Commercial Banks and Industrial Finance in India: The Pre-Liberalisation Scenario

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Abstract: Development of industry is an essential prerequisite for the development of the economy of a country. Needless to say that it is absolutely imperative to have a proper supply of finance for the industrial sector to develop and prosper. Commercial banks, *inter alia*, of a country have to play a pivotal role in this respect, especially when the economy is a budding one. The economy of India has grown at a rapid pace since the economic liberalisation process took off in 1991-92. With the onset of this process, the capital market in India snowballed and has become a major source of industrial finance. But one must not forget that in the pre-liberalisation era, the underpinning in this respect was provided mainly by the commercial banks. With this in view, this paper attempts to analyse in-depth their contribution prior to the incipience of economic liberalisation since the infancy of modern day banking in India.

Key-words: Commercial banking, sectoral deployment, bank advances, underwriting.

1. Introduction

It is a known fact that from very early times there existed in India a reasonably developed mechanism of banking and credit by contemporary standards, capable of fulfilling the needs of the then Indian society. The *Vedas*, *Manusmriti* and Kautilya's *Arthashastra* bear testimony to the existence and efficient functioning of banking in ancient India. "From all this it is obvious that India possessed for all times known to history a system of banking which admirably fulfilled her needs and proved very beneficial to her, although its methods were different from those of modern Western banking" (*Garg, 1964*).

The method of banking that existed in India in those days consisted of money lending and transfer of monetary claims through Hundis from one place to another. "The use of credit instruments is also quite old in India and Hundi, the indigenous credit instrument, has been in vogue for a very long time. In our early history one comes across references to bankers whose Hundis were honoured throughout the length and breadth of the country" (*Ghoshal and Sharma, 1965*). The banking system carried on by individuals known as 'Shresthis' and 'Sahukars' served the needs of primitive and medieval agriculture, industry and trade. These bankers were also the bankers of the native rulers. The house of Jagat Seths, the hereditary bankers of the Nawab of Bengal, was founded as early as in 1715 (*Sinha, 1927*).

With the arrival of the East India Company in India the modern era of trade and commerce commenced. The British businessmen, conversant with the banking system that was in existence in their country at that time, found it inconvenient to carry on their activities in India as the indigenous bankers were either incapable or unwilling to extend banking or credit facilities to them. Thus, in order to meet the requirements of English businessmen, the Managing Agency houses of Calcutta and Bombay gradually extended their horizon of operation to include banking. In fact, the entry of the Managing Agency Houses into the arena of banking marked the emergence of the practice of British commercial banking in India. The earliest example of such banks in India was the Bank of Hindostan, established in Calcutta by Messrs. Alexander & Co. in 1770 and that was also the first public bank of the country.

The second wave of banking development came at the beginning of the nineteenth century with the establishment of the first Presidency Bank, the Bank of Calcutta, in 1806. Two more Presidency Banks, the Bank of Bombay and the Bank of Madras were established in 1840 and 1843 respectively. The Presidency Banks acted as the bankers of the Government and had the right of issuing currency notes till 1862. These banks also served the interest of the East India Company and British businessmen till their merger and the formation of the Imperial Bank of India in 1921.

Modern joint stock banking in India may be said to have begun from 1860 when the concept of limited liability was made applicable to the banking business by the Companies Act of 1860, which followed the English Act of 1858 (Rungta, 1970). Since the passing of the Companies Act of 1860, large number of banking and loan companies were established. In 1895-96 there existed 299 such banking and loan companies, but most of those companies were so small that they were no more than small savings and loan societies. Thus, the progress of modern organised banking was not very satisfactory; by the end of the century there were three Presidency Banks, eight Exchange Banks and nine Indian Joint Stock Banks, besides a number of small savings and loan societies. The Presidency Banks, as has already been mentioned, were semi-Government institutions. The Exchange Banks, owned by foreigners, engaged themselves primarily in the international trade of India and the Joint Stock Banks, owned mainly by the Indians, confined themselves primarily to the internal trade.

2. State of Industrial Finance in India

The modern banking system, developed in India under the initiative and enterprise of those who were conversant with the British counterpart, naturally followed the orthodox British system. The banking system arose out of the requirements of foreign investors who transacted business in India, mainly foreign trade, and remitted money to their country. "They needed a modern banking system to carry out the processes of foreign trade–most important, to transfer foreign exchange or to supply it, and also to meet credit requirements between order and payment. ...The English investors normally invested their own resources and ploughed back their earnings. ...There was little demand for long–term credit under such circumstances; the banks maintained their English character as institutions for the supply of short-term credit" *(Rosen, 1962)*.

Indian businessmen, who began to shift from commerce to industry under the stimuli of examples set by the foreigners or self-recognised opportunities, also experienced inconvenience in financing their ventures without support from the banking system. In the absence of issue houses and investment banks, the Indian entrepreneurs were neither in a position to get their shares and debentures underwritten nor was there any supply of finance specially for meeting the long-term needs. The Indian entrepreneurs, however, did not lag behind. A number of Indian-owned banks were set up, in some cases, by the entrepreneurs themselves for ensuring the supply of fund to the ventures owned or patronised by them. "Many of the banking, insurance, and finance companies were under the domination or influence of particular business houses, giving rise to a system of what may be called 'captive' financial institutions which were integral parts of financial and industrial complexes" (*Gupta, 1969*). Such chain holding of financial and industrial companies gave birth to a system of individual or family control over a number of industries, which ultimately paved the way for investment of profits of industries under the same ownership among themselves. Thus, the long-term financial needs of the industries under the big business houses were met to a considerable extent from the internal sources and the banks were ultimately allowed to follow the British system of supplying only short-term working capital. The Indian-owned banks, modelled on the British, thus performed a similar function– the supply of short-term credit against tangible, rapidly turned over assets in the form of stocks of raw materials and finished products.

