# CHAPTER-III

## Interlinking PSBs Loan with Social and Economic Development

## 3.0: Introduction

India since its independence had been subjected to continuous economic and social development. The government, both being at central and state level, had been continuously after this development and had taken up several plans in support of this and taken all feasible measures towards economic and social development.

Though there have been changes in situation and India is maintaining a steady track record of social and economical developments still even after crossing of last century and a steady pass out of a decade and a half in this millennium leave some discrepancies in the pattern of development as under observation and for which though much of efforts have been made by authorities, still there remain much to analyse and identify.

Bank nationalisation had been done in 1969 and in 1980 with the prime idea of bringing all the people of the country to bring under the privileges of enjoying all the facilities extended by banks towards the desired group of people. With the new system, PSBs had actively wanted to involve themselves in the process of extending the benefits of bank finance for social and economical developments. In this process in this way, the PSBs wanted to interlink the fund offered by them for social and economic growth.

## 3.1: Needs to Link PSBs Loan with Development

Industries belonging to different categories like medium, small and micro sectors are basically means of social transformation. Industries have got penetration to different areas of society and thereby industries by means of its close association with society directly or indirectly become involved with prospects and prosperity of the society and thereby become the cause of advantages and advancements of different systems and elements of the society. The society has got its different stakeholders and nature of stake to which different stakeholders among members of a society are subjected are different.

In fact, it needs to undertake careful thoughts and considerations over the identity of the stakeholders – who are the stakeholders of the society, what are their backgrounds, what are their expectations from the society to where they stay etc.

Once the identity of the stakeholders of society is identified, it requires to undergo an elaborate analysis of the requirement of the stakeholders of society keeping it compromising or accordance with their identities as desired enlisted above. Consequently upon analysis taking into consideration of the stakeholders of society judged in accordance with different constructs of an individual group of stakeholders like socio-political, socio-economical, psychological-cultural and socio-cultural etc. their need and expectation from the society requires being established.

As mentioned above in process of need identification that PSBs are to satisfy the social and economic growth of people of the society priority requires to be given specifically to identify what social development and that too for which group of people of society or should be done and also should be specifically seen to which demography of stake these stakeholders belong. This is necessary because all people in society are not similar and equal or same categorical social or economical development should not be established. What an ideal society does is it creates need-based economical and social growth. Just an ad hoc and classless formal development will not create any permanent solution over the presently existing social and economical system. Such an effort will just create ambiguity and confusion and the already existing heterogeneous system will be additionally heterogeneous being far away from a homogeneous social and economical system. As happening in present society the result of the development, thus coming out due to the effort of public finance systems like PSBs etc will be reaped by privileged classes of the society on leaving the poorer segments of the society or the stakeholders of society not being in the affluent group or privileged group. This will at the end create more of confusion and social differences and unevenness. The Stakeholders of society being so long deprived of the available benefits, in a situation of a common approach and presence of common ladder towards the approach to the platform of development will only be slipped off from achieving the scope of benefit. They will never be capable to share a common platform of economical and also social development with the already existing heavyweights belonging in affluent demography of social with economical platforms of development. It needs to identify the identities of the lean members in stakeholders' list and very critically analyse and assure what they may achieve with their potentialities and abilities. It is not always that the people in the stakeholders list being in weaker section lack potentialities and due ability which, if the opportunity is achieved, are not in position because of lack of ability to enjoy the benefit of the given opportunity. In several cases with their abilities, they deserve to climb upon the ladder and reach the suitable high platform of the opportunity of social and economical development if the opportunities are duly targeted by the facilitators of opportunities like PSBs etc. towards these groups of people. Hence it is the prime duty of PSBs to arrange that the facilities they extend, reach to the people who actually need those and for whom it is desired.

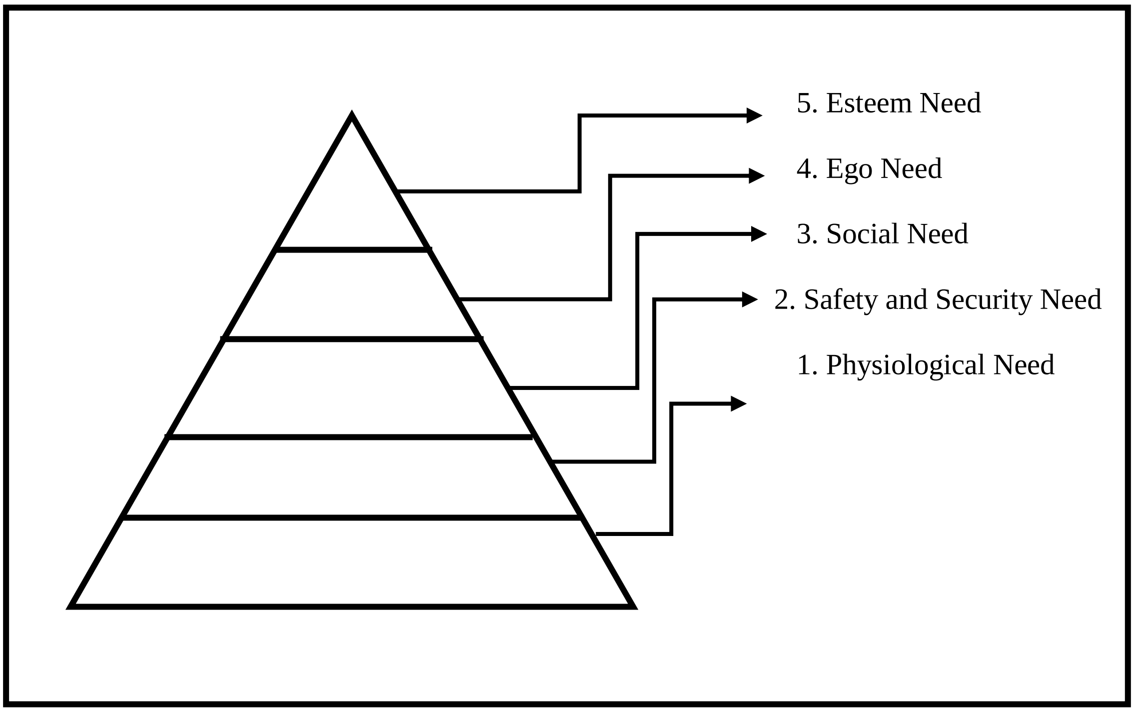
## 3.2: Prioritisation of Critical Elements of Social and Economical Development

