

Chapter VI

SUMMARY OBSERVATIONS AND POLICY IMPLICATIONS

The genesis of universal banking is beautifully brought out by Alexander Gerschenkron. According to Gerschenkron universal bank evolves in a country where industrialization has a time distance from its birthplace in England. Gerschenkron considers three typical cases in his hypothesis. They are advanced region, moderately backward region and extremely backward region. In an advanced and extremely backward region, factory and state respectively take part in industrial financing while in a moderately backward region banks itself take initiative to industrial financing. This hypothesis cannot claim its general application. It can explain the genesis of universal banking in Germany, Italy, Austria. But in the cases like Japan, United States of America this hypothesis fails to claim its application to explain genesis of universal banking. In these countries rapid increase of time deposits, rather than economic backwardness, encouraged the commercial banks to provide long term loan along with short term working capital loan. Much of the contribution that the financial sector can make to growth and development depends upon the legislative and regulatory arrangements devised to guide the activities of financial institutions. The formulation of universal banking regulation also favoured the commercial banks to take part in economic

Growth of the country. In Germany and Japan banking regulations are more liberal than the U.S.A. in favour of universal banking. In U.S.A. although universal banking was being hampered on account of the imposition of strict restriction by the National Banking Act (1863) yet the Federal Reserve Act (1913) and latter on the Mefadden Act (1927) and the medium of holding companies opened the doors for the commercial banks to do universal banking. In United States of America Commercial banks has concentrated largely on term-financing - principally through the form of subscription to equity capital of industries. In the U.S.A. commercial banks had already developed term-loan business in the 1930s; till today it has continued to be an important line of their activities. Similarly, commercial banks in Germany and Japan also ventured into the term-lending activities with the strength of their vast amount of short and long-term deposits. In order to minimise the risk of long-term financing borne by a single bank and to lead the investing public to purchase share of a company it is very common for several banks to come together to form a syndicate in Germany. In Japan also commercial banks may get loan from Bank of Japan against security of long-term investment.

To search for the genesis of universal banking in India before independence, assistances from the contemporary financial machineries like managing agencies, insurance companies etc. were not adequate. The insurance companies which were considered a significant machinery for long-term investment in foreign countries confined their investment activities mainly in government securities. While invest-

in government securities was essential to a certain extent, those concerns could easily cultivate some of our neglected fields of investment like industrial debenture. During the period 1921-36 70 percent workable assets of the insurance companies' in India invested in government port trust and municipal securities. Similarly joint stock banks were also very shy to long-term investment in corporate sector even though time deposits were increasing rapidly. Time deposits which was Rs.386, 08 thousand in 1915 increased to Rs.37, 37, 01 thousand in 1934. Even the small scale industries were facing acute problem for getting working capital loan from the banks given vide evidences before the Indian Industrial Commission. The effect of 'Swadeshi' movement and the World War I gave birth to the nationalist sentiment in the mind of the Indian public. The main object of the 'Swadeshi' movement was to set up Swadeshi enterprises with the help of necessary assistances from the Swadeshi banks. To investigate^{into} the matter of industrial finance, Indian Industrial Commission was set up by the Imperialist government in 1916. Suggestion of the Commission was to establish the industrial bank following the model of German style universal bank. Under such adversities, the domestic entrepreneurs^{came forward to} set up banking institutions on their own with a view to mobilising private deposits for investment in their own concerns.

The universal banks evolved for the first time in pre-independence India particularly at the beginning of the

present century, started with People's Bank in 1901, a chain of such banks were established under the domestic entrepreneurship during ^{the period} 1900-13. Following People's Bank, the pioneer universal banks, which came into existence, were The Bank of Burma, The Indian Specific Bank, The Credit Bank of India, Lahore Bank, The Doaba Bank, The Hindusthan Bank, The ^{Bengal} National Bank, The New People's Bank and The People's Industrial Bank. After the banking crisis of 1913-15 some more universal banks under the title industrial bank came into existence. The lead, given by Tata Industrial Bank in 1917, ^{and} was followed by, among others, The Calcutta Industrial Bank, The Karnani Industrial Bank, The Laksmi Industrial Bank etc. Following ^{the} German model of universal banking, they used to mobilise savings and provide long-term finances. To attract more deposits it was the policy of the banks to pay interest at a rate 2-3 percent higher than the market rate. This explains why these banks used to invest in speculative business.

Unfortunately, almost all the banks had collapsed during the banking crisis of 1913-15. There were a lot of reasons behind this collapse. Deterioration of Cash reserve in relation to deposit was an important cause of bank failure. Among others, financed units were very weak. So that banks were failed along with the liquidation of those ^{weak}/financed units. Mismanagement, investment against worthless security or no

security were also the causes behind bank failure.