Demand for fostering indigenous industries, however, gained momentum with the onset of the twentieth century under the influence of the Swadeshi Movement. Ambition of industrial development, strengthened by the spirit of the Swadeshi Movement, led to the establishment of a number of banks in different parts of the country particularly for meeting the needs of indigenous industries. Attempts at such industrial financing were made for the first time by a number of commercial banks, mostly in the Punjab, during the Swadeshi movement of 1906-13. Instead of pursuing the orthodox system of commercial banking, these banks freely subscribed to the shares and debentures of the industrial companies set up by the Indians and also granted loans and advances against the mortgage of real estates and capital goods. The new Joint Stock Banks undertook varied types of business, including industrial financing and developed an unmistakable tendency to provide long-term finance to industry. But these banks, popularly known as Swadeshi Banks, had a very brief history of operation. A large number of these banks failed during the crisis of 1913-15. The founders of these banks were mostly enthusiastic Indians without any experience in banking or industrial finance, nor did they pay due regard to known principles and practices of investment banking. They were primarily deposit banks and the policy of locking up almost the whole of their resources in long-term industrial investments, unrealisable at the time of a crisis, was inevitably followed by disastrous consequences.

During the boom that followed the First World War, a number of commercial banks were promoted to provide long-term finance to the companies set up by the Indian entrepreneurs. The promoters of these banks were moved by the role played by the Japanese and German industrial banks in the spectacular industrial development of those countries. But whatever might have been there in the minds of the promoters, these banks were far from well-conceived industrial banks. A perusal of their Memoranda and Articles of Association shows that they intended to pursue every variety of ordinary banking business and couple with it issue, investment trust and real estate mortgage business.

Undaunted by the massive periodic failures, the search for an appropriate system of industrial financing institutions continued. Formation of the Imperial Bank of India in 1921 and the establishment of the Reserve Bank of India in 1934 failed to provide any solution to the problem in the absence of a definite policy for industrial development and a plan for realising the goal. Thus, at the start of the programme of industrialisation after independence, India had a large unorganized money market which met the demands for funds on the part of the rural and poor urban population; an almost unrelated modern banking system, the main purpose of which was to supply the short-term capital needs of firms whose longer term requirements were largely met from the internal sources of the firm or the ownership group; and a security market which contributed to meeting the longer term investment needs of only a few firms.

3. Commercial Banking in India since Independence: Trends and Progress

An analysis of the policy of commercial banks with respect to the financing of industrial development in the period since the independence of India must be preceded by a brief account of the various types of commercial banks, their relative importance and their lending practices.

In India there are scheduled banks and non-scheduled banks. Scheduled banks are banks that are included in the Second Schedule of the RBI Act, 1934 having paid-up capital and reserves of an aggregate value of Rs. 5 lakh and above. Such banks must maintain a minimum reserve with the Reserve Bank of India and have the right to borrow from it under different circumstances. The non-scheduled banks, on the other hand, are smaller banks with paid-up capital and reserve below Rs. 5 lakh. These banks are not required to maintain any reserve with the Reserve Bank of India, but can borrow from it only under special circumstances. Both the scheduled and non-scheduled banks are under the control of the Reserve Bank of India. The control of the Reserve Bank of India has been strengthened by the Banking Companies Act of 1949 and the nationalisation of the Reserve Bank of India in the preceding year. In this context, it may be noted that since May 1997 there does not exist any non-scheduled commercial bank in India, although there are some non-scheduled cooperative banks.

From the point of view of the number of banks and the volume of business transacted, the non-scheduled banks occupy a very insignificant position. From Table 1 it can be found that over the years from 1951 onwards, the non-scheduled banks have lost their significance steadily both in terms of attracting deposits and extending credit. In 1970, the non-scheduled banks attracted only 0.45 per cent of the deposits and extended 0.27 per cent of credit of both the categories of banks taken together.

Table-1 : Commercial Banking Trends at a Glance
(As on the last Friday of June)

(Rs. Crore)

	1951	1961	1967	1970
No. of Banks:				
i) Scheduled Banks	92	84	74	72
ii) Non-Scheduled Banks	474	249	24	14
Deposits:				
i) Scheduled Banks	918.1	1775.8	3517.0	5239.8
ii) Non-Scheduled Banks	69.9	43.4	24.5	23.5
Bank Credit:				
i) Scheduled Banks	545.1	1282.8	2631.1	4227.6
ii) Non-Scheduled Banks	45.8	27.6	15.1	11.3

Sources: 1) Reserve Bank of India: *Annual Report on the Working of the Reserve Bank of India and Trend and Progress of Banking in India, June 30, 1970, Bombay.*

2) Reserve Bank of India: *Statistical Tables Relating to Banks in India, 1953, Bombay.*

The scheduled banks also include the branches of foreign banks which were centred in and around the port cities for facilitating the financing of foreign trade. Since 1947, the situation has changed considerably. Now the branches of foreign banks are taking part in internal banking business as well and the Indian scheduled banks are also taking an interest in foreign trade. Thus, side by side, with expansion in the volume of business, the scheduled banks have also extended the scope of their operations. The non-scheduled banks, on the other hand, serve mainly the rural and unorganised sector. In the context of the above analysis, our examination of the role of commercial banks in the supply of industrial finance would naturally include only the scheduled commercial banks.

Indian banking made considerable progress during and after the Second World War. But it was not sufficient to meet the requirements of a vast country like India. A small number of big banks concentrated their operations mostly in the urban areas, whereas the vast rural areas remained either completely unbanked or were banked by a few smaller banks with meagre financial resources. Hence, in order to consolidate the banking system, a policy of merging the non-viable units with the viable ones was followed. This led to a reduction in the number of banks in the subsequent years. Simultaneously, however, the branches of scheduled commercial banks were opened in the unbanked or meagrely banked rural areas. The twin policy of strengthening the banking system and extending the area of operation of the organised banking was successfully pursued, through the formation of the State Bank of India in 1955 and the nationalisation of the fourteen major commercial banks in July, 1969.

From Table 2 it would appear that since nationalisation in 1969, the commercial banking recorded an all-round progress. Through the opening of new branches, the commercial banks were able to go nearer to the people and mobilise their precious savings for use in productive purposes. While the deposits of commercial banks during the period increased by more than 51 times, the number of people served by each office of commercial banks decreased from 64,000 to 14,000 only. This necessarily means that there was also qualitative improvement in the services of the commercial banks. Increase in per capita deposits by more than 31 times conclusively proves the ability of nationalised banks in mobilising the savings of the people by going nearer to them. In fact, the all-round progress of the commercial banks since nationalisation demonstrated the confidence of the society in the economic philosophy which did away with the domination and control of banks by large business houses.