India having a population of nearly 130 crores of people as of now and with nearly 23 % of people being under the poverty line requires being very strongly vigil of its present status in social and economical position. The liberalisation in economical policy as initiated in the last decade of the previous century and also the process of globalisation has brought a vortex of change at the socio-economic system of India. Indian socio-economical system is in the middle of turbulence in among the massive thrust of global socio-economic situation. In one side of the scenario, there are multinational groups wresting for more of social and economical stability in the global socio-economic scenario and on the other side as mentioned above it is limping with its large mass of population being below the poverty line in this situation in India.

India at its present stage is in developing stage of the economy and is in a bid to bail out from the different existing eventualities in the stage of growing status of social and economic growth. Economists are of the opinion that social development is linked to economic advancement and advancement in one area is not possible without the progress of the other.

The basic priority of an individual is the satisfaction of his needs. According to the theory of Abraham Maslow, total categories of need that human beings perceive are of five needs. Accordingly, the hierarchy of Maslow is conceptualised as below in Figure 3.1:

**Figure 3.1: Maslow's Need Hierarchy**




Hence, as it is observed primary need or fundamental basic need (level-1) of an individual is the satisfaction of his Physiological Needs. The physiological need of an individual is the need for Food and Accommodation. Next higher order or level –2 is Safety with Security need. The level-1 or basic need fulfillment should be sustained permanently. These two-level needs are bare minimum needs of an individual. The want of these two level needs should be eradicated permanently. The other three needs belonging to the level above these two are not basic needs; satisfaction of needs of these three higher levels is for people who belong above these two levels.

The primary or essential elements contained in social and economical development are the eradication of these basic levels of needs permanently and these are the prime and essential features of development in the area of general and social and economical development specifically.

The Banks in Public Sector are required to come out for the help and rescue of these sections of people living at the stage where the basic needs of Food and Accommodation are not satisfied. PSBs are to link themselves with these two critical elements - social development and economical development.

## 3.3: Basic Need for Social and Economic Development of People

As identified above in the previous section unless the basic needs of food and accommodation are satisfied, an individual cannot get the minimum essence of economic development and social development. The minimum needs that a person staying in a society is to satisfy are the necessary requirements of food and accommodation for self and his family.

Accordingly, a person, who may be called to be adult, is to have minimum basic regular earnings which may from employment or form of self-employment like trade or commerce. Unless a person has the scope of making earning, he cannot be in a position to satisfy these two needs for him and his family.

Hence self-employment promotes self-earning of the owner of the venture being a trade and commerce or an industrial unit in form of MSME which also may satisfy the financial needs of the persons who may be involved with the industrial unit being any of the different types like MSMEs as employees.

Accordingly, it is observed that it requires economic development of the people staying in society and living a social life in association with others. The primary need of minimum economic development of people of society is because of the reason that unless people have some basic minimum means of earning minimum sum, he cannot satisfy the minimum essential requirements of his life for attaining the ability of his safety need satisfaction as mentioned above. Safety needs are bare needs like food, clothing, accommodation etc. and if for an individual staying in a society, if these bare minimum needs remain unsatisfied it may be concluded that because of not suitable development of the economic position of the individual, social needs are remaining not satisfied.

Hence, for satisfying the minimum social needs of an individual, his minimum economical needs require being satisfied. The above discussion justifies that public commercial banks may move to a great extent to develop the economic systems of society by promoting industries etc. in MSME categories which may develop self-employment as well employment of others as an employee.

