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**IMPACT OF INSTITUTIONAL FINANCE ON BORROWERS CONCERNED WITH PRIORITY SECTOR**

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**ABSTRACT**

*A broad based and diversified institutional structure has gradually been built up for providing substantial amount by way of short, medium and long-term loans. The institutional financing agencies stand for the institutions of different types engaged in the task of rural finance. The subject of institutional finance vis-à-vis rural development has been receiving increasing attention from the government academicians. There is no denying the fact that ongoing process of rural development call for a continues stream of financial assistance easily and timely accessible to the rural masses. To tackle the problems of rural credit in an effective manner, the government has assigned the task to three main agencies, namely, co-operative banks including land development banks, commercial banks and regional rural banks. The main objective of the study is to analyze the functional system of the Co-operative Banks, Commercial Banks and Regional Rural Banks, to assess the extent of involvement of banks in spreading credit and their efforts in reducing inter-regional and inter-institutional disparities in rural credit, to assess the impact of institutional finance on the recipients operations, to study the problems encountered by bankers as well as borrowers in connection with institutional finance and to offer healthy suggestions for removing the problems involved in rural credit operations and for improvement in the working of institutional financing agencies. It also brings out the impact of institutional finance on standard of living, examine the problems relating to rural credit faced by the banks and borrowers, highlights the preference for borrowing from each of the institutions and reasons thereof. The study also provides valuable findings and suggestions on various issues rising during the course of the investigation.*

**KEYWORDS**

institutional finance, co-operative banks.

**LIST OF ABBREVIATIONS**

CBS : Commercial Banks  
 NPAs : Non Performing assets  
 RRBs : Regional Rural Banks  
 DCCB : District Central Co-Operative Banks

**INTRODUCTION**

The study offers interesting result on operational and structural problems of the system, evaluation of district-credit plans, and the extent of involvement of major financial institutions in filling the rural credit gaps. The study also provides valuable findings and suggestions on various issues rising during the course of the investigation.

**REVIEW OF LITERATURE**

The researcher has made an attempt here to review of research studies that have come up in the shape of research papers & books and reports.

**Narayan, A. (1984)** in his study on impact on banking finance on farmer's concluded that the bank finance had a reasonable impact on cropping pattern, level of productivity and per acre net income in the area surveyed and a such the banks should feel encouraged to enhance further the volume of credit to agriculture and accelerate its disbursement to needy farmers so as to accomplish a sound growth in this priority sector.

**Verma A.K.** has conducted his research work of Haryana Kshetriya Gramin Bank under the title "**Rural Development & Regional Rural Banks**" in 2001. He concluded that the schemes of loan for crop to buy bullock and camel-carts and to establish poultry farms were successfully. But the applicant has to face various corruption practices, misbehavior and lack of proper guidance by the bank officials.

**IMPORTANCE**

To strengthen the system the functioning, impact, problems and experiences of this Multi-agency system of rural credit now required a fresh inquiry. But before venturing into an examination of factors, an analysis of a number of related issues are essential. Major among these issues are, whether the involvement of bank credit in rural areas has reduced the inter-institutional and interregional disparities with regard to their geographical and functional coverage; whether the district credit plans are suitably tailored to meet the requirements of rural credit; whether institutional credit has had some impact on the economic growth of its clientele; which category of borrowers (small, medium or big) has benefited more?

What problems are experienced by the banks and the borrowers? Which type of institution do the borrowers prefer; and for what reasons. Evidently, these issues require detailed investigations into credit supply (banks) and demand (borrowers) both at the macro- and macro-levels.

**RESEARCH METHODOLOGY**

The study has two main facts, namely the supply side related to the banks and the demand side pertaining to the borrowers. Further, the supply aspect has been studied at the macro as well as micro-level and the demand aspect at the micro-level. The macro level investigations are based on secondary data, which have been collected from the records of banks, annual reports, various statistical abstracts, journals, newspapers and such other sources.

Despite a phenomenal growth of priority sector lending by the commercial banks in recent years, certain basic issues have been left untouched in the system.