Table-2 : Progress of Commercial Banking at a Glance

Important Indicators	June 1969	June 1984	June 1988	March 1992
1. No. of Commercial Banks of which	89	247	278	276
a) Non-Scheduled	16	4	4	4
b) Scheduled	73	243	274	272
of which (RRBs)	(-)	(162)	(196)	(196)
2. No. of Bank Offices in India	8262	45332	55410	60570
3. Population per office (in thousands)	64	16	14	14
4. Deposits of Scheduled Comm. Banks in India of which (Rs. Crore)	4646	64620	126323	237566
a) Demand	2104	12195	21936	48893
b) Time	2542	52425	104387	188672
5. Credit of Scheduled Comm. Banks in India (Rs. Crore)	3599	43613	72436	131520
6. Deposits of Scheduled Comm. Banks per office (Rs. Lakh)	56	143	228	392
7. Credit of Scheduled Comm. Banks per office (Rs. Lakh)	44	96	131	217
8. Per Capita Deposits of Scheduled Comm. Banks (Rs.)	88	878	1586	2738

Source: **Reserve Bank of India:** ***Banking Statistics: Basic Statistical Returns,*** **Vol. 20, March 1991, Published in February 1993, Bombay.**

4. Financial Practice of Indian Commercial Banks: Emerging Trends Toward Industrial Financing in India

Commercial banks are a major source of finance to industry and trade. During the period from 1969 to 1992, the volume of bank credit increased by 36.54 times from Rs. 3599 crore to Rs. 131520 crore. Banks in India mainly provide short-term credit for meeting the working capital needs of the borrowers. This is mainly because of the fact that a substantial portion of the resources of these banks consists of demand and short-term deposits. In actual practice, however, a considerable portion of the short-term bank credit is always renewed and therefore, serves as a substitute for long-term finance. Moreover, quite in tune with the changing practice of commercial banking from 'real bills doctrine' to the 'anticipated income theory', the Indian commercial banks extended the scope of their operations in order to meet the requirements of planned economic development. S.K. Basu wrote in 1980: "Commercial banking today presents a new picture–a picture of innovations in practice, of wider horizons and of new enterprises." Supply of credit for packing, advances against export and import bills, foreign currency loans and cash incentives for export were examples of such innovations. While there were development banks and other financial intermediaries for supplying term loans, the commercial banks also enhanced the supply of term loans to industry. While participation in long term industrial financing has taken place through clearly distinct financial intermediaries and has therefore been indirect, there appears to be a broad trend towards a shift of commercial banks' interest in favour of direct term loans on American lines to trade and industry.

From Table 3 it can be seen that during the period from 1972 to 1991, the composition of outstanding credit of commercial banks underwent very meaningful changes. In the first place, cash credit, the most popular form of bank credit, lost much of its importance and the term loans gained considerable prominence. In 1972, cash credit constituted as much as 50.4 per cent of the outstanding bank credit whereas in 1991, it came down to 35.7 per cent. During the same period, the share of term loans increased from 11.9 per cent to 30.5 per cent of the outstanding bank credit. Again, during the same period, the shares of overdrafts and demand loans declined slightly, but those declines were made good by the addition of new forms of credit granted for specific purposes such as those against foreign currency cheques, etc. and advances against Export Cash Incentives and Duty Drawback claims. Over the period of twenty years, as shown in Table 3, the volume of bank credit increased by more than nineteen times.

Corporate sector of India, the centre of all industrial and business activities, is a deficit sector in the sense that its requirements for new investments cannot be met from its internal sources. Thus, for meeting the deficit, the corporate sector draws upon the surplus of other sectors, particularly the household sector, the commercial banks and other financial institutions.

Table-3 : Distriution of Outstanding Credit of Scheduled Commercial Banks according to Type of Account

(Amount outstanding as on the last Friday)

(Rs. Crore)

Type of Account	Dec. 1972	Dec. 1980	Dec. 1988	March 1991
1. Cash Credit	2544.7 (50.4)	8578.3 (42.4)	22613.2 (38.0)	34554.6 (35.7)
2. Overdrafts	479.7 (9.5)	1345.2 (6.7)	4387.8 (7.4)	7505.0 (7.8)
3. Demand Loans	330.9 (6.6)	981.1 (4.9)	2259.3 (3.8)	3363.8 (3.5)
4. Term Loans	601.1 (11.9)	4492.4 (22.2)	17204.3 (28.9)	29615.6 (30.5)
5. Packing Credit	209.6 (4.1)	754.5 (3.7)	2726.4 (4.6)	4255.6 (4.4)
6. Export Bills Purchased / Discounted / Advanced against	212.4 (4.2)	795.7 (3.9)	1944.6 (3.3)	3642.1 (3.8)
7. Inland Bills Purchased / Discounted	631.9 (12.5)	3056.8 (15.1)	7718.0 (12.9)	10847.9 (11.2)
8. Advances against Import Bills	30.3 (0.6)	217.0 (1.1)	545.2 (0.9)	1269.3 (1.3)
9. Foreign Currency Cheques / TCs / DDs / TTs / MTs purchased	–	–	124.8 (0.2)	1608.3 (1.7)
10. Advances against Export Cash Incentives & Duty Drawback claims	–	–	–	218.2 (0.2)
11. Unclassified	10.8 (0.2)	–	–	–
TOTAL :	5051.4	20221.0	59523.7	96880.4

Note: Figures in brackets indicate percentage to total.

Source: Reserve Bank of India: *Banking Statistics: Basic Statistical Returns*, Vol. 1, 1972; Vol.11, 1980; Vol. 17, 1988; Vol.20, 1991.

Table 4 depicts the composition and the volume of flow of fund to the private corporate sector from various sources from the beginning of the First Five Year Plan to 1990-91.

