Commercial Banks and Industrial Finance

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The banking industry in India has come a longway since the year 1770 when the first bank was set up by an English agency house in Bombay. The history of the banking industry has seen many important development since then before the arrival of the Indian banks on the scene in the wake of Swadeshi Movement 1905. The Reserve Bank of India was established in 1935. The government took the most important decision in 1969 and in 1980 by nationalisation of major banks.

The very early years the role of Indian banks was limited mainly to financing the movement of agricultural products. With growth of industrialisation, industry gradually replaced trade as the major sector in bank finance and since then the industry sector has continued to enjoy the largest share of the bank assistance which today stands at a figure of approximately 50 per cent.

Some very significant concept and policies have evolved in the period since nationalisation. There is a 'priority sector' concept according to which certain sectors of the economy, whose growth is important from the economic and social point of view, like agriculture, small industry and cottage industry etc. would enjoy a high priority in the allocation of bank resources. Banks have been expected to give up their pronounced urban leaving favour of a mere rural orientation and they have been required to spread out into the rural and the under-

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banked areas. There is also the 'lead bank' concept which arose out of National Credit Council's Study Group on the Organisation and Framework for the implementation of Social Objectives (Dahejia Study Group) which submitted its report in October1969. The Group suggested an "area approach" in evolving plans for the development of the banking and credit structure and recommended that depending upon the area of operation and location, commercial banks should be assigned particular district where they should act as pace setter and consortium leaders for providing integrated banking facilities in tune with local requirements. The various districts in the country were accordingly apportioned among the public sector banks and each bank was designed as the "lead bank" in the districts allotted to it.

The concept of "District Credit Plan" has also been evolved with a view to giving an idea about the total credit requirements of each district in the operations of the banks and to integrate these operations more effectively with the overall development plans of the district.

In line with the general change in the policies and outlooks of the banks, described above, significant changes have taken place in the field of industrial financing. Small scale industry has come to be recognised as a very important productive sector of the economy deserving special support from the banking institutions. Therefore, various concessions and facilities have been made available to this sector from the banks. As already stated above, small scale industry is included in the priority sector for bank finance. It has been given concessional rates of interest both for term loans as well as a matter of routine on margins and guarantees from borrowers in this sector and no viable scheme should be turned down merely for want of security. They have also been told that repayment period should be fixed not on an ad-hoc basis but should be related to the surplus generating capacity of the unit.

Banks have also been advised to set up special cells for providing guidance to this sector. Yet more concessions have been made available to the smallest amongst the small industry. Credit up to Rs. 25000 is now made available in the shape of composite loan covering both working capital and term loan. The rates of interest for such loans are lower then the normal rates for small scale industry and the periods for repayments are also more liberal

Over the years, various refinement and improvements have been introduced in the banks lending to industries. These include a more clear defining of the respective roles of the banks and financial institution. While the financial institution concentrate mainly on providing term finance and underwriting support. The banks role is related mainly to providing working capital. An other major refinement in the financing of industry by banks has been the Credit Authorisation Scheme under which banks expected to seek approval of RBI for limits above Rs. 2 crores to private industries and above Rs. 3 crores to public sector industries. This scheme has emerged as an instrument for credit restraint and for bringing structural changes in the flow of credit from banks. It also enables the RBI to oversee large industries credit portfolies of the banks.

One of the most important changes introduced was the laying down of norms for inventories. It was felt that there was no uniform approach among bankers in assessing

inventory requirements of industries. Further, if bank credit was to be viewed as a tool for resources allocation in the economy, on could not get away from the need to define norms for reasonable levels of inventories and receivables in each industry.

The second important change was to lay down lending norms which were in a way more basic and had more far-reaching implications than the inventory role. Tondon committee evolved three months of lending for working capital. Under Method 1, bank assistance for working capital was to be limited to 75 per cent of the working capital gap, which meant a current ratio of 1 : 1. Under Method II, the borrower's contribution to working capital was to be atleast 25 per cent of the current assets and after taking this into account bank assistance was to be limited to the balance of working capital gap. This meant a current ratio of 1.33 : 1 Method III envisaged a still higher contribution from the borrower's own sources. These recommendation was accepted by RBI, in which, all borrowers should be immediately placed at least on method I and they should progressively be made to more toward Method II and III.

The banks have also been told that while assessing credit requirements, they should fix separate limits for the normal non-peak level as also for peak level credit requirement, indicating also the periods during which the separate limits would be utilised by the borrowers. This practice is to be adopted for all industries which show reasonal variation in their working capital needs like agro based industries, fans, refrigerators etc.

Although, each system of lending has its advantages and disadvantages—and in our country, for historical and practical reasons, a combination of the three system would need to be retained—at the same time, however it has been found necessary to introduce some corrective measures with regard to cash credit system.

Criticism has often been made of the instructions relating to increased use of internally generated funds for working capital and the implementation of the second method of lending. There has been a belief in some quarters that it is responsibility of the commercial banks to provide at all times the entire working capital requirements of the industrial sector and that surplus cash generation of a unit need not be utilised for this purpose. Some rethinking on this subject is called for. In order to ensure a more equitable distribution of financial resources for the weaker and new units in the industry, it is necessary that the surplus cash generation of the larger borrowers should be utilised partly at least for reducing borrowings for working capital. The question has often been raised whether this policy would not reduce the availability of internal generation for capital expansion thereby curbing industrial growth. This argument would not, however hold good because in as much as this would reduced the reliance on bank resources by some of borrowers, it would release funds which could be lent for the productive purpose like expansion and new projects. It has also to be realised that while growth of various industrial ventures is desirable project. The low current ratio in the existing projects adversely affects their liquidity and profitability and their ability to withstand lean periods for the industry. This leads to sickness in existing ventures which, is necessary to avoid.