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DEVELOPMENT BANKING IN INDIA

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ABSTRACT

Development banking in India is almost as old as India's independence. The emergence of development banking in India is a post-independence phenomenon. Development bank is essentially a multi-purpose financial institution with a broad development outlook. It is a financial institution which provides all types of financial assistance (medium as well as long-term) to business units, by way of providing loans, underwriting, investment and guarantee operations and promotional activities – economic development in general and industrial development, in particular. Through this discussion we try to highlight the phases through which Development Banking in India underwent, purpose for which they were established and how they are different from commercial banks in India. We also try to stress on the extent to which presence of Development Banks is relevant and important in the current scenario.

KEY WORDS: ***Development Banks ,Capital Market, Commercial Banks, Financial Institutions, Foreign Exchange***

INTRODUCTION

The development banks are an important constituent of a capital market of any country. Development banking in India is almost as old as India's independence. The emergence of development banking in India is a post-independence phenomenon

In India, the first development bank called IFCI was established in 1948.In the Western countries, however, the development banking had a long period of evolution. The origin of development banking may be traced to the establishment of Socrates General Pour Favouriser I'Industrie Nationale in Belgium in 1822. But the important institution was the 'Credit Mobiliser of France' established in 1852, which acted as the industrial financier.

In 1920 Japan established the Industrial Bank of Japan to fulfill financial needs of her industrial development. In the post-war era the Industrial Bank of Canada (1944), the Finance Corporation for Industry Ltd and the Industrial and Commercial Finance Corporation Ltd. Of England etc. were established as modern development banks to provide term loans to industry. In 1966, the U.K. Government set up the Industrial Reorganization Corporation.

Development bank is a product of developmental efforts of new developing country. There is no universal model to which Development banking conform. Each bank is studied according to the political, social and economic conditions of the country.

Development banks can be defined as an institution to promote and finance enterprises in private sector.

According to Boskey (1959) Development Bank is defined as an institution public/private, which has as one of the principal functions the making of medium/long term in industrial projects.

According to Kane (1975) Development bank is a financial intermediary supplying medium and long-term funds to bankable economic developmental projects and providing related services.

According to L.C. Gupta, "Development banks were established to supplement existing sources of industrial finance. Therefore, not expected to compete with normal channels of finance but were the gap fillers intended to help stimulate the emergence of missing ingredients required for economic development

Thus there is no precise definition of the development bank. Fundamentally, a development bank is essentially a multi-purpose financial institution with a broad development outlook. It is a financial institution which provides all types of financial assistance (medium as well as long-term) to business units, by way of providing loans, underwriting, investment and guarantee operations and promotional activities – economic development in general and industrial development, in particular.

Development banks are different from Commercial banks in the way that Commercial banks work for mobilization of savings through financial intermediaries and channelize them to profitable investment outlets. While Development Bank is the financial institution which not restrict its activities to banking function but also attempt to remove problems and bottlenecks of development, the magnitude, and importance of which may vary from country to country.

Development banks are the gap fillers in a way that when there is a deficiency in the availability of finance through the regular channel, and there is a gap in demand for and supply of industry capital sector, the special machinery of development bank was created to fill this gap.

The primary function of development banks is the promotion of economic development through facilitating investment in the areas like manufacturing, agriculture etc. The promotion can be through means like provision of risk capital, underwriting of new issues, arranging for foreign (exchange) loans, identification of investment projects, preparation and evalua-tion of project reports, provision of technical advice, market informa-tion about both domestic and export markets, and management services.

Thus the task of development bank goes far beyond the conventional function of providing term capital to qualifying entrepreneurs and mobilizing resources for their lending operations.

REASONS FOR EMERGENCE OF DEVELOPMENT BANKS IN INDIA ARE

i) Capital market not able to finance to a particular segment of enterprises and to that extent market is imperfect.