The table indicates that during the First Plan period, about 15 per cent of the fund required by the private corporate sector had come from the Banking sector. Flow of fund from the banking sector to the private corporate sector increased to 61 per cent in 1966-69 and reached a low point of 23 per cent of its requirements in 1980-81. Since 1981-82, the share of the Banking sector began to increase and by 1988-89 it accounted for the next all-time high of 55 per cent of the total flow of fund to the private corporate sector. Overall proportionate decline in the flow of fund from the Banking sector to the private corporate sector since 1969-70 is attributable to the nationalisation of fourteen major commercial banks in 1969 and the adoption of the policy of providing greater financial support to the priority sector. It is also very interesting to note that the flow of funds from the other financial institutions, which include mainly development banks, increased appreciably during the period. In fact, decline in the flow of fund from the Banking sector during the period was made good, at least to a considerable extent, by increase in the flow of funds from the other financial institutions. Barring the First Five Year Plan period and early 1980s, flow of funds to the private corporate sector from banking and other financial institutions taken together varied between 54 per cent and even one hundred per cent during the period covered by the study.

Table-4 : Flow of Fund to Private Corporate Sector

(Rs. Crore)

Year	Banking	Other Financial Institutions	Govt.	Households	Rest of the World	Others	Total
1951-56	63 (15)	40 (10)	29 (7)	275 (66)	8 (2)	1 (-)	416 (100)
1956-61	363 (44)	82 (10)	95 (12)	281 (34)	61 (7)	-58 (-7)	824 (100)
1961-66	813 (51)	354 (22)	115 (7)	253 (16)	62 (4)	- (-)	1597 (100)
1966-67 to 1968-69	695 (61)	226 (20)	68 (6)	89 (8)	60 (5)	-4 (-)	1134 (100)
1969-70 to 1971-72	450 (43)	211 (20)	143 (13)	292 (28)	-60 (-6)	21 (2)	1057 (100)

Table-4 : Flow of Fund to Private Corporate Sector (*Contd.*)

(Rs. Crore)

Year	Banking	Other Financial Institutions	Govt.	Households	Rest of the World	Others	Total
1980-81	637 (23)	686 (24)	134 (5)	1017 (36)	2 (-)	328 (12)	2804 (100)
1981-82	1641 (28)	1056 (18)	150 (2)	1481 (25)	40 (1)	1579 (26)	5947 (100)
1982-83	1464 (25)	1175 (20)	171 (3)	1716 (30)	48 (1)	1220 (21)	5794 (100)
1983-84	1053 (26)	1320 (32)	101 (3)	519 (13)	37 (1)	1026 (25)	4056 (100)
1984-85	1625 (32)	1406 (28)	-164 (-4)	1178 (24)	76 (2)	904 (18)	5025 (100)
1985-86	2311 (35)	1642 (25)	-35 (-)	1827 (28)	- (-)	789 (12)	6534 (100)
1987-88	2886 (46)	3238 (52)	-69 (-1)	1035 (16)	86 (1)	-892 (-14)	6284 (100)
1988-89	7107 (55)	5502 (42)	-446 (-3)	1362 (10)	451 (3)	-937 (-7)	13039 (100)
1989-90	6373 (44)	8196 (57)	71 (-)	1807 (12)	788 (5)	-2798 (-19)	14437 (100)
1990-91	6067 (41)	8393 (56)	165 (1)	1423 (10)	1029 (7)	-2245 (-15)	14832 (100)

Note: Figures in brackets indicate percentage (in rounded figure) to total.

Sources: a) V.V. Divatia & T.R. Venkatachalam: "Flow of Funds Accounts" in *Reserve Bank of India Staff Occasional Papers,* Vol. No. 2, Dec. 1976, p.129;

b) Reserve Bank of India: *Reserve Bank of India Bulletin,* Bombay, January 1991 and June 1993.

Having analysed the pattern of flow of funds from different sectors to the private corporate sector, it would now be pertinent to analyse the relative importance of the different sources of fund from the point of view of the users of fund, that is, the corporate sector.

The corporate sector secures funds from internal and external sources. Internal sources consist of depreciation fund, retained profit and capitalised reserve, whereas, equity capital raised by new issues and borrowings are the major components of external source of fund. Principal sources of borrowed funds are the commercial banks, other financial institutions and debentures. The optimum combination of internal and external sources depends upon the need and ability of the company as well as upon the conditions of the capital market. How much a company can borrow again depends upon the position of the net worth and projected future level of cash flow.

Table 5 indicates the pattern of flow of funds to the medium and large public limited companies from internal and external sources and from the commercial banks in particular during the period from 1951-1955 to 1990-91. The table has been prepared on the basis of the data published by the Reserve Bank of India on the sample of companies having paid-up capital above Rs. 5 lakh and representing the major portion of the total paid-up capital of pubic limited companies. To make the study a representative one, RBI left out smaller companies with paid-up capital below Rs. 5 lakh and big companies with paid-up capital of Rs. 1 crore and above.

Table-5 : Source of Fund to the Medium and Large Public Limited Companies: 1951-55 To 1990-91

(Rs. Crore)

Years	Total of All Sources	Internal Sources	External Sources		
			Total	Borrowing	Borrowing from Banks
1951-55	443	306 (69.7)	137	58 (13.1)	26 (5.2)
1956-60	1116	624 (55.9)	492	292 (26.2)	181 (16.2)
1961-64	1047	632 (60.4)	415	196 (18.7)	154 (14.7)
1964-65 to 1965-66	843	388 (46.0)	455	279 (33.1)	199 (23.6)
1966-67 to 1970-71	2963	1466 (49.5)	1497	799 (26.8)	497 (16.8)
1971-72 to 1975-76	6021	3104 (51.6)	2917	1214 (20.2)	785 (13.0)
1976-77 to 1981-82	14456	5432 (37.6)	9024	4386 (30.3)	1791 (12.4)

Table-5 : Source of Fund to the Medium and Large Public Limited Companies: 1951-55 To 1990-91 (*Contd.*)

(Rs. Crore)

Years	Total of All Sources	Internal Sources	External Sources		
			Total	Borrowing	Borrowing from Banks
1982-83 to 1984-85	9975	3635 (36.4)	6340	3552 (35.6)	1020 (10.2)
1985-86 to 1987-88	21805	7193 (33.0)	14612	8094 (37.1)	2642 (12.1)
1988-89 to 1990-91	46368	14756 (31.8)	31612	17355 (37.4)	6138 (13.2)

Notes: 1) Borrowing includes trade dues.
2) Figures in brackets indicate percentage of the total of all sources.

