An attempt has been made in the earlier chapters to outline and analyse the changes that have occurred, over the past quarter of a century, in the volume, composition and direction of commercial bank credit in India. An attempt has also been made in the preceding chapter to review the Credit Policy followed by the Reserve Bank of India in the recent past. The purpose of this analysis was to show how the traditional security-oriented approach has been replaced by
the new philosophy of lending. It will be seen that changes in the figures and percentages of bank credit are the result of the basic change in ideology. The Indian bankers can no more think of helping only the rich, accelerating thereby the concentration of economic power. They have now to finance the varied economic activities in terms of the plan priorities and other socio-economic objectives accepted by the country. During the last decade or so, bank lending in India has thus been reoriented to meet the growing needs of a developing economy.

WA. IT DESIRABLE?

A pertinent question that arises here is whether these changes were warranted and whether they are justifiable. In other words, it involves an objective assessment of the basic change that has taken place in the theory and practice of bank lending in India. This assessment is to be made in the light of the published literature and the experiences of practical bankers in the recent past.

Broadly, there are two schools who have either supported or have criticised the changes consequent upon the bank nationalisation. The views, expressed by these schools are, however, contradictory to each other and they take us to one of the two extremes. Nevertheless, a brief account of their main arguments is essential, before making an objective
The prominent school, comprising politicians, academicians, financial journalists and the common man advocated nationalisation of banks on several grounds. They wanted to break the hold of big business houses on the allocation of credit by banks. They wished that the flow of bank credit be diverted to agriculture and other neglected sectors. Although such people are happy to see the banks nationalised, many of them are not happy with the performance of the nationalised banks. It is argued that the banks are still following their security-oriented approach and that they are not helping the neglected sectors on an appreciable scale. The echo of these complaints is often heard in the pages of leading financial journals. It was pointed out for example, that —

"It is revealed recently that inspite of the efforts of the Union Government, not much headway has been made in the disbursement of loans by the nationalised banks to small farmers. While banks have made some beginning towards financing agriculture, a lion's share
of these loans has been cornered by the big farmers and the benefits have not percolated to small or marginal farmers or to landless labourers.

Even earlier, the 'Commerce' had complained in one of its editorials, that -

"It is fantastic that at a time when the precious capital wealth of rural India in terms of cattle is perishing in severe drought, the banks have been watching helplessly, simply because the rules do not provide any guidelines to assist drought affected agriculturists. This is but one instance of the utterly unrealistic atmosphere in which our banks function. The nationalised banks still remain spiritually the banks of the upper middle class of metropolitan India."*

Many supporters of nationalisation are thus unhappy with the lending techniques of banks. They suggest that the banks should lend money to the small farmers, to the landless

* Commerce - December 16, 1972 P. 1480
labourers and drought affected people. Coming to the down-trodden poor, the Chief of the Commerce Research Bureau felt that -

"Despite all the policy pronouncements, at the grass-root level the banks do not bother much about lending a helping hand to the poor. The small artisans and farmers have to pay a dozen visits, wait for months before they get a small loan at all. In many cases they just do not get any loans."

The advocates of nationalisation should on the whole be happy; because their long felt desire has been satisfied.

NATIONALISATION OPPOSED

As opposed to the above views, the second school feels that nationalisation of banks has brought in its train more problems than achievements. It has been pointed out, for example, that tremendous expansion of branches, and large-scale recruitment of staff have reduced the profitability of banks. It has also created problems of organisation, methods, procedures, training of staff and co-ordination between various branches of the same bank. It is pointed

---

out that in the pre-nationalisation period, the network of branches was small; and the branch managers were in direct touch with their higher authorities. An early sanction of an advance was, therefore, possible. In the post-nationalisation period, however, the branches are scattered over wider areas which lack the means of transport and communications. This has resulted in unavoidable delay in sanctioning advances. What is more important is that there is too much interference in the management of banks both by the Government and by the local political leaders. Such an interference has resulted in the flow of credit going to the wrong parties and the consequent problems of poor recovery or even bad debts. It is argued that all these problems are the result of nationalisation; and they could have been avoided by leaving the banks in the private sector.