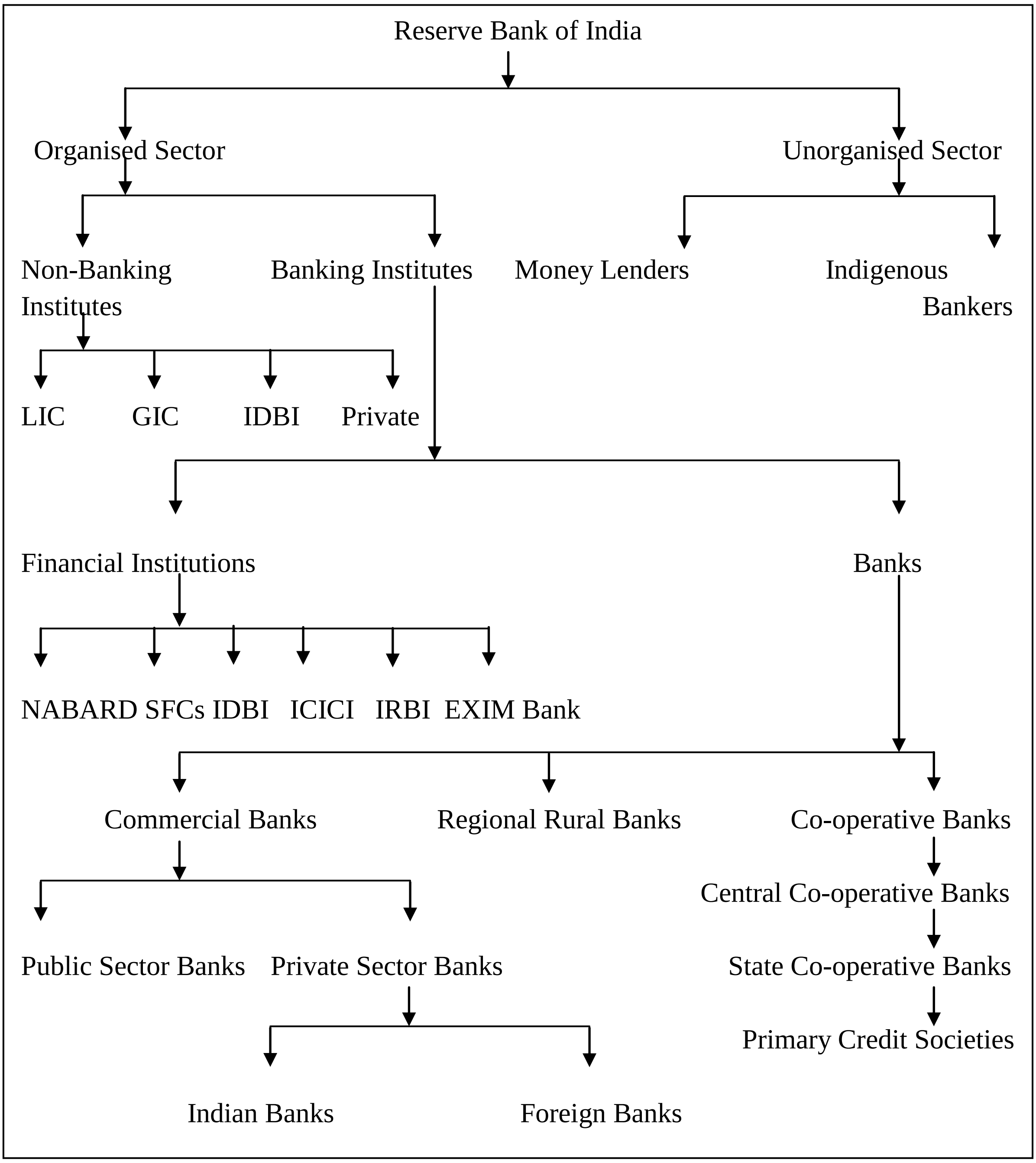
Accordingly, it is understood that public sector banks have got a significant role in industrial development and consequently economical development of people of the country.

## 3.4: Structural Mechanism of Interlinking PSBs with Economical and Social Development

In the Indian banking system and correspondingly credit structure money and capital market are included with their organised and unorganised components. The interlinking is primarily done on the basis of the credit system from the banks to different MSMEs and other types of industries.

The prime position in the credit system of the country is occupied by Reserve Bank of India which is the apex bank and also the central bank of the country. As in other developing countries, the Reserve Bank of India has assumed the role of regulator of monetary system and policy in the country. It functions not only as "watchdog" of the monetary system also it work as promotional and development banker. According to the plan of first Five Year Plan "Central banking in a planned economy can hardly be restricted to the regulation of the overall supply of credit. It would have to create machinery required for financing developmental activities all over the country and ensuring that the finance available flows in the directions required.

**Figure 3.2: Credit Structure in India economy**



The activities and operating functions of Reserve Bank of India have grown up steadily from discharging traditional central banking function and regulatory functions to the role of developmental promotional activities in accordance to need of developing and expanding Indian economy.

## 3.5: Public Financing through Credit Management by RBI

The monetary –cum- credit policy of a country is controlled under the total authority of Reserve bank of India. It requires having a complete idea of total objective, instruments, and mechanisms of monetary policy and its operations in order to understand and appreciate the role of Reserve Bank of India or the Central bank of a country and in its economy.

The Prime purpose of monetary policy in an economy is maintaining the stability of domestic price and exchange rate. There are also other subsidiary objectives like the promotion of the social system and also the growth rate of expansion.

The Central Bank of India which is the Reserve Bank of India has the authority of working with the following sets of instruments towards the supply of capital and credit to the economy.

**Quantitative Credit Control**

*Bank rate Operation

*Open Market Operation

* Reserve Ratio Variation

**Qualitative Credit Control**

- Margin Requirement
- Moral Suasion

- Season-wise Commodity Policy
- Consumers credit

The objective of Quantitative or General Credit Control is controlling the volume of total money and credit. The objective of Quantitative or Selective credit control is aimed at the availability of credit.

## 3.6: Restructuring Indian Banking System for Satisfying Public Utility: A Historical Perspective

The oldest bank in India that had been operating to meet the need of public finance had been three Presidency Banks (located in erstwhile Bengal, Bombay, and Madras) since the early 1800s. By December 1934 total number of operating banks in India had been 105, this figure of operating banks had been turned upon with inclusion several small banks. In 1921 three Presidency banks as above had been merged to form Imperial Bank of India. These banks had been entrusted with the responsibility of undertaking several central banking functions apart from their individual usual commercial operations.

In 1935 Reserve Bank of India was established as a full-fledged central bank. The imperial bank had been nationalised and was named as State Bank of India. The State Bank of India had to undertake several critical activities in process of growing economic activities in India. Since then there had been steady growth in process of the banking system in India and during a post-independence period, much of share of development and growth of Indian banking system involving Indian economy had been entrusted upon Reserve Bank of India and State bank of India. There had been steady growth in the Indian banking system during the post-independence period. During mid-sixties of the previous century, the banks in Indian Public system had been fairly compact and strong.