Sources: a) Reserve Bank of India: *Reserve Bank of India Bulletin,* Bombay, Different issues.
b) Reserve Bank of India: *Report on Currency & Finance,* Bombay, Different issues.

From the data presented in Table 5 an idea can be had about the importance of internal and external sources of finance as well as that of borrowing from the commercial banks in the overall financing of the growth of the public limited companies in India since independence. The facts submitted above do not provide a complete picture about the sources of finance of the corporate sector but are no doubt representative. Facts depicted in the table clearly indicate that the internal source continued to supply the major portion of the fund required by the corporate sector for its growth and development till 1964. Thereafter, the importance of the internal source of fund till the early 1960s are attributable to the non-existence of a vibrant capital market, absence of a developed network of financial institutions capable of catering to the need of the corporate sector itself. Under these circumstances, internal financing had to be resorted to on a wider scale, which the corporate sector was also capable of bearing in the context of their limited requirements.

Conversely, the importance of the external sources increased during the period, from a meagre 30 per cent in 1951-55 to 68 per cent in 1988-89 to 1990-91. Borrowing constituted an important component of the external sources, with banks being the suppliers of a considerable part of the funds borrowed by the corporate sector. During the period, borrowing from banks increased from 5.2 per cent of the total investment from all sources in 1951-55 to 23.6 per cent in 1964-66 and then came down to 13 per cent in the early 1970s where it settled down since then with insignificant year to year variations. It is thus clear that the borrowings from banks, as percentage of total investments from all sources, after reaching the peak in 1964-66 settled down around 13 per cent during the 1970s and 1980s. During the entire period, however, average net annual borrowing from banks by the corporate sector increased steadily, from a little above Rs. 5 crore in 1951-55 to about Rs. 900 crore in 1985-86 to 1987-88 and to more than Rs. 2045 crore in 1988-89 to 1990-91. Reasons behind the relative decline of the share of borrowing from banks since the late 1960s are nationalisation of the major commercial banks in 1969 and diversion of funds to the priority sector, growing reliance of the private corporate sector on other financial institutions such as the development banks and the increasing popularity of debentures as an important source of borrowing to the corporate sector.

Having examined the pattern of flow of fund to the private corporate sector from different sources including the commercial banks, we now venture to have a probe into the sectoral distribution of bank advances. Economic activities of the country are conveniently classified as the products of certain sectors and the advances given to those sectors by the commercial banks from time to time indicate the extent of patronage the banking system extended to those sectors. In India, simultaneously with increase in the control of the State over the banking system ever since the independence of the country, there has also taken place changes in the direction of flow of fund from the banking sector to different activities.

Table 6 indicates purpose-wise distribution of bank advances from the First Five Year Plan to the Seventh Five Year Plan. The table has been divided into two parts, Part-A and Part-B. Part-A includes the period up to the nationalisation of major commercial banks in 1969, and Part-B includes the period after nationalisation. This will enable us to find out the changes, if any, taking place in the direction of flow of advances of commercial banks after nationalisation. The tables are prepared on the basis of the data on the functioning of commercial banks made available by the Reserve Bank of India. As such, a complete picture about the direction of flow of advances of commercial banks and the changes taking place therein from time to time can be had from these tables.

It transpires from Table 6A that from the beginning of the planning for economic development, there started taking place significant changes in the purpose wise distribution of advances of commercial banks. The share of 'Industry' increased from 35.2 per cent during the First Plan to 59.7 per cent in the Third Plan. The trend continued during the Annual Plans of 1967 and 1968. The Second Five Year Plan, it is known to us, laid the foundation of the heavy industries and the commercial banks, by and large, provided necessary support to the endeavour of the State. There was little change in scheduled bank finance until 1955, and that thereafter the large increases in total bank credit were primarily associated with the increase of finance to industry. Commercial banks, during the period, provided financial support for industrial development in all conceivable means in the absence of a developed capital market and a developed network of term-lending institutions. The growth in the industrial credit during the late 1960s and early 1970s had taken place at a higher rate in relation to the growth of industrial production and the rising prices. "During the five-year period from 1968-69 to 1973-74, the value of the net domestic product originating in industry as a whole at 1960-61 prices increased by about 14.5 per cent; at current prices, it increased by 72 per cent. Broadly, during the same period, commercial bank credit to industry increased by 135 per cent and total institutional credit by 118 per cent" (*Shetty, 1978*). It is also interesting to note that the share of commerce in the advances of commercial banks steadily declined during the period from as high as 49.3 per cent during the First Plan to only 19.3 per cent during 1967-68. Till the beginning of planning, commerce alone used to attract more than half of the total advances of commercial banks; in 1949 it was 50.8 per cent and in 1950 it was 51.8 per cent of the total advances of commercial banks.

Table-6A : Analysis of the Sectoral Deployment of Advances of Scheduled Commercial Banks

(Rs. Crore)

Sectors	1951-1956	1957-1961	1961-1966	1967-1968
Agriculture	75.6 (2.1)	83.6 (1.7)	26.9 (0.3)	19.0 (0.3)
Industry	1262.3 (35.2)	2432.0 (48.9)	5510.5 (59.7)	3815.4 (66.0)
Commerce	1765.9 (49.3)	1807.7 (36.3)	2449.0 (26.5)	1114.2 (19.3)
Personal & Professional	296.0 (8.3)	408.8 (8.2)	567.9 (6.2)	227.9 (3.9)
Financial	–	63.0 (1.3)	422.1 (4.6)	180.9 (3.1)
Plantations	–	–	–	104.7 (1.8)
All others	181.9 (5.1)	180.5 (3.6)	246.8 (2.7)	319.5 (5.5)
Total :	3581.8 (100.0)	4975.5 (100.0)	9223.2 (100.0)	5781.6 (100.0)

Notes: 1) Figures in brackets indicate percentage to total.