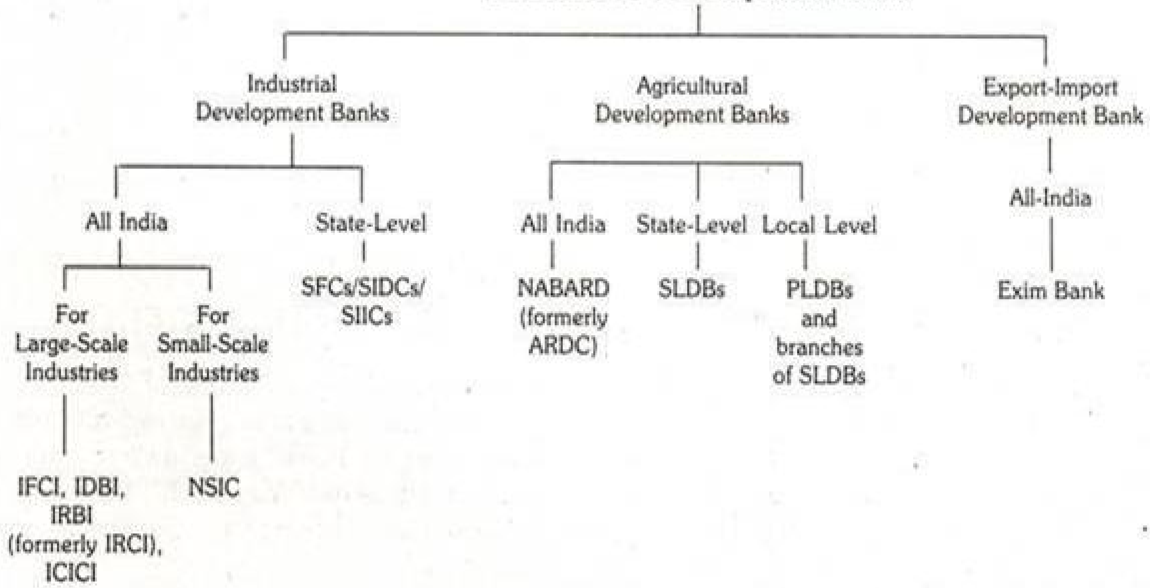
ii) Capital market in India was ill-developed as a result overall supply of finance to industry was inadequate through the normal channel to keep pace with the growth of industry because of low capital formation resulting in failure of the financial market to develop pari passu with growing requirements of the industry.

iii) The gap created in demand for and supply of industrial capital is met by term credit from these banks.

THE MAIN CHARACTERISTICS OF DEVELOPMENT BANKS IN INDIA ARE

1. Development banks are set up by or sponsored by government and derive most of their funds from government, RBI and Public Financial institutions or Private financial system. They are distributive agencies having no direct link with the ultimate sources of savings.
2. They are the specialised financial institution which provides medium and long-term finance to industrial sector both large and small industry. They finance business units and promote successful enterprise with adequate technical know-how.
3. Criteria to select the project operation is wider in scope and conception they take into account broader objectives, prospects, viability, public interest rather than strictly commercial profitability.
4. It is an agency through which broader socio-economic objectives are achieved.
5. Government creates it by state policy to ensure distribution of finance according to planning priorities.
6. Development banks achieve balanced regional growth objective by promoting industry in the backward area with high risk and substantial investment.
7. Development banks undertake directed efforts towards achieving a specific objective of Govt., which change from time to time and country to country.
8. Development banks provide foreign exchange for import of technology, essential spare parts, and scarce raw material after getting foreign currency loans from international agencies like World Bank.
9. Development banks help remove entrepreneurial bottlenecks by helping potential promoters in identifying profitable investment opportunities, preparing project reports and executing them.
10. Unlike commercial bank, it does not accept deposit from the public.
11. It is not just a term lending institution. It is a multi-purpose financial institution
12. It provides financial assistance to the private sector as well as the public sector undertakings.
13. It aims at promoting the saving and investment habit in the community.

Chart 1
Structure of Development Banks



IFCI – Industrial Finance Corporation of India
IDBI – Industrial Development Bank of India
IRBI – Industrial Reconstruction Bank of India
NSIC – National Small Industries Corporation
NABARD – National Bank of Agricultural Development
ARDC – Agriculture Refinance and Development Corporation
SLDBs – State Land Development Bank
PLDBs – Primary Land Development Bank
EXIM – Export-Import Bank of India

- IFCI was the first development bank in the country established in 1948. It is a non-banking public sector bank. This manages seven numbers of subsidiaries and one associate under its fold. The financial activities of this bank are various projects like airports, roads, telecom, power, real estate, manufacturing, the services sector, and other industries.
- IDBI was established in 1964. It is owned by the Indian government. It gives credit and other financial help for the development of industries.
- IRBI was established in 1985. It not only provides financial help but also helps to revive the sick industries in both private and public sectors. It also helps the managerial and technical help to sick industries.
- NSIC deals with the small-scale industries. It was established in 1955. Its headquarters is in Delhi. It provides a wide range of services. Its main work is to supply machines and types of equipment to small-scale industries for commercial purposes.
- At present, there are 18 SFCs.
- NABARD is the only all-India level agricultural development bank which was established in 1982. It provides loan for agriculture purposes.
- Industrial Investment Bank of India- (IIBI)– This banking center was established in 1971. It is a 100% government-owned bank. Its work is to encourage and promote the participation of private capital, in India and foreign.
- EXIM set up to promote and develop export-imports at all India level was also introduced in 1982. It takes care of the promotion of trade from abroad. It is a semi-government agency.
- SIDBI- This bank was established in 1990. Its head-quarter is in Lucknow. It is a subsidiary of IDBI. It helps micro, small and medium business people. This took over the responsibility of taking care of small-scale industries, which were under IDBI.
- RBI uses the term 'Term financing institutions' to refer to development banks plus LIC, GIC, and UTI.
- But LIC, GIC, and UTI are the specialized forms of financial establishments in the capital market of India and play the role of providing industrial finances in the form of loans, underwriting and investment, but they in no way have direct responsibility to promote industrial development.

