Chapter III

GROWTH OF FINANCIAL INTERMEDIARIES IN INDIA

Having discussed the growth of primarcy securities, the next problem is to examine the growth of financial intermediaries in India during 1951-71. Along with the growth of primary securities there takes place, a growth in variety and complexity of the financial intermediaries and in the volume of their activities. Financial intermediaries play a useful role in financial development of the country. They are primarily dealers in debts. They buy primary securities from the non-financial units in the form of purchase of stocks, debentures, treasury bills, subscription to government securities, extension of loans and credits to non-financial units in the economy. They in their turn issue debts of their own, in the form of money, bank deposits, insurance claims etc. Thus they buy one type of debt and issue another type of debt. In doing so they help the savings and investment process. To the savers, they increase the variety of choices in regard to the form in which their savings can be kept. That is to say, they increase the range of securities available to the savers in terms of liquidity, safety, divisibility, risk, scope for capital appreciation, yield etc. There is thus reason to believe that a well developed financial system causes the rate of savings to be higher than what it would otherwise have been. On the investment side, financial intermediaries improve the allocative efficiency of scarce savings by providing marketability and institutional evaluation and economics of scale. Principal financial intermediaries in India are the Central Bank, Commercial Banks, Insurance Companies, Co-operative CreditSSocieties and special Financial Institutions. Developed countries have a larger variety of institutions. In this chapter, in Section I, we discuss institutional developments and in Section II we discuss the quantitative aspects of growth of financial intermediaries.

Section I

Role of Financial Intermediaries Since Independence

The role played by the financial intermediaries in mobilising and providing resources for development since 1951 can be better appreciated in the light of financial organisation as it existed on the eve of Independence.

Importance of Internal Financing:

Before Independence one of the most important sources of financing industrial investment was the internal financing i.e. financing out of one's own savings or resources (i.e. flow back of retained profits). It should be noted that the size of the industrial sector was itself very small.[1]

Managing agency system' as an unusual form of financial organisation played a historical role in bringing about industrial growth during the pre-independence period by providing finance and entrepreneurial ability at times when they were scarce factors of production.[2] The system has its own limitations. Bulk of the investible resources of the managing agency firms in fact derived from the profits of their managed enterprises.[3] Thus, in a way, financing by the managing agency firms is as good as internal financing. Moreover, the system has one important drawback. It is very well known fact that intercompany investment by the same firms has led the control of large number of industrial enterprises by a few business houses.[4]

State of capital market, as generally found in all the underdeveloped countries, was highly underdeveloped. Issues of industrial securities were not popular. Industrial

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[1] L.C. Gupta. Charging Structure of Industutional Finance in India. Clarendon Press, Oxford, 1969, p.8.

[2] P.S. Lokanathan, Industrial Organisation in India. George Allen and Unwin, Ltd., London, 1933, pp.15-16.

[3] L.C. Gupta, Op.Cit., p. 8.

[4] Here it should be pointed out that the managing agency system has been abolished from 3rd April 1970 as continuation of the system was no longer consistent with the social, political and economic objectives of planned process of economic development in India.

securities market functioned poorly and on a very narrow basis. There were no institutional buyers of the industrial securities. Thus, raising the funds by issueing securities in the market was not a significant source of funds for industry.[5]

Commercial Banks:

Among the organised financial intermediaries, commercial banks were most important. Historically commercial banks developed on the British Model[6] and specialised in providing short-term credit to trade and industry in India. There were no industrial banks or development banks nor any institutional arrangement for buying the industrial securities. The close relationship between banks and business houses resulted in the control over banks by the business houses, which has given rise to a system of what may be called of "captive" financial institutions which were integral parts of financial and industrial complexes.[7] Thus, the commercial banks denied the provision of finance for the agricultural sector, small and medium industrial sector and new industrial enterpreneurs.

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[5] Ibid., pp. 8-9.

[6] George Rosen, Some Aspects of Industrial Finance in India. Bombay, 1962, p. 7.

[7] L.C. Gupta, Op.Cit., p. 9.

Agricultural Finance:

Condition of agricultural finance was extremely pathetic. Indian agricultural sector consisting of millions of small and poor farmers, entirely and hopelessly depended for their financial requirements on the private agencies, particularly on the money lenders who charged exorbitant rates of interest. Though, cooperative institutions came into existence long back in India in 1904, they were insignificant as a source of finance to the agricultural sector. Thus, there was absence of institutional arrangement of finance for the largest and important sector (agricultural sector) in India.

Features of Financial System Before Independence:

The principal features of financial system that existed at the time of Independence may be summarized as follows:

(1) So far as the provision of short-term finance for the industrial sector was concerned, the institutional arrangement was narrow in scope and defective. By and large the commercial banks catered to the needs of a few large business houses and large proportion of bank credit was used to finance trade rather than industry.

(2) There was virtually "gap" for meeting the financial requirements, short-term as well as long-term of the small and medium sized industrial enterprises.

(3) The then existing financial institutions may be characterised as lackof open financial facilities for the new enterpreneurs.[8]

(4) There was virtual "gap" for meeting the long-term financial requirement for the industrial sector. Industrial security market was narrow and semi-organised, and devoid of issuing houses and under-writing facilities. Moreover, there was virtual absence of institutional participation in the capital market.[9]

(5) For the agricultural sector, there was negligible institutional provision of finance for the millions of small and poor farmers in India.

(6) Thus, except for a minor segment of the industrial sector, there existed either "gap" for meeting the financial requirement or virtual absence of institutional provision of finance for most of the sectors in the Indian economy. From the point of view of the role of the financial institutions in the developmental process, the financial system which existed was incapable of sustaining high rate of industrial growth.[10] Such a "financial system" exists in a "traditional economy", the financial system of the traditional economy can be characterised by the absence of innovation financing and incapacity for raising per capita output.[11]

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[8] Ibid., p.9.

[9] Ibid., p.9.

[10] N.Das. Industrial Enterprise in India, London, 1938,p.7.