2) In 1967, 1968 and 1969, there were three Annual Plans. Figures for 1969 were not available.

Sources: a) Reserve Bank of India: *Trend and Progress of Banking in India,* Bombay, Different issues.

b) Reserve Bank of India: *Reserve Bank of India Bulletin,* Bombay, Different issues.

c) Reserve Bank of India: *Statistical Tables Relating to Banks in India,* 1968.

Nationalisation of commercial banks in 1969 and adoption of separate targets for financing the growth of small-scale industries and the priority sector brought about further changes in the direction of flow of advances of commercial banks. Table 6B covers the period since the nationalisation of commercial banks.

From Table 6B it emerges that the share of industry in the advances of commercial banks which reached an all time high of 66 per cent in 1967-68, steadily declined since nationalisation of commercial banks and in 1991-92 (as on March 20, 1992) it was 37.4 per cent of the total bank advances outstanding. Since the nationalisation of commercial banks, the share of priority sector increased and the priority sector included small-scale industries as well. Small-scale industries could attract special patronage of commercial banks only since the early 1970s and were shown separately as receivers of advances of commercial banks during mid-1970s. Hence, the share of 'medium and large-scale industries' since the early 1970s is generally comparable with the share of 'Industries' of the years preceding the nationalisation of commercial banks. The decline in the share of trade in the advances of commercial banks continued during and throughout the 1970s and 1980s. In 1991-92, the share of trade in the total advances of commercial banks outstanding stood at only 4.9 per cent.

Table-6B : Analysis of the Sectoral Deployment of Advances of Scheduled Commercial Banks

(Rs. Crore)

Sectors	Outstanding as on the last Friday of				
	June 1975	March 1980	March 1985	March 1990	March 1992
1. Agriculture & Allied Activities/ Public Food Procurement Credit	968.7 (10.8)	2100 (9.9)	5665 (11.8)	2006 (2.0)	4670 (3.7)
2. Industry	5634.1	–	–	–	–
(a) Large & Medium	4516.6 (50.1)	8269 (38.9)	15939 (33.2)	38272 (37.3)	47090 (37.4)
(b) Small Scale Industries/ Priority Sector	1117.5 (12.4)	6730 (31.7)	18409 (38.4)	40387 (39.3)	45425 (36.0)
3. Trade	1499.8 (16.6)	1915 (9.0)	2649 (5.5)	5472 (5.3)	6154 (4.9)
4. Personal Loans	319.6 (3.6)	–	–	–	–

Table-6B : Analysis of the Sectoral Deployment of Advances of Scheduled Commercial Banks (*Contd.*)

(Rs. Crore)

Sectors	Outstanding as on the last Friday of				
	June 1975	March 1980	March 1985	March 1990	March 1992
5. Others	588.8 (6.5)	2221 (10.5)	5294 (11.0)	16534 (16.1)	22666 (18.0)
Total:	9011.0 (100.0)	21235 (100.0)	47956 (100.0)	102671 (100.0)	126005 (100.0)

Notes: 1) Figures in brackets indicate percentage to total.

2) Since 1980, by 'Industry', only medium and large-scale industries were meant and priority sector included small-scale industries. Hence, nothing was shown against 'Industry' in the above table from 1980 to 1992.

3) Since 1980, Agriculture came to be included within the priority sector and separate credit was granted for public food procurement.

Sources: a) Reserve Bank of India: *Banking Statistics,* Bombay, December 1976.

b) Reserve Bank of India: *Report on Trend and Progress of Banking in India,* Bombay, 1980-81.

c) Reserve Bank of India: *Report on Currency and Finance,* Bombay, Vol. I, 1985-86, 1989-90.

d) Reserve Bank of India: *Reserve Bank of India Bulletin,* Bombay, September 1993 (Supplement).

It can now be said that the scheduled commercial banks, true to the aspirations of the people of India, extended steadily increasing financial support to Indian industries during the 1950s and 1960s. The volume of support, measured in terms of the percentage of total advances of commercial banks to industry, was, however, far in excess of the contribution of this sector to the national output and employment. The logic behind such state of affairs may be drawn from the facts that such assistance was necessary for laying the foundation of organised industries in the independent India and that the absence of alternative sources, such as, an organised capital market and / or a network of development banks bestowed upon the banking system, the responsibility of helping the corporate sector in the early years of its growth. Subsequently, since the nationalisation of commercial banks and the fixation of definite targets for the priority sector, the share of industries in the total advances of commercial banks fell considerably and at present, the share of industries comes only next to the share of the priority sector. The decline in the share of trade/commerce in the total advances of banks from 49.3 per cent in 1951-56 to 4.9 per cent of the advances outstanding in 1991-92 also indicates that over this period the Indian commercial banks moved far away from what their founders wanted them to be, that is, the prototypes of the British counterpart.

Scheduled commercial banks also make long-term investment of funds in joint stock companies by subscribing to their shares and debentures. Such investments, which are partly the outcome of the underwriting agreements entered into by the banks with the companies issuing shares and debentures, however, constituted a very minor portion of the total investments of commercial banks from time to time.

Table 7 indicates that the commercial banks had always invested in shares and debentures of joint stock companies. Such investments also included investments in shares and debentures of the development banks. It appears that though in absolute terms the volume of investment holdings of commercial banks in shares and debentures of joint stock companies increased from Rs. 13.28 crore as on 31December, 1949 to Rs. 2364.16 crore as on 31 December, 1991, as percentage of total investment there was absolutely no increase. In fact, from an all time high of 3.6 per cent of total investment in 1951, such investments declined to an all time low of 0.6 per cent in 1986 and then again rose to 2.9 per cent in 1991. Relative decline in the investments of commercial banks in the shares and debentures of joint stock companies since the early 1970s is attributable to the fact that such investments of nationalised banks received lesser importance during the period. During the period, however, investments of commercial banks in the shares and debentures of development banks and term-lending institutions formed a considerable portion of the outstanding investment of commercial banks in shares and debentures shown in the table. It is also worth noting that nearly one-half of the total outstanding investments in shares at end-March 1976 was in the shares of Industrial Credit and Investment Corporation of India (ICICI), Agricultural Finance Corporation and Industrial Reconstruction Corporation (IRCI), and ICICI and IRCI accounted for one-third of the banks' investments in debentures (Source: RBI Bulletin, 1977).