Under the existing system, the classification of priority sector advances has remained broad-based, so that even big borrowers could avail of the benefits of priority treatment provided by the banks. For example, in the case of agricultural loans, in a joint-family farm, the members may claim loans on an individual basis, by distributing holding among them and posing themselves as small farmers through actually their operations may be on a big scale. It has been, therefore, suggested that economic norms like level of income, technology used etc., should be adopted as eligibility criteria for priority sector lending. It is necessary to identify appropriate sectors within the priority sectors on a rational basis.

While granting credit to artisans, cottage industries, etc., the banks should also examine the viability of the project from the marketability point of view. Such loans will not be productive if the borrowers use them to produce goods, which have no demand. This also poses a problem of recovery for the bank. There are always the problems of ensuring the effective end use of the loans given to the priority sectors.

Situation of reaching a target of 40 percent of total bank credit to the priority sector also needs probing. Though it is a laudable objective, one cannot deny the possibility of certain undesirable effects caused by it. When a larger quantum of bank credit flows into priority legitimate share. There may be a crowding out effect or undue hardships experienced by the traditional sectors, on bank financing; especially industry and wholesale trade. It is, therefore essential to examine if there is any such adverse effect of the present course of bank lending on these sectors.

Another problem is the problem of bad debt arising from indiscriminate lending by banks, keeping an eye on the fulfillment of the stipulated targets.

Quantitatively, banks have well in priority lending's but their qualitative is to be examined. For instance, overdues and bad debts have been a serious problem faced by the banks in respect of advances made to the weaker sections of the society. Thus, what is warranted is a minute and careful micro- economic credit planning by each bank to avoid such pitfalls.

**PROBLEM ENCOUNTERED BY ORGANIZATION**

The lending institutions are following the area approach in the sphere of rural banking. The intention is to cover a given area intensively by granting loans for an eligible and viable economic activity that can be taken up by the villagers. Branches of the CBs and MGBGB have extended their operations to large areas without reference to their resources, both man-power and otherwise, for the purpose of exercising proper supervision and ensuring end-use of funds.

Many of MGBGB branches have no field supervisor, instead only a clerk does this work. But in several other branches which do have field supervisors, they combine the work of a clerk with that of field work. For this purpose, they are mostly stationed at the branches. This has resulted in mis-utilisation of funds and in consequence impaired the repayment capacity of the borrower. The branches have adopted 10 to 30 villages at a distance ranging upto 30 Kms from their headquarters. This has undisputedly resulted in dilution of standards of appraisal, follow-up and supervision leading to problems of recovery.

There is obviously a need for the RRBs to strengthen their own organizational machinery and streamline the follow up and supervisory procedures and skills with a view to pre-empting the mis-utilisation of credit and diversion of funds for other purpose.

**PAUCITY OF SUITABLE STAFF**

A common handicap from which the Gramin Banks and Cooperative Banks suffer is the paucity of suitable staff. The rapid branch expansion has considerably strained the staff resources of these banks. Many a time, in experienced personals are sent to the branches.

The importance of right type of personnel with right qualification, experience and training and right aptitude to work can hardly be over-emphasized for the success of any programme and policy of rural anti poverty. In view of importance of bank credit for the betterment of the rural poor, it is obvious that the banks personnel have to functions as friend/advisor and guide to the borrower.

The researcher discovered that most of the discovered branches surveyed had inadequate staff. One branch of the Gramin Bank is manned by a four member team including the branch manager, one field-supervisor-cum-clerk, one cashier and one peon. Similarly one another branch is also manned by four members but without a field supervisor. During the course of our discussion with the bank officials it was revealed that many of branches in the districts have only two members staff. It goes without saying that the paucity of the right type of the official gives rise to the problems of supervision of loans and its recovery in addition to a lack of report between the banks and borrowers.

