Development Banks

Introduction

Development Banks are special industrial financing Institutions. This concept is of recent origin. These banks were mostly set up after World War II in both developed and underdeveloped countries. The role of Development Banks is more pronounced in developing countries where governments have taken upon themselves the task of accelerating the pace of economic development.

Development Banks do not mobilise savings like other banks but invest the resources in a productive manner.

Definition of a Development Bank

A Development Bank may be defined as a financial institution concerned with providing all types of financial assistance medium as well as long term two business units.

Features of a Development Bank

- A Development Bank does not accept deposits from the public like commercial banks and other financial Institutions who entirely depend upon saving mobilisation.
- It is a specialised financial institution which provides medium term and long term lending facilities.
- It provides financial assistance to both private as well as public sector institutions.
- The objective of this bank is to serve Public Interest rather than earning profits.

Development banking in India

1. In 1949 Reserve Bank had undertaken a detailed study to find out the need for specialised InInstitutions.
2. It was in 1948 that the first Development Bank Industrial Finance Corporation of India IFCI was established. IFCI was assigned the role of a gap filler and it was not expected to compete with the existing channels of industrial finance.
3. The Industrial credit and Investment Corporation of India Limited ICICI was established in 1955 as a joint stock company.
4. In 1964 Industrial Development Bank of India IDBI was setup as an Apex institution in the area of industrial finance. IDBI was a wholly owned subsidiary of RBI and was expected to coordinate the activities of the Institutions engaged in financing promoting or developing industry.

Need for Development Banks

- Lay Foundation for industrialisation
- Meet capital needs
- Need for promotional activities
- Help small and medium sectors.

Functions of development banks

1. Financial Gap Fillers:

Development banks do not provide medium-term and long-term loans only but they help industrial enterprises in many other ways too.

These banks subscribe to the bonds and debentures of the companies, underwrite their shares and debentures and, guarantee the loans raised from foreign and domestic sources. They also help undertakings to acquire machinery from within and outside the country.

2. Undertake Entrepreneurial Role:

Developing countries lack entrepreneurs who can take up the job of setting up new projects. It may be due to a lack of expertise and managerial ability. Development banks were assigned the job of entrepreneurial gap filling.

They undertake the task of discovering investment projects, promotion of industrial enterprises, provide technical and managerial assistance, undertaking economic and technical research, conducting surveys, feasibility studies, etc. The promotional role of the development bank is very significant for increasing the pace of industrialization.

3. Commercial Banking Business:

Development banks normally provide medium and long-term funds to industrial enterprises. The working capital needs of the units are met by commercial banks. In developing countries, commercial banks have not been able to take up this job properly. Their traditional approach in dealing with lending proposals and assistance on securities has not helped the industry.

4. Joint Finance:

Another feature of the development bank's operations is to take up joint financing along with other financial institutions. There may be constraints of financial resources and legal problems (prescribing maximum limits of lending) which may force banks to associate with other institutions for taking up the financing of some projects jointly.

5. Refinance Facility:

Development banks also extend the refinance facility to the lending institutions. In this scheme, there is no direct lending to the enterprise. The lending institutions are provided funds by development banks against loans extended' to industrial concerns.

6. Credit Guarantee:

The small scale sector is not getting proper financial facilities due to the clement of risk since these units do not have sufficient securities to offer for loans, lending institutions are hesitant to extend the loans. To overcome this difficulty many countries including India and Japan have devised the credit guarantee scheme and credit insurance scheme.

7. Underwriting of Securities:

Development banks acquire securities of industrial units through either direct subscribing or underwriting or both. The securities may also be acquired through promotion work or by converting loans into equity shares or preference shares. So, as learn about development banks may build portfolios of industrial stocks and bonds.

Objectives of Development Banks:

The main objectives of the development banks are:

1. They promote industrial growth.
2. To develop backward areas.
3. To create more employment opportunities.
4. They generate more exports and encourage import substitution.
5. To encourage modernization and improvement in technology.
6. To promote more self-employment projects.
7. The revive sick units.
8. To improve the management of large industries by providing training.
9. To remove regional disparities or regional imbalance.
10. They promote science and technology in new areas by providing risk capital, and.
11. To improve the capital market in the country.

Operational activities of Development Banks

1. Project appraisal and Eligibility of applicant - every financial institution serves a particular area of activity are there are certain limits prescribed beyond which we cannot go. Before processing the application, it is important to find out whether the applicant is eligible under the norms of the institution or not.
   The second aspect which is looked into is to determine whether the enterprise has fulfilled various conditions prescribed by the government.