The insignificant investment holding of commercial banks in corporate securities can be explained by the following factors: (a) the commercial banks wanted to confine their lending and investment activities as far as possible, to the supply of short-term working capital, (b) greater emphasis was put on the supply of funds to the priority sector since nationalisation of the major commercial banks in 1969, (c) emergence of development banks and other institutional investors as the principal suppliers of long-term funds, and (d) under Statutory Liquidity Ratio (SLR) requirements, commercial banks were required to make some investments in government bonds and securities which also meant that the banks were not left with sufficient funds for investment in the securities of the private corporate sector.

Table-7 : Investment of Scheduled Commercial Banks in the Shares and Debentures of Joint Stock Companies

(Rs. Crore)

As on 31st December	Total Investment of Scheduled Commercial Banks	Investments in Shares & Debentures of Companies	Col. (3) as percentage of Col. (2)
1	2	3	4
1949	402.54	13.28	3.3
1950	416.22	14.37	3.5
1951	358.12	12.71	3.6
1955	453.53	11.86	2.6
1956	442.39	11.23	2.6
1960	N.A.	N.A.	N.A.
1961	674.34	18.10	2.7
1965	935.16	25.04	2.7
1966	995.92	25.61	2.6
1970	1586.58	43.74	2.8
1971	1870.51	39.65	2.1
1975	4040.85	79.71	2.0
1976	5136.34	92.67	1.8
1980	10884.02	113.53	1.0
1981	13359.05	113.92	0.9
1985	25703.11	174.81	0.7
1986	32217.60	185.46	0.6
1987	N.A.	N.A.	N.A.
1988	49642.99	1115.99	2.2
1989	59394.65	1333.58	2.2
1990	69321.51	1696.95	2.4
1991	80355.41	2364.16	2.9

Notes: a) Figures include shares and debentures quoted on a recognised stock exchange as well as those not quoted on any recognised stock exchange.

b) Shares and debentures are shown at market value, and where it is not available, at book value.

c) N.A. means 'Not available'.

Sources: a) Reserve Bank of India: *Report on Trend and Progress of Banking in India,* Bombay, Different issues.

b) Reserve Bank of India: *Reserve Bank of India Bulletin,* Bombay, Different issues.

In addition to the above, the commercial banks also help the corporate sector in getting the long-term fund by underwriting the issues of shares and debentures made by them. In fact, by standing behind the public issues as underwriters, the commercial banks provide the most meaningful support for marketing the new issues. In India, the organisation of the new issue market is in fact, synonymous with the structure of underwriting of issues of capital (*Khan, 1978*).

Way back in 1931, when the regular arrangement for providing institutional support to capital issues was nowhere in sight, the Indian Central Banking Enquiry Committee recommended the participation of Indian commercial banks in the underwriting of corporate securities.The Committee's suggestion did not materialize, presumably because the necessary lead was not forthcoming. The Shroff Committee also recommended in 1953 that the banks and insurance companies should form syndicate for underwriting. Although the Shroff Committee's suggestion for the formation of an underwriting consortium was finally dropped, a few commercial banks, using their individual discretion, started participating in underwriting activity. Subsequently, the underwriting activity was stimulated by the participation of the Industrial Credit and Investment Corporation of India, other development banks, the Life Insurance Corporation of India and other non-banking financial intermediaries.

Table 8 depicts the trend of progress of underwriting in India since the mid-1950s and the extent of participation of banks and other financial institutions in the underwriting of issues of corporate securities.

Table-8 : Underwriting of the New Issues of Securities

(Rs. Crore)

Year	Total Amount of New Issue Offered to Public	Amount Underwritten	Amount Underwritten by			
			Banks	Financial Institutions	Brokers	Others
	1	2	3	4	5	6
1956-60	37.36	35.20	8.71	8.55	10.29	7.67
		(94.21)	(24.74)	(24.28)	(29.23)	(21.78)
1961-65	139.69	124.13	12.75	68.41	26.42	16.58
		(88.86)	(10.27)	(55.11)	(21.28)	(13.35)

Table-8 : Underwriting of the New Issues of Securities *(Contd.)*

(Rs. Crore)

Year	Total Amount of New Issue Offered to Public	Amount Underwritten	Amount Underwritten by			
			Banks	Financial Institutions	Brokers	Others
1966-70	205.33	186.33 (90.74)	15.54 (8.34)	123.80 (66.44)	28.54 (15.31)	20.79 (11.15)
1971-75	214.96	199.32 (92.72)	12.87 (6.45)	102.18 (51.26)	67.60 (33.91)	16.67 (8.21)
1976-80	266.06	200.05 (75.18)	29.62 (14.80)	111.81 (55.89)	36.29 (18.14)	22.33 (11.16)
1980-81	74.10	42.12 (56.84)	4.90 (11.63)	24.36 (57.83)	12.82 (30.44)	–
1981-82	301.98	261.38 (86.56)	35.25 (13.49)	111.44 (42.63)	118.73 (45.42)	–
1982-83	198.89	162.70 (81.80)	30.63 (18.83)	61.83 (38.00)	67.09 (41.24)	–
1983-84	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
1984-85	193.69	144.20 (74.44)	12.78 (9.55)	62.35 (43.23)	68.07 (47.20)	–
1985-86	429.80	274.13 (63.78)	31.30 (11.41)	104.19 (38.00)	137.88 (50.29)	0.76 (0.27)
1986-87	689.89	418.40 (60.64)	74.27 (17.75)	93.58 (22.36)	250.00 (59.75)	0.55 (0.13)
1988-89	1083.70	432.25 (39.89)				
1989-90	1698.89	536.06 (31.55)				
1990-91	827.30	772.49 (93.37)				
1991-92	847.17	836.69 (98.76)				

Notes: a) Figures in brackets in column (2) indicate percentage to column (1) and those in column (3) to (6) indicate percentage to column (2).
b) Financial Institutions include development banks, LIC, GIC & UTI.
c) N.A. means 'Not available'.