Nationalisation of banks was opposed by the men occupying top positions in Government and the Reserve Bank of India, mainly on the ground that it would lead to inefficiency and red tape. Mr. ..V.R. Iyengar, the former Governor of the Reserve Bank of India thus felt that -

"It was only on the ground of inefficiency, that the nationalisation of banks was a misconceived move."*  

A few other people who opposed nationalisation of banks, pointed out that financing of agriculture was no business of commercial banks. Thus, the ex-Chairman of one of the finance commissions said -

"I would, therefore, urge most seriously that there should be no departure from the policy of granting agricultural credit mainly through the co-operative movement. The commercial banks can help by subscribing to the debentures of land mortgage banks. They have also their legitimate responsibility for financing the trade in agricultural products. If they venture further into the sphere of agricultural financing, they will do more harm than good."

AN OBJECTIVE VIEW:

It will be seen that both these points of view take us to two extremes. While the former school represents the desire to nationalise every important economic activity; the latter shows its disapproval of all state interference. Both the points of view, being too onesided, should therefore, be discarded. As a matter of fact, the changes in the lending

policies of banks should be judged in terms of larger interests of the Indian society as a whole. Prior to nationalisation, the Indian banks had confined their operations to the metropolitan areas and advances were made mostly to the affluent people. Commercial banks thus exhibited a narrow view of promoting the welfare of a small section of the society. They had neglected the welfare of the masses and of different regions.

Now, those who are in power cannot afford to take a narrow view of the concept of public welfare. In a democratic country like India, where politicians are elected by the literate and the illiterate alike, the elected members cannot afford to lose sight of their voters. The government of a democratic country must give equal attention to the development of different regions and different classes in the community, no matter how big or small they are.

When most other countries of the world are marching towards welfare states, Indian Government can no longer confine its attention to the welfare of a small section of the society. Those who govern the affairs of nearly 66 crores of people, must promote the welfare of the neglected and the downtrodden sections.

Now, promotion of welfare of masses may involve some loss or damage to the interests of a few. Widening of roads so as
to facilitate greater volume of traffic, may thus cause a loss of house properties owned by a few individuals. Construction of huge irrigation projects, so as to facilitate greater agricultural production, may also cause a similar loss of private property. In terms of Pigou's analysis, this would mean that the promotion of Marginal Social Net Product (MNP) may cause a loss of Marginal Private Net Product (MPNP). Nevertheless, such works are quite essential for public welfare and no one would oppose such growing public activity on grounds of theory. From the point of view of public welfare it is, therefore, essential that flow of bank credit is diverted to the priority and the hitherto neglected sectors. In our opinion, the nationalisation of banks and the consequent changes in the bank credit were, therefore, inevitable.

After seven years of bank nationalisation, the banks in India have realised that they owe a primary duty to the society. It is true that the changes that were brought about in the lending policies were initially resented to by the bankers. But now, the bankers have learnt to live with and appreciate the new situation. The traditional orthodox outlook which purvaded the minds of bankers over decades, has now disappeared; and it is sufficiently tuned up so as to suit the new situation. It is gratifying to note that the bankers have accepted the challenges of nationalisation in its true spirit.
The Change Desirable:

It is, therefore, our considered opinion that the nationalisation of banks was quite desirable; and that it has been trying to achieve desired results. Indeed, the nationalised banks have promoted the welfare of the Indian people on a greater scale than ever before. The private sector banks would have taken a much longer time to achieve the socio-economic objectives; whereas the public sector banks appear to have achieved the same goal within a very short time. There is, therefore, no point in saying that the nationalisation was undesirable.

