CMDR Monograph Series No. - 49

SOCIETAL GOALS OF COMMERCIAL BANKS IN INDIA : PROMISE AND REALITY

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Societal Goals of Commercial Banks in India: Promise and Reality*

The Backdrop

Sound financial systems with stable macro economic fundamentals are some of the primary requirements to be ensured for sustaining higher growth of the economy over time. In the financial system, banking sector plays a crucial role in mobilizing resources and in ensuring timely disbursement of credit to certain productive units. Allocation of credit for various developmental purposes including priority sector is expected to smoothen the persisting economic disparities across regions and likely to improve overall growth in employment. Taking cognizance of it, nationalization of commercial banks was undertaken so as to transform the commercial banking into social banking by assigning priority to certain sectors and in fulfilling credit needs of the deprived section. The policy urged the bankers to reprioritize lending process by shifting from urban-centric growth to rural-oriented approach.

It is during the reforms period when skepticism has arisen about the role played by the banking sector partly because of disquieting trends in some of the macro economic indicators and inadequate priority assigned to social aspect of banking.[1] Added to this, farmers' suicide in various states especially in Andhra Pradesh, Maharashtra and Karnataka can be partly the outcome of erosion in disbursement of credit to agriculture.[2]

Against this backdrop, the present paper attempts to examine the overall progress and achievement of Scheduled Commercial Banks (SCBs) operating in India during the pre-reforms and reforms periods with focus on societal goals. Efforts have been made to capture achievement of the banking sector in fulfilling few major objectives of bank nationalization, including shift form 'elite banking' to 'mass banking' and lending for priority sector.

The paper is organized as follows. With a brief analysis about conceptual and functional issues associated with banking in section I, an overview of the performance of commercial banks during pre-reforms and reforms periods has been captured in section II. The penultimate section deals with achievement of commercial banks with focus on social baking followed by summary and conclusion in section IV.

* This is part of ongoing research work in Banking and Development, partially sponsored by Canara Bank. An earlier version of the paper was presented in a seminar in Centre For Multi-Disciplinary Development Research, Dharwad in 2004. I am grateful to Canara Bank for providing financial support and to Professors P R Panchamukhi and Sailabala Debi for their critical comments on an earlier version of this paper.

[1] For instance, the overall growth in per capita income of the states edged up during the 1990s as compared to the 1980s but persisting disparities among the states got aggravated during the previous decade. Similarly, the rate of unemployment measured in Current Daily Status (CDS) also went up (from 6.03 per cent in 1993-94 to 7.32 percent in 1999-2000) during the 1990s. Growth of employment has also dropped from about 2 per cent per annum in 1983-93 to less than 1 per cent during 1993-94 to 1999-2000.

[2] Based on some of the issues discussed above, the Finance Minister, Government of India urged the PSBs to double credit to agriculture in three years ahead, by 2007.

Section I

1. Commercial Banks: Classification and Function

The Commercial banks are considered as the dominant financial intermediaries in India as it channelises large amount of savings into investment and consumption. In the financial system it occupies the second position as a financial institution next to the Reserve Bank of India. In this contest, it may be essential to touch upon some of the conceptual issues associated with banking, namely commercial bank, Scheduled Commercial Banks (SCBs) and various categories of SCBs.

A bank is an institution that accepts deposits of money from the public withdrawable by cheque and used for lending.[3] In other words, two essential functions that make a financial institution a bank are acceptance of chequable deposits (of money) from public and lending to others (but not for financing its own business of any kind, say manufacturing or trade). [4]

In defining Commercial banks the business of commercial firms that provide various types of services to its customers (provision of different types of deposits, purpose specific loans, safety lockers to store valuable assets of the customers and so on) can be taken into account.

Further, commercial banks can be broadly classified into Scheduled Commercial Banks (SCBs) and non-Scheduled Commercial Banks; with proportionately larger share contributed by the former. In March 2004, out of total 291 commercial banks 289 are Scheduled Commercial Banks and the remaining 5 are non-scheduled Commercial Banks. Of the total 289 SCBs, a majority (196) are Regional Rural Banks.

A 'scheduled bank' is a bank which is included in the second schedule to the Reserve Bank of India Act 1934. These banks enjoy certain privileges such as free confessional remittances facilities and financial accommodation from the RBI. They also have certain obligations like minimum cash reserve ratio (CRR) to be kept with the RBI. All Scheduled Banks comprise Schedule Commercial and Scheduled Co-operative banks.

The commercial Banks which conduct the business of banking in India and which (a) have paid up capital and reserves of an aggregate real and exchangeable value of not less than Rs. 5 lakhs and (b) satisfy the Reserve Bank of India that their affairs are not being conducted in a manner detrimental to the interest of their depositors, are eligible for inclusion in the Second schedule to the Reserve Bank of India Act, 1934, and when included are known as 'Scheduled Commercial Banks'.

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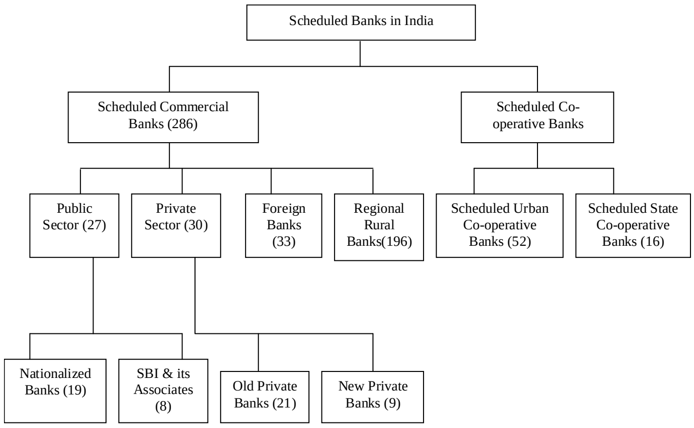
[3] In exploring the origin of the word 'bank', one may go back to the days of Lombard money –changers who used to keep overseas travellers' money in safe custody. They conducted their business from a bench (*banc* in French). Therefore, the word 'bank' is used to specify a place where money is handled (Dhingra, I. C, 2000).

[4] Acceptance of chequable deposits is a necessary but not a sufficient function to consider a financial institutions as a bank. In other words, it has to fulfill others' lending requirement. Therefore, Post Office Savings Bank are not technically considered as bank though some of them accept chequable deposits. Similarly, lending alone does not make a financial institution a bank as it has to accept chequable deposits (Gupta, Suraj: 1999).

Chart-I Scheduled Banking Structure in India



The Scheduled Commercial Banks in India can be broadly classified into five different groups according to their ownership and / or nature of operation. These bank groups are (i) State Bank of India and its associates, (ii) Nationalized Banks, (iii) Regional Rural Banks, (iv) Foreign Banks and (v) Other Indian Scheduled Commercial Banks (in the private sector)[5]. Among the various groups of banks the Public Sector banks (19 nationalized banks and SBI with Associates) occupy the dominant position. At the other end Scheduled Co-operative banks can be classified as Scheduled State Co-operative banks and Scheduled Urban Co-operative banks (chart I). [6]

1.1 Functions of Commercial Banks

Commercial bank fulfills investment requirements of savers and credit needs of both the investors and consumers. Overall, the basic functions of bank intermediation include Liability-Asset transformation, Maturity Transformation and Risk Transformation (Jadhav and Ajit, 1996). Liability-Asset transformation indicates acceptance of deposits from the public as liability and converting the same into assets such as loan. Asset-Liability management is defined as a process of adjusting bank liabilities to meet loan demands, liquidity needs and safety requirements. It focuses on profitability and long term operating viability (Louis, I J H, 1997-98). Similarly, size-transformation implies providing large loans on the basis of numerous small deposits and maturity-transformation ensures provision of alternative forms of deposits to the savers according to their liquidity preference while at the same time offering the borrowers with loans of desired maturities. At the other end, risk-transformation offers distribution of risks through diversification, which substantially

[5] The Regional Rural Banks have been set up since 1975 onwards under the Regional Rural Banks Act 1975 while Co-operative Banks' existence can be traced back to the period prior to independence.

[6] Under the Banking Regulation (B.R.) Act, 1949 only Urban Co-operative Banks (UCBs), State Co-operative Banks (St CBs) and District Central Co-operative Banks (CCBs) are qualified to be called as banks in the Co-operative sector.

reduces risk for savers (depositors), and this would prevail while lending directly in the absence of financial transformation. Apart from the said functions, commercial banks attempt to meet credit requirements of the households by earmarking certain percentage of credit for the priority sector especially for agriculture.

Section II

2.1 Progress of Commercial Banks: An over view

The banking sector is considered as one of the major organs of the financial system. It acts as a catalyst to economic growth by mobilizing adequate savings which in turn is allocated into productive channels. It also plays a crucial role in the socio-economic transformation of an economy by discharging the social responsibilities, namely, eradication of poverty, reducing regional disparity, ensuring high growth of employment and so on.

Over the years the banking industry in India has passed through various distinct phases and its overall performance varies widely across time and space. The entire period since independence till date can be broadly classified into four periods, i.e., Foundation, Expansion, Consolidation and Reform phase. The first period covered a decade or so during the fifties and sixties when development of necessary legislative framework for facilitating the re-organization and consolidation of the banking system was noticed so as to fulfill certain requirements of economy. The expansion phase covers the period since the nationalization of commercial banks (1969) to mid-1980s. It is during this period when banking sector gained momentum.