But in this process, several discrepancies had been noted. The fair number of the branches of public sector banks had been newly started were located in urban areas. The people in geographical areas or semi-urban and rural areas were deprived very badly the benefits of these branches. The major portion of credit deployment had been concentrated in a few areas of operations and areas belonging to agriculture, small scale industries, and self-employed sectors received weak attention.

## 3.7: Developments in the Banking System

***Social Control of Banks***

Because of strict and active control of Reserve bank of India, the banking system in India had grown in size, strength, and stability. However, as observed above there had been some discrepancies in the area of operation of the banks and these discrepancies had developed some difficulties which have been noted as above. In order to come over these difficulties, the Government of India had taken up some action plans. The government of India had introduced a scheme on social control of banks. As stated by Banking Commission in 1972, Social Control of banks was introduced with the objective of extending the privileges of financial and credit facilities to deprived groups of people belonging mostly to the poor people and people staying in rural and semi-urban areas. According to Banking Commission, the facilities will be extended for providing a wider spread of bank credit, avoiding misuse and also inefficient us of bank finance, extending the significant volume of credit facilities to priority sectors and also seeing that bank finance turn to an effective means of social and economic development. With these aims and objectives Government established the National Credit Council (NCC) desired to satisfy the following purposes:

i) Identifying and assessing the need for credit from various sections of the economy

ii) Determining the priorities of grant of loans for investment with respect to the availability of resources.

iii) Coordinating different commercial banks, cooperative banks and other financial institutes with respect to loan issuing and investment policies.

***Nationalisation of Banks***

Though the scheme of Social control upon banks was introduced through NCC, nothing much in this area had been available with respect to the reorientation of lending activities towards meeting needs of agriculture, micro and Small industries etc. Keeping this in mind Government of India had passed a bill in parliament and nationalised 14 major commercial banks with individual deposits being more than 50 crores in July 1969. During nationalisation the paid up capital of 14 nationalised commercial banks had been 28.5 crores, deposits had been Rs. 2626 crores, the number branches in all had been 4134and and advances had amounted Rs. 1813 crores.

The main objectives of this nationalisation had been

i) To take away the concentration of economic power from the control of few and to bring the benefit to a wider section of people.

ii) Extending credit facilities to priority areas which had since long been deprived, to name few to be included in this list - agriculture, small scale industries etc.

iii) Limiting the use of bank credit for unproductive and speculative purposes.

iv) To give the bank management a professional look and make it more effective.

***Lead Bank Scheme***

It was decided to organise the reorientation in credit policy of nationalised bank and accordingly to make the credit policies more accessible by people in need, it was decided for mobilisation of the resources through a process of large expansion of bank branches. With this idea Government of India had introduced lead bank scheme in December 1968. It was in principle of "area approach" for the development of credit structure and banking system and accordingly a scheme was taken in order to cover 336 districts in the country. From this approach the then Bombay, Calcutta, Madras, and Union Territories of Delhi, Chandigarh, and Goa had been excluded. Accordingly, the different districts belonging to whole the country had been allotted to various public sector banks. For each district, the allotted lead bank had been assigned with the role and responsibility of lead role in undergoing survey and meeting the requirement of credit needs and the corresponding development of branches in the respective district. "District Credit Plans" were made accordingly for the satisfaction of credit needs of people in the concerned district for each branch. Subsequently, schemes for modifications and corresponding implementation the capacity of lead banks for the formulation of area-based banking schemes and developing area-based credit acceptance and utilisation schemes of rural industrial and other entrepreneurial activities were strengthened.

***Regional Rural Banks (RRBs)***

In 1975 another concept of "multi-agency approach" related with rural credit system had been drawn up by the Government of India and Regional Rural Banks (RRBs) were established. RRBs were introduced mostly with the idea of providing credit facilities to rural sectors. Though thrust was given to public sector banks located around length and breadth of the country and effort was given to extend credit facilities to so long neglected sectors, certain discrepancies still were left in this situation. The need of developing a new set of institutions was thought of since a gap was seen between regional and functional rural credit structure and it was required to fill up this gap adequately.

The RRBs had been created to connect with the local scenario and making an all way familiarity with the local situation and the needs thereof. The commercial banks had been behind the sponsorships of RRBs. The RRBs had primary objectives of providing credit facilities to sectors related to agriculture purposes and also to entrepreneurs engaged in trade and industries and relative activities in rural areas. The RRBs primarily cater to the needs of weaker sections of people belonging in rural areas.

***Second Nationalisation***

The commercial banks brought under the head of the nationalisation was not enough to satisfy the need of rural people and also people at large regarding credit need for growth and development of entrepreneurial needs mostly under small, micro and medium sectors causing required development of the economy and also promote the welfare of people in larger numbers. Six more commercial banks had been nationalised in April 1980. The banks taken under nationalisation in this phase had D&T liabilities being more than 200 crores. After the second phase of nationalisation , the total number of public sector banks had come upto the number 28 including State Bank of India, 7 associates of state bank of India and 20 banks in the nationalised sector.

## 3.8: Commercial banks in Post Nationalisation Period

In the post-nationalisation period, there had been a massive change in the concept of operation of banks and public interaction of banks in the country. In accordance with report of banking Commission (1972), "It was expected that the nationalised banks would endeavour to ensure that the needs of productive efforts of diverse kinds, irrespective of the size and social status of borrowers and in particular those of farmers, small scale industries and self- employed professional groups are met in increasing measure a number of changes in attitude of banks and methods of operation were called for". Accordingly, as it is observed it may be concluded that a structural as well operational changes had taken place in the performance of banks and also the bank operating system.

