

THE ROLE OF NON-BANKING FINANCIAL INSTITUTIONS IN INDIAN ECONOMY

M. ARUMUGAM

1. *TERM-FINANCE — Its Function in the Capital Market*

Industry requires financial resources for : (1) setting up a new industrial concern, (2) expansion, modernization, renovation, etc. of an existing unit, and (3) carrying out the day-to-day business operations. Finance is required for the first two purposes on a long-term basis for the acquisition of fixed assets like land, building, plant, machinery, etc. On the other hand working capital is required for financing current assets like stock of raw materials, semi-finished goods, stores, bills receivable, etc.

The essential function of the commercial bank in relation to industry consists in the furnishing of working capital. They are normally unwilling to lock up their funds in long-term credits to or participations in industrial enterprises. Commercial bank loans are largely based upon goods in process of production and the expectation is that as the goods move to a further stage of production, they will in the normal economic process be sold and thus permit the repayment of the loans. Hence, the orthodox theory of commercial banking is that commercial banks should confine themselves to short-term self-liquidating transactions.

The investment banking function consists, on the other hand, in the raising and redistribution of fixed capital. It is carried on mainly through the purchase of shares and debentures of joint-stock companies and their subsequent sale at a profit to investors. But, the function of the capital market consists in the creation of a variety of financial assets and channelling them to meet the investment needs of entrepreneurs. The growth of institutional facilities for medium-term and long-term loans has some important implications for the growth of industry. In the very nature of the stock market, short period expectations regarding changes in prices tend to predominate over long-period prospects of enterprise. To the extent that long-term institutional loans reduce the dependence of