The beginning of consolidation phase can be traced back to 1985 when improvement in house-keeping, customer service, credit management, improvement in productivity of staff and profitability of the banks were emphasized. Since the introduction of reforms in the financial sector till date can be considered as reforms period. It needs to be specified that reforms in the banking sector was introduced based on the recommendation of the M Narasimham Committee (1991). During the said phase there has been introduction of new accounting and prudential norms relating to income recognition, provisioning and capital adequacy. However, in the present paper we have classified the entire period since nationalization of commercial banks till date into two phases: Pre-Reforms Period and Reforms Period.

As mentioned, one of the major objectives of India's development strategy has been wide spread expansion of financial institutions so as to mobilize adequate resources to meet the emerging needs of the economy. In this context, banking sector was expected to play a vital role by ensuring timely and adequate credit disbursements to the productive units.[7] No doubt, during the sixties, the Indian banking system made good progress and expanded quite considerably but it failed to cater to the economic needs of the community. There was absence of banking facilities for the large segment of the population as major part of the rural and semi-urban areas was either sparsely banked or not at all banked (Ojha, 1987). In addition, the money lenders used to charge exorbitant rates of interest on loans borrowed (Rangarajan, 1989) and there was prevalence of urban bias as evident from easy availability of bank credit for the large industries and trading houses. At the other end certain productive units were deprived of having access to banking funds. Therefore, a scheme of social control was introduced in early 1968 with the aim of changing the lending pattern by directing increasing volume of credit flow to the desired sectors and making banks an effective instrument of economic development.[8] Identifying slow progress of the banking system in achieving societal goals through the scheme of 'social control', nationalization of 20 major banks was initiated to hasten the pace of branch banking and to smoothen regional disparities.

In addressing the nationalization of commercial banks it may be mentioned that the Imperial Bank, treated as the largest bank in India in those days, was nationalized in 1955 and merged with the government owned banks of some of the princely states to become the State Bank of India (Agarwal, 1996). The first phase of major bank nationalisation was introduced in July 1969 when 14 largest privately owned commercial banks, each having a deposit liability of Rs 50 crores and above were nationalized. It followed nationalization of 6 more commercial banks in 1980, each having a deposit liability of Rs 200 crores and above.

Nationalization of banks was effected for speedy achievement of social purposes such as meeting the legitimate requirements of the weaker sections of the society. This can be facilitated by reducing both concentration of banks in a specific region and their influence on industrial and business monopolies as reflected by allocation of more resources for this sector. In other words, the savings mobilized cab be utilized for productive purposes based on plans and priorities. To be specific, it needs to be ensured that credit needs of the productive sectors and weaker sections of the economy especially farmers, SSI and self-employed have been fulfilled. The distribution of institutional credit in favour of the farmers and informal sector production units, viz., small scale industries, village artisans and household enterprises, could serve the purpose of expanding production base along with rise in employment opportunities. This, in turn, could reduce the extent of poverty and improve the standard of living of the households. Further, efforts have to be made to kick start growth in some of the hitherto neglected backward regions.

2.2 Banking Sector During Pre-Reforms Period

Prior to economic reforms introduced in 1991, the Indian banking and financial system made commendable progress in extending its geographical spread and expanding branch network. This is reflected by the growth of financial savings and fulfillment of the credit requirements of the borrowers especially in agriculture and small scale indus-

[7] The banking sector comprises public sector banks, foreign banks, urban cooperative banks, private sector banks, regional rural banks and co-operative banks.

[8] The scheme of social control over banking was introduced in 1968 with the major objectives of achieving a wider spread of bank credit, preventing its misuse, directing large volume of credit flow to the priority sectors and making it a more effective instrument of economic development.

[9] Later on New Bank of India got merged with Punjab National Bank

try (Narasimham, 1991). In contrast, there has been a decline in productivity and efficiency, and erosion of profitability of the banking sector. This is partly on account of lower interest rate charged by the commercial banks for directed investments and directed credit programmes, rise in expenditure on account of fast and massive expansion of branches, inadequate progress in updating work technology and weaknesses in the internal structure of the banks.[10] No doubt, various factors are held accountable for this yet, the crucial one is the policy induced rigidities such as excessive degree of central direction of their operations in terms of investments, credit allocations, branch expansion and even internal management aspects of the business. The operation of the banking system in the rigidly controlled system especially maintenance of high reserve requirements, interest rate controls and allocation of financial resources to priority sectors made them neither competitive nor innovative.

Shetty (1996) argues that poor performance of the banking sector during the early 1990s can be on account of poor loan portfolio, sizeable non-performing assets, declining productivity and operational efficiency, low capital base which deteriorated due to sharp erosion in profitability, poor housekeeping and deterioration in customer service. But erosion in profitability of banks is not due to directed investment or directed credit as it is generally believed to be. Therefore, there was an urgent need for the banks to get involved in priority sector lending else the state had to intervene. Similarly, to tackle the management related weakness, public sector banks need to be freed from the clutches of bureaucrats. No doubt, different committees set up over time examined some of the issues discussed above and recommended policy measures. But either non-implementation or adoption of piece meal approach in implementing the recommendations culminated the problem further.

2.3 Reforms and Challenges in the Banking Sector

Introduction of reforms in the Banking sector seems to have been initiated during the 1980s based on the recommendation of the Chakravarty Committee Report (Report of the Committee to Review the Working of the Monetary System). The committee justified the necessity to move away from quantitative controls so as to remove distortion in the credit market in achieving higher growth of the economy. Similarly it is also specified that administered interest rate system has become unduly complex and therefore, it has reduced the ability of the system to ensure effective use of credit. The persistence of administered interest rates failed to make sure necessary flexibility to mobilize adequate financial savings by introducing suitable changes in the deposit rates. This, in turn, affected average cost of deposit and therefore, a decline in profitability can not be ruled out.

In the backdrop of erosion in productivity and efficiency, reforms in the banking sector were introduced based on the

[10] In other words, the interest rate was lower than the prevalent market rates or what the banks could have earned from alternate deployment of funds.

recommendations of the Committee on the Financial System (1991) and the Report of the Committee on Banking Sector Reforms (1998) headed by M Narasimham. Undoubtedly, reforms in the financial sector received a major thrust with the identification of various factors accountable for decline in productivity, profitability and erosion in efficiency during the two decades since nationalization of commercial banks. Overall, the major reforms in the banking sector introduced in Indian economy can be grouped into six categories: prudential measures, reforms in institutional and legal set-up, changes in supervisory aspects, adoption of various methods to enhance competition, issues related to improvement in the role of market forces and technology related aspects. Broadly, the recommendations of the committee include liberalization of entry norms for domestic and foreign banks, reduction in the levels of statutory pre-emption, to dismantle the complex structure of interest rates, lay down capital adequacy requirements, introduce income recognition and provisioning for bad debts. To ensure safety and soundness of the financial system and at the same time to encourage market forces to play a crucial role, prudential norms and regulations need to be introduced (Jadav and Ajit, 1996).[11] There are two primary purposes to introduce prudential norms, i.e., to reveal the true picture of the banks' loan portfolio and to help arrest its deterioration (Rangarajan, 1994). Based on this,

Prudential norms for classification of assets and provisioning for bad debts have been introduced. The capital adequacy norm can be considered as incentive based regulation whereby well capitalized and efficient banks can compete and impose cost on under capitalized and poorly managed banks (Jadav and Ajit, 1996). It allows the efficient banks that can control its risk can hold less capital as compared to the inefficient banks. The C apital-to-risk weighted assets ratio of 8 per cent have been introduced with further rise to 9 per cent since 1999-2000.

As part of statutory pre-emption, the Committee argued that it can be used as a prudential requirement but not as an instrument for financing public sector requirement. Further, the SLR needs to be brought down to 25 per cent over a period of five years and Cash Reserve Ratio to be gradually reduced though interest on these instruments to be raised. Also Debt Recovery Tribunals have been set up to assist the banks in the recovery of loans. The scheme of Ombudsman introduced in 1995 can look into and resolve customer grievances.

Based on the recommendations, noticeable change in various norms has been observed over time. For instance, during the early 1990s through the use of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) as much as 63.5 per cent of the bank resources were pre-empted (Rakesh Mohan, 2004). But these rates have been cut considerably in a sequenced manner as SLR declined from 38.5 per cent in 1991-92 to the statutory minimum of 25 per cent now while CRR dropped from 15 per cent to 4.5 per cent during the said period. The level and

[11] Reforms in the prudential norm include income recognition, asset classification, provisioning for bad and doubtful debts and capital adequacy.

structure of interest rates have been rationalized in a phased manner. There has been abolition of minimum lending rates and the banks have been allowed to determine their prime lending rates. The Prime Lending Rates (PLRs) declined from 19 per cent in 1991-92 and the benchmark PLR in respect of 5 major banks remained in the range of 10.5-11 per cent. The interest rates on loans above Rs 2 lakh have been fully deregulated. Similarly, interest rates on domestic term deposits have also been deregulated. In 1995, all controls on deposit rates above one year maturity were removed. To strengthen supervisory system of banks and financial institutions Board of Financial Supervision (BFS) has been set up. Further, less strong banks that suffered capital erosion due to rising levels of NPA have been recapitalised.

It is during the 1990s when the commercial banks particularly the public sector banks have faced new challenges, namely, improving bottomline, reducing non-performing assets and to observe the discipline of regulatory and prudential norms for capital adequacy. The persistence of soft interest rate regime across the globe also motivated the banks to diversify their activities form purely traditional banking to providing various financial and other services to its customers. Of late, banks have preferred non-interest income deployment of funds for their survival.