The deficiency of capital and entrepreneurship from which indigenous industries were suffering during the pre-independence period became a post-independence phenomena. According to government statistics, ^{the} net amount repatriated from India was Rs. 100.52 billion during the period 1935-45. In these circumstances ~~and the~~ government's eagerness to build up industrial economy of India through a series of five years plan, a chain of DFIs were set up. ~~for~~ But ~~their~~ weak branch network, lack of local contacts and non-availability of sufficient working fund ~~are hampering~~ ^{they} ~~the~~ interest of the industries to get necessary finance in time. On the other hand, commercial banks in India are seeking new avenue with their vast volume of deposits and strong branch network both in rural as well as ~~in~~ ^{the} urban areas. But the problem of liquidity, lack of proper project appraisal machineries, fear of non-recovery of term-loan are creating barriers before the commercial banks to do universal banking, spontaneously although there is ample scope to do so. In these circumstances ~~the~~ IMF mission visited India in 1953 and ~~the~~ Shroff Committee submitted its report in 1954. Both of these two boldly suggested in favour of commercial bank's participation in universal banking. Similarly, section 6 of the Banking Companies Act, 1949 also endorsed the commercial banks to take part in underwriting of corporate shares and

debentures. Purchase of Corporate shares and debentures also have its legal sanction. Considering all these favourable situations commercial banks came forward to take part in universal banking. Industrial term loan which was Rs.282.52 crores in 1972 rose to Rs.7,695.31 crores in 1990. In underwriting activities bank's share was Rs.136.6 lakhs in 1967, it increased to Rs.739.0 lakhs in 1983.

To find out a suitable assessment methodology for our purpose we have reviewed the literature on universal banking. Almost all the studies demonstrate only descriptive analysis to assess viability of universal banking without considering econometric tools and techniques. But a recent study has assessed^{the} performance of universal banking within India's commercial banking set up. This study has shown the strong scale and scope efficiency of universal banking within the commercial banking set up. This study is based on time series data.

The present study, however, seeks to examine the same hypothesis on the basis of cross section field survey data collected from 31 branches of commercial banks in the district of Darjeeling, in West Bengal. This study has estimated four alternative models of conventional and hybrid translog specifications and shows :

- I. that the fixed deposits shared highest proportion in total deposits although the study period. It accounted nearly one-half of the sum during the period 1990-92;
- II. that growth rate of expenditures are 8.62 per cent and 11.40 per cent in 1991 and 1992 respectively, given 34 per cent and 16 per cent growth rate in deposits during the corresponding years. These growth rates in total expenditure indicates lower expenditure per unit of deposit;
- III. that the industrial financing of sample banks reveals a striking balance between the term loans and working capital loan. This may be explained by the backwardness of the region;

Moreover, according to our econometric investigation, this study confirms the 'overall' scale economies and product specific scale economies to the commercial and development banking activities separately. In regard to scope economies this study shows that the existence of cost complementaries among the commercial and development banking activities.

From the above observations, we have drawn the following policy implications :

- (1) To minimise the risk of liquidity in the course of term-lending by the commercial banks, Reserve Bank of India should give advance to the commercial banks against security of term-loan given to the industries like their counterpart in Japan.
- (2) In regard to underwriting and direct participation in corporate shares and debentures commercial banks in India should proceed in co-operation with insurance companies forming a consortium or syndicate. Such a consortium or syndicate participation in corporate shares and debentures is very common among the German universal banks to share risk of liquidity among themselves.
- (3) On the basis of various evaluation criteria, such as efficiency, it is found that India may be benefited more from the adoption of universal banking system, in particular from the exploitation of economies of scale without the inefficiency that often ensues from an increase in the degree of concentration than from adoption of a specialised system.
- (4) To know the overall creditworthiness and paying capacity of a client firm, banks should ask for funds flow statement constructed for a number of years before granting loans.

- (5) Repayment of term-loan will flow in smoothly only if the income of the borrower from the financed units increases as anticipated. So, the commercial banks in India should extend consultative service to the authorities of financed units like their counterpart in Germany.
- (6) There should be a review programme of the progress made in the implementation of the project so that corrective steps, if necessary could be taken well in time. Such a review may be done, in every half year. A review should also be undertaken after the borrowers have committed 75 per cent of the project costs or three months before the scheduled date for completion of the project- whichever is earlier. Such a system would enable the banks to detect the overruns also and to take necessary steps.
- (7) The borrower should provide evidence of insurance on business and on himself sufficient to repay the bank if anything happens to it or him.