[11] Robert L. Bennet. The Financial Sector and Economic Development, The Johns Hopkins Press, Baltimore, 1965,pp.22-24.

Changes Since Independence:

Since Independence many changes have taken place. The most important factors determining the nature and magnitude of development of financial institutions have been the need for rapid economic development with priority for industrialization and the establishment of a process of planning in the framework of a mixed economy.[12] The structure, character and working of the existing financial institutions have undergone significant changes to meet the new challenges. Secondly, a large number of specialized financial institutions have been established at the state initiative to meet the gap in the old arrangement. Qualitative and quantitative progress has been made in case of almost all the financial institutions.[13]

Commercial Banks Since Independence:

The most important development was the Indian Banking Companies Act, 1949, by which the Reserve Bank of India assumed extensive power of control and regulation of the banking system and structure in India. This resulted into consolidation and qualitative improvement of the banking

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[12] L.C. Gupta, Op.Cit., p.11.

[13] S. Jagannathan, "Resources for Development - Role of Financial Institution", Reserve Bank of India Bulletin, December, 1972, pp. 2119-20.

system. This has led to strengthening of the banking system in the country. A new spirit was infused and a dynamism generated during the Planning Era. Consequently, the banks recorded phenomenal and uninterrupted growth. But what was remarkable was that banks shouldered increasingly heavier responsibilities for fulfilling the requirements of the modern growth oriented and planned economy, and widened their horizons by undertaking new and diversified banking functions.[14]

Next important development which took place was the nationalisation of the Imperial Bank of India and its conversion into the State Bank of India. The All India Rural Credit Survey Committee (1954) recommended "the creation of one strong, integrated, state sponsored, state partnered commercial banking institution with an effective machinery of branches spread over the whole country."[15] The recommendation was accepted by passing the State Bank of India Act of May 8, 1955. Consequently, the State Bank of India came into effect from July 1, 1955. It should be remembered that the State Bank of India was charged with special responsibility to look after the financial requirements of the

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[14] B.P. Sharma, The Role of Commercial Banks in India's Developing Economy, Bombay, 1974, P. 22.

[15] All India Rural Credit Survey Report, Vol.II, 1954, Reserve Bank of India, Bombay, 1954, p. 404.

agricultural sector in the context of imperative need for agricultural credit in a growing economy. State Bank of India, beside this, was also expected to promote banking habits in the rural sector, thereby mobilising the saving from the rural sector.

The most significant event that occurred in the development and role of the banking sector in the process of economic development, when the "Scheme of Social control over Banks" was introduced in the Parliament in December 1967. The concept and the scheme were novel and peculiar to India. It was evolved in the context of the role of the banking sector in the process of planned economic development. In that context the banking sector would have had to play dynamic and non-traditional roles. Thus, the scheme of "Social Control over Banks" was designed to serve three-fold objectives; to mould the working of the banking sector according to the general policy of economic growth and planned economic development of the country. Secondly, to allocate the credit in a desired proportion and purposefully in confirmity with the priorities laid down in the plans. And finally, by conferring greater and wider power on the Reserve Bank of India, it was envisaged to bring banking operations under the greater scrutiny and control.[16] The scheme of social control over Banks, was followed.

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[16] B.P. Sharma, <u>Op.Cit.</u>, p.27.

by the nationalisation of 14 major commercial banks on 19th July 1969. This was the great landmark in the history of commercial banks. It was strongly felt that the objectives of social control could be better and more rapidly attained if the state completely excercised its power and control under the state ownership. Thus the major part of the banking sector in India turned into public sector.

The record of quantitative growth of the commercial banks is very impressive. The number of their branches have increased from 4151 to 14030 between December 1951 to September 1972 and average population served by a commercial bank has gone down from 87000 to around 39000 during the same period.[17] This shows extension of the commercial banking facilities in the country. The commercial banks have played increasingly important role in mobilising the savings. This is evidenced from the deposits which commercial banks abolished during the period. The deposits withthe commercial banks have increased from Rs.9000 million in 1950-51 to Rs.78000 millionin September 1972 and these deposits as a proportion of national income have increased from 9 per cent in 1951 to 19 per cent in 1972. And amount of per capita deposits has increased from Rs.25 to Rs.139 during the same

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[17] S. Jagannathan., Op.Cit., p.2120.

period.[18]

The structural and qualitative changes that have taken place are no less impressive. Historically commercial banking system was concentrated in urban areas only. However, in recent years the commercial banks have opened large number of their branches in semi-urban and rural areas. During the period 1955-68 scheduled commercial bank's offices increased by as many as 4605, of which 1231 (27 per cent) were in rural centers, 1649 (36 per cent) in semi-urban centers.[19] Between July 1969 and June 1972 the proportion of branches opened in urban areas was 64 per cent.[20] The percentage of branches in centers with population of 10,000 or below was 17.8 per cent at the end of 1967.[21] which increased to 22.3 per cent in July 1969 and it further increased to 38.7 per cemt in June 1972.[22] Thus, the urban character of the commercial banking system has been rapidly changing. The most striking and fundamental change has taken place with regard to the

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[18] Ibid., p.2120.

[19] Organisation framework for theImplementation of Social Objectives, Reserve Bank of India, October 1969,p.5.

[20] S. Jagannathan, Op.Cit., p. 2120.

[21] Organisational Framework for the Implementation of Social Objectives, Op.Cit., p.511.

[22] S. Jagannathan, Op.Cit., p. 2120.

allocation of financial resources among the different sectors in the economy. The trading and commercial sector accounted for 40 per cent and industrial sector for 36 per cent of total bank credit in 1950-51. Since then allocation of bank credit has changed. By March 1966 the industrial sector accounted for 64.3 per cent, whereas commercial sector accounted for 17 per cent.[23] of the total bank credit. And by now the proportion of bank credit would have further increased. Thus, in 1951 the commercial banks used to finance chiefly trading and commercial sector. Whereas by now they have emerged as a significant financier to the industrial sector. Thus, it clearly shows that the increasing proportion of bank credit has gone to the industrial sector. This have been very reflected by the composition of the non-government corporate sector (i.e. private corporate sector) primary securities. The following figures worked out from chapter II tables show the percentage of outstanding borrow-

1950-51	12.9 per cent
1960-61	19.6 per cent
1970-71	25.5 per cent

[23]"Purpose-wise Survey of Bank Advances", Reserve Bank of India Bulletin, December, 1968, p. 2120.

ings by non-financial non-government corporations from the banks to the total outstanding non-government non-financial corporate sector primary securities.