***Expansion in Branch Network towards Economical Development in the country***

There was the creation of wide horizontal and spatial increases of bank branches after the post-nationalisation period. This spatial expansion is the outcome of the structural transformation of Indian banks after the post-nationalisation period. Rarely anywhere else around the whole world there has been such a big dispersion and diversification of activities of public sector banks. In the period in between first phase of nationalisation in the year 1969 and 1975, just before the emergence of Regional Rural Banks (RRBs), there had been the massive spread of geographical area and span of activity of banks for being involved towards economic development of people of the country. On average, the growth of branches of public sector banks during this period had been four numbers per day. A number of public sector bank branches hid gone up from 6596 in 1969 to 15,077 in 1975. Because of this expansion in a number of bank branches, the number of people coming under the service of each branch had come down from 65,000 to 32,000. In accordance with Government of India policy decision, a large number of bank branches had been started in rural India since there had been the existence of very few or almost nonexistent of public sector bank branches. To bring the rural people under the services of public sector bank branches being at per with urban people to provide the services of economic development such policy decisions had been taken by the Government of India.

From the year 1975 to 1979, there was the establishment of another 6869 new public sector branches. Also along with this there been creation of anther1969 offices by RRBs in between this period – from 1975 to 1979. In addition to this, during 1989 to 1984, there had been a further expansion of branches of banks in the public sector and this additional number of branches opened during this period had gone up to 7612. By end of March 1984, the total number of branches jointly opened by public sector banks and also RRBs had gone up to 39,910.

Because of such horizontal expansion of bank branches, there had been a remarkable rise in a number of deposit accounts. In June 1979n this number of deposit account holders had been 1.8 crores and in June 1983 this figure had gone up to 17.85 crores. Also along with this people had been more interested in accounting habits and the bank deposits during the period from June 1969 to December 1984 had gone from Rs. 3,885 crores up to Rs. 64,710 crores.

***Sectorial Diversification to Aid Public Finance***

After such massive changes in banking systems and opening up of new branches, there had been changed the situation in the banking system which had accelerated the credit flow to priority sectors. This is an all-round changed situation in the banking operations of the country. Till the nationalisation of 14 major banks, the main function of banks had been to provide credit to prospective and profitable trading and industrial sectors on the basis of some security against the loan issued. This "security-oriented" approach precluded banks from financing other activities like agriculture or small scale industries. Agriculture during the period of the eighties had been a major contributor to national income, financing for agriculture had turned up to be low security and high risk related. Accordingly, in 1968, when large scale industries had been getting 61% of total bank credit and also sectors belonging to wholesale trade had obtained 18% of bank advances, the share of agriculture on bank credit had been only 2.2%. The share of small scale industry on public sector bank credit had been only 7% of total credit issued.

Since the process of nationalisation of public sector banks and the increase in the number of nationalised banks, the flow of credit to people in rural areas started growing up considerably. The number of bank branches belonging to the public sector had been growing up quantitatively and this caused qualitative growth in issued credit amount to people. Qualitative growth in lending practices of public sector banks had been because of quantitative growth in public sector bank branches. The on an average existing subsistence level of income in rural areas had led to the understanding that people in general in rural areas did not possess the minimum ability to provide a security deposit to banks against loan required by them. In order to come over this situation and bring such people under the facilities of obtaining bank credit, banks had taken the measure of coming away from traditional low-security purpose oriented credit measures. This nonconventional development in bank financing may be termed "mass banking" instead of "class banking".

Subsequently because of this measure there had been a severe change in credit deployment policy of banks. It was observed that in 1985, the credit issued to agricultural sector was increased to amount 25%, the credit issued to small scale sector had been to the level of 14% of total bank credit -a healthy growth in this sector. Also, it is seen that total credit issued to medium and large scale industries had been moving below%.

Another aspect to remember regarding this change is the change in the attitude of large and medium business houses upon overdependence upon bank loan or the banking system for the fund. It has been mainly brought about by linking working capital limits to inventory norms laid down on the basis of the Tandon Committee and subsequently by Chore and Marathe Committees.

Launching of the Integrated Rural Development Program (IRDP) in 1978, with the objective of providing assistance to 15 million families by 1985, had been the cause of bringing another dimension to the system of social orientation introduced by banks. In an actual situation, IRDP is the greatest unit program being ever attempted to remove rural poverty. It offers a marked role to the banks in providing the basic input of credit.

***Indian Public banking System in Role of Social Banking***

The government of India had made an overview of the fund to be credited people and the national goal for lending by the banks and in order to meet the system as such, there had been transformation belonging to both the areas belonging structural and operational areas. In fact, the broad national goal of elimination of poverty, unemployment, and growth with social justice have shaped the formulations of various directives and schemes.

These may be noted as below:

- Advances to priority sectors offered by banks should reach a target of 40% of outstanding credit.
- 16% of total advances of the bank should be made as Direct Agricultural Advances.
- 1% of total advances of the bank be made under the Differential Rate of Interest Scheme (DRIS) at a concessional rate of interest. Of the above, 40% should be provided to persons belonging to SC/ST.

- In order to reduce regional imbalances, banks have been directed to attain a credit-deposit ratio of 60% in respect of rural/semi-urban areas separately on an on-going basis. In other words, 60% of the deposits mobilised from rural areas should be deployed in these areas only.

**Priority sectors** mean agriculture, small scale industries, road, and water transport operations, setting up of new industrial estates, retail trade and small business, professionals and self-employed persons, education, housing, and consumption.

**Weaker Sections** include small and marginal farmers with all and holdings of 5 acres or less, Landless labours, tenant-farmers and sharecroppers, artisans, village and cottage industries, IRDP beneficiaries, DRI beneficiaries, and SC/ST borrowers.