Nationalisation – A Hasty Measure:

It should, however, be pointed out that the nationalisation of banks and the subsequent changes in the lending policies were brought about in a rather hasty manner. The banks, which were inexperienced in certain lines of financing, were asked to go into the unknown fields without proper understanding, trained staff, and proper procedures. Ultimately, this has resulted in several problems and it has done a lot of damage to the banking business itself. The problems which the commercial banks have been experiencing are unfortunately not discussed on any platform; nor have the worries of the lending bankers been brought out to the notice of the common man. An attempt is therefore, made here to outline these
problems at some length.

**PROBLEMS OF NATIONALIZATION — a) DWINDLING PROFITABILITY:**

The main problem facing the bankers to-day is the dwindling profitability of banks. During the past seven years or so, there has been a phenomenal growth in the number of branches and staff. The operating costs in terms of premises, rent, salaries, stationery etc., have, therefore, gone up. What is more important is that most of the branches opened in the rural areas have not yet become viable. They continue to be a drain on the profits of banks. With the rapid expansion of bank branches in villages and small towns over the past few years, the expenditure of banks as a proportion of working funds increased from 7.73% in 1973 to 9.22% in 1976. As a proportion of their spread, expenditure rose from 273% in 1973 to 398% in 1976.*

Lowering profitability is also due to the poor recovery of agricultural advances. In a number of cases, the banks have had to resort to court action for recovery of their loans. It has been observed further that the law charges incurred by banks on account of such legal action have considerably gone up; and this has affected the profitability adversely. In addition to the heavy cost of legal action, the banks

---

* Business India - Banks in a Profits' Squeeze - August 6, 1978 P.41.
have to incur huge losses on account of bad debts. The
dwindling profitability of banks is evident from the follo-
wing figures:

**TABLE 7.1**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Income as percentage of Working Funds</th>
<th>Profits as percentage of Working Funds</th>
<th>Profits as percentage of Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>4.5</td>
<td>0.2</td>
<td>2.9</td>
</tr>
<tr>
<td>1971</td>
<td>4.9</td>
<td>0.2</td>
<td>2.9</td>
</tr>
<tr>
<td>1972</td>
<td>4.8</td>
<td>0.1</td>
<td>2.3</td>
</tr>
<tr>
<td>1973</td>
<td>7.3</td>
<td>0.2</td>
<td>1.9</td>
</tr>
<tr>
<td>1974</td>
<td>8.6</td>
<td>0.2</td>
<td>1.7</td>
</tr>
<tr>
<td>1975</td>
<td>8.8</td>
<td>0.2</td>
<td>1.8</td>
</tr>
</tbody>
</table>

It is clear from Table 7.1 that although the total income
of banks has nearly doubled during the past five years, the
percentage of profits to total income has considerably fallen.
Thus the total income of banks rose from 4.5% to 8.8% of the

---

working funds between 1970 and 1975; whereas, the percentage of profits to total income has fallen from 2.9% to 1.8% over the corresponding period.

There is a tendency to attribute the dwindling profitability to the high and rising wages and salaries of the 'irresponsible, inefficient and privileged' bank employees. Available statistics,* however, show that this view is misconceived. Productivity of bank employees, on the other hand, has been rising consistently. The deposits, advances and incomes of the public sector banks, per employee, have registered sizeable increases between 1973 and 1976. While deposits per employee expanded from Rs.3.17 lacs in 1973 to Rs.4.14 lacs in 1976, advances increased from Rs.2.76 lacs to Rs.3.63 lacs. Banks' income per employee almost doubled from Rs.0.25 lacs to Rs.0.45 lacs over the corresponding period. It is, therefore, difficult to say that the profitability has fallen on account of increased salaries and perquisites of the bankmen.