DISADVANTAGES OF DEVELOPMENT BANKS IN INDIA

The development banks have contributed in a big way to the Indian economy. Despite that it has some drawbacks. Some of them are listed below:

- The Development banks are dependent on the Government for their funds.
- They do not take money or deposits from the public.
- They do not sell their shares, bonds or debentures in the market.
- As they borrow at low rates of interest, they have led the industries to the high- level intensity.
- These banks give a loan to the industrial units and face defaulters in large number. It is difficult for them to get back the money.
- They have failed to develop a corporate bond market because they do not encourage lending on the basis of loan or debenture of industrial units.
- They have not been able to achieve success to balance regional development of India.

- Due to the bureaucratic influence there is a lot of scope for delay in sanctioning and disbursing of loans.

CURRENT SCENARIO

Development banks formed the central piece of growth strategy in India .After independence, the institutional framework for development banking was developed in India with the establishment of — IFCI (1948), IDBI (1964), IIBI (1972), NABARD and EXIM Bank (1982), SIDBI (1990), etc. The private sector got its due place with ICICI in 1955. In 1952, SFCs came into being followed by refinancing institutions to promote rural electrification, housing and urban development. According to a recent UNCTAD study (December 2016), development banks loans which formed 2.2 per cent of the gross capital formation in the early 1970s reached 15.5 per cent by the early 1990s which shows that the objectives for the establishment of Development banks have been duly attained in India.

However with reforms in the Indian economy the pace of their growth altered. The reforms have put private markets in the forefront. To overcome the inefficiencies of the development banks wide-ranging reforms were introduced in stock markets, foreign capital flows and ownership norms. The private and foreign banks were allowed to enter the banking sector in order to strengthen the private local markets. Accordingly, ICICI in 2002 and IDBI in 2004 converted into commercial banks.

However these reforms did not lead to the desired outcome and fall short of requirements. New capital issuance remained monotonous, private capital inclined towards higher valuations and the domestic corporate bond market did not develop extensively .The UNCTAD study notes: "As a proportion of the financial system as a whole, between the early 1970s and late 1980s, their loans (development banks) accounted for over two thirds of total disbursals. Between financial liberalization in the early 1990s and early 2000s, this share declined to 30 per cent; after 2004, it declined further, to 1.7 per cent."

Recent policy changes by the RBI have induced development banks and commercial banks to intrude on each other's turf. Many commercial banks want to get into term finance especially infrastructure finance businesses, till recently the role presence of the development banks. The development banks on their part have started giving out loans for working capital requirements. As a result of the expected future scenario works out as follows:

- After the dissolution of ICICI and IDBI in the late 1990s, bank credit tenor expectedly declined. Several attempts to recreate development banks without a secure source of funding met with little success. Old barriers between commercial and development banks have gone down. Universal banks have emerged and will give workings capital loans as well as finance new projects.
- The IDFC—perhaps the most serious effort in this direction— got converted into a commercial bank in 2015.
- Some banks will use their branch network to raise deposits while others will use their assessment skills to lend to companies. Also, many banks will do both i.e. collect deposits and lend to companies.
- Corporate risk will be supreme. Low-grade companies will find in increasingly difficult to get money easily. One possibility is that these companies will gravitate towards weak banks.
- Difficult negotiations will be the order of the day. Good companies will lure banks with the promise of fees from new issues management, opening letters of credit and demand lower interest rates in return.

CONCLUSION

Development Banks in the past have played a very important role in the economic development of India .They have contributed to the growth through financing, advisory, support technological initiatives and industrialization .It has acted as a gap filler in financing by the banking sector in India. They have achieved the objective of creating a new class of business people and spreading the benefits of financing to weaker sections of the economy. Their programmes aim at development of rural areas, facilitate villager's cottage industries along with promotion of artisans and other weaker sections of the society. In order to have a new breed of development banks in India the policy makers will have to assess the capital requirement and the alternative sources of finance. Also the need will be redesign its governance structure keeping in mind the past mistakes and conserving the managerial independence without compromising the requirement of periodic independent public scrutiny.

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