Since mid-fifties, the commercial banks have entered newer forms of industrial financing such as medium term lending and underwriting new issues of industrial securities jointly with special financial institutions.

The commercial banks traditionally neglected agricultural sector, smallindustrial sector, retail trade small business sector. In 1951 only 2 per cent of bank credit was extended to to the agricultural sector. The direct and indirect finance taken together the proportion of total bank credit to the agricultural sector accounted for 8 per cent in 1972. The credit extended by the nationalised banks to the priority sector which were hitherto neglected sectors such as agricultural sectors, small industrial sector, retail trade and small business, professional and self-employed persons and education increased from 14.5 per cent in June 1969 to 22.8 per cent of their total bank credit in March 1972.[24] This reflects the diversification of bank credit and activities of banking sector in financing the different sectors in the economy.

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[24]S. Jagannathan, <u>Op.Cit.</u>, p.2121.

Life Insurance:

Life Insurance business was nationalised in September 1956 and Life Insurance Corporation of India was set up. "This was great event for the Indian capital market, not only because it transferred from private to public ownership an important saving institution but even more so it resulted in concentration of investible funds hitherto dispersed over a large number of independent institutions."[25]

Life Insurance Corporation of India essentially being a saving institution plays the role of mobilising the resources. It also allocates the resources. As the form of the saving being contractual in nature the funds at the disposal of Life Insurance Corporation has steadily grown. Life funds have increased from Rs.3810 million in 1956 to Rs.20670 million in 1972.[26] From the point of view of allocation of resources, the nationalisation of life business has improved the allocative efficiency as compared to pre-nationalised numerous independent insurers having fraction of total life funds at their disposal. Life Insurance being the single big institution makes far-reaching influence in the Indian capital market.

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[25]L.C. Gupta, Op.Cit., p. 48.

[26]S. Jagannathan, Op.Cit., p. 2120.

By statutory provision Life Insurance Corporation is obliged to invest fifty per cent of its resources into government securities. Thereby, savings of the individuals flow to the government sector. Life Insurance Corporation also plays an important role in the purchase of industrial securities.

The participation of Life Insurance Corporation is an important recent development in contrast to insignificant role of life insurance companies in industrial securities before nationalisation in 1956. Life Insurance Corporation's share in the underwriting of all the industrial securities was 2.22 per cent during the period January 1955 to June 1959. It increased to 18.82 per cent during the period July 1959 to December 1963.[27] This reflects the increasing participation of Life Insurance Corporation in underwriting the industrial securities.

Unit Trust of India:

Establishment of unit trust of India in 1964 was another important institutional development. In the context of increased opportunities for investment in the industrial securities due to the programme of industrialisation in the country. There arose a need for channalising savings into

[27] L.C. Gupta. Op.Cit., p. 135.

industrial securities. This becomes more important where in the capital market buying of the industrial securities by and large is confined to a very small fraction of the population. Very large section of the population is not familiar with the capital market in the country. It is from this point of view that role of Unit Trust of India is important as the mobiliser of resources from the small savers and specialising in the investment of industrial securities.

Special Financial Institutions:

A major lacuna in the financial structure of pre-Independence India was lack of issue houses, undersriting agencies and term lending institutions. Development of large scale industries requiring huge financial resources would have been impossible without a commensurate development of financial institutions. Vigorous steps were taken to develop special financial institutions. To name, Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India, Refinance Corporation, Unit Trust of India, Industrial Development Bank of India and at the state level, State Finance Corporations and State Industrial Development Corporations have come into existence. They act as issue houses and underwriters and provide long-term finance to the industries. It may be noted that except the Unit Trust of India, they are financial institutions of second degree, in the sense that they are not mobilizers of savings; they are allocatory of savings. They obtain their funds from the government and other financial institutions. Today, the institutional basis for industrial financing is much stronger.

The traditional and conventional sources of finance were found highly inadequate to meet the long-term financial requirement for the fixed capital of the large-scale industries. Secondly, the provision of finance for the small scale industries by and large had been neglected by the commercial banks (Unitl the nationalisation of commercial banks, this was the practice. Commercial bans have now started providing finance to the small scale industries also). And in the absence of any other institutional source of finance, the small scale industries were hopelessly forced to depend for their financial requirement on indigenous bankers. And, in the context of planned and rapid industrialisation meeting the growing financial needs of industries, particularly the provision of fixed capital becomes all the more important and necessary. Thus, we could see there was a gap in the sphere of industrial finance in India at the time of independence. The traditional sources of finance and conventional financial institutions working according to their conventional mode of operation seem that they are incapble of bridging the gap in the sphere of industrial finance and unable to meet the increasing requirementof finance in the context of planned economic development in the country. Hence, it was strongly felt to establish the specialised industrial financial institutions to fulfil these purposes. And consequently, the specialised industrial financial institutions were established and of course, they were government sponsored.