Section III

3. Progress in Social Aspect of Banking

The commercial banks can play a vital role in the process of economic development and achievement of social justice. This can be facilitated through extension and expansion of banking facilities in unbanked and under-banked areas, mobilization of savings to meet investment requirement of an economy, allocation of credit for developmental purposes with focus on priority sector lending so as to relieve the farmers from clutches of money lenders and to improve growth of employment, diversification of banking activities based on the changing needs of the customers, and improvement in productivity, profitability and quality of customer care to grow and face the challenges over time. However, mere growth in the banking sector may not necessarily alleviate poverty and reduce disparities in per capita income across regions and various groups of people. Therefore, one of the major issues that needs to be assigned priority is the concept of 'social banking', i.e., a shift from urban centric growth to adoption of rural –oriented growth strategy. The shift from 'class banking' to 'mass banking' was one of the crucial issues that motivated nationalization of commercial banks.

'In social banking, not only fresh procedures are to be evolved to suit the needs of new class of borrowers, but the whole philosophy of lending has also to undergone a radical change, and is an entirely new and unconventional approach to bank lending (Garg, 1994).' Social banking aim at participation of the bankers in the process of economic development to achieve developmental goals without jeopardizing or even diluting the professional standards of banking. In other words, social banking refers to the policy induced bank assistance to the designated priority sectors of the economy and weaker sections of the community (Garg, 1994). However, the present paper may not necessarily capture the said issues in detail. But an attempt has been made to infer the progress and achievement of commercial banks in fulfilling the societal goals in both pre-reforms and reforms period. To analyse the achievement during different periods, growth of office, mobilization of deposit and CD ratio in both rural and urban area has been examined along with pattern of priority sector lending.

3.1 Growth of Bank Office

Prior to economic reforms Indian banking and financial system made commendable progress in extending its geographical spread and functional reach. For instance, number of Scheduled commercial banks increased about two times in about a decade during the 1970s and the trend almost continued during the 1980s with slowdown in the 1990s (table 1).[12] Similarly, massive growth of commercial bank office was noticed during the 1970s (from marginally higher than 8,000 in 1969 to close to 32,500 in 1980) and to a large extent in the early 1980s (a rise of about 19,000 during 1980-1985). An unprecedented growth of office since nationalization of major commercial banks implies adequate availability of banking facilities at large. In contrast, during the initial period of economic reforms when the growth of bank office witnessed slow growth though it picked up during the second half of the 1990s. The number of offices went up by about 2000 during 1990-1995 while it increased by about 5,500 during 1995-2000 (table 1). A comparative analysis of annual average growth of SCBs office during the pre-reforms and reforms periods reveals a sharp erosion during the latter period (from 5.1 per cent in1980-91 to 0.8 per cent during1992-2003).

A mere slow down in growth of office would not be a major source of concern provided the commercial banks sustained rising trend in the rural area. In this context, it can be mentioned that one of the major objectives of bank nationalization is to shift from '*elite banking*' to '*mass banking*' by expanding banking facilities in the rural, semi-urban areas especially in unbanked and under-banked areas. In other words, persistence of 'urban-centric' nature of banking at the cost of rural areas can affect allocation of credit for developmental purposes especially for the priority sector and therefore, it can be a cause for serious concern.

Decline in growth of offices in the rural and semi-urban areas is noticed during the reforms period despite the fact that a large chunk of total population live in rural areas (Chart 1). In rural area it declined from 6.7 per cent in 1980-91 to 0.8 per cen in 1992-2003.Growth in semi-urban area also witnessed a fall during the said period but the extent of decline is not so pronounced as compared to the rural area. At other end there has been improvement in growth of offices in the metropolitan area during the reforms period.

The disparity in growth of office (as noticed during the 1990s) can change the share of office across population groups. For instance, close to 60 per cent of total offices were in the rural area during the mid-80s and early 1990s (table 1). It declined sharply to about 47 per cent during the closing years of the 1990s and also in recent years. At the other end, there has been growth of office in the urban and metropolitan area during the reforms period (tables 1 and 2). The share of

[12] The number of commercial banks in India went up from 73 in June 1969 to 154 in June 1980.

Table 1: Key Indicators of Commercial Banks in India

	Number of Commercial Banks				Number Of Bank Offices					
Year	Sch.Com Banks	of which RRBs	Non Sch Commercial Banks	Total	Rural	Semi - urban	Urban	Metropolitan	Total	Population per office ('000)
1	2	3	4	5(=2+4)	6	7	8	9	10(=6 to9)	11
1969	73	-	16	89	1833	3342	1584	1503	8262	64
					22.2	*40.5*	*19.2*	*18.2*	*100*	
1980	148	73	5	153	15105	8122	5178	4014	32419	21
					46.6	*25.1*	*16*	*12.4*	*100*	
1985	264	183	4	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]5
					[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
1990	270	196	4	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]4
					[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
1992	272	196	4	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]4
					[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
1995	281	196	3	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]5
					[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
2000	297	196	1	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]5
					[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
2003	289	196	5	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]6
					48.6	*22.3*	*16.1*	*13*	*100*	
*2004**	286	196	5	291	[illegible]	[illegible]	[illegible]	8996	[illegible]	16
					[illegible]	*22.5*	*16.5*	*13.4*	*100*	

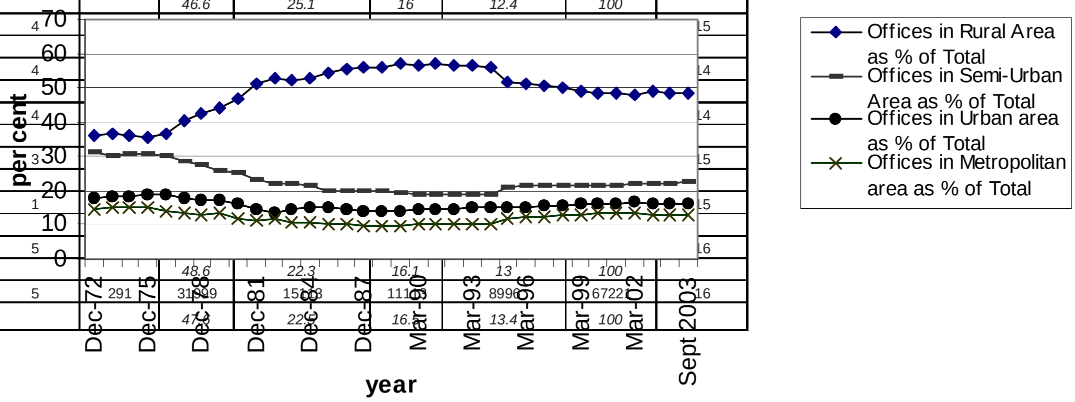
*September

Notes: (i) Sch.com: Scheduled Commercial Banks, Non-Sch: Non-Scheduled Commercial Banks, RRBs: Regional Rural Banks

(ii) Figures in *Italic* are percentages to total

Source: Compiled from RBI's Banking Statistics: 1972-95 and Basic Statistical Returns of Scheduled Commercial Banks in India, March 2003, Vol.32.

Chart 1: Proportion of SCBs Office Across Population Group (in per cent)



metropolitan area in total office of the commercial banks which was less than 10 per cent during the mid-1980s and early 1990s, went up to 14 per cent in the recent past (table 1). The number of rural office decline by close to 2,500 during 1992 – 2000. In contrast number of office in urban and metros went up by around 2,200 and 3,500 during the above said period. It reflects emergence of a tendency to exit from rural areas in the recent past. This is noticed despite the fact that cost of deposit is relatively low in rural areas as compared to urban and metros. Normally people in the rural areas prefer savings account deposit and withdraw money less frequently while bulk of the deposits in urban and metros comes from the people working in the organized sector (salaried class) who used to withdraw money more frequently. No doubt, proliferation of ATM facilities is likely to reduce cost of serving a customer in the urban areas provided customers would feel comfortable to withdraw cash from ATM.

While examining the fall in growth of office during the reforms period, the role of RBI can not be ignored. The RBI gave up its bank expansion programme in April 1995 and therefore, the number of SCBs rural offices steadily declined from 32,981 in March 1996 to 31, 999 in September 2004 (Shetty, 2005). It can be mentioned that since 1996, banks having three year profitability record and non-performing assets below 15 per cent can be allowed to open new branches. The banks will have to fulfill certain other requirements such as maintaining capital adequacy norm of 9 per cent and minimum owned fund requirement of Rs 100 crore. This seems to be difficult to achieve for a number of Public Sector Banks.

Apart from the policy reforms, the growth of branch expansion can be determined by performance of various sectors. A substantial growth in service sector during the reforms period might have motivated the bankers to accelerate growth of branch expansion in the Metropolitan area. Added to this, the growth of private sector and foreign banks threw a challenge to their public sector counterparts in the recent past.

3.1.1 Distribution of Bank office across Regions/States

The presence of bank office in a region is determined by a number of factors including density of population, level of development, availability of adequate infrastructure and so on. With the rise in per capita income on account of growth of business activity/ agriculture, a substantial amount of resource mobilization seems to be feasible and therefore, there is scope for expansion of

Table 2: Growth of Office, Deposit and Credit of SCBs Across Population Groups

(In per cent)

Population Group		1980-1991			1992-2003			1980-2003	
Rural Area	6.7	10.6	6	0.8	9.8	6.4	2	8.4	6
Semi-Urban Area	2.7	7.8	7.5	2.3	10.3	7.3	2.3	7.3	4.9
Urban Area	4.6	8.9	8.1	1.9	10.3	8	2.9	7.5	5.6
Metropolitan Area	3.4	9.2	7	3.8	10.6	13	3.6	9	8.8
India	**5.1**	**8.9**	**7.9**	**0.8**	**10.3**	**10.5**	**2.4**	**8.1**	**7.3**

Note: Real compound growth has been estimated for deposit and credit by using semi-log model.

credit. Taking into account population as the sole determinant it is noticed that concentration of banks is more in southern and northern regions as on an average 12,000 people are served by each office in those regions (table 5). Of late, around 28 per cent of the total bank office is confined to the southern region followed by central (20 per cent), northern region (16 per cent) and western (close to 16 per cent). In contrast, close to 3 per cent of bank offices is confined to North-Eastern region (table 3, chart 2). Among the states, concentration of office is noticed in few states, namely, Uttar Pradesh (14 per cent) followed by Maharashtra (close to 10 per cent) and some of the middle income states in the southern region (Tamil Nadu, Karnataka and Andhra Pradesh) each having about 7 per cent share in total. It is only during the early 1980s when substantial improvement in share of office was observed in some of the relatively backward regions including Eastern and Central Regions. In contrast, no noticeable change in share of office is noticed in the said region during the first half of the 1990s.