Sources: a) Reserve Bank of India: *Reserve Bank of India Bulletin,* Bombay, Different issues.
b) *Company News and Notes,* Different issues.
c) Reserve Bank of India: *Report on Currency & Finance* 1992-93, Vol.II, Bombay.

From the table it emerges clearly that since 1956-60 a significant portion of the total amount of new issues of shares and debentures offered to public for subscription was underwritten. The principal underwriters were the banks, the other public financial institutions such as the development banks, the LIC, the GIC and the UTI. It is also pertinent to note that from 1976-80 the percentage of new issues of securities underwritten steadily declined. This is mainly because of the fact that since the late 1970s, when the investors' participation in the new issue market increased with the initial thrust given by the new issues made by the FERA companies for the purpose of dilution of foreign control, the participation of underwriters declined. The trend continued till the late 1980s as, during this period, the new issues of securities made by the well established existing companies were readily accepted by the investors, minimising further the importance of the institutional underwriters. Since 1990-91 again, the percentage of new issues of securities offered for public subscription underwritten increased significantly and reached the all-time high of the pre-liberalisation period in 1991-92. The phenomenon is attributable to the requirements prescribed by the SEBI for underwriting of new issues offered to public for subscription.

The share of commercial banks in the underwriting of new issues offered to the public for subscription, which was 24.74 per cent in 1956-60, declined to 6.45 per cent in 1971-75 and then again increased to 17.75 per cent in 1986-87. It can be seen from the table that there is an inverse relationship between the share of the banks and the share of the financial institutions in the underwriting of new issues offered to the financial institutions in the underwriting of new issues offered to the public for subscription. Every increase in the share of the financial institutions was matched by a corresponding decline in the share of the banks and vice-versa. The share of commercial banks in the underwriting of new issues was not very significant mainly because of the fact that they never wanted to commit much of their resources in acquiring the securities in the event of the public not taking up any portion of the securities underwritten by them. Moreover, the commercial banks, unlike other public financial institutions, had other areas of operation exclusively reserved for them. Thus, the banks were more selective in entering into underwriting agreements than the other public financial institutions which entered into such agreements in a general way in view of the fact that the principal purpose of such financial institutions was to supply or to facilitate the supply of long-term fund to the corporate sector. But, in the early phase of the development of underwriting in India, the commercial banks played a very important role; the role of the initiators. A study of 380 public offerings of shares and debentures during the nine years 1955-63 showed that 219 of them were underwritten and that banks participated as underwriters in 88 (or 40 per cent) of the underwritten issues (*Gupta, 1969*).

In addition to the supply of finance, industries, both old and new, need various other services such as financial and managerial consultancy, project counselling, issue management, loan syndication, portfolio management, advice on and formation of schemes of amalgamation, etc. These services, broadly known as merchant banking, enable the industries to cope with the changing business environment in an effective manner. With the development of London as the centre for international trade and finance after the Industrial Revolution of England, the young, resourceful and enterprising traders of neighbouring European countries settled down in London and started rendering the services of merchant banking. Thus England became the nursing mother for the development of merchant banking. "The Dutch and the Scottish traders made a beginning of merchant banking but it was really developed and professionalised in Britain" (*Verma, 1990*).

In India, the merchant banking was first initiated by the managing agency houses in the early nineteenth century for financing trade and commerce. The foreign merchant bankers operated in India through an agency house which was very well known as 'East India House' representing a group that produced several merchant bankers during the 19th century. After the abolition of the managing agency system, the responsibility of continuing merchant banking in the modern lines was gradually shouldered by the commercial banks, both foreign and Indian. "Merchant banking services were initially started in India by foreign banks, namely, the National Grindlays Bank in 1967 and the First National City Bank in 1970. The first Indian Commercial Bank to provide these services was the State Bank of India, which set up Merchant Banking Division in 1972, one of the main considerations of which was to help small industrial units in their transition to medium scale and then to large scale" (*Pawar, 1988*). Other commercial banks, such as Canara Bank, Bank of Baroda, Bank of India, Punjab National Bank and the UCO Bank started merchant banking services in the late 1970s and early 1980s. Following the liberalisation of industrial licensing and other policies, the commercial banks also took steps in the direction of extending the merchant banking activities. In order to provide the services more effectively, some banks, like the State Bank of India and the Canara Bank, opened separate merchant banking subsidiaries.

In the early years of the development of merchant banking in India, most of the commercial banks used to confine their activities to issue management, underwriting and investment counselling. But subsequently, with the participation of ICICI, IDBI and other development banks, the merchant banking services of the commercial banks got diversified in new lines. Merchant banking services of the commercial banks near the end of the pre-liberalisation era included loan syndication, monitoring of industrial sickness and even investment banking. Afterwards, in the first years of the liberalisation period, the Reserve Bank of India cleared the entry of banks into leasing, factoring and hire purchase.

5. Conclusion

Modern commercial banking in India, developed under the initiative of the British businessmen, followed in all possible details the British system of banking. But, in the absence of merchant capital for investment in industries or a developed capital market capable of mobilising the savings of the society for investment in industries, the banking system proved unsuitable for the needs of Indian economy, particularly for the supply of finance for industrial development. Some early attempts for supply of industrial finance through the commercial banks, promoted by the Indians, miserably failed because of the lack of proper experience in industrial banking. Attainment of Independence in 1947 paved the way for making the commercial banks responsive to the needs of Indian economy. Near the end of the pre-liberalisation era, the State-owned commercial banks with wide network of branches were able to mobilise savings even from the rural areas. The operations of commercial banks also underwent significant changes. Type wise, term loans alone constituted about a third of the total investment and sector-wise, industries, consisting of large, medium and small, received about seventy per cent of the total investment of commercial banks. Banks then not only provided credit but also subscribed to shares and debentures of companies and underwrote the issues of corporate securities to a considerable extent. For serving the needs of the corporate sector more effectively, Indian commercial banks, near the end of the pre-liberalisation era, extended their area of operation to include merchant banking. With a carefully laid out elaborate institutional arrangement for supply of industrial finance in India at that time, specialised services, like that of merchant banking, heralded an ever-expanding horizon of operation for the commercial banks for the years to come.

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