Though, all the specialised industrial financial institutions had post-independence origin, within a short-period they have acquired such importance that they have been described as the cornerstone of modern industrial finance in India. The rise of these institutions was the most outstanding development in the field of industrial finance in India. These financial institutions have created a far reaching effect on the entire industrial financing system in India.[28]

Between 1951 and 1971 the growth of financial assistance to industries from these institutions has been phenomenal. The qualititive aspects of assistance rendered by the specialised industrial financial institutions are worth noticing. The most outstanding feature of financial assistance rendered by them is that a major part of it has

[28]L.C. Gupta. Op.Cit., p.85.

gone to entirely new enterprises in contrast to the non-availability of finance to the new enterpreneures during the pre-independence period. Out of 425 companies assisted by ICICI upto 1966, 187 were new companies. Upto 1966 about two-thirds of assistance given by SFC has gone to new under-taking. A study made by the Department of Company Affairs covering forty-two new companies floated during the year ended 31st March 1966 indicates that loans from the specialised financial institutions contributed as much as 35 per cent of the project cost of these enterprises and if the shares and debentures taken by them are taken into account, the percentage contribution of these institutions will be still higher. These evidences strongly suggest that specialised financial institutions have become really massive source of finance for the new enterprises. In fact it has now become common practice in India for new industrial enterprises to raise substantial part of their initial financial require-ment by way of loans from specialised financial institutions.[29] In contradistraction with earlier development this period which is dominated by state sponsored and supported financial institutions has ushered in an era of innovating finance.

[29] *Ibid.*, pp. 103 and 106.

Financing the small and medium sized firms was also one of the objectives of the setting up the specialised financial institutions. The predominance of small companies among IFC's borrowers was great upto 1953-54. Later on the financing the small companies has been progressively taken over by the SFC and commercial banks. The great bulk of SFCs assistance goes to small enterprises.[30]

Co-operative Credit:

A major development in the agircultural field is the tremendous extension of the co-operative credit. The Rural Credit Enquiry Committee had recommended a fusion of state help and co-operative initiative. Accordingly the Reserve Bank of India and the State Bank of India have been specially entrusted with the task of fostering co-operative credit movement. A significant development has been the shift in the norm of extending credit - the norm has been shifted from "credit worthy persons" to "credit worthy uses", so that even small farmers have been brought within the purview of the co-operative credit. Though money lenders have not been displaced and continue to be important suppliers of credit in the rural areas, co-operative credit has broken their monopoly.

[30] Ibid., pp. 107-109.

Changes Since Independence:

To summarize, then the major changes in the financial institutional structure:

(1) The older institutions have grown quantitatively and penetrated deeper into the economy;

(2) The older institutions have widened the scope of their activities by undertaking non-traditional functions;

(3) Specialized financial institutions have come into existance;

(4) The involvement of the government in the ownership or management or control and direction of the financial institutions has increased tremendously.

The purpose of presenting this "historical" analytical perspecitve in this chapter is to show the changing character of financial structure and intermediation both autonomous and induced by the many sided initiative of the state and their interaction.

Section II

Quantitative Aspects of Growth of Financial Intermediaries

Differences in Growth of Assets:

The growth of financial intermediaries is not uniform. One group of financial intermediaries enter first and earlier than others in the process of growth. Secondly, relative importance of one or other group of financial intermediaries gets changed, increases or decreases in the process of financial development and economic development in the country. This explains the differences in the growth of assets of the financial intermediaries.

Table III-1 presents aggregate assets of all financial intermediaries and of the main group of financial intermediaries in India during the period 1950-51 to 1970-71.

The rate of growth (in absolute terms) of different financial intermediaries has been uneven. The aggregate assets of all financial intermediaries increased from Rs.3,030,25 lakhs to Rs.17,265,37 lakhs between 1950-51 and 1970-71. Thus, the aggregate assets of all financial intermediaries increased more than five and a half times. The assets of "Other Financial Institutions" increased as much as seventy-two times between 1950-51 and 1970-71. This was due to smaller base of calculation of its growth of assets, as it can be seen that the assets of "Other Financial Institutions" increased just from Rs.10,68 lakhs to Rs.770,91 lakhs between 1950-51 and 1970-71. The Reserve Bank of India showed smallest rate of growth. The assets of Reserve Bank of India increased (from Rs. 1,612,27 lakhs to Rs.5,463,07 lakhs a little more than three times between 1950-51 and

Table III-1: Total Assets of All Financial Intermediaries in India, 1950-51 to 1970-71.

(Rs.in lakhs)

Year	Total Assets	Reserve Bank of India	Commercial Banks	Insurance Organisations	Co-operative Institutions	Other Financial Institutions
1	2 (3+4+5+6+7)	3	4	5	6	7
1950-51	3,030,25	1,612,27	1,069,30	227,47	110,53	10,68
1951-52	3,034,61	1,530,94	1,100,00	272,00	120,44	11,23
1951-52	2,947,38	1,455,80	1,056,20	296,58	127,36	11,44
1953-54	3,003,61	1,452,76	1,072,40	320,70	143,91	13,84
1954-55	3,215,75	1,521,84	1,170,40	351,42	158,47	13,62
1955-56	3,666,50	1,737,18	1,335,30	370,52	185,27	38,23
1956-57	4,139,13	1,925,68	1,475,60	458,70	228,75	50,40
1957-58	4,601,17	2,045,12	1,681,00	514,92	293,03	67,10
1958-59	5,044,73	2,159,38	1,917,50	558,46	334,84	74,55
1959-60	5,656,70	2,360,36	2,181,90	612,63	417,05	84,76
1960-61	5,940,21	2,470,39	2,189,00	687,96	493,55	99,31
1961-62	6,428,15	2,639,79	2,307,83	769,67	579,38	131,48
1962-63	7,047,03	2,850,79	2,488,77	868,36	672,84	166,27
1963-64	7,858,96	3,097,44	2,781,83	971,02	801,15	207,52
1964-65	8,711,27	3,346,61	3,094,20	1,089,01	932,10	249,35

1970-71. Next to the growth of "Other Financial Institutions" was that of co-operative institutions. The assets of Co-operative Institutions increased (from Rs.110,53 lakhs to Rs.2,236,00 lakhs) more than twenty times, between 1950-51 and 1970-71. The Insurance Organisations showed an increase of assets (from Rs.227,47 lakhs to Rs.2,189,18 lakhs) of a little more than nine and half times, between 1950-51 and 1970-71. The assets of Commercial banks increased (from Rs.1,069,30 lakhs to Rs.6,606,21 lakhs) a little more than six times, between 1950-51 and 1970-71.