LOSS OF INCENTIVE:

The real income of the bankmen has been, on the other hand, falling in the past few years. For example, employees whose total emoluments exceed Rs.1000/- per month, are not entitled

* Business India: August 6, 1978 P.41-42
to bonus at all and those who are drawing a salary of less than this figure are subject to a ceiling of Rs.750/- so far as bonus payment is concerned. Further cuts in the salaries and perquisites payable to the bank officers and executives, are likely to be imposed as per the recommendations of the Pillai Committee Report. Various post allowances that are paid to the branch managers, accountants and executives are also likely to be abolished. It should be stressed here that the remuneration paid to the chairmen of the nationalised banks, is also subject to a ceiling of Rs.45,000/- per year.

c) GROWING FrustratioN:

As a matter of fact, there should be some relation between risk and reward. Those who take greater risk should be paid more than others. In the post-nationalisation period, there appears to be an inverse relationship between risk and reward. It is pertinent to note that in banks, the risk in lending is still considered to be personal risk of the branch manager who recommends or sanctions an advance; and if his judgement of the borrower turns out to be wrong, it is certainly the branch manager who is punished even if he has acted in the best interests of the bank. The annual increment of his salary is stopped, and he is transferred to a distant place forthwith. Thus, on the one hand, the risk which the managers are running is constant; whereas
their reward is diminishing on the other hand. This has resulted in growing frustration among the middle level management in banks. The branch managers are not now taking as much interest in developing their business, as they used to take previously. Even the most experienced and senior bankers prefer to sit as assistants in one of the central office departments, rather than work as branch managers.

d) POLITICAL INTERVENTION:

A still more important factor which prevents the bankers from carrying out their duties smoothly is the interference in the lending operations by local politicians and social workers. These political and social workers have now found out a profitable business in the post-nationalisation period. They collect a group of people from slum areas, take them to the banks, and try to secure loans for the 'down-trodden' people. Such leaders bring political pressures, and create other nuisance for the lending bankers. It has been observed further that they inject false ideas into the minds of the borrowers. The borrowers are told that the loans given to them by the nationalised banks are not to be repaid because they are subsidies or aids given to the borrowers so as to enable them to vote for the Congress Government. Several bankers privately complain that 'the problem that arises here is that of stupid political lending. If in order to be able to claim to have fulfilled your social objectives, you lend
Rs.1000/- each to a list of 300 farmers supplied to you by the local politicians, your chances of recovery are inevitably rather limited."

e) LOSS OF PROFESSIONAL RESPECT:

The bankers who are already frustrated are thus subject to an additional tension on account of the interference by outsiders. The result of this is obvious. The bankers find that much of the charm in their business has been lost; and the high dignity which they once enjoyed in the society, has also been lost. In consequence, a number of talented people who have occupied responsible positions are leaving the banks and are seeking better jobs in the private sector.

f) THE QUALITY OF BOARDS:

While talented people are leaving the banks, the quality of people coming to the banks is not much satisfactory. It will be recalled that the persons who are appointed on the boards of banks are drawn from various fields; and they happen to be chartered accountants, advocates, economists, agriculturists, small-scale industrialists and co-operators. Although these persons are experts in their own fields, they certainly lack the knowledge of the business of banking. It is

* Business India - August 5, 1978 P.42.
well known that many of them find their seats in the boards through political influence; and on a number of occasions, they have exhibited their poor calibre and selfish motives. It would be interesting to cite a few such instances.

One of the directors of a large nationalised bank thus happened to be an advocate practising in a taluka place. In one of the meetings he was introduced to one of the regional managers of that bank. The Regional Manager gave a brief resume of the progress made by his region in terms of deposits, advances and profitability. He thus pointed out that the deposits in his region stood at Rs.5/- crores, and that he had lent around Rs.30/- crores. The director immediately issued instruction to the Regional Manager -

"You have still Rs.20/- crores with you; lend it immediately!