2. Technical appraisal - Technical appraisal involves the study of :
    - Feasibility and suitability of Technical process in Indian conditions.
    - The scale of operations and its suitability for the planned project.
    - The technical soundness of the projects etc
3. Economic viability - The economic appraisal will consider the national and industrial priorities of the project export potential of the product employment potential, study of market.
4. Assessing commercial aspects- The examination of commercial aspects related to the arrangements for the purchase of raw materials and sale of finished products. If the concern has some arrangement for sale then the position of the party should be assessed.
5. Financial feasibility -the analysis of existing capital structure contribution of owners debt equity ratio past performance help in assessing the financial position of the concern and viability for investing in the project.
6. Managerial competence
7. National contribution
8. Balancing of various factors
9. Loan sanction -if the Advisory Committee is satisfied by the proposal than it recommends the case to the Managing Director or board of directors along with its own report.
10. Loan disbursement - the loan is disbursed after the execution of loan Agreement the execution of Documents of security or guarantee etc should proceed the disbursement of loan.

Promotional activities of Development Banks

1. Surveys of backward areas -surveys studied the availability of resurveys, demand potential and availability of infrastructure facilities.
2. Establishing technical consultancy organisations
3. Entrepreneurial development programs.
4. Technological improvements- the main thrust of EPP'S has been to institutionalize entrepreneurship activities, generating, sharpening and sharing knowledge through research documentation and publication, developing a cadre of professionals.

Industrial Finance Corporation of India (IFCI)

Government of India set up the Industrial Finance Corporation of India (IFCI) in July 1948 under a special Act. This is the first financial institution set up in India with the main object of making medium and long term credit to industrial needs.

The Industrial Development Bank of India, Scheduled banks, insurance companies, investment trusts and co-operative banks are the shareholders of IFCI. The Union Government has guaranteed the repayment of capital and the payment of a minimum annual dividend.

The corporation is authorised to issue bonds and debentures in the open market, to borrow foreign currency from the World Bank and other organisations, accept deposits from the public and also borrow from the Reserve Bank.

Functions:

The functions of the IFCI base as follows:

i) The corporation grants loans and advances to industrial concerns.

(ii) Granting of loans both in rupees and foreign currencies.

(iii) The corporation underwrites the issue of stocks, bonds, shares etc.

iv) The corporation can grant loans only to public limited companies and co-operatives but not to private limited companies or partnership firms.

Activities of the IFCI:

The promotional activities of IFCI are explained below:

1. Soft Loan Assistance:

This scheme provides soft loan assistance to existing industries in small and medium sector for developing technology through in-house research and development.

2. Entrepreneur Development:

IFCI provides financial support to EDPs (Entrepreneur Development Programmes) conducted by several agencies all-over India. in cooperation with Entrepreneurship Development Institute of India.

3. Industrial Development in Backward Areas:

IFCI also take measures to promote industrial development in backward areas through a scheme of concessional finance.

4. Subsidised Consultancy:

The IFCI gives subsidised consultancy for,

(i) Small Entrepreneurs for Meeting the Cost of Project.

(ii) Promoting Ancillary Industries

(iii) To do the Market Research.

(iv) Reviving Sick Units.

(v) Implementing Modernisation.

(vi) Controlling Pollution in Factories.

5. Management Development:

To improve the professional management the IFCI sponsored the Management Development Institute in 1973. It established the Development Banking Centre to develop managerial, manpower in industrial concern, commercial and development banks.

Industrial Credit and Investment Corporation of India (ICICI)

The Industrial Credit and Investment Corporation of India was registered as a private limited company in 1955. It was set up as a private sector development bank to assist and promote private industrial concerns in the country.

Broad objectives of ICICI

(a) to assist in the creation, expansion and modernisation of private concerns;

(b) to encourage the participation of internal and external capital in the private concerns;

(c) to encourage private ownership of industrial investment.

Functions of the ICICI

(i) It provides long-term and medium-term loans in rupees and foreign currencies.

(ii) It underwrites new issues of shares and debentures.

(iii) It guarantees loans raised by private concerns from other sources.

(iv) It provides technical,managerial and administrative assistance to industrial concerns.

Industrial Development Bank of India (IDBI)

The Industrial Development Bank of India (IDBI) was set up in July 1964, as a wholly-owned subsidiary of the Reserve Bank of India. It was given complete autonomy in February 1976. Today, the IDBI is regarded as an apex institution in the arena of development banking. The IFCI and the UTI are the subsidiaries of the IDBI. As an apex development bank, the IDBI's major role is to coordinate the activities of other development banks and term-financing institutions in the capital market of the country.

Functions of the IDBI

1. Planning, promoting and developing industries with a view to fill the gaps in the industrial structure by conceiving, preparing and floating new projects.

2. Providing technical and administrative assistance for promotion, management and expansion of industry.
3. Providing refinancing facilities to the IFCI, SFCs and other financial institutions approved by the government.