It is obviously to ensure proper utilization of loan assistance that this system of advancing the loan in kind to a full or partial extent is being followed. One cannot of course dispute the rationale that lies at the root of kind loans, one has to agree that in the process the borrower's freedom to choose inputs and material should not be allowed to get restricted. Moreover, it is highly essential to keep a check on the malpractices suppliers may adopt in respect of poor quality and the higher price of the inputs/machinery/material supplies by them. In no case should the borrower get the impression that he has been made to pay more compromise of the quality of the inputs etc. Keeping these aspects in view, the policy of disbursement in kind has to be followed with caution and with in-built checks against the possible malpractices of the suppliers and bank staff so that borrowers confidence in the system doesn't get lost.

**LACK OF CO-ORDINATION**

During the course of field study, it has been discovered that the bank staff do not know many borrowers personally. They may also not be knowing whether a particular borrower residing in that village or has since migrated to other village or for that matter, if he is still surviving. Infact, this virtually means complete absence of an effective communication system between the bank and borrowers. Obviously, it leads to mis-utilization borrowed funds.

Another problem related to staff is the complete absence of a transfer policy for their personnel. It is general phenomenon that before a branch manager gets familiarized with his area and established rapport with borrowers, he is again transferred. For solving the problem it is necessary that a proper transfer policy should be evolved in such a manner that branch staff including the manager is not transferred before a specified period of stay at a particular branch, say, three years unless his shifting becomes absolutely necessary in the interest of the bank.

**ECONOMIC VIABILITY OF RURAL FINANCIAL INSTITUTIONS**

Agricultural loans were considered to be unviable by rural financial institutions due to low rates of interest and high risk and transaction cost in the pre-reform period. The interest rate structure started undergoing changes after the financial sector reforms of 1991 in order to improve the economic viability of rural credit and provide more flexibility to banking institutions to decide the interest rate structure for agriculture and other sectors. The interest rates were further rationalised after the exchange rate mechanism was made more flexible and foreign capital was allowed in the Indian economy. However, sharp rise in interest rates for different sectors of economy has put a pressure for upward revision in the interest rates of agricultural loans as well. Still the economic viability of rural financial institutions is not good due to high transaction and risk cost. It was noted that the net margins (as per cent of working capital) in the case of DCCBs was negative at All-India level while the economic position of RRBs has improved. The cooperative loans have become more costly due to some margins getting added at every level of its three-tier structure.

**POLITICAL INTERFERENCE**

Political interference in the lending process of banking leading to the neglect of proper credit appraisal, need-based credit, follow up and supervision has been projected as one of the major reasons for increasing Non-Performing Advances. Political connections are widely perceived but, as is the case with willful defaulters, difficult to prove. Almost certainly, the public sector character of banks and their vulnerability to outside influence has been a dampener even in loan recovery.

Several studies have gone into the causes of Non-performing Advances and come to the conclusion that changes in the macro-economic environment like recession, infrastructural bottlenecks, change in Government policies, etc. result in some lending of banks becoming unproductive and borrowers turning defaulters. Changes in Economic policy, i.e. Fiscal and Monetary, affected in response to the economics and political needs from time to time in the context of domestic and international scenario, have a bearing on the performance of banks and business, as also on loans going bad. Changes in Industrial and Agriculture policies, Export Import policy, Credit policy, Exchange Rate policy, Labour policy are also started to have partially contributed to the failure of some borrowers in the

repayment of loans, as the borrowed funds could not be used fruitfully due to some of the unfavourable impact and effects of policy measures. Both banks and borrowers have been caught unaware by the fast changing policies and find themselves trapped with funds locked up in units producing nothing. On the social side, lack of education and enlightenment among the borrowers buttressed with poor legal infrastructure generally stated to be supportive of the borrowers rather than lenders and corruption have been observed to be major stumbling blocks in the recovery of loans. Lack of integrity on the part of both bankers and borrowers has also influenced formation of NPAs. Erosion in social values, ethics and accountability has been highlighted as some of the reasons for formation of huge NPAs. Awareness that banks lend public money which is required to be returned, is unfortunately found missing, aggravating the problem of recovery of loans.