Thus, the examination of the growth rates of the financial intermediaries has shown that all the financial intermediaries have grown, but at different rates. They differed considerably in rates of growth. The "Other Financial Institutions" showed noticeable growth more rapidly than the cooperative institutions and insurance organisations. Then the rapid growers among the five different financial intermediaries include co-operative institutions and insurance organisations. They have experienced faster growth than the commercial banks. The commercial banks growth rate was just little more than the growth of all financial intermediaries during the period, whereas the Reserve Bank of India has shown the growth rate considerably lower than the growth rate of all financial intermediaries.

The growth rate (i.e. 9 per cent a year) of assets of financial intermediaries during the period 1950-71 in India seems tobe higher than that observed for the advanced countries of the world in their earlier phase. The following figures give relevant information.

Growth of financial assets

Per cent per year

Countries	1881-1900	1901-1913
Canada	6.6	8.5
France	4.4	3.8
Germany	5.6	6.4
Great Britain	2.5	2.7
Japan	15.2	7.2
Sweeden	4.5	5.5
U.S.A.	6.4	6.5

Source: Raymond W. Goldsmith, Financial Structure and Development, Table IV-4, p. 186.

It should be pointed out that Raymond W. Goldsmith's estimates of financial assets include provident fund, Post Office Savings, and assets of the financial intermediaries of second degrees. Whereas, in our estimates provident funds and Post Office Savings are not treated as assets of financial intermediaries, and assets of financial intermediaries of the second degree are not included. In that case if we would have included the above mentioned in our estimates then the growth rate of assets of financial intermediaries would have been more than 9 per cent during the period under study.

Shifts in Distributions of Assets Among the Financial Intermediaries:

The differing rates of growth of the various financial intermediaries, of course, led to considerable changes in the distribution of aggregate assets among the financial intermediaries. This can be readily seen from Table III-2, which gives the percentage distribution of aggregate assets of all financial intermediaries in India during the period 1950-51 to 1970-71. The shifts in the percentage distribution among the financial intermediaries are seen from the table. It seems that each group of financial intermediaries has shown a pattern of its own in the movement of its share in the aggregate assets of the financial intermediaries. Let us examine this in detail.

Table III-2 presents percentage share of various financial institution in total assets of all financial intermediaries during the period 1950-51 to 1970-71.

Table III-2: Percentage Share of Various Financial Institution in Total Assets of All Financial Intermediaries in India, 1951-71.

(in percentage)

Year	Reserve Bank of India	Commercial Banks	Insurance Organizations	Co-operative Institutions	Other Financial Institutions	Total assets of all financial Intermediaries
1	2	3	4	5	6	7
1950-51	53.2	35.3	7.5	3.6	0.4	100.0
1955-56	47.4	36.4	10.1	5.1	1.0	100.0
1960-61	41.6	36.8	11.6	8.3	1.7	100.0
1965-66	37.1	35.6	12.5	11.0	3.8	100.0
1970-71	31.6	38.3	12.7	12.9	4.5	100.0

Source: Calculated from Table III-1.

Table III-2, column 2, clearly shows the outstanding movement is the sharp decline in the share of the Reserve Bank of India to the aggregate assets of all financial intermediaries. From the table it is seen that the share of the Reserve Bank of India has continuously declined throughout the period. The share of the Reserve Bank of India successively declined from 53.2 per cent in 1950-51 to 31.6 per cent in 1970-71. It should be pointed out that the sharp decline in the share of the Reserve Bank of India has occurred notwithstanding the sharp expansion of the currency in circulation i.e. money, the most important liability of the Reserve Bank of India. This movement is, indeed the reflection of the fact that generally financial intermediation begins with the Banking system in the country and particularly with the central bank,and of necessarily banks would lose relative importance as other financial intermediaries enter, grow up and develop.

The share of the Commercial Banks the most important group of financial intermediaries, has remained distinctively stable during the period. From Table III-2, column 3, it is seen that the share of the commercial banks have been varied within narrow range, from 35.3 per cent in 1950-51 to 38.3 per cent in 1970-71. The relative steadiness of the share of commercial banks can be explained in terms of growth of commercial banks in the country. The number of their branches have increased from 4,151 to 14,030 between December 1951 and September 1972. The deposits with the commercial banks have increased from Rs.9,000 million in 1950-51 to Rs.78,000 million in September 1972. Deposits as percentage of national income increased from 9 per cent to 19 per cent during the same period.[31] The banking system at the time of Independence was highly underdeveloped as generally found in

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[31] S. Jagannathan, Op.Cit., p.2120.

an underdeveloped country. The above statistics about number of branches of banks and deposits with the banks reflects the development of banking system in the country. However, it should be noted that the existing banking system still reflects the underdevelopment of banking in India as compared to some of the advanced countries of the world. The magnitude of the underdevelopment of banking in India can be known from the fact that average population served by a commercial bank office in India was as high as 73000 in 1967 as against 4000 in united kingdom, 7000 in united states of America and 11000 in Japan (in 1965). Commercial banks deposits and credit as a proportion of national income formed 14 per cent and 10 per cent respectively in India in 1967 as compared to 84 per cent and 79 per cent in Japan, 56 per cent and 36 per cent in the united states of America and 49 per cent and 29 per cent in Canada in 1965.[32] That the relatively steady share of the commercial banks (though there is some marginal increase) can be related to the present stage of the growth of the commercial banks in the economy is plausible.

The share of the Insurance organisations has increased from 7.5 per cent in 1950-51 to 12.7 per cent in 1970-71.

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[32] Organisational Framework for Implementation of social objectives. Op.Cit., p.

Thus, there has been marginal increase in the relative share of the Insurance Organisations. Though there has been upward trend in their relative share, but this was not sharply marked upward. The upward trend in the relative share of the Other Financial Institutions has been clearly marked as it is seen from column 6, table III-2. Its relative share has increased just from 0.4 per cent in 1950-51 to 4.5 per cent in 1970-71. Thus, there has been marginal increase in the relative share of the Other Financial Institutions. The trend in the relative share of the Co-operative Institutions was distinctively marked upward during the period. As it is seen from Table III-2, column 5, that its share has successively increased during the period from 3.6 per cent in 1950-51 to 12.9 per cent in 1970-71.