Instances where the bank directors have shown selfish motives are also not uncommon. Thus, a small-scale industrialist was appointed on the board of a nationalised bank. Now, it is customary that meetings of the board are held at different places and each time, the members of the board do meet their valued clients in that place. One such meeting was arranged at a place where the director was residing. The said director was, therefore, asked to prepare a list of the valued clients of the bank in that place. The director, whose small-scale
industrial unit was located in that city then prepared the list. It was, however, noticed that most of the invitees to the tea party did not happen to be customers of that bank—they were either creditors or debtors of the industrial unit owned by the director.

g) CALIBRE OF CHAIRMAN

Lack of financial acumen is not, however, limited only to the directors. In certain cases, the chairmen are also found to be incompetent to take the decisions. The story of a chairman, narrated by a Regional Manager of one of the large nationalised banks is interesting.

During the Emergency, the posts of Chairmen were filled in an ad-hoc manner, and the necessary criteria stipulated for a full-time chairman by the Banking Regulation Act, was dispensed with. The chairman appointed for one of the nationalised banks, thus possessed little knowledge of banking. In his early career he had worked as an expert on the Management Science and of late had occupied a few top positions in public corporations. On taking charge of the bank, he, therefore, introduced his own concepts of progressive management. All the decisions he believed, out to be taken through the discussion method; and he allowed his assistants to discuss in his room, the pertinent matters relating to the bank’s business. While his deputies were discussing the
problems and suggesting solutions, the chairman kept himself silent, and picked one of the solutions suggested by his assistants. "Our Chairman" said the Regional Manager, "has no capacity to take independent decisions."

In another nationalised bank, a person who had retired from the Union Secretariat, was appointed as Chairman. He thought he was an able administrator and, therefore, addressed himself only to the personnel problems. While dealing with the staff matters, he followed the iron-handed rule which he had followed earlier in government departments and ultimately spoiled the whole atmosphere in the Bank. The earlier chairman, during his 30 years' service, had developed personal and cordial relations almost with each member of staff, and had built very good business for the Bank. But all that was done earlier was spoiled in a short time, and the reputation of that Bank built by the earlier management in the public eye was considerably reduced. The point to be stressed here is that the persons who are appointed on the boards of banks often lack the necessary business and financial acumen. Ultimately, the quality of boards, as a whole has gone down when compared with the boards prior to the imposition of social control.

h) PROBLEMS OF LENDING - SMALL BORROWERS

The most serious problem is, however, connected with the
recovery of advances. Looking to the experience the bankers have had by now, it could be said that we are moving from the principles of class lending to the principles of mass lending. It is worthwhile to highlight a few episodes either experienced by the author, or narrated to him by his fellow bankers.

As has been indicated, each bank is sanctioning loans to the weaker sections of the society. These loans are often sanctioned under the pressures from local political leaders or social workers. In a number of cases, it has been noticed that the illiterate borrowers are sent to the banks to borrow money for unauthorised purposes.

Thus, a certain unknown person Mr. X entered the branch and asked for a loan of Rs.2000/-. He claimed to be a retailer in stationery and was staying outside the municipal boundaries. On scrutiny of his application it was found that he had no licence, no cash or credit memos representing sales or purchases, and no other evidence to show that he was carrying on the said business. His application was, therefore, rejected by the Bank's officials.

In the following week, a prominent social worker visited the bank. His main purpose was to attend the funeral of another leader residing in that locality and since there was some time for the procession to start, the social leader entered
the bank. He introduced himself as a physician whose hobby was also to work in the social field. He asked the branch manager as to why the application of Mr. X was rejected, and requested to sanction the loan immediately. "I sent him to you," said the physician-cum-social worker, "because I have to recover the bill in respect of the medical treatment given to the applicant's wife."

Another person who entered the branch, introduced himself as a political leader. He did not seem to be educated but had contested and won an election of the municipal corporation. He stated further that he was a political prisoner, and had just come out of the prison. After narrating the story of his petty political triumphs, he requested the manager to sanction loans to a group of small borrowers. He agreed to sign the bank's guarantee form and said that he would come to the bank in the following week. Within a couple of days, a news item in the local press showed that he was arrested for some crime.