3.1.2 Growth of Major Scheduled Commercial Banks

The dominance of various groups of banks has undergone a change over the years (chart 3). It is found that the share of nationalized banks which constitute close to 50 per cent of total banks has declined form about 55 per cent during the initial year of the 1980s to about 48 per cent during the latter part of the same decade with marginal improvement in recent years (table 4). This can be partly the outcome of reforms in the banking sector, i.e., allowing new private banks to enter the market and decision taken by RBI to give up bank expansion programme in April 1995. Growth of New Private Sector Banks and Foreign Banks may not necessarily pose a

Chart 2: Distribution of SCBs Office Across Regions

(in per cent)

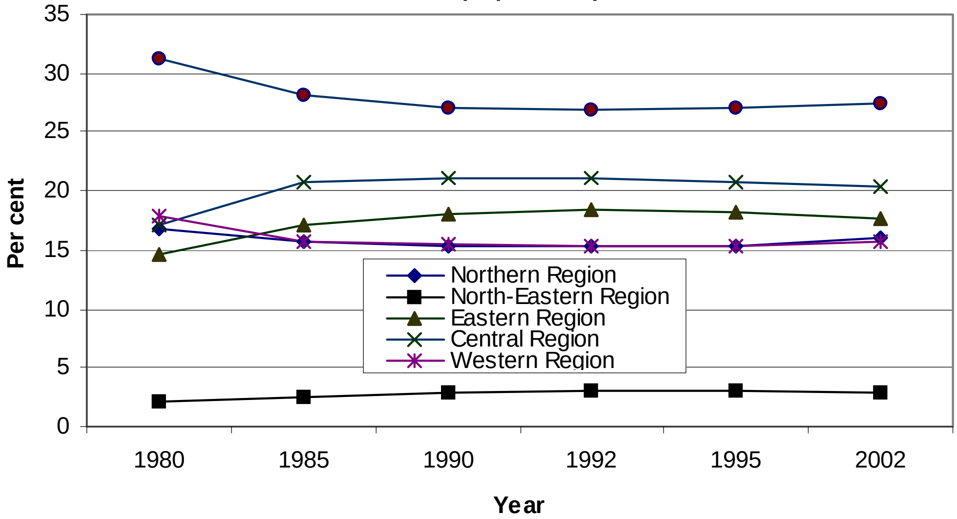


Table 3: Distribution of SCBs' Office Across Regions/States (in per cent)

-: Negligible/Not available.

Note: On account of bifurcation of the states the figures for U.P, M.P, Bihar and Goa can not be strictly comparable.

Source: RBI (1998) : Banking Statistics: 1972-75 and various issues of RBI's Basic Statistical Returns of Scheduled Commercial Banks.

threat for the economy provided they expand their network in rural area and provide adequate credit to priority sector. There is apprehension that the said objective may not be fulfilled as these groups of banks are mostly confined to Metropolitan area and Urban area. In June 2003, there was 32, 303 rural bank branches, but not a single foreign bank had an office in rural areas.

The Regional Rural Banks (RRBs), which could serve the unbanked areas, failed to do so during the reforms period. The share of RRBs in SCBs declined from around 24 per cent in 1990 to less than 22 per cent in recent years. The decline is more pronounced in rural branches. Around 91 per cent of all RRBs were confined to rural areas during early 1990s but it declined to 81.7 per cent in March 2003.[13]

Table 4: Scheduled Commercial Banks' Office in India (in percentage)

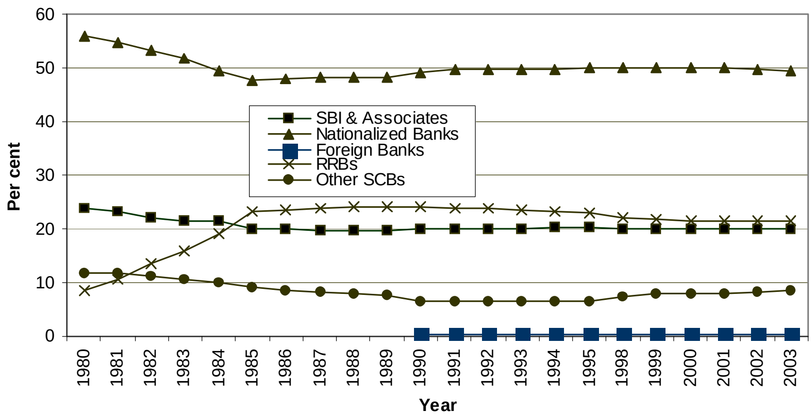
Year	SBI & Associates	Nationalized Banks	Foreign Banks	Regional Rural Banks	Other Scheduled Commercial Banks	All Scheduled Commercial Banks
1	2	3	4	5	6	7
1980	23.9	55.8	-	8.4	11.9	100
1985	20.1	47.6	-	23.1	9.2	100
1986	20	48	-	23.6	8.4	100
1990	20	49.2	0.2	24	6.5	100
1991	19.9	49.6	0.2	23.8	6.4	100
1992	20	49.6	0.2	23.7	6.4	100
1993	20.1	49.7	0.2	23.5	6.4	100
1994	20.2	49.7	0.2	23.2	6.6	100
1995	20.3	49.9	0.2	23	6.6	100
1998	20.1	50.1	0.3	22.1	7.4	100
1999	20	49.9	0.3	21.7	8	100
2000	20	50	0.3	21.6	8	100
2001	20.1	49.9	0.4	21.6	7.9	100
2002	20.1	49.7	0.4	21.6	8.2	100
2003	20	49.5	0.3	21.6	8.6	100

-Nil/Not available

Sources (i) RBI (2003): Statistical Tables Relating to Banks in India 2002-03

(ii) RBI (1998): Banking Statistics: 1972-95

Chart 3: Share of Different Groups of Commercial Banks in India



Despite slow down in growth of offices, people served by a bank office does not seem to have undergone drastic change during the reforms period (table 1). This has declined from as high as 64,000 in 1969 to 21, 000 in 1980. But during 1985-2003, the population served per bank office did not vary to a large extent as it remained between 14,000-16,000. The population served per bank office did not come down drastically partly because of slow down in growth of office. However, this reflects only overall scenario in the economy not across regions. A wide spread disparity across regions and states is evident from table 5. In southern and northern regions an office used to serve 12,000 people while it is as high as 21,000 in North-Eastern Region in 2003. Similarly, in Bihar and Uttar Pradesh 24,000 and 22,000 people are served per office respectively. Nevertheless, the number of customers served per bank branch that turns out to be 16,000 and this is very high as compared to some of the developed countries (Mohan, 2004).

Table 5: Populations per Bank Office Across Regions/States (in '000s)

Region	3-Mar	Mar-91	Dec-81	Dec-72
Northern	12	11	13	26
North-Eastern	21	17	30	97
Eastern	19	16	24	76
(I) Bihar	24	18	26	98
Central	20	16	24	60
(I) U.P	22	16	25	61
Western	14	13	15	24
Southern	12	12	14	27
All-India	16	14	18	37

Source: EPWRF (2005): Metamorphic changes in the Financial System, Special Statistics, 38, Economic & Political Weekly, March

3.2 Pattern and Trends in Deposit, Credit and CD Ratio

Indian economy witnessed a relatively weak economic base and financial infrastructure during the initial years of independence. The performance of the economy in mobilsing adequate saving and allocating it for productive channels was not quite promising. This trend seems to have been arrested to a large extent since nationalization of commercial banks. The per capita deposit of SCBs went up almost five times in about a decade between first and second phase of bank nationalization (from less than Rs 100 in 1969 to close to Rs 500 in 1980). During the 1980s and 1990s it went up about four times and it hovers around Rs 12,000 in recent years (table 6).

3.2.1 Mobilization of Deposit Across Regions

In the mobilization of deposits, western region occupied first position during the last three decades partly because of some of the commercial centres, namely, Mumbai, Pune and Ahmedabad (table 7). It is surprising to learn that of the total deposits, around 72 per cent is generated in three regions together (western, southern and northern regions) and the remaining is the contribution of other three regions (central, eastern and north-eastern region) in 2003. There has been no improvement in the share of bank deposit in three underdeveloped regions (North-Eastern, Eastern and Central region) while the share of Eastern Region in total deposits has steadily declined during the last three decades.

[13] Classification based on 1981 census was done up to March 1994 while in the subsequent period classification is based on 1991 census (EPW, March 19, Table 2 (b) P.1270).