Annexure 2.1

Balance-sheet of the People's Banks of Punjab,

30th June, 1910

	Rs.
Liabilities :	
Capital	9, 80, 401.00
Reserve	1, 25, 000.00
Deposits (Fixed, saving and current)	80, 02, 712.00
Security Deposit	59, 599.00
P/F Deposits	31, 066.00
	<hr/>
	91, 98, 778.00
Assets :	
Cash Credit and Loans	75, 39, 672.00
Debentures and Other Investments	4, 18, 625.00
Other Assets	12, 40, 481.00
	<hr/>
	91, 98, 778.00

Source : 'Capital' 1910.

Annexure 2.2

Balance-sheet of the Specie Bank Ltd.

30th June, 1908

	Rs.
Liabilities :	
Capital	74, 57, 400.00
Reserve Call	9, 250.00
Reserve Fund	1, 00, 000.00
Deposits	1, 30, 94, 968.00
Bills for Collection	21, 27, 373.00
Sundries	2, 13, 453.00
Profit & Loss Account	4, 34, 607.00
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	2, 34, 37, 051.00
Assets :	
Credits on Govt. & other Authorised Securities	20, 56, 848.00
Loan on Govt. and other Authorised Securities	1, 19, 84, 332.00
Bills Receivable Discounted	35, 66, 709.00
Overdraft	1, 75, 023.00
Sundries	2, 26, 220.00
Preliminary Charges	12, 607.00
Government Securities	98, 469.00
Bullion	35, 47, 480.00
Cash at Head Office	17, 69, 363.00
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	2, 34, 37, 051.00

Source : 'Capital' 1908.

Annexure 2.3

Balance-sheet of the Specie Bank Ltd.

30th June, 1910.

	Rs.
Liabilities :	
Capital	75, 00, 000.00
Reserve Fund	5, 00, 000.00
Deposits, Bills, Discounted, Acceptance and other sums due by the Bank against Security	3, 39, 27, 283.00
Sundries	3, 66, 756.00
Profit and Loss Account	8, 48, 188.00
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	4, 31, 42, 227.00
Assets :	
Credit on Govt. and Other Authorised	
Security	1, 14, 36, 703.00
Loans on Govt. and Others Authorised Securities	2, 32, 15, 538.00
Bills Receivable Discounted and Purchased	28, 40, 398.00
Overdraft	1, 64, 327.00
Sundries	2, 41, 268.00
Bullion	5, 93, 239.00
Cash	6 <u>46, 50, 754.00</u>
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	4, 31, 42, 227.00

Source : 'Capital' 1910.

Annexures 2.4

Balance-sheet of the Bengal National Bank Ltd.

30th June, 1910

Rs.

Liabilities :

Capital	8, 05, 437.00
Shares Forfeited	13, 376.00
Current, Fixed and Savings Deposit	14, 54, 708.00
	<u>22, 73, 521.00</u>

Assets :

Loans, Cash Credit etc.	
and Overdraft	14, 82, 313.00
Government Securities	
with interest to date	2, 40, 939.00
Other Assets	5, 50, 269.00
	<u>22, 73, 521.00</u>

Source : 'Capital' June, 1910.

Annexure 2.5

Balance-sheet of The Amritsar Bank Ltd.

30th September, 1914.

	Rs.
Liabilities :	
Deposits	25, 58, 804.00
Providend Fund	21, 398.00
Capital	1, 80, 202.00
Unclaimed Dividend	1, 533.00
Surplus	<u>1, 02, 345.00</u>
	<u>28, 64, 282.00</u>
Assets :	
House Property	2, 875.00
Investment	81, 836.00
(Shares in Lahore Spinning Company)	
Debts due	25, 48, 097.00
Drafts	2, 749.00
Furniture etc.	6, 721.00
Cash and Investment,	<u>2, 22, 004.00</u>
	<u>28, 64, 282.00</u>

Source : 'Capital' 1915.