Besides such irresponsible leaders, there are a number of professional people who 'help' the weaker sections in securing loans from nationalised banks. They approach a newly opened branch of a bank, bring pressures on the manager, secure the loans and receive their commission. It is reported that thousands of loan accounts introduced by one single leader have now become bad.
During the past few years, the bank officials have tried to contact their borrowers for the recovery of loans, but the experience in this behalf is most unhappy. It has been noticed that the whereabouts of borrowers are untraceable, and in 9 out of 10 cases, the borrowers are found in a drunken state. These borrowers have spent the borrowed money either on liquor or gambling, or in paying off their private debts. In a very few cases, the loans have been used for productive purposes. The crux of the problem is that the branch managers who have known the misutilisation of money cannot stop the loans to the weaker sections. The central offices of banks which are answerable to the Reserve Bank of India and the Banking Department are interested in increasing the number of accounts and the amount outstanding. A constant flow of circulars is, therefore, directed to the branches asking them to lend more to the vulnerable sections; and the branches which do not lend much are getting a firing from their higher authorities. Furthermore, they are getting firing for the poor recovery of small loans.

The irony is that the banks have been asked to step up their advances to the weaker sections so as to achieve social justice. Newspapers are also expressing their dissatisfaction at the performance of banks in this area. No practical banker would be opposed to such lending if the money is utilised for production. The need to provide finance to the neglected sectors is now fully recognised by the Indian bankers. What
is necessary is to stipulate the criteria for a small borrower. The Government should, therefore, do rethinking on this subject, or simplify the procedure followed by the Credit Guarantee Corporation of India, in paying off the claims submitted to it by the lending bankers.

The amount which has become doubtful or bad in respect of small loans, may not form even a fraction of the amount which the banks have sunk in large sick units. It has been estimated that, at the end of 1976, a sum of Rs.609/- crores was tied up in large sick units, each with a credit limit of Rs.1/- crore or more. Of this, Rs.479/- crores has been lent under the soft loans scheme of the Industrial Development Bank of India. This enormous sum is basically unrecuperable. It also includes a sum of Rs.52/- crores which the banks have sunk in the mini-steel plants.*

**SMALL SCALE INDUSTRY**

The total amount lent to the small-scale industry at the end of June 1975 stood at Rs.1,118/- crores.** Now how much of this amount is doubtful or bad is not known precisely, but experience shows that quite a large number of small-scale industrial units are facing serious problems. It is therefore, worthwhile to highlight the causes of this failures.

* Business India - August 1978 P.42
** See Table 5.9
It has been found that most of the persons who intend to start small-scale industrial units, happen to be fresh graduates in engineering. They lack the practical experience so essential to run an industrial unit. They lack the knowledge in purchases, marketing, accounting, finance and public relations. They may know the techniques of production, but they do not know how to produce it at the lowest cost and sell it for the best price. Moreover, there are several impediments which come in the way of successful operation of the unit. It should be seen how these units are established, run and why ultimately closed down.

A number of engineering graduates choose to become entrepreneurs because they wish to be masters of their own, instead of servants of somebody else. Their desire to become industrialists is partly supported by their inexperienced parents and partly by the speeches and articles about eminent people in society. The young, inexperienced minds, which are moved by such speeches and advices, therefore, decide to take up the challenges of business which are not known either to them or to their advisers.

These young men then start drawing designs and layouts of their products. With these designs they move from one big industry to another and secure orders for their products. Although the orders received by them are a large number of oral promises, some of the orders are written on the order
from, stating the schedule of delivery, mode and time of payment and so on. The young entrepreneurs who do not possess any land, workshed, machinery or tools, are thus in a position to market the products, which are yet to take a visible shape.

They are now in a position to prepare a Project Report incorporating therein the market potential and demand projections, the proposed outlay on land, shed, machinery and raw materials. The various statements showing the cost of production, personnel required and the expected wage bill, etc., are prepared; and the final report, emerging from this information is submitted to a bank.