**Assistance under the Scheme of Anti-poverty Programmes**

As mentioned previously, banks are given directions for deployment of their lendable resources in socially oriented schemes of financial assistance. The emphasis f several Five-year Plans has been on providing increasing assistance to the weakest of the weaker sections of the population. Keeping this view in mind various anti-poverty programmes have been launched by the banks. Some of the important among those has been discussed below.

**Integrated Rural Development Program (IRDP)**

Launched in April 1978, the IRDP mainly aims at assisting properly identified families those exist below the poverty lines in rural areas. To begin with, 2000 blocks of the country were selected for this program. The main target groups covered under the program include small and marginal farmers, agricultural labourers, rural craftsmen and artisans, persons belonging to SC/ST etc.

IRDP activities consist of very financial schemes for financing the targeted population and these are mentioned below:

i) Schemes for financing various priority sectors such as agriculture, fisheries, animal husbandry, horticulture, farm forestry etc.

ii) Schemes for financing different secondary sectors like handlooms, handicraft, Khadi and Village industries etc.

iii) Schemes for financing different tertiary sectors including small business, transport, and other service sectors.

Under the above schemes loan up to Rs. 5000 is provided by bank branches without insisting for any guarantees, securities or any margin money.

Another scheme which is known as Training of rural youth for Self–employment (TRYSEM) has also been initiated under the program IRDP. The purpose of TRYSEM is to provide suitable training to rural youths for developing their skills in order to equip the youths to apply the technologies received during these training programs in for of enterprises in the rural areas.

**Scheme for Self-employment to Educated Unemployed Youth (SEEUY)**

This scheme was initiated in August 1983, and the purpose of this scheme is to motivate educated unemployed youths to initiate for self-employment in ventures involving industry, services or business. Under this scheme, a composite loan within the limits of Rs.25,000 is sanctioned to youths being within the age group of 18 to 35. This amount of loan as sanctioned includes money as an investment and also the working capital. In such cases, the bank branch issuing the loan is not to ask for any collateral security or margin money or any third party guarantee as a guarantee from the owner.

**Scheme for Self-Employment Programme for Urban Poor (SEPUP)**

The government has gone for further assistance for urban poor taking into consideration that unemployment of youths is restricted not only in rural areas and accordingly introduced means of assistance of bank finance for urban educated youths. On the basis of this consideration, the government of India had initiated Scheme for Self–employment Program for the Urban Poor (SEPUP). Under this scheme, the assistance of up to Rs.5,000 is required to provide to various beneficiaries under this scheme depending upon the unit cost of the activity to be undertaken. This scheme started with time frame based objective and initially, it was started with the target object that by March 1987, banks will identify one beneficiary under this scheme out of 500 numbers of youths in all metro/urban/semi-urban centres having a population of more than 10,000 for assistance. As had been in other assistance programmes as noted above no collateral security, margin money or guarantee had to be given by borrowers.

Successively in this process in the Seventh Five Year Plan further benefit schemes were assigned for the nationalised bank branches. Primarily banks, being a major source of finance, had been entrusted with the responsibility of mobilising finance on an increasing scale for financing plan outlay. Also, the Seventh Five Year Plan had emphasised that anti-poverty programme should be regularly and adequately followed under the guidance of banks and being the sources of fund banks should provide necessary finance required for this purpose under IRDP scheme. Also for other programmes which imply that the banks will have to involve themselves on an increasing scale to meet the credit needs of the economy which are likely to emerge during the plan period.

## 3.9: Financial Institutions in Aid of MEMEs towards Social and Economic Development

It is not possible for any business organisation to depend upon its own fund as a fund for investment towards working capital and fixed capital development. Accordingly, business organisations are to depend upon external sources of fund for getting not only short term finance but also getting long term fund for meeting different requirements. Different financial institutions provide credit facilities as required by business organisation and in this respect enterprises coming under MSMEs get special facilities for obtaining short term as well as medium and long term credit facilities.

### 3.9.1: Rationale of development banking

The economic growth is a complex process that involves a host of social, political, economic, technological and institutional factors. Industrial development is a vital area in process of economic development and contribution of the industrial sector is very much significant in economical growth and development, Government of India has emphasised upon industrial development and out of this the development of MSMEs also has got priority. Successful development in the industrial sector whatsoever may be its classification either in the large sector or in MSMEs, along with other different factors like nature of entrepreneurship, the technology used, management, market availability of product it depends significantly upon availability of finance as capital in form of long term as well as short term finance. For this purpose, suitable financing institutions are required to acquire, mobilise and develop resources in order to sustain the process of growth. The purpose of developing banking is to help the industrial development and ultimately economic development in such situations. Accordingly, the growth of developing banking is very much relevant for such purposes and economic development on the whole.

The financial system is the system that regulates the complex institutional mechanism which mobilises the savings in the economy and the accumulated fund thus generated is transferred to industrial investment. Under this spectrum of the economic system, the banking system is a menace towards financing investment purposes.

As discussed earlier in this work, the banking system consists of the institutions of banking including commercial banks, co-operative banks, regional rural banks, and other specialised financial banks.

The economic development of a developing economy requires the availability of ‘term finance’ as compared to working capital finance. Other than finance in form of short term credit and long term credit, the entrepreneurs require technology, skill, market, consultancy etc. The development banking system in India has come up and been developed being equipped to provide the above-mentioned needs of entrepreneurs in specific and in general for the economy. The development banks have come up in India as ‘gap fillers" in credit structure and also technology and other needs of entrepreneurs. A development bank may be defined as "an institution either wholly or partially owned by the government or by private interests, primarily devoted to the stimulation and invigoration of the national capital market, to the provision of long term capital (both loan and equity) and to the supply of entrepreneurship including technical know-how and management to corporate sector.” (Singh, 1975)[1].