## PROBLEMS ENCOUNTERED BY BORROWERS

### DEFECTIVE LENDING PROCEDURE

The lending procedure of lending agencies despite efforts towards simplification continues to be cumbersome, particularly in the case of small loan. Two issues are involved in agriculture lending in India. The banking sector has to cater a very large number of small borrowers spread over a very large area. Secondly, size of the loan is very small. The small and marginal farmers constitute more than 80 per cent of the farmers and some of the areas are remotely located. Catering to their requirements of farmers of such areas becomes very difficult and costly. From borrowers' point of view, access to institutional credit especially for small, resource poor and illiterate farmers gets inhibited as the procedural and documentation requirements are cumbersome, time consuming and increase the cost of borrowing for the farmers. On the other hand, access to non-institutional credit is regarded to be very simple where transaction cost is negligible and involve no procedural complications. Empirical studies show that transaction cost in case of non-institutional loans was negligible whereas it ranged from 3 to 5 per cent in case of CBs, 1.4 to 3 per cent in case of cooperatives and more than 8 per cent in case of RRBs.

It is widely known fact that the cost of credit to small man is very high, when incidental expenses in obtaining credit are taken into account. A number of formalities, such as, production of evidence regarding ownership/possession of land in the case of agriculture borrowers, procuring no dues certificate from other lending agencies in the area, getting non encumbrance certificate etc., are processes which are required to be complete before a loan is disbursed. A borrower has to face incalculable harassment and the time of money he has to spend to get, the formalities are considerable. Each of the formalities involves the borrower's visits to the concerned office and on each visit he spends time, energy and money besides the loss of wage-income in order to obtain his loan assistance.

These formalities are in addition to the visits that he has to make from time to time to the branch for submitting the loan application and other papers. It goes without saying a number of visits are required to complete these formalities. Needless to add, the intermittent visits to the bank and their number depend upon the type of attitude of the bank staff towards the borrowers, cannot be forecasted for a particular borrower. As regards the no dues certificate, the position is far from clear. The borrower may have to know the half a dozen doors for them and has to grease the palm for obtaining them. If we add the money cost of these items of expenditures to the loan amount, which is generally small, the actual cost of containing it would work out to be very high.

Efforts should, therefore, be made to ensure that none interest cost of credit to the small borrower is kept as low as possible. Some positive steps will have to be taken, if a sizable number of the rural poor are to be brought within the fold of institutional credit. The crux of the problem is not only simplification of procedures but in addition, to ensure that a borrower does not face any kind of harassment including unwanted time and money that he has to spend in order to obtain the loan.

The main objective of the Lead Bank Scheme is that banks should work in rural environment with rural ethos. But quite contrary to it, the researcher practically witnessed the same culture and psychology among the RRB officials as are possessed by their counterparts in commercial banks. Intact the researcher observed in them a lack of responsiveness both attitudinal and emotional to the needs and ethos of rural poor, it is characterized by apathy and coldness. Some of our respondents complained about the rude behaviour of bank officials. If this behaviour undergoes no favourable change, the task of rural development will remain unresolved.

In the area of customer services, the questions of courtesy are most crucial. Of all the factors that cause customer irritations, lack of courtesy is perhaps the most damaging. A customer may condone some delay in service, if only he gets friendly smile, sympathy and respect from across the customer. But he can't tolerate discourtesy.

### UNPRODUCTIVE EXPENDITURE

The class of people whose debts are intended to be discharge totally are those that live from hand to mouth. Obviously, the consumption loan they avail themselves of are generally for expenditure on clothing and food during the lean month of the year. These loans are generally paid back, in kind and sometimes in cash, when the harvest reaped. In addition, these families take loans for social purpose like birth, funeral or marriage ceremony or to meet medical expenses. Any system which seeks to replace the money lenders will have to make readily available alternative sources of credit without too many formalities.

On the contrary, this study reveals that rural branches have not provided consumption loan to the rural poor. In fact, it is treated that their consumption expenditure is an unproductive expenditure. It is undisputed fact that the entire expenditure on farm consumption cannot be treated as completely unproductive. During the course of a farm season when the farmer and his family are engaged in the farming operations, their consumption cannot be regarded as unproductive.