In a few cases, the assistance of management consultants is also sought. These consultancy firms have established a standard formula of such project reports and they present all the available information in the necessary jargon. The report is then typed on the costly sun-lit bond, is well bound and submitted to the bank. The consultants get their 'professional fees' for preparing the report.

On the basis of the project report, the banks assess the technical and economic feasibility of the project. Sometimes, an additional information is asked for, and the advance is sanctioned to the entrepreneur for acquiring fixed assets as well as for working capital. The advance is sanctioned on
the most liberal terms so far as the margin money, rate of interest and the terms of repayment etc., are concerned. Some banks, with a progressive outlook, sanction advances without any margin. Thus 100% cost of project is made available so as to provide employment potential to young entrepreneurs and to boost the production in the economy.

The amount of term loans sanctioned by banks to acquire fixed assets is based on the cost of machinery, the cost of its transportation and installation etc., and the term of repayment depends upon the income that would be generated by the plant. The cash flow statement prepared by the borrower forms an important part of the scrutiny and sanction of term loans. This statement is of course, based on the assumption that the factory would be run to its full capacity, production of a high quality would be carried out in an uninterrupted manner, i.e. there are no strikes or other hindrances, that the entire production would be sold at once, and the bad debts would be realised in time.

Similar assumptions are made while computing the working requirements of a small-scale industrial unit. The period of credit allowed in that business forms the basis of financial requirements. Since this period is ranging between 30 to 90 days, it is assumed that the debtors would pay on the due date, and the borrower is accordingly allowed to hold raw-materials or inventories. The working capital
requirement, as calculated by the lending banker thus makes an allowance for holding the inventories, payment of wages and other incidental expenses for a given period.

When the credit facilities are sanctioned, the documents are executed by the borrower and the securities are charged in the bank's favour. The security for the term loan is hypothecation of machinery and equitable mortgage of land if any, and for the cash credit facility, it is hypothecation of raw material, work-in-process, finished stock and sundry debtors. When the formalities are over the borrower is allowed to avail the credit facilities.

During the initial period, the entrepreneur is able to secure order from big industries. He purchases raw materials, engages labour, and produces the goods as per design. These goods are supplied to the buyers, and credit bills are shown as outstanding debtors. Instead of paying the bills on the due dates these debtors place additional orders, and give a push to the productive activity carried on by the small scale unit. At the same time, the entrepreneur also undertakes intensive travelling campaign for securing orders. To complete these orders, raw materials are purchased on credit, and a number of bearer cheques, payable to 'self' are encashed with a view to meeting the wage bill and the travelling expenses. On the face of things, the activity seems to be smooth, and within a year's time the entrepreneur feels
that he is getting success in his new venture.

The successful entrepreneur then begins to feel that he should live according to his increased status. He gathers, at an early stage, the feigned ideas of status and begins to spend lavish amounts on certain items. He begins to add costly furniture in his residential flat, spends substantial sums on entertaining the clients, stays in five star hotels while on a business tour, and gets himself accustomed to the habits such as a glass of beer and a peg of whisky. All these expenses are met by drawing 'self' cheques on the cash credit account which is granted against hypothecation of stocks.

The friends, relatives and admirers of this young entrepreneur are indeed astonished at the success achieved by the latter in a short span of time. On the first anniversary of the unit they, therefore, congratulate the young man and wish him all success. These admirers, who are brought up among the usual middle-class traditions, certify that the entrepreneur has been successful in his industrial activity and suggest further that his next endeavour should be to marry and settle in life.

The young man follows the advice and gets married. During the first year of his marriage, and the second year of operation of the business unit, his heart is elsewhere. He
becomes still more dreamy and leaves a large part of the business to the prudence of his assistants. He still comes to the bank to encash 'self' cheques, but soon disappears for a week or two, on a pleasure trip to a hill station with his beloved. While in the city, he is always to be seen in the costly hotels or cinema houses. During the first two years of operation, he arrives at the so-called 'settled' state in business.