<u>Shift in the Relative Position of Monetary and Non-monetary Intermediaries:</u>

Now we will examine the other hypothesis and generalisation about the relative growth and role of monetary intermediaries and non-monetary intermediaries in the financial structure of the country. Generally, during the initial stage of the economic development of the country, development of the financial intermediaries begins with themmonetary system i.e. central bank and commercial banks. Thus, the monetary intermediaries emerge and develop earlier on the scene. Non-monetary financial intermediaries emerge at a later stage. As the process of economic development proceeds further a variety of non-monetary financial intermediaries emerge and develop in the process of development of the financial structure in the country. The share of the monetary intermediaries to the total assets of all financial intermediaries, originally predominating, tends to decline as the economic development proceeds further and that of the non-monetary intermediaries tends to increase. This seems to be common experience of most of the advanced countries of the world. For instance, the share of the banking system in the total assets of all financial intermediaries in the United States of America declined from 65.5 per cent to 48.2 per cent between the period 1900 and 1952. This was mainly due to decline in the share of commercial banks from 52.8 per cent to 33.9 per cent during same period.[33] This shows the increasing importance of non-monetary intermediaries in the United States of America.

The information about the relative share of monetary and non-monetary intermediaries to the total assets of all financial intermediaries in India is presented in Table III-3.

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[33]Raymond W. Goldsmith. Financial Intermediaries in the American Economy since 1900, Princeton University Press, 1958, Table II, p.75.

Columns 2 and 3 of the Table III-3 give account of the relative share of monetary and non-monetary intermediaries respectively during the period 1951-71.

Table III-3: Percentage Share of Assets of Monetary and Non-monetary Intermediaries to the Total Assets of All Financial Intermediaries, 1951-71.

(In percentage)

Year	Monetary Intermediaries	Non-monetary Intermediaries	Total Assets of all Financial Intermediaries
1	2	3	4 (2+3)
1950-51	88.5	11.5	100.0
1955-56	83.8	15.2	100.0
1960-61	78.4	21.6	100.0
1965-66	72.7	27.3	100.0
1970-71	69.9	30.1	100.0

Source: Col. 2: Column 2 + Column 3, Table III-2.
Col. 3: Column 4 + Column 5 + Column 6, Table III-2.
Col. 4: Column 2 + Column 3.

Table III-3 brings out the distinctly marked changes in the relative shares of monetary and non-monetary intermediaries in India. As it is seen from columns 3 and 4 of the Table III-3 the relative share of the monetary intermediaries has successively declined from 88.5 per cent in 1950-51 to 69.9 per cent in 1970-71 and of non-monetary intermediaries increased from 11.5 per cent in 1950-51 to 30.1 per cent in 1970-71. However, it should be noted that the shift in the relative shares between monetary and non-monetary intermediaries was mainly due to the decline in the share of Reserve Bank of India from 53.2 per cent to 31.6 per cent between 1950-51 and 1970-71 (See Column 2, Table III-3). This movement i.e. decline in the relative share of the monetary intermediaries and increase of non-monetary intermediaries, indeed, is merely a reflection of the fact that the monetary intermediaries were first an important branch of the financial intermediaries and necessarily lost ground relatively as the non-monetary intermediaries emerged and developed. It should be noted that the relative share of the monetary intermediaries accounted for more than 69.9 per cent of the total assets of all financial intermediaries during the period. Thus, the monetary intermediaries still retained their dominant share in the total assets of all financial intermediaries. Never theless, it reflects the fact that shift in the relative shares has set in between the monetary and non-monetary intermediaries, and that the declining share of monetary intermediaries and increasing share of non-monetary intermediaries in the process financial development of the country is a usual one. And also this shows the important emerging trend that the primacy of monetary intermediaries as a branch of financial intermediaries is tending to give place to monetary intermediaries in India.

And lastly, the above analysis has led us to conclude that the growth and development of the financial intermediaries and changes in the relative shares among the monetary and non-monetary intermediaries are in accordance with the general and universal experience of the financial intermediaries in most of the advance countries of the world. And this strongly confirms the above stated hypothesis in India also.

The Relation of the Assets of the Financial Institutions to National Income:

The financial intermediaries emerge and develop during the process of financial development along withthe economic development in the country. Generally, the rate of growth of assets of the financial intermediaries seems to be at a faster rate than the national product during process of financial development in the country. Thus, the assets-income national ratio will have a tendency to rise during the process of financial development of the country. The secular upward trend in the assets-income ratio of the financial institutions seems to be universal, and this has been the experience of the developed countries of the world. One of the characteristics of that ratio is that in the early period of the country's economic development the upward trend in the ratio seems tobe most pronounced. Secondly, the ratio begins to rise from low level and reaches a very high level till the country has built up a fullfledged financial system. Our aim is to focus on this hypothesis.

Table III-4 presents the account of financial intermediaries assets-income ratio, during the period 1951-71.

Table III-4: Ratio of Assets of Financial Intermediaries to National Income in India, 1951-71.

(Rs. in crores)

Year	Assets of all financial inter-mediaries	Net National product	Ratio
1	2	3	4 (2 ÷ 3)
1950-51	30,30	91,46	0.33
1955-56	36,67	91,76	0.40
1960-61	59,40	132,63	0.45
1965-66	97,38	206,37	0.47
1970-71	172,65	344,62	0.50

Source: Col. 2: Column 2, Table III-1.
Col. 3: Column 2, Table II-1.
Col. 4: (Column 2 ÷ Column 3)

From column 4 of the Table III-4, it is seen that financial intermediaries assets-income ratio has successively increased from 0.33 in 1950-51 to 0.57 in 1970-71. This clearly bringsout the upward trend in the ratio of financial intermediaries assets-income during the period. The upward trend in the ratio reflects that the rate of growth of the financial institutions was faster than that of the national income during the period.