Annexure 3.2

Financing of Projects by Companies which Issued Capital
by Prospectus

		1984-85 Rs.crores	Per cent to total cost			
			1984-85	1983-84	1982-83	1981-82
1	2	3	4	5	6	7
1.	Reserves & Surplus	56	6.0	2.8	10.5	5.5
2.	Capital Market					
	(a) Share capital	330	35.7	38.6	24.7	18.9
	(b) Debentures	73	7.9	4.3	21.9	15.2
	Total	403	43.6	42.9	46.6	34.1
3.	Borrowings					
	(a) Financial Institutions	229	24.7	34.7	24.5	29.5
	(b) Banks	52	5.6	5.0	7.8	10.3
	(c) UTI/LIC/GIC	52	5.6	2.1	2.2	2.5
	(d) State Govts/ FI	16	1.7	4.1	2.8	2.6
	(e) Others	95	10.3	6.0	4.1	6.0
	Total	445	48.0	51.9	41.4	59.9
4.	Others	22	2.4	2.4	1.5	0.5
	Total	926	100.0	100.0	100.0	100.0

Source : Company News and Notes, Vol.XXIV, No.3, Sept., 1986.

Financing of Project Cost During 1966-1982.

(Rs. in billion)

Year	Development Finance				Institutions		Com. Banks	Invest. Inst.	Stock Market			Promoters Contra.	Others	Grand Total
	IDBI	IFCI	ICICI	SFCs/SIDCs	Total				Shares	Deb.	Total			
1966	1.70 (11.5)	1.21 (8.2)	0.44 (3.0)	0.48 (3.2)	3.83 (25.9)	NR (1.4)	0.21 (25.3)	3.76 (5.2)	0.77 (30.5)	4.53 (30.5)	NR (30.5)	6.27 (42.2)	14.84 (100)	
1967	0.59 (4.4)	0.57 (4.4)	0.62 (4.7)	0.07 (0.6)	1.85 (14.1)	NR (4.5)	0.59 (30.0)	4.00 (2.8)	0.37 (32.8)	4.37 (32.8)	NR (32.8)	13.56 (48.6)	20.37 (100)	
1968	0.29 (2.7)	0.38 (3.6)	0.48 (4.5)	0.18 (1.7)	13.3 (12.5)	1.35 (12.6)	0.07 (0.7)	2.48 (23.1)	1.35 (22.6)	3.83 (15.7)	NR (15.7)	6.68 (38.5)	13.26 (100)	
1969	0.49 (4.1)	0.28 (2.7)	0.55 (4.5)	0.20 (1.7)	1.52 (13.0)	1.31 (11.0)	0.14 (±.2)	2.84 (23.6)	3.36 (27.7)	6.20 (51.3)	NR (51.3)	4.54 (23.5)	13.71 (100)	
1970	0.19 (1.4)	0.28 (1.9)	0.70 (4.9)	0.22 (1.5)	1.39 (9.7)	1.63 (11.3)	0.05 (0.03)	4.80 (32.2)	0.49 (3.4)	5.29 (35.6)	NR (35.6)	6.41 (43.3)	14.77 (100)	
1971	2.18 (13.1)	0.96 (5.8)	1.16 (7.0)	0.40 (2.4)	4.70 (28.3)	3.18 (19.2)	0.82 (4.9)	5.15 (31.1)	0.26 (1.6)	5.45 (32.7)	NR (32.7)	2.45 (14.9)	16.60 (100)	
1972	1.85 (6.6)	1.20 (4.4)	1.78 (6.4)	0.38 (1.4)	5.21 (18.8)	5.82 (20.8)	0.86 (2.7)	5.36 (19.2)	1.92 (7.0)	7.28 (26.2)	NR (26.2)	8.79 (32.0)	37.96 (100)	
1973	1.92 (8.8)	0.85 (3.9)	1.27 (5.8)	2.42 (11.0)	6.46 (29.5)	4.24 (19.2)	0.43 (2.0)	8.05 (36.4)	0.76 (3.5)	8.81 (39.9)	0.10 (0.5)	1.99 (8.9)	27.03 (100)	
1974	0.99 (9.9)	0.52 (5.2)	0.73 (7.3)	0.57 (5.7)	2.81 (28.1)	2.50 (25.0)	0.15 (1.5)	3.06 (30.6)	0.45 (4.5)	3.51 (35.1)	0.04 (0.4)	1.01 (9.9)	10.02 (100)	
1975	3.52 (13.7)	1.40 (5.4)	1.94 (7.5)	0.99 (3.8)	7.85 (30.4)	4.61 (17.9)	1.45 (5.6)	8.83 (34.3)	0.02 (0.1)	8.85 (34.4)	0.30 (1.2)	27.10 (10.5)	50.16 (100)	
1976	1.32 (8.5)	0.74 (4.7)	1.05 (6.7)	0.89 (5.7)	4.00 (25.6)	2.48 (15.9)	0.69 (4.5)	4.37 (28.1)	0.02 (0.1)	4.39 (28.2)	0.38 (2.4)	3.63 (23.4)	15.57 (100)	
1977	4.52 (13.7)	2.01 (6.1)	2.50 (7.6)	1.37 (4.1)	10.40 (31.5)	5.94 (18.0)	1.57 (6.5)	8.73 (24.5)	0.22 (0.7)	8.95 (25.2)	0.14 (0.4)	5.98 (18.4)	32.98 (100)	
1978	3.46 (14.8)	3.39 (14.6)	1.55 (6.7)	2.22 (9.5)	10.62 (45.6)	1.63 (7.0)	1.20 (5.2)	6.96 (29.9)	0.20 (0.9)	7.16 (30.8)	0.23 (1.0)	2.47 (10.4)	23.31 (100)	
1979	2.71 (11.7)	1.54 (6.6)	2.07 (8.9)	1.77 (7.6)	8.09 (34.8)	2.44 (10.5)	1.31 (5.6)	9.70 (41.7)	0.71 (3.1)	10.41 (44.8)	0.06 (0.2)	9.54 (4.1)	31.85 (100)	
1980	4.24 (10.8)	2.11 (5.4)	2.20 (5.6)	1.76 (4.5)	10.31 (26.3)	1.34 (3.4)	1.17 (2.9)	7.40 (18.8)	6.38 (16.2)	13.78 (35.0)	0.13 (0.3)	126.41 (32.1)	153.14 (100)	
1981	30.28 (20.8)	6.11 (1.2)	6.58 (4.5)	3.84 (2.6)	46.81 (32.1)	28.14 (19.3)	4.40 (3.2)	27.40 (18.9)	22.16 (15.2)	49.56 (34.1)	1.78 (1.2)	15.02 (10.1)	145.71 (100)	
1982	9.86 (11.8)	4.81 (5.7)	5.83 (7.0)	2.36 (2.8)	22.86 (27.3)	6.52 (7.8)	2.03 (2.3)	20.65 (24.7)	18.29 (21.9)	38.94 (46.6)	0.20 (0.2)	132.37 (15.8)	202.92 (100)	