### MOUNTING OVERDUES

A significant feature of banks' lending is that, despite mounting over dues in each year, the agriculture and allied sectors enjoyed relatively major portion of bank credit. The agriculturists and poor people of the area could not repay the loans because they spend their loan on consumption purposes rather than productive purposes without bothering the liability of making repayment because of illiteracy.

In the perspective of economic development, there have been many disparities in the area in the distribution of resources. The flow of institutional loans has particularly benefited the richer section. In that content, the priority sector lending provides privileges to the poor people in order to lift their economic structure and condition. They are provided loans for buying buffaloes, cows, to buy auto-rickshaw, to rear hen, and different machines for small-scale industries. Indeed, they get subsidy by the government on this loan, but they do not use the loan in the proper way for productive use. So, the loanee cannot return loan. Constant failure of monsoon, natural calamities as famine, flood etc, willful default, deficiencies in lending policies are the chief reasons for non-recovery of loans. The reasons for poor recovery may also be attributed to various other factors such as lack of supervision of end use of fund owing to lack of vehicle and paucity of staffs, defective processing of loan application, political interference's, communication gap between banker and customer etc.

The loans sanctioning authority begins to take undue advantage from such people. No effort is made for recovery of such loan. The local leaders do not encourage them to pay it back. They assure them that govt. will exempt it. Consequently, the loan is never recovered in future; it becomes difficult to pay it back due to heavy amount. As a result, the mounting over-dues restricted the banks lending capacity. Therefore, an immediate action from appropriate authority to accelerate the recovery position in all sectors is necessary.

The capabilities of any lending institution are seriously eroded on account of mounting over dues. Today, all lending institutions have to bear the burden of over dues and this result in curtailing the recycling of the funds. Plainly speaking, the low level of recovery of the loans has put into jeopardy the financial viability of banks. Mounting over dues defeats the whole purpose of credit; instead of loans being recycled among several applicants, they remain frozen in the hands of a few.

Our finding provide a strong evidence to conclude that despite the improvement in the levels of income and surplus of the borrowers repayment performance of borrowers under all the segments is rather unsatisfactory.

The Mounting over dues continue to cause a serious concern not only because over dues prevent banks from recycling their funds effectively but also because continued defaults in repayment of loans to the poor section of the rural society has to late been the focus of public comments and has attracted serious attention of the concerned authorities.

### PROBLEM OF POTENTIAL BAD DEBTS

During the course of field survey, while we were canvassing the questionnaire with our respondents, some socially influentially defaulters came forward with the plea to get their outstanding written off. This is not a stray and isolated development, which should be brushed aside lightly. The leading agencies, the union

government and certain committees have had similar experiences. Keeping in view the growing tendency, which is discernible among a sizeable chunk of defaulters, the problem demands serious consideration and such solution that its ramification is stalled in an effective manner.

There is a general agreement among the leaders and experts that deferment of recovery of dues or writing off the over dues also tends to produce adverse impact on the recovery performance of lending agencies. In the past, several State Government had unilaterally written off agriculture debts not because of economic consideration but for the sake of expediency. The main drawback of such measure is to make no distinction between willful default and a genuine default, unquestionably, it is unfair to borrowers who repay their loans regularly. Such a decision on the part of State Government, Vitiating as in does the climate of recovery, make an invidious between those who pay back and those who do not and is patently inequitable to the farmers.

The Shivraman committee also observes that some of the governments have banned coercive action for recovery of overdues from defaulters even there were no valid reason, such a general step had uncovered willful defaults, besides generating psychology of non- repayments. It has thus endangered the survival of the institutional credit structure itself.

### CONCLUSION

The globalization of agriculture is underway with a number of changes such as changes in livelihood pattern, pattern of holdings, high-value agriculture, agribusiness development and food retailing. The rural credit institutions must shed their inhibitions to support the process of agricultural diversification and commercialization. A progressive integration of financial markets with emphasis on self-regulation, accountability and autonomy of the institutions with social responsibility will be required.

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