Concluding Remarks:

In conclusion, one may say that the financial structure has become diversified in institutional terms and financial institutions have grown in volume and variety in terms of their business. The assets of the financial institutions have grown very rapidly. The relative share of the monetary financial intermediaries has declined, but it is remarkable that the entire decline is accounted for by the decline of the relative share of the Reserve Bank of India. The share of the Commercial Banks has slightly increased, due to the phenomenal progress of the commercial Banks in smaller towns and semi-urban areas. The share of the non-monetary financial intermediaries has increased which is in keeping with the experience in other countries. The Assets-income Ratio has increased rapidly during the period.

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Appendix Table III-1: Assets of the Commercial Banks, 1950-51 to 1970-71.

(Rs. in lakhs)

Year	Total Assets of the Commercial Banks	Assets of the Scheduled Commercial Banks	Assets of the Non-scheduled commercial Banks
1	2 (2+3)	3	4
1950-51	1,069,30	1,020,40	48,90
1951-52	1,100,00	1,029,50	70,50
1952-53	1,056,20	978,30	77,90
1953-54	1,072,40	997,40	75.00
1954-55	1,170,40	1,091,30	79,10
1955-56	1,335,30	1,250,90	84,40
1956-57	1,475,60	1,385,70	89,90
1957-58	1,681,00	1,621,00	60,00
1958-59	1,917,50	1,859,90	57,60
1959-60	2,181,90	2,118,60	62,40
1960-61	2,189,00	2,135,01	53,99
1961-62	2,307,83	2,259,47	48,36
1962-63	2,488,77	2,441,40	47,37
1963-64	2,781,83	2,741,15	40,68
1964-65	3,094,20	3,059,58	34,62
1965-66	3,465,03	3,437,02	28,01
1966-67	3,999,54	3,972,08	27,46
1967-68	4,407,96	4,378,91	29,05
1968-69	4,948,88	4,918,27	30,61
1969-70	5,692,39	5,663,99	28,40
1970-71	6,606,21	6,587,97	18,24

Source: Col. 3: Figures for the years 1950-51 to 1960-61 are obtained from statement on "Liabilities and Assets of Banking Companies", annual reports of Trends and Progress of Banking in India, (TPBI), Reserve Bank of India, Bombay. Figures for each year are obtained from the respective annual reports of TPBI. The figures given in the annual reports relate to a year from January-December. Therefore, we have collected figures of total assets of the scheduled bank at the end of the March for each year from 1950-51 to 1970-71 from the respective annual reports of TPBI, which also gives the figures liabilities and assets of the scheduled banks for every month of the year. From 1961-62 onwards we do not get the figures of the total assets of the scheduled commercial banks. So we relied on statement on "Scheduled Commercial Banks Business", Annual Reports of the Report on Currency and Finance, (RFC), Reserve Bank of India, Bombay. However, the above statement of the RCF does not give us figures of the total assets of the scheduled commercial banks as such. Hence we arrived at the figures of the total assets for each year from 1961-62 to 1970-71 by adding up the figures of items falling on the assets side. But these figures of total assets which we have arrived at do not include the above mentioned statement do not give this item. The amount of miscellaneous assets was about Rs.6000 lakhs in the year 1960-61. In order to include this item of miscellaneous assets, we added Rs.6000 lakhs to the figures of total assets whichwe have arrived at by adding up the items whichfall on the assets side for each year. The finalfigures arrived at would give us the total assets of the scheduled commercial banks for 1961-62 to 1970-71. The figures of the items which fall on the asset side for the years from 1961-62 to 1965-66 are obtained from the statement on "Scheduled Commercial Banks Business, annual Report of 1966-67, RCF, and for the years from 1966-67 to 1970-71 from the annual report of 1970-71, RCF.

Col. 4: Figures for the years 1950-51 to 1960-61 are obtained from the statement on "Liabilities and Assets of Banking companies", annual report of <u>Trend and Progress of Banking in India</u>, (TPBI). Figures for each year are obtained from the respective annual reports of TPBI. And we have collected the figures of total assets of the non-scheduled banks at the end of the March for each year from 1950-51 to 1960-61. And the figures from 1961-62 onwards we have obtained from the statement on "Liabilities and Assets of Non-scheduled Commercial Banks, annual reports of <u>Report on Currency and Finance</u>. The figures of the total assets for the years 1961-62 to 1965-66 are obtained from the annual report of 1966-67, RCF, and for the years from 1966-67 to 1970-71 from the annual report of 1970-71, RCF.

Appendix Table III-2: Assets of the Insurance Organisations, 1950-51 to 1970-71.

(Rs. in lakhs)

Year	Total Assets of the Insurance Organisations	Assets of the Life Insurance Corporation of India	Assets of the Indian Insurances
1	2 (3+4)	3	4
1950-51	227,47	-	227,47
1951-52	272,00	-	272,00
1952-53	296,58	-	296,58
1953-54	320,70	-	320,70
1954-55	351,42	-	351,42
1955-56	370,52	-	370,52
1956-57	458,70	415,00	43,70
1957-58	514,92	464,98	49,94
1958-59	558,46	505,72	52,74
1959-60	612,63	554,75	57,88
1960-61	687,96	622,83	65,13
1961-62	769,67	696,31	73,36
1962-63	868,36	785,90	82,46
1963-64	971,02	880,46	90,56
1964-65	1 089,01	986,75	102,26
1965-66	1,213,00	1,099,99	113,01
1966-67	1,379,92	1,247,54	132,43
1967-68	1,546,18	1,400,01	146,17
1968-69	1,740,24	1,577,33	162,91
1969-70	1,960,33	1,771,78	188,55
1970-71	2,189,18	1,971,18	218,00

Source: Col.2: Sum of the columns 3 and 4.

Col.3: Statement on "Liabilities and Assets of the Life Insurance Corporation of India", given in "Insurance", Statistical Abstract, India, Central Statistical Organisation, Government of India. The figures for the years 1956-57 to 1957-58 are obtained from SAI, 1961. The figures for the years 1958-59 to 1960-61 are obtained from SAI, 1966. The figures for the years from 1961-62 to 1965-66 are obtained from SAI, 1967. And figures from 1965-66 to 1970-71 are obtained from SAI, 1972.