Table 6: Major Performance Indicators of Scheduled Commercial Banks in India

Year	Credit per Office (Rs lakh)	Per Capita Credit (Rs)	Share of Priority Sector Advances in Total Credit	Deposit Per Office (Rs)	Per Capita Deposit	Deposit To National Income (percent)
1969	44	68	14	56	88	15.5
1975	48	148	25	67	208	19.9
1980	68	327	33	103	494	35.8
1985	107	747	41	150	1026	39.4
1990	176	1275	40.7	290	2098	48.6
1992	217	1516	37.1	392	2738	49.5
1995	339	2320	33.7	620	4242	51.7
2000	669	4555	35.4	1255	8542	53.5
2001	779	5228	31	1456	9770	56
2002	893	5927	33.7	1659	11008	49.3
2003	1143	7275	Na	1925	12253	51.8

Note: National Income at current prices.

Sources: (i) RBI (1998): Banking Statistics:1972-95

(ii) RBI(2003): Statistical Tables Relating to Banks in India 2002-03.

The extent of deposit mobilized is determined by various factors including the levels of development, concentration of office and RBI's policy prescription. Taking into account the concentration of office alone it is learnt that there is a mismatch between extent of resource mobilized in a region and share of total office in the same region (table 8, chart 5). In 2002 the share of Northern and Western Region in total office turns out to be 16 per cent but in the resource mobilization it is much higher, i.e., 23 and 26 per cent respecively. In contrast, the resource mobilized in Central, Southern and Eastern Region is much less as compared to share of total office in those regions. No doubt it can be partly on account of level of development, per capita income and growth of urban centres. In the Southern region it is surprising to learn that most of the states are in the middle income category and people are relatively more mobile, especially in Kerala and parts of Karnataka. The population served per bank office is also very low (12, 000) as compared to some other regions. Despite this the extent of resource mobilized is lagging behind the level of concentration of office in this region.

3.2.2 Growth of Deposit vis-à-vis National Income

An analysis of deposit as percentage of National Income reveals a substantial improvement during the 1970s (an increase by about 20 percentage points) and 1980s (13 percentage points rise) but the trend was not sustained during the 1990s. This implies that bank deposit had grown faster than national income during pre-reforms period as compared to reforms period. The deposit as percentage of National Income that was close to 49 per cent in 1990 went up to 53.5 per cent in 2000 with further decline in recent years (table 6).

The slow growth in deposit-to-national income ratio during the reforms period can

Table 7: Regional Share in Bank Deposits in India

(per cent to all India)

Deposits						
Regions/Year	**Mar-03**	**Mar-02**	**Mar-96**	**Mar-92**	**Dec-82**	**Dec-72**
Northern	23.0	22.9	22.2	20.7	21.3	18.3
North-eastern	1.6	1.6	1.6	1.6	1.5	1.2
Eastern	12.4	12.9	13.0	14.5	16.7	19.1
Central	13.6	13.6	13.5	13.4	13.7	11.5
Western	26.2	26.4	27.2	28.9	25.4	31.9
Southern	23.2	22.6	22.4	20.9	21.4	18.1
All - India	100.0	100.0	100.0	100.0	100.0	100.0

Note: Number of offices includes Administrative offices. Population group (Rural/Semi-Urban etc.) classification is based on 1991 census.

Source: EPWRF (2005): Metamorphic changes in the Financial System, Special Statistics, 38, Economic & Political Weekly March, 19 and RBI's Basis Statistical Returns

Table 8 Regional Share of Bank Office vis-à-vis Bank Deposit in Total

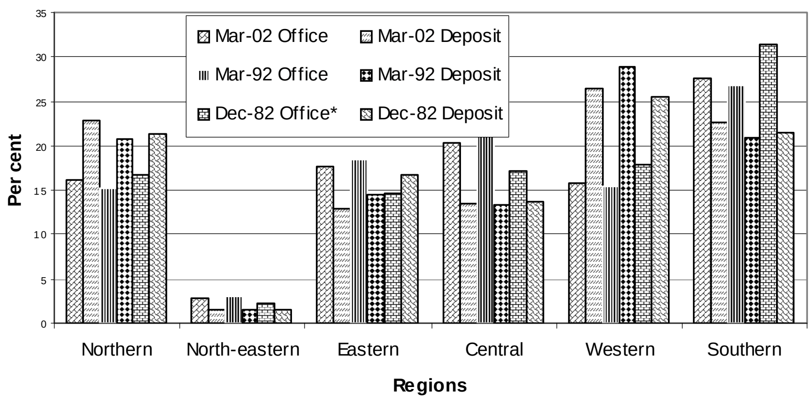
(per cent to All India)

Year	**Mar-03**		**Mar-96**		**Mar-92**		**Dec-82**	
Region	**Office**	**Deposit**	Office**	**Deposit**	**Office**	**Deposit**	**Office***	**Deposit**
Northern	16.3	23.0	15.4	22.2	15.3	20.7	16.7	21.3
North-eastern	2.8	1.6	3.0	1.6	3.1	1.6	2.2	1.5
Eastern	17.6	12.4	18.2	13.0	18.4	14.5	14.7	16.7
Central	20.2	13.6	20.8	13.5	21.1	13.4	17.2	13.7
Western	15.6	26.2	15.4	27.2	15.4	28.9	17.9	25.4
Southern	27.6	23.2	27.1	22.4	26.8	20.9	31.3	21.4
All – India	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

* Refers to 1980 **Refers to 1995

Source: Compiled from RBI's Basic Statistical Returns and EPWRF (2005).

Chart 5: Regionwise Share of Office & Deposit of Commercial Banks in India

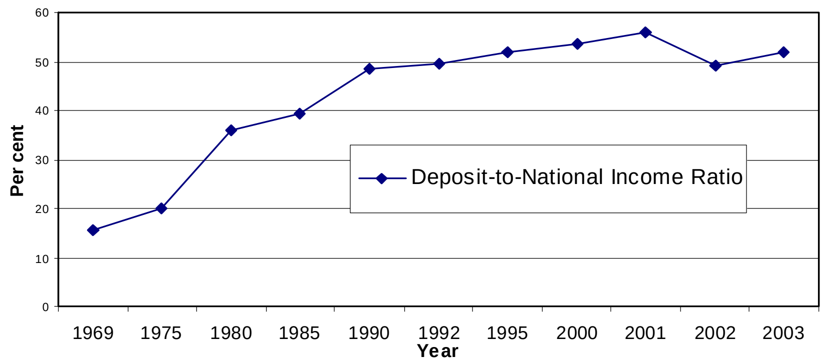


be partly due to low level of inflation during the 1990s as compared to 1980s. Further, a fall in interest rate on deposits and slow growth in office might have affected its growth in the recent past. With the emergence of declining trend in rate of interest on demand and term deposits (from the closing years of the previous decade) the people in general might have diversified the pattern of saving and investment. The interest rate on National Savings Certificate declined from 12 per cent in 1996 to 8 per cent in 2003. For instance, interest rate for one-year bank deposit fell from 11 per cent in 1996 to 5 per cent in 2004 with marginal improvement in the current year (5.5 to 6 per cent).[14] The risk lovers may opt for mutual fund and investment in various shares while the risk averse may go for post office savings as the later offers relatively high interest rate to along with income tax benefit. Besides, people in the unbanked areas and rural area may opt for savings in post office.

3.2.3 Urban Centric Banking and Mobilization of Deposit

The tempo of deposit growth has been improved during the reforms period despite fall in interest rate on term deposits from 11.1 per cent in 1998 to 8 per cent in March 2003. 'The public sector image of the banking system, combined with the absence of effective social security system for the populace, and fluctuating nature of investment opportunities in the capital market, has retained the attractive nature of bank deposits even at longer maturity levels (EPWRF, 2005)'.Nevertheless, the growth of deposit in reforms period is not quite encouraging in the rural area (table 2). Banking statistics reveal that annual average compound growth of deposit for the economy as a whole was

Chart 6: Deposit of SCBs as Percentage of National Income (current price)



[14]The interest rate on National Savings Certificate declined from 12 per cent in 1996 to 8 per cent in 2003. The interest rate on Public Provident fund also steadily fell from 12 per cent in 1999 to 8 per cent in 2003. Interest rate on post office saving deposit also declined from 5.5 during the second half of the 1990s to 3.5 per cent in recent years.

close to 8 per cent during the pre-reforms period, it went up to marginally higher than 10 per cent during reforms period. An improvement in growth is noticed across population groups barring Rural area where the growth rate declined by 0.8 percentage points during the said period.

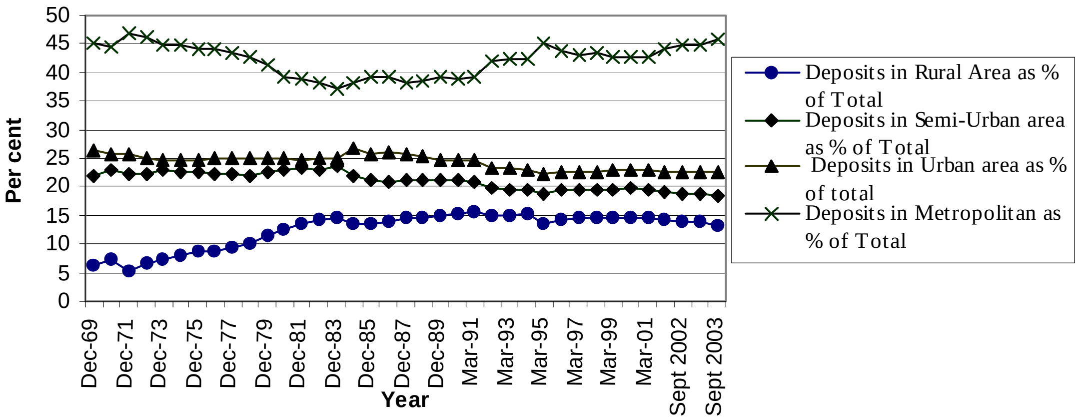
A considerable increase in per capita deposit and credit as noticed over the years suggest an improvement in average business per bank branch and likely to have improved the viability of individual bank branches including those in rural and semi-urban branches (Mohan, 2004). But one should not be carried away with this observation as it is partly on account of growth of deposits and offices in the metropolitan area; not in the rural area (chart 1). The pattern of deposit of SCBs also reflect a similar trend as percentage share of metropolitan area in total deposits of all the SCBs taken together went up since mid-80s and especially during the early 1990s (chart 7). Contrary to it, share of semi-urban, urban area followed by rural area suffered a setback during the above said period.