However, developing banks and banking financial intermediaries differ with each other with respect to ultimate sources of fund. The development banks obtain their funds primarily from government and central banks of the country. The banking financial intermediaries and private as well as public banking institutions are linked with ultimate sources of savings.

The special feature with development bank is that these banks provide development finance which may be treated as an actual investment into real assets. In fact, these banks other than providing finance also provide the resources as necessary for the business.

The essential characteristics of development banks in a developing economy may be summed as

i) stimulating capital market

ii) allocates risk capital and/or long term credit to large and MSMEs

iii) promotes broad-based entrepreneurship, encourages coming up of new enterprises, assists MSMEs encourages regional aspects of development,

iv) control and direction of private industry through corporate shareholding.

Thins the social implication of development banking is promoting growth and development of backward region assisting new coming up projects, taking mass consumption goods into production, export promotion and substitution of imports,

[1] **Singh, P. N. (1975).** *Role of development banks in a planned economy*. Vikas Publishing House.

through the development of large and MSMEs in accordance with national plans and priorities.

"Development Banks, like other institutions, reflect the background, situation and needs of the country in which they appear" (William, 1957)[2]. Indian commercial banks, as noted earlier, traditionally provide credits to industries and trade in order to meet their short term fund requirement. However, there was a need for restructuring the institutional structures of industrial sectors by satisfying their medium and long term requirements. The development banks had been created by the government to satisfy such need of industrial sectors including large sectors and MSMEs. The setting up of Industrial Financial Corporation of India in 1948 had been the beginning of development banking in India.

To make the development process more dynamic the National Industrial Development Corporation (NIDC) was established in 1954and after this Industrial Credit and Investment Corporation (ICICI) in 1955 and Industrial Development Bank of India in 1964 were created by government. For purpose of rehabilitating sick industries Industrial Reconstruction Corporation of India was established in 1971.

However, development of industries belonging to MSMEs and large sectors existing in rural areas was aimed and in 1982 National Agriculture and Rural Development Bank (NABARD) was established for purpose of rural development through the development of these industrial sectors. However, in this process to take off the attention of export and import activities related fund need, the Export-Import Bank of India (EXIM Bank) was also established in 1982.

[2] **Diamond, W. (1957).** *Development banks* (No. HG4517 D5).

Thus in order to satisfy the need of industrial sectors belonging to large and MSMEs and also agricultural sectors a set of institutions with variegated structure had been established in the country.

The setup and various functions of the institutes are discussed in the following discussion.

***Industrial Finance Corporation of India (IFCI)***

This development bank had been established in 1948 with main objective of providing more readily available medium and short term finance to MSMEs and also large scale industries even in situations when normal banking does not accommodate the demand because of situations being inappropriate or because of situations where capital issue channels are impracticable. The activities of this development bank have presently been widened since its initiation and it has covered a wide range of industries. The assistance of IFC may be available in the following forms:

i) The granting of the loan in Indian and foreign currencies
ii) Underwriting of share/debentures of public limited companies
iii) Guaranteeing of deferred payments for machinery imported from abroad or purchased within the country, foreign currency loans raised by industrial concerns and rupee loans raised from scheduled banks and co-operative banks.

The corporation takes care to provide credit and medium-term capital requirements of the industry for setting up the new industrial project and also for renovation, modernisation, diversification, and expansion of existing projects.

***Industrial Credit and Investment Corporation of India (ICICI)***

The second development bank in India after IFCI had been Industrial Credit and Investment Corporation of India (ICICI). This development bank had been set up in 1985.

ICICI, unlike IFC, is a private sector development bank since there had been no government participation in the share capital of this bank.

The objective behind setting up this development bank had been;

i) to encourage and help industrial finance in the private sector

ii) to assist in the availability of scarce foreign currency loans

iii)to develop underwriting facilities in India, these facilities were not provided by IFC.

Broadly, ICICI assists in respect of operation terms the following facilities:

i) in establishment, expansion, and modernisation of industries belonging to MSMEs and large scale sizes in private sectors

ii) motivating and promoting participation of private capital, both internal and external, in the ownership of industrial investment through a) providing long term or medium term loans for equity participation, b) sponsoring or underwriting of new issues of securities c) guaranteeing of loans from over private investment sources and iv) providing managerial, technical and administrative services to the industry.

The resource available to ICICI has consisted of loans in rupees from Government of India, Industrial Development Bank of India, lines of credit extended by World Bank and credit available from international/internal capital markets etc.

***Industrial Development Bank of India (IDBI)***

Before 1964 other than Industrial Financial Corporation of India (IFCI) and Industrial Credit and Investment Corporation of India (ICICI) only Life Insurance Corporation of India (LICI) and Unit Trust of India had been providing financial assistance by subscribing /underwriting shares and debentures of industrial concerns. But the financial assistance thus available were considered to be much less in comparison to the then required and growing need for industrialisation.

Accordingly under these considerations the Industrial Development Bank of India (IDBI) had been created in 1964as wholly owned subsidiary of the Reserve Bank of India with the primary function of coordinating and supplementing the activities of other term lending institutes and also to work as developing agency of planning, coordinating, promoting and developing of coming up industries and also promotion of industries.