Col. 4: Statement on "Liabilities and Assets of the Indian Insurers", given in "Insurance", Statistical Abstract, India, Central Statistical organisation, Government of India. The figures for the years 1950-51 to 1955-56 are obtained from SAI, 1955-56. The figures for the years 1956-57 to 1960-61 are obtained from SAI, 1966. The figures for the years 1961-62 to 1965-66 are obtained from SAI, 1967. And figures for the years 1966-67 to 1970-71 are obtained from SAI, 1972.

Appendix Table III-3A: Assets of Co-operative Institutions,* 1950-51 to 1956-57.

(Rs. in lakhs)

Year	Total Assets of Co-operative Institutions	Assets of Agricultural credit societies**	Assets of Non-agriculture credit societies**	Outstanding loan given by the primary credit societies
1	2 (3+4+5)	3	4	5
1950-51	110,53	13,07	18,46	79,00
1951-52	120,44	12,51	17,84	90,09
1952-53	127,36	11,17	19,27	96,92
1953-54	143,91	13,77	23,24	106,90
1954-55	158,47	15,96	26,22	116,29
1955-56	185,27	21,81	26,37	137,09
1956-57	228,75	26,92	29,94	171,89

Note:- *Assets of the cooperative institutions includes only the assets of primary credit societies.

**Assets of agriculturaland non-agricultural societies are exclusive of outstanding loan given by them. (The outstanding loan given bythem is given in column 5 of the table, which includes theoutstanding loan given by agricultural and non-agricultural credit societies)

Source: Col. 3: Statement on operation on "Agricultural Credit societies", annual reports of "statistical statement relating to cooperative Movement in India, Reserve Bank of India, Bombay.

Col. 4: Statement on "Operation on Non-agricultural credit societies", annual reports of Statistical statement on cooperative movement in India.

Col. 5: Statement on "Loan Transaction of Primary Credit societies by states, Annual reports of statistical statement relating to cooperative movement in India.

<u>Note on the Estimation of total Assets of Co-operative Institutions</u>: It should be brought to the notice that the statement on "Operation on Agricultural Credit Societies" and Operation on Non-agricultural Credit Societies" as such do not give the figures of assets of agricultural and non-agricultural credit societies. Therefore, in order to arrive at the assets of agricultural credit societies, we have added the figures of the items falling on the assets side given in the statement on "Operation on Agricultural Credit Societies", (That is the column 3). In the same way, we arrived at the figures of the assets of non-agricultural credit societies. The items falling on the assets side, (which we have obtained from the above mentioned statements to arrive at the figures of the assets of agricultural and non-agricultural credit societies) are as follows: cash on hand, balance with the banks, investment, and miscellaneous assets i.e. baiding and other assets. Since the above mentioned statements do not give the figures of outstanding loan advanced by the primary credit societies i.e. agricultural and non-agricultural societies, which we have obtained from the statement on "Loan Transactions of Primary Societies by States", and that is given in column 5 of the table. The sum of columns 3, 4 and 5 give us the total assets of the co-operative institutions.

Appendix Table III-3B: Assets of Co-operative Institutions, 1957-58 to 1970-71.

(Rs. in lakhs)

Year	Total Assets of Co-operative Institutions	Assets of Agricultural credit societies	Assets of Non-agricultural credit societies	Assets of primary land mortgage Banks
1	2 (3+4+5)	3	4	5
1957-58	293,03	147,57	130,18	15,28
1958-59	334,84	186,21	131,05	17,58
1959-60	417,05	243,99	150,87	22,19
1960-61	493,55	300,13	164,95	28,47
1961-62	579,38	356,24	182,69	40,45
1962-63	672,84	407,89	205,68	59,27
1963-64	801,15	484,14	237,64	79,37
1964-65	932,10	545,81	278,66	107,63
1965-66	1,073,04	617,48	303,86	151,70
1966-67	1,232,76	703,00	335,34	194,42
1967-68	1,416,04	800,07	369,52	246,45
1968-69	1,671,87	918,90	407,52	345,45
1969-70	1,941,71	1,045,67	446,08	449,96
1970-71	2,236,00	1,153,40	531,94	550,66

Source: Cols. 3 and 4: Statement on "Primary Credit Societies-Assets, annual reports of Statistical Statement relating to Co-operative Movement in India, Reserve Bank of India, Bombay.

Col. 5: Statement on "Primary Land Mortgage Banks, annual reports of Statistical Statement relating to co-operative Movement in India.

Appendix Table III-4: Total Assets of the Other Financial Institutions, 1950-51 to 1970-71.

(Rs. in lakhs)

Year	Total Assets	Industrial Finance Corporation of India	State Financial Corporations	Industrial Credit and Investment Corporation of India	Industrial Development Bank of India
1	2 (3+4+5+6)	3	4	5	6
1950-51	10,68	10,68	-	-	-
1951-52	11,23	11,23	-	-	-
1952-53	11,44	11,44	-	-	-
1953-54	13,84	13,84	-	-	-
1954-55	13,62	13,62	-	-	-
1955-56	38,23	14,70	10,70	12,83	-
1956-57	50,40	21,70	14,75	13,95	-
1957-58	67,10	33,99	18,04	15,07	-
1958-59	74,55	35,04	23,32	16,19	-
1959-60	84,76	41,07	26,38	17,31	-
1960-61	99,31	51,09	29,80	18,42	-
1961-62	131,48	61,34	40,22	29,92	-
1962-63	166,27	77,09	47,76	41,42	-
1963-64	207,52	92,80	61,80	52,92	-
1964-65	249,35	110,65	74,28	64,42	-
1965-66	371,08	135,36	90,12	75,95	69,65
1966-67	507,04	183,18	106,31	108,11	109,44
1967-68	588,26	194,15	114,31	121,36	158,44
1968-69	645,96	208,20	125,30	123,98	188,48
1969-70	708,85	214,59	140,99	135,23	218,04
1970-71	770,91	215,23	163,10	149,15	243,43