3.3.1 Status of Rural Credit in Aggregate Disbursement

The growth and development of an economy is determined by the availability of credit from institutional sources. But mere growth in allocation of credit can not necessarily offset the persisting regional disparities in levels of development. In the allocation of credit there is a need to identify credit needs of backward regions and various employment generating sectors especially agriculture.

An improvement in growth of credit from close to 8 per cent in the pre-reforms period to 10.5 per cent in the reforms period has been noticed for the economy as a whole (table 2). This phenomenon can be partly attributed to substantial growth of credit in the Metropolitan area as annual average compound growth of credit in Metropolitan area went up by 6 percentage points during the reforms period as compared to pre-reforms period. At the other end, there has been decline in growth of credit for other population groups barring Rural area which

Chart 7: Pattern of Aggregate Deposits of Scheduled Commercial Banks



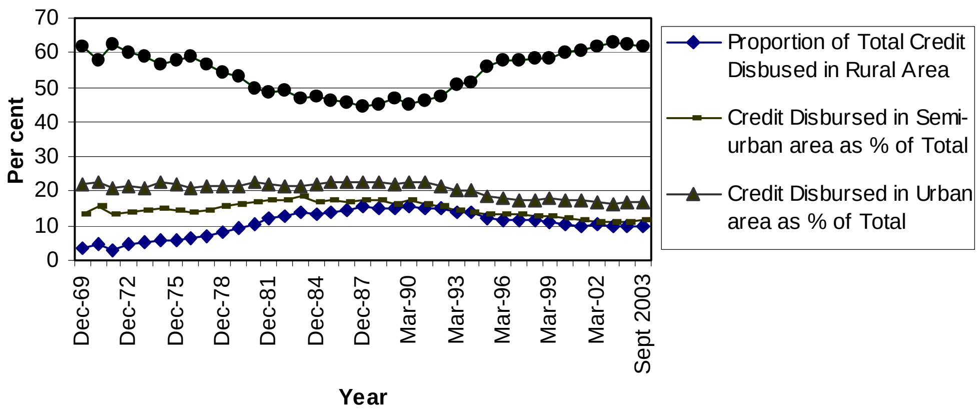
witnessed a marginal growth of 0.4 per cent during the said period (chart 8). A higher growth in credit for metropolitan area during 1992-2003 is noticed despite a general decline in the share of loans and advances in total credit.

The allocation of credit to various regions (developed vis-à-vis underdeveloped) and for different sectors has also undergone a change during the last few decades (tables 9). Of late, around 82 per cent of total credit is disbursed in three relatively developed regions, namely, Western (36 per cent), Southern (26 per cent) and Northern (22 per cent) regions and the remaining 18 per cent is sanctioned in other three relatively backward regions (Eastern, Central and North-Eastern). The persistence of disparities is evident from the fact that less than 1 per cent of total credit is disbursed in North-Eastern region while it is as high as 36 per cent in the Western region. Second, the share of above said developed regions (Western, Southern and Northern regions) together also witnessed a rising trend as it went up from about 75 per cent during the early 1970s and 1980s to 82 per cent in recent years implying positive correlation between level of development and disbursement of credit. Third, share of credit sanctioned across regions also witnessed a change during reforms period. To be specific share of credit disbursed in western region alone witnessed a steady rise from 29 per cent in 1992 to about 36 per cent in recent years. While it has declined in three backward regions during the reforms period.

3.3.2 Migration of Credit

Credit sanctioned in a region may not necessarily reflect the same amount has been utilized in that region as emergence of mismatch between credit sanctioned and utilization can not be ruled out partly because of credit migration. In this aspect the backward regions relatively enjoyed improvement as compared to other regions. In contrast, the extent of credit utilized in Western region is much less than that of credit sanctioned, implying out-migration of credit to other regions. But it is surprising to

Chart 8:Disbursement of Credit by Scheduled Commercial Banks Across Population Group (in per cent)



learn that credit utilized in southern region is higher than credit sanctioned in this region.

As regards migration of credit across population groups, it is noticed that rural sector enjoyed migration of credit from other areas. Normally it is of the order of above 30 per cent (EPWRF, 2005). But it is interesting to note that average level of in-migration of loans to rural area which hovered around Rs 5 lakh till March 1998 went up around Rs 30 lakh in the recent past. Therefore, it needs close scrutiny.

3.3.3 Pattern of Priority Sector Lending: Is it Growth Compressing?

A substantial improvement in growth of credit does not necessarily ensure achievement of higher growth with equity. The pattern of allocation of credit especially for priority sector can to some extent determine the level of growth and development of an economy. In this context, it needs to be specified that Scheduled Commercial Banks excluding the Regional Rural Banks are supposed to earmark 40 per cent of net bank credit for priority sector. Out of the 40 per cent net bank credit, allocation for agriculture sector alone, under direct and indirect lending, has to be 18 per cent. To avoid dilution of direct credit to agriculture, indirect credit can not exceed one-fourth of the 18 per cent target, i.e., 4.5 per cent.

The growth of financial savings and fulfillment of the credit requirements of the borrowers especially in agriculture and small-scale industry were fulfilled to a large extent during the pre-reforms period. This is reflected by share of priority sector lending in non-food credit which went up by 22 percentage points (from 15 per cent to 37

Table 9: Regional Share of Credit (As per Sanction & Utilization)

(in per cent)

Credit (As Per Sanction)						
	3-Mar	**2-Mar**	**Mar-96**	**Mar-92**	**Dec-82**	**Dec-72**
Northern	21.8	22	19.1	18.4	22.2	13.1
North-eastern	0.7	0.8	1	1.3	0.9	0.6
Eastern	8.5	8.3	10.2	12.4	14	18.1
Central	7.7	7.9	9	11.1	9.8	6.8
Western	35.5	36	32.8	29.1	27.9	36.6
Southern	25.8	25	27.8	27.7	25.3	24.8
All - India	100	100	100	100	100	100
Credit (As Per Sanction)						
Northern	21.6	21.5	18.7	17.7	21.5	12.8
North-eastern	1.3	1.5	1.1	1.9	1.3	1.2
Eastern	9.2	9.2	10.1	12.3	13.7	18
Central	8.9	8.9	9.5	11.7	10.3	7.7
Western	31.4	32.2	32.5	28.3	27.6	34.4
Southern	27.7	26.6	28.1	28.1	25.6	25.8
All - India	100	100	100	100	100	100

Source: EPWRF(2005): Metamorphic changes in the Financial System, Special Statistics, 38, Economic & Political Weekly March, 19 per cent) in about a decade (1969-1980) with further marginal rise to 39 per cent in 1991. The priority sector advances in total non-food credit has declined from 39 per cent in 1990 to 33.7 per cent in 2003.

In the allocation of credit, both agriculture and SSI suffered a setback during the reforms period. The share of agriculture in total credit has been declining and it dropped from about 16 per cent of total in 1980 to close to 10 per cent in 2002 (table 10). In fact, the target for agriculture was introduced in 1989 and was supposed to be met by March 1990 but later on it got extended to March 2003. Despite abnormal delay in meeting the target, few commercial banks have been able to fulfill it. Undoubtedly, commercial banks agricultural advances outstanding grew nearly four fold (Rs 22,000 crore to Rs 85,000 crore) over the last decade but only 5 Public Sector Banks (PSBs) and 2 private sector banks met the target of extending 18 per cent of net credit outstanding to agriculture in March 2003 while the remaining 22 PSBs and 27 private sector banks remained off the target (Vyas, 2004).

The high risk of NPA in agriculture can be one of the factors that discourage lending to farm sector (table 11). For instance, NPAs of PSBs emerged from priority sector (14.2 per cent) is much higher than that of non-priority sector (9.4) in 2001-03. In priority sector, the risk of NPA is relatively high in SSI followed by Agriculture and other sectors. In contrast, for the private sector banks, NPAs generated in non-priority sector outweighes the priority sector in 2001-03. Overall, the performance of the private sector is relatively better as compared to the PSBs in Non-Performing Assets. But the performance of the private sector banks needs to be examined in the light of resources allocated for this sector.

A sharp decline in disbursement of credit to agriculture can be on account of acceleration in growth of service sector during the reforms period. As such, the commercial banks have been diversifying their activities from traditional banking to retail banking so as to improve the profit margin. In recent years, a relatively large share of credit has been allocated in favor of personal loans. At the other end, low interest earnings from small loan accounts and farm loans, combined with relatively high servicing cost, have left no incentives for banks to prefer such lending in an environment of business freedom and competition (Shetty 2004). Overall, to compete with the private sector and foreign banks PSBs have to explore the avenues to park the fund so as to improve the bottom line. In this contest, it can be argued that an economy can not afford to ignore priority sector especially agriculture which remained the major source of income for a large chunk of population? The RBI and government of India need to find out ways out to reduce the level of NPAs in agriculture.