Notes : (i) Figures in brackets represent percentages to total.

(ii) NR - Not reported.

Source: Annual Reports of the Working and Administration of the Companies Act, 1956 (Various issues).

**RESEARCH SURVEY
ON
TERM FINANCING BY COMMERCIAL BANK IN SILIGURI REGION**

(No identity of respondents will be disclosed in the presentation and/or interpretation of data to be supplied).

(Please use / whenever applicable)

A. Operation Statistics :

1. What was the levels of deposit ? (Rs. in lacs)

1990 1991 1992

- i) Fixed -
- ii) Saving -
- iii) Current-

2. What are the numbers of account ?

1990 1991 1992

- i) Fixed deposit
- ii) Saving deposit
- iii) Current account

3. What are your annual operating expenditures ?

(in Rs.)

1990 1991 1992

- i) Rent & Rates -
- ii) Electricity -
- iii) Stationary -
- iv) Interest paid-

4. Please furnish the following information regarding employment at present :

	<u>Number</u>	<u>Wages & salaries</u>
		(per month)

- i) Managerial -
- ii) Technical -
- iii) Non-technical-

B. Loans :

1. Have you provided term-loans (i.e. investment in fixed assets) during the last three years : Yes/No.
2. If yes please furnish the following information :

Year	Amount of term loan (Rs. in lacs)	No. of beneficiaries (only industry)
1990		
1991		
1992		

3. What is the industry-wise break-up of the amount of term loans ?

Industry	1990	1991	1992	(Rs. in lacs)
Engineering				
Chemical				
Electronics				
Food Products				
Servicing				
Others				

4. To how many entrepreneurs you have provided only term loan and both term loan and working Capital loan ?

Contd...

Year	Term loan	Term loan & working Capital loan
1990		
1991		
1992		

5. How many among your beneficiaries are first-generation entreprenurer ?

Year	1st generation entrepreneurs	Established entrepreneurs
1990		
1991		
1992		

6. Do you state the number of beneficiaries of your working capital loans during the last five years (1988-93) in industries where you assisted term loans in 1992 ?

Engineering
 Chemical
 Electronics
 Food Products
 Servicing
 Others

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Contd...

7. What was the scheduled amount of repayment and actual amount of realization of industrial term loans :

(Rs. in lacs)

Year	Scheduled	Actual
1990		
1991		
1992		

8. What sorts of supervision you follow to ensure proper utilisation of term loans :

9. What sort of mortgage you ask for term loans ?

- 1.
 - 2.
 - 3.
 - 4.
-