The IDBI was authorised to finance different types of industrial concerns being involved in the manufacturing and processing of goods belonging to MSMEs and large scale with entrepreneurs originating from private or government agencies. Indirect assistance through refinancing of loans granted by banks to industrial units, guaranteeing of their obligation and subscription of the shares and bonds of term lending and other financing institutes are provided by IDBI. Other than this IDBI is also empowered to discount or rediscount bills of exchanges or promissory notes of industrial organisations. As an apex institution, IDBI also takes different measures for achieving socioeconomic objectives by the creation of regional growth through industrial development and creation employment etc.

The principal sources of IDBI include share capital, borrowings from government/Reserve Bank of India, market borrowings, foreign currency borrowings, deposits from companies, loan repayment etc.

The components of the assistance of IDBI are as below:

i) Direct assistance

ii) Indirect assistance through refinancing, rediscounting of bills etc.

iii)Promotional assistance

***Direct Assistance***

Direct assistance takes the forms of loan, soft loan, underwriting, /subscription to shares, debentures, and guarantees.

***Indirect Assistance***

IDBI provides assistance to Micro, Small and Medium enterprises indirectly by way of refinancing of loan issued by commercial banks, cooperative banks, regional rural banks through rediscounting bills of exchange.

Promotional Assistance

a) Assistance for development of backward regions

b) Assistance by way of seed capital scheme

c) A large range of consultancy services

***Export-Import Bank of India (EXIM)***

Export-Import Bank of India was (EXIM Bank) was set up in January 1982 with the objective of providing financial assistance to importers and importers. Also work for functioning as a principal financial institution for assisting institutions engaged in export and import of goods and services, by this way this bank promotes foreign trade of the country.

The bank is authorised to provide assistance as below:

- Grant loans to commercial and other eligible financial institutions by way of refinancing of loans for purpose of import and export.
- Underwrite the issues of stocks, shares, bonds etc of any organisation involving export and import
- Accept, collect, discount, rediscount, purchase, sell or negotiate inside or outside India bills of exchange or promissory notes in the transactions related to export or import.

- Open, grant, issue and confirm letters of credit and collect bills and other documents related to export and import.
- Undertake limited development or merchant banking activities related to export-oriented units.
- Do other activities related to export-import performances like trading, buying, selling etc.

The bank operates in glob competitive environment through innovative financial packages and this has resulted promoting export-import in India.

***National Bank for Agricultural and Rural Development (NABARD)***

A committee known as Committee to Review Arrangements for Institution Credit for Agriculture and Rural Development (CRAFICARD) had in its interim report in 1979, envisaged that a new apex bank is required to provide attention, powerful direction and pointed focus to credit problems of rural sectors. It was recommended by this committee that the new bank should take over the supervision of the total rural credit system from reserve bank of India.

With the acceptance of the recommendation of that committee, the National Bank for Agricultural and Rural Development (NABARD) was established in 1982.

The bank is empowered to provide short term refinance assistance, for a period not exceeding 18 months, to state cooperative banks, regional rural banks, and other approved financial institutions. Long term assistance of loan is provided by the bank through refinancing facilities to scheduled commercial banks, regional rural banks, and other approved financial institutions for the purpose of making investment loans available and for giving loans to artisans, small scale industries and village and cottage industries coming under MSM sectors.

***Industrial Reconstruction Bank of India (IRBI)***

One of the outcomes in industrial development had been an increasing number of industrial sickness, especially for MSME sectors. In case of such industrial sickness, a large amount of money which were credited to these sectors belonging to financial institutes are locked and this freeing of fund cause serious problem to the process of industrial rehabilitation. For purpose of coming over such problems, Industrial Reconstruction Corporation of India was established in 1971.

Subsequently, in 1986, this financial institution was renamed as Indian Reconstruction Bank of India (IRBI). This bank works as a principal credit and reconstruction agency for the revival of sick industries. The bank undertakes reconstruction and revival of sick industries by renovation, modernisation, expansion, diversification, reconstruction, and expansion of sick industries.

The bank is entrusted with the primary duty of providing financial assistance and suitable guidance to sick industrial units when such units are not in a position to get credit facilities from public sector banks. The assistance from this bank is in form of the term loan, equipment leasing, hire purchase, a line of credit etc. to MSMEs and large scale industries.

The total term loan sanctioned since the creation of bank has been observed to be 54.38% for expansion, renovation, restructuring, and diversification, the percentage of loan issued on account of the provision of margin money, working capital coming next to this percentage of the issued loan.

Recently, under the guidance and leadership of IRBI, an inter-institutional group has been formed and the purpose of this group is taking into consideration various issues related to rehabilitation of industrial units which are sick. This group is termed and known as Inter-Institutional Rehabilitation meeting (IIRM). The IIRM will take into consideration different issues connected with sick units make in-depth analytical study over the problem and even if necessary discuss with different authorities, consultants and experts. In this way, IIRM will find out the evolution of policy to come over the problem to find the means of rehabilitation and reconstruction of the sick units.

Thus it is observed that money and capital market provide support to business and industry belonging to MSMEs for their creation, function, and development and also in situations when they face the problem of industrial sickness. Hence from the standpoint of environment, including industrial, social and economic, it is the crucial function for entrepreneurs of both MSMEs and large sectors to have a close association with these financial institutes and also knowing all about the possibilities of progress and development the industries can avail with their assistance.

**Social Orientation of the Activities of Bank**

Over the years, with the directional change that has occurred in the banking system and the fact that the banks responding favourably by evolving new strategies and innovative ideas, the credit structure of the country has become strong and stable. Recognising the fact that the banks are vital catalytic agents of growth that provide the basic input of credit, new programs with a strong social orientation have been designed with a view to assisting the weaker sections of the society. It is expected that the banks will discharge their functional responsibilities more diligently so that they take the economy successfully to a big horizon towards its coming days.