To sustain higher growth in credit to farm sector there is also a need to improve demand for it. The demand for credit is determined by several factors. In this context, it is difficult to rule out that decline in share of agriculture in GDP along with persistence of unstable and slow growth in agriculture during the 1990s is partly on account of erosion in capital formation in agriculture. Unless improvement in allocation of resources

Table 10: Distribution of SCB's Credit (Amount Outstanding) according to Occupation

(In percentage)

Sl.No.	Occupation	1980	1990	1996	2001	2002	2003
I	Agriculture (Direct and Indirect)	15.7	15.9	11.3	9.6	9.8	10.0
II	Industry	48.8	48.7	48.0	43.9	41.4	41.0
III	Transport Operations	4.6	3.2	1.8	1.6	1.4	1.2
IV	Professional and Other Services	2.2	9.4	12.8	3.6	4.2	4.5
V	Personal Loans	NA	6.4	9.3	12.2	12.6	15.1
(a)	Lonas for purchase of consumer durables	NA	0.4	0.3	0.6	0.5	0.4
(b)	Loans for Housing	NA	2.4	2.8	4.7	5.0	6.5
(.C)	Rest of persnal loans	NA	3.6	6.1	6.9	7.1	8.2
VI	Trade	19.7	13.9	13.9	16.6	15.4	13.8
VII	Financial Institutions	3.4	2.1	3.5	4.9	5.7	6.7
VIII	Miscellaneous	5.6	6.8	8.6	7.5	9.5	7.7
IX	**Total Bank Credit**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
	of which:						
(i)	Artisans and Village Industries	NA	0.9	0.6	0.4	0.9	0.7
(ii)	Other Small Scale Industries	1.2	11.5	10.1	6.9	4.9	5.0

Notes (i): The amount outstanding figurers shown against each year represent the month March.
(ii) Figures for professional services and other services include personal loan for 1990 and 1996. Therefore the aggregate figures do not match with the sum of all the constituents.
Source: EPWRF (2004)

for infrastructure development in agriculture especially for irrigation system and development of connecting roads is ensured it can be difficult to improve the demand for credit. Assured irrigation system can motivate the farmers to shift from traditional to commercial agriculture, introduce changes in cropping pattern and rotation of crops. This, in turn, can ensure improvement in demand for credit. No doubt, in the present contest the role of output market can not be ignored as price of output and extent of procurement by the government decide the level of production else distress sale can be a normal phenomenon.

At the other end mere supply of credit does not necessarily ensure improvement in demand by the borrowers as timeliness and adequacy of credit, cost of availing the credit, prevailing rate of interest and cost effective lending procedures are some of the issues need to be emphasized. The attitude of the bankers towards priority sector lending especially to agriculture needs to be changed. The SCBs should realize that there is hardly any better avenue of retail banking than agriculture in India (Vyas, 2004). There is tremendous scope for credit expansion in the productive sector and it needs the adoption of risk management policy rather than risk aversion.

Table 11 : Non-Performing Assets Across Bank Groups and Sectors, 2001-03

(Amount in Rupees crore)

Bank Groups / Sectors	Agriculture	SSIs	Others	Total Priority Sector	Non-Priority Sector
Public Sector Banks	7,635	10,362	6,748	24,745	28,764
Avg. Non-Performing Assets					
Avg. NPA to Avg. outstanding					
Advances (in per cent)	**12.0**	**20.6**	**12.2**	**14.2**	**9.4**
Private Sector Banks	433	1,249	593	2,275	9,271
Avg. Non-Performing Assets					
Avg. NPA to Avg. outstanding					
Advances (in per cent)	**5.1**	**15.9**	**5.3**	**8.1**	**10.2**

Source: Mohan (2004b): RBI Bulletin, November.

Note: NPAs and outstanding advances as on March 31, Avg.: Average

As agriculture is still considered as gamble in monsoon, introduction of crop insurance scheme can to some extent address this problem. Concomitantly, by providing more teeth to the legal system so as to ensure easy recovery of loans by the bankers; an improvement in allocation of credit for agriculture can not be ruled out.

To reduce level of NPAs, integration of credit and output market may be a feasible option. The provision of credit along with introduction of government purchase of horticulture product from the farmers need to be explored and it is likely to reduce the debt burden of the latter. Overall, it is high time for the RBI and policy makers to address the issues discussed above and credit needs to be integrated with production and marketing.

3.4.1 Credit-Deposit Ratio of Commercial Banks

The aggregate credit orientation of the commercial banks gets reflected by Credit-Deposit (CD) ratio. It intents to capture the extent of resources allocated in the form of credit as proportion of total deposit in a specific region. To ensure development of rural areas, the bankers have to stick to the norm specified by the RBI, i.e., CD ratio of 60 per cent needs to be maintained in the rural and semi-urban area.

Over the years a consistent rise in nominal per capita deposit and credit has been noticed (chart 8). The growth of the said indicators seems to have been accelerated since the second half of the 1990s. But it is surprising to note that the gap between per capita deposit and credit got widened over the said period, implying a decline in CD ratio during the reforms period.

From table 13 it is evident that CD ratio dropped from 78 per cent in 1970 to 67 percent in 1980 with further decline to about 61 per cent in 1990. There has been a decline in CD ratio during the reforms period as it remained in the range of 55-59 per cent, but the extent of decline is not so pronounced as compared to the pre-reforms period (chart 8).

3.4.2 Regional Variation in Credit-Deposit Relationship

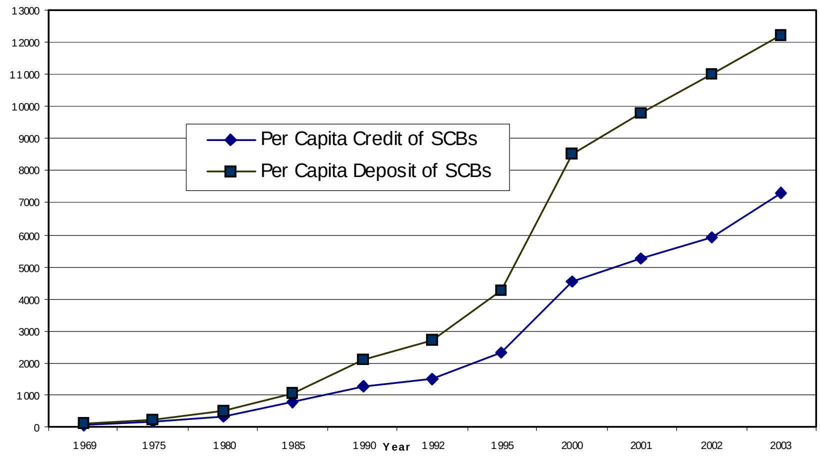
To ensure steady growth in income and achieve overall development, a proportionately higher CD ratio needs to be maintained in the backward regions. Banking statistics reveal that CD ratio in the country has been declining since 1980 (from 67 per cent in 1982 to 58 per cent in 1992 and remained almost the same in recent years). Across the regions, CD ratio as per sanction is very high in the Western Region (81 per cent) while it is as low as 27 per cent in the North-Eastern Region in 2003. In other words, around 81 per cent of the deposit is provided in the form of credit in the Western region while it is about one –fourth in the North-Eastern region.

It is mentioned that CD ratio as per utilization can be a better indicator in comparison to CD ratio as per sanction. The difference between the two can track the direction and extent of migration over time. In this aspect the underdeveloped regions have enjoyed considerable improvement since the nationalization of commercial banks. From table 12 it is evident that relatively more resources have been flowing to some of the backward regions especially to the North-Eastern region where the extent of difference between sanction and utilization is very high (28 percentage points) in 2003. The flow of resource is from some of the developed regions especially from the Western region. But it is surprising to learn that utilization outweighed sanction with a high margin in the moderately developed southern region and the extent of difference is very high in recent years. This calls for close scrutiny.

3.4.3 Credit Deposit Ratio Across Population Groups

The credit-deposit relationship across population groups indicates distinct changes over the years. From table 13 it is discernable that CD ratio declined for all population groups barring Metropolitan area during the reforms period.

Chart 8: Per Capita Deposit & Credit of SCBs



The extent of decline is distinct in rural area- showing a fall by 18 percentage points (from 60 per cent in 1991 to 42 per cent in 2003) during the reforms period. This is in contrast to the RBI norm of maintaining 60 per cent CD ratio in the Rural areas. Even in semi-urban and urban areas the extent of fall is around 14 percentage points during the reforms period though the ratio went up by about 10 percentage points during the said period for metropolitan area (from 73 per cent in 1991 to as high as 83 per cent in March 2003).

Despite an erosion in CD ratio in the rural area net migration of credit to this area is much higher (around 30 per cent) as compared to other population groups (semi-urban and urban area). In contrast, there has been net out-migration of credit from the metropolitan area during the said period. Nevertheless, CD ratio as per utilization is still higher in Metropolitan area as compared to the rural, semi-urban and urban area. For instance, in recent years CD ratio as per utilization (amount outstanding) remained between 70-75 per cent in Metropolitan area while it is lying between 50-60 per cent for rural area, hovers around 40 per cent for semi-urban area and confined within the range of 40-50 per cent for the urban area. The persistence of CD ratio in rural areas indicate that rural areas provide resources more than what it receives in the form of credit. It implies net siphoning of savings from the country side to other developed centres (urban and metros).

The persistence of branch expansion in the metropolitan area along with higher growth in deposit, credit and CD ratio in the said population group can be explained by considering some of the issues discussed below. As mentioned since 1995, expansion of branch network became the responsibility of the bank board and therefore, growth of branch expansion in the metropolitan area can not be an abnormal phenomenon. The bankers might not be keen to allocate more resources for agriculture partly because of high level of NPA in agricultural lending as compared to lending for other sectors. Added to this, a majority of the farmers and small account holders became defaulters due to genuine or political reason and this, in turn, deprived them to have access to fresh loans. The persistence of slow and unstable growth in agriculture and decline in its share to 23 per cent of GDP can be some of the issues that might have motivated the PSBs not to allocate more funds for agriculture.