4. Coordinating the activities of financial institutions for the promotion and development of industries.

5. Purchasing or underwriting shares and debentures of industrial concerns.

6. Guaranteeing deferred payments due from industrial concerns and for loans raised by them.

7. Undertaking market and investment research, surveys and techno-economic studies helpful to the development of industries.

In short, the IDBI is the leader, coordinator and innovator in the field of industrial financing in our country. Its major activity is confined to financing, developmental, coordination and promotional functions.

Industrial Reconstruction Bank of India (IRBI)

To provide financial assistance as well as to revive and revitalise sick industrial units in public/private sectors, an institution called the Industrial Reconstruction Corporation of India (IRCI) was set up in 1971 with a share capital of Rs. 10 crores.
In March 1985, it was converted into a statutory corporation called the Industrial Reconstruction Bank of India (IRBI), with an authorised capital of Rs. 200 crores and a paid-up capital of Rs. 50 crores.

Functions of IRBI:

i. To provide financial assistance to sick industrial units.

ii. To provide managerial and technical assistance to sick industrial units,

iii. To secure the assistance of other financial institutions and government agencies for the revival and revitalisation of sick industrial units,

iv. To provide merchant banking services for amalgamation, merger, reconstruction, etc.,

v. To provide consultancy services to the banks in the matter of sick units, and

vi. To undertake leasing business.

Small Industries Development Bank of India (SIDBI)

With a view to ensuring larger flow of financial and non-financial assistance to the small-scale sector, the Government of India set up the Small Industries Development Bank of India (SIDBI) under a special Act of the Parliament in October 1989 as wholly-owned subsidiary of the IDBI. The bank commenced its operations from April 2, 1990 with its head office in Lucknow. The SIDBI has taken over the outstanding portfolio of the IDBI relating to the small-scale sector.

Functions performed by SIDBI

1. To initiate steps for technological up-gradation and modernisation of existing units.

2. To expand the channels for marketing the products of SSI sector in domestic and international markets.

3. To promote employment oriented industries especially in semi-urban areas to create more employment opportunities and thereby checking migration of people to urban areas.

The SIDBI's financial assistance to small-scale industries is channelised through the existing credit delivery system comprising State Financial Corporation, State Industrial Development Corporations, Commercial Banks, and Regional Rural Banks.

The SIDBI introduced two new schemes during 1992-93; equipment finance scheme for providing direct finance to existing well-run small-scale units taking up technology up-gradation, modernisation, and refinance for resettlement of voluntarily retired workers of the National Textile Corporation (NTC).

The other new scheme launched was venture capital fund exclusively for small -scale units, with an initial corpus of Rs. 10 crore. It enrolled itself as an institutional member of the OTC Exchange of India (OTCEI). SIDBI also provides financial support to National Small Industrial Corporation (NSIC) for providing leasing, hire-purchase, and marketing support to the industrial units in the small-sector.

State-Level Industrial Development Banks: (SFCs and SIDCs)

Some of the kinds of institutions to study the state-level industrial development banks are:

1. The SFCs and

2. The SIDCs/SIICs.

At the state-level, too, there is a combination of financing agencies and industrial development banks, mainly for the development of medium and small-scale industries in respective states, with some emphasis on the industrial development of their backward regions. They are State Financial Corporation's (SFCs) which are primarily financing agencies. Besides, most individual states have either a State Industrial Development Corporation (SIDC) or a State Industrial Investment Corporation (SIIC). In 1994-95, there were 18 SFCs and 26 SIDCs/SIICs. We study the two kinds of institutions separately.

1. The SFCs:

The SFCs came to be organized in individual states after the enabling Central Act to this effect came into force in August 1952. They are state-level organizations for the provision of term finance to medium and small scale industries. The share capital has been contributed by the state governments, the RBI (transferred to the IDBI after its separation from the RBI in February 1976), the IDBI, scheduled banks, insurance companies, and others.

The two most important items of liabilities were bonds and debentures and borrowings from the IDBI. The IDBI, which is the main source of loans, provides funds mainly in the form of refinance. It also administers the International Development Association (IDA) credit to them in the form of foreign currency loans. The SFCs also borrow from the SIDBI and IDBI.

The SFCs are authorized to provide financial assistance in all the four major forms, namely loans and advances, subscription to shares and debentures, underwriting of new issues, .and guarantee of loans from third parties and deferred payments.

2. The SIDCs/SIICs:

The SIDCs/SIICs came on the scene much after the SFCs. Whereas the SFCs of the state governments and IDBI (earlier, the RBI) the SIDCs/SIICs have been set up entirely by state governments. Besides providing finance, these institutions perform a variety of functions, such as arranging for land, power, roads, licenses for industrial units, sponsoring the establishment of such units, especially in backward areas, etc.