.6%

of the national income and the labour force working in these establishments was only 1.6% of the total working population of the contry. The goods produced in the country were mainly consumer goods and given the resource endowment both natural and human, and the size of the domestic market, the country needed a strong capital good sector to support the overall industrial development of the country. There were district gaps from efficiency point of view even in the existing industrial structure, and more concious efforts and planning were called for to accelerate the pace of industrialisation and overall economic development of the country. In response to these felt needs, the Industrial Finance Corporation of India was established in 1948. Thereafter many new financial institutions have been started. Industrial Finance Corporation of India is the oldest institution in India ofthis nature and with its establishment, a new chapter was opened in the history of Industrial finance. India is now well served by a network of development banks at the all India level and in the states.[1]

3.10 After taking brief review of these Institutions, attention will be concentrated on the study of Industrial Finance Corporation of India.

Right from the beginning, India has chosen the path of planned economic development in a mixed economy, where both public and private sectors have an important role to play. The success of the programmes of industrialisation under the 5 year plans, deponded to a great extent, on the availability of adequate financial resources for a wide variety of industries. There was also agreed for adopting and enlarging the institutional structure to meet the medium and long term requirements of the industrial sector. The need for specialised financial institutions to meet the requirements of term finance was recognised as early as in 1931 by the Central banking and Enquiry Committee. It was also realised that such institutions need to be established, both at all India level and state level.

3.11 The proposal for establishing all India institution went through several stages and modifications were made, generally in the direction of broadening the institutions range of Functions. On account of the constitutional changes that took place, legislation for the establishment of the Industrial finance Corporation of India (IFCI)was passed on February 1948. The Corporation came into being on July 1, 1948.

3.12 In 1954, the Central Government set up a full pledged Government institution, the National Industrial

Development Corporation (NIDC) for the promotion and development of industries in India, on a balanced regional basis, in both the public and private sectors.

The NIDC was to be primarily a developmental agency rather than a financial institution. In the initial stages, it took interest in financing the modernisation and rehabilitation of the jute and cotton textile industries. It is now mainly a consulting agency.

3.13 The Industrial Credit and Investment Corporation of India limited (ICICI) was the next all India Institution to be established in 1955. This was to be a private sector financial institution, that is to say, without any contribution to its share capital from the Government, the Reserve Bank etc. But the Corporation was to have the Government's full support, including provision of loans. It was to take special interest in the provision of foreign currency loans and underwritings, the latter function having been sadly neglected by the IFCI.

3.14 The next agency for the provision of industrial finance to be set up was the Refinance Corporation for Industry Limited (RCI), in 1958, jointly by the Reserve Bank, the L.I.C. and some leading commercial banks. The RCI was intended to provide refinance facilities to commercial banks (later to State Financial Corporation too),

in respect of their medium term lending to medium sized borrowers in the private sector. This institution was established primarily to utilise the funds earmarked for the Financing of private enterprise, in terms of the PL 480 Agreement between the Government of India and the Government of the U.S.A. This Corporation was merged with the Industrial Development Bank of India (IDBI) in September, 1964.

3.15 The IDBI was established with effect from July 1, 1964, as a wholly owned subsdiary of the Reserve Bank, and as an apex agency in the field of Development finance. It was to be both a financial institution and a developmental agency. With effect from February 16, 1976, the IDBI was delinked from the Reserve Bank.

3.16 The latest institution to be set up was the Industrial Reconstruction Corporation of India Limited (IRCI), in 1971, with a view to rehabilitating sick units. Although this is called on all India institution, so far it has operated largely in the State of West Bengal. Thus at present there are four all India development banks, namely, the IFCI, the ICICI, the IDBI, and the IRCI. The IFCI is a 50% subsidiary of the IDBI, which also holds 50% of the IRCI's capital. The other all India development banks, the LIC and major commercial banks hold the rest

of the IRCI's capital. Some share capital of the IFCI and State Financial Corporationsis held by the Life Insurance Corporation of India. The Unit Trust of India (UTI) also holds some shares of the ICICI. Thus there is a lot of inter-institutional share ownership and naturally participation in management.

3.17 In nearly all the states, there are State Financial Corporations(SFCS). In a number of States, there are also special Government owned Financial Institutions, called generally by the name Industrial Investment Corporations (LICS) for the purpose of granting loan and underwriting assistance, besides promoting industrial units and locating entrepreneurs. These institutions enjoy a considerable amount of freedom in regard to their operations. Such corporations may operate in the whole of a State or they may be nicant for concentrating on fix development of the economically backward regions in the respective state. In many states, these investment Corporations coordinate their activities with the industrial financing operations of SFCS all-India development banks and commercial banks.

3.18 Besides, most of the States have institutions known as Industrial Development Corporations(SIDCS), whose function is mainly to give all help to entrapreneurs in regard to

the supply of intrastructure facilities. They acquire land, put up Industrial estates for a number of units to work in the same area, build roads and arrange for the supply of water and electric power. They also introduce the entrepreneurs to the State level financial institutions.

3.19 In 1955, the Government of India set up the National Small Industries Corporation limited (NSIC) which has its head office at New Delhi and three regional offices, besides sub offices. This is both a financing and Developmental agency, the latter role being more important. Its financing takes the form of supply of machinery on hire-purchase basis.

320 In Short, there is now a wide variety of what one might call development banks proper. In addition, there are two all-India investment institutions, which also play a role in the provision of finance for industry, in the form of loans, underwriting and investment, in addition to their primary role of buying and selling securities of already established industrial units. The Life Insurance Corporation and the Unit Trust of India (UTI) established in 1964, as a subsidiary of the Reserve Bank of India are the two investment institutions.[2]

Thus there was dearth of long term finance for industries, at the beginning of planning erra. But India is now well served by specialised financial institutions providing long term financial assistance to industries. Commercial banks also have changed their conservative out look and they have been gradually turning to the field of medium term finance. This changing financial structure will make a valuable contribution to the industrial development of India.

References:

1) M.J. Joshi, " Financial Intermediaries in India." Bombay, 1965. Chapter V

2) S.L.N.Simha," Development Banking in India, " IFMR Publication; Madras 1976 PP 35-37.