Table 12: Credit-Deposit Ratio of Commercial Banks Across Regions in India

(In Per cent)

	Dec-72		Dec-82		March-92		March-96		March-02		March-03	
Regions	Sanction	Utilization	Sanction	Utilization	Sanction	Utilization	Sanction	Utilization	Sanction	Utilization	Sanction	Utilization
Northern	47.6	46.6	70.0	67.7	51.1	49.3	51.4	50.4	56.2	55.0	56.0	55.5
North-eastern	36.3	71.4	41.2	57.5	46.7	66.3	35.5	41.1	27.2	53.2	27.4	48.2
Eastern	62.9	62.6	56.1	55.2	49.5	49.1	47.0	46.4	37.6	41.4	39.6	42.8
Central	39.1	44.4	47.8	50.6	47.6	50.2	40.0	42.0	33.9	38.4	33.3	38.6
Western	76.2	71.8	73.7	73.0	58.2	56.5	72.2	71.4	79.7	71.3	81.0	71.5
Southern	91.1	94.7	79.2	80.2	76.5	77.7	74.2	74.8	64.6	68.9	66.3	71.2
All - India	66.4	66.4	67.1	67.1	57.7	57.7	59.8	59.8	58.4	58.4	59.2	59.2

Source: EPWRF(2005): Metamorphic changes in the Financial System, Special Statistics, 38, Economic & Political Weekly March, 19.

The growth of branch network in the metropolitan area can be on account of high demand for credit in this area partly due to buoyant service sector. To improve the bottom line the bankers have diversified their activities from traditional lending to retail lending. To achieve this goal urban and metros can be prioritized. There has been persistence of soft interest rate regime especially for housing loans leading to growth of real estate. This is mostly confined to urban and metropolitan area. The proliferation of credit card business is somewhat an urban phenomenon. The consumers in the urban and metropolitan area are relatively more aware of the new products and willingness to spend as compared to the rural area.

Table 13: Credit-Deposit Ratio of All Scheduled Commercial Banks

(in per cent)

Year	Rural	Semi-Urban	Urban	Metropolitan	Total
Dec-69	37.6	43	59.1	98.2	71.9
Dec-70	48.3	53.3	68.3	101.4	78.1
Dec-75	51.9	46.7	64.4	96.4	73.5
Dec-79	56.3	49.6	58.8	89.1	68.9
Dec-80	56.9	49.2	59.7	85.2	66.9
Dec-81	60.6	51.4	61.3	85.1	68.1
Dec-84	68.6	53.1	57.2	84.6	68.3
Dec-85	63.9	50	53.4	73.1	61.9
Dec-86	65.3	51.3	54.9	73.8	63
Dec-89	63.8	50	57.4	77.6	64.7
Mar-90	61.2	49.2	55.6	69.9	60.7
Mar-91	60	49	56.5	72.8	61.9
Mar-92	57.9	46.4	53.6	65.1	57.7
Mar-95	48.6	39.7	46.5	68.8	55.6
March 1996*	47.3	40	47.2	79.2	59.8
March 1997*	44.1	38.1	44.4	76.1	56.8
March 1998*	43.4	36.6	43	74.1	55.3
March 1999*	41	35.7	42.6	74.7	54.8
March 2000*	40.4	34.7	41.9	78.9	56
March 2001*	39	33.2	43	80.9	56.7
March 2002*	41.8	34.3	42.4	82.5	58.4
Sept 2002*	41.2	32.8	40.5	80.3	56.9
March 2003*	42.4	35.2	43.2	83	59.4
Sept 2003*	42.6	35	42.1	76.6	56.7
Mar-04	43.7	37.9	47.3	75.7	58.7
Sep-04	46.5	39.7	46.3	76.9	59.9

Source: EPWRF (2005): Metamorphic Changes in the Financial Systems, Economic and Political Weekly, March 19,2005.

Section IV

4.1 Summary and Concluding Observations

The performance of the banking sector has undergone noticeable change during different periods since independence till date. Before nationalization of commercial banks, slow progress in mobilization of adequate savings failed to meet investment requirements. There was also prevalence of urban-bias as reflected by distribution of credit in favour of industry and trading sectors. To ensure expansion of branch network particularly in the rural and urban areas, flow of credit for the priority sector and accumulation of adequate savings to meet the development requirements, nationalization of major commercial banks was introduced.

By and large the major objectives of bank nationalization was fulfilled during one and a half decades since 1969. Despite its splendid performance in terms of functional aspects and geographical coverage, the banking industry was not in its pink during the said period. Skepticism has arisen about the viability of the banks partly due to considerable erosion in efficiency, decline in productivity and profitability.

In order to remove the said ailments including strengthening its viability, financial sectors reforms with focus on prudential norms (income recognition, asset classification and capital adequacy norm) was introduced. Then again, to inject competitiveness in the banking industry, private sector banks have been allowed to enter the industry. The outcome of it is reflected by the achievement of the industry in cleaning the balance sheet. Nevertheless, the performance of the banking sector in achieving societal goals does not seem to be quite promising during the reforms period.

As specified, no reform is successful unless it ensures equity in distribution. There has been considerable overall growth of deposit and credit during the reforms period but it is mostly confined to the metropolitan area, implying emergence of urban centric growth. Based on credit sanctioned, there has been erosion in CD ratio for the rural area during the said period but it has been arrested to a large extent by in-migration of credit to rural areas thereby improving CD ratio as per utilization.

A disaggregation of credit allocated to various sectors reveals inadequate weight assigned to the priority sector including agriculture during the said period. In the absence of requisite support for agriculture and allied areas from the financial system, the economy can hardly sustain higher growth, eradicate poverty through improvement in growth of employment and smoothen regional disparity. The recent Tenth Plan Mid-Term Appraisal also indicates an erosion in growth of agriculture from 3.2 per cent that it had notched up during 1980/81-1995/96 to 1.9 per cent in the subsequent periods, implying decline in productivity growth. Therefore, it is quite difficult to accept that 1.9 per cent growth can support more than 60 per cent of total population living in rural area. Needless to say, to sustain overall higher growth in an economy with equity leading to rural area and agriculture can not be looked down upon. At the other end mere supply of bank credit to agriculture can not necessarily ensure improvement in effective demand unless development of infrastructure in agriculture is prioritized and the price policy is based on functioning of the agrarian markets.

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PREFACE

Centre for Multi-disciplinary Development Research (CMDR) is one of the Social Science Research Institutes located in a *moffusil* area of Karnataka. The institute is recognized by the Indian Council of Social Science Research (ICSSR), Government of India. Since its inception till date the Centre aimed at undertaking analytical studies of conceptual and policy significance on the socio-economic and cultural issues using multi-disciplinary perspectives.

As a part of publication programme, the Centre has initiated CMDR Monograph Series, consisting of both invited contributions and the research studies undertaken at the Centre.We are happy to present Monograph No.49 with the title "Societal Goals of Commercial Banks in India: Promise and Reality" authored by Dr.Mihir Kumar Mahapatra, Associate Fellow, CMDR.

The present monograph deals with overall progress and achievement of commercial banks with focus on societal goals during the periods prior to financial sector reforms and afterwards. By and large, the major objectives of bank nationalization were fulfilled during one and a half decades since nationalization of commercial banks. In contrast, the banking industry was not in its pink during the said period. To strengthen its viability, financial sector reforms with focus on prudential norms were introduced based on the M.Narasimham's Committee Report. Over the years, banking industry succeeded to a large extent in cleaning its balance sheet but its performance in fulfilling societal goals is not quite promising during the reforms period.

We acknowledge with gratitude for the financial support provided by Canara Bank, Bangalore to carry out research work in banking and development at the Centre.

16-08-2005

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Societal Goals of Commercial Banks in India

Abstract

The paper made an attempt to capture progress and achievements of commercial banks in India during pre-reforms and reforms periods with focus on societal goals. Some of the major objectives of bank nationalization were fulfilled to a large extent during the period prior to financial sector reforms. Despite encouraging performance in functional aspects and geographical coverage, the banking industry was not in its pink during the said period partly on account of erosion in efficiency, decline in productivity and profitability. To remove the said ailments and strengthen viability, reforms in the banking sector were introduced during the early 1990s. The outcome is reflected by the industry's achievement in cleaning the balance sheet.

In social aspect of banking the performance of the industry does not seem to be quite promising during the reforms period. There has been improvement in mobilization of deposit and allocation of credit but this is mostly confined to the urban centres. Concomitantly, rural area witnessed sharp decline in office and Credit-Deposit ratio (CD) though the declining trend in CD ratio has been arrested to some extent due to in-migration of credit.

A disaggregation of credit allocated to various sectors reveals inadequate weight assigned to the priority sector including agriculture during the reforms period. In this context, the recent Tenth Plan Mid-Term Appraisal also indicated erosion in growth of agriculture from 3.2 per cent noticed during 1980-81 to 1995-96 to 1.9 per cent in the subsequent period. For the present, the major cause for concern is 'how 1.9 per cent growth can support around 60 per cent of the total population living in rural area?' Overall, skepticism has arisen about sustaining higher growth, eradication of poverty through improvement in growth of employment and smoothening of regional disparity.

Key words: Social aspect in banking, priority sector lending and CD ratio

JEL Code: G 21

Monograph Series: No. 49
August: 2005

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