During this period, the lending banker keeps a close watch on the operations in the business, by means of periodical inspection. It does not, however, take him long to notice the diversion of funds for unwarranted purposes. He therefore, advises the borrower to curtail the expenses and becomes strict in passing 'self' cheques. The banker's advice is, often misunderstood, and a grudge is developed in the mind of the borrower about the bank itself.

The time is critical. The entrepreneur finds that the corporate debtors are delaying the payment beyond 120 to 150 days; and the creditors now begin to demand cash for further supplies. The long outstanding creditors begin to press for their dues. Since the cash credit limit happens to have been drawn fully, the borrower has to approach the bank and ask for an increase in the limit.

But the banker, who is closely watching the course of events,
is unwilling to allow any excess over the limit. The industrialist now finds himself in a fix. He is not able to honour his commitment in the market, and finds it difficult to pay the wage bill in time. The highly skilled workers, therefore, begin to leave the factory, leaving the Master in distress. This hampers production, and increased the proportion of rejected goods supplied to the clients. Additional wages are now to be paid for carrying out repairs to the rejected goods undermining thereby the rate of profitability. Large discounts are also allowed to the debtors for making an early payment. To overcome these difficulties, additional dose of cash becomes necessary and efforts are made once again to secure additional credit facilities from the Bank.

But the branch manager, who initially recommended the proposal happens to have been transferred, and the new manager after a careful study of the account, turns down the demand for an increased credit facility. Meanwhile, inspection of the industrial unit takes place by the Bank’s inspecting officer. He points out a number of irregularities in the account and asks the branch manager to set them right. The manager, knowing that the borrower is unable to do so, asks the latter to repay the overdue instalments in the term loan account, together with interest, and suggests further that the borrower should augment his resources in some other way. The industrialist, therefore, decides to bring in additional cash either by raising deposits from friends and relatives, or by admitting a partner who could bring additional capital.
In both the cases, however, the results are harmful. In particular, the industrialist undertakes an additional responsibility of being punctual in paying the interest on deposits, or in meeting the demands for a premature payment of deposits.

Within a period of two to three years from inception, the entrepreneur thus comes in serious financial troubles. He cannot face the business creditors, the depositors and the banker. The bank account which does not show any turnover, is classified as a sticky and stagnant account by the Bank's auditors. The borrower, who is able to secure a few cheques from his debtors, therefore, opens a Current Account with some other bank to encash these cheques. He withdraws money from this account and spends it on household expenses or personal luxury.

For some more time, he is able to pull on in this manner; but sooner or later, his account is classified as 'bad' in the records of the lending bank. When all the efforts at recovery prove fruitless, the bank is compelled to take legal action against the borrower. The possession of the assets is taken over, and finally they are sold in an auction by the bank. The entrepreneur is now freed from all botheration, and is free to find out the job of an engineer. The problem of providing employment potential to young entrepreneurs thus remains unsolved, even though the banks provide liberal
financial assistance to the technicians.

This, however, is the story of small-scale industrial units run on a proprietary basis. A slightly different experience is gained by the bankers when they happen to finance an industrial unit, run as a partnership firm.

A certain group of schoolmates happens to meet at regular intervals. Two of them happen to be engineers and the other holds a degree in commerce. All of them are employed and well placed in different concerns. Now, while discussing the close association which subsisted between them during their school career, an idea to perpetuate the old association is mooted, and they decide to start a small scale industrial unit. Since all the three are drawing good salaries in their present employment, and since all are married, leaving the jobs for the sake of the joint venture, does not seem to be viable. It is, therefore, decided to start the unit with their wives as partners. The three friends, of course, agree to devote their time and talent to the unit, after the office or factory hours.

The project report is then prepared, credit facilities are secured from a bank, machinery is installed, and production is started in due course. The bank account is operated by the lady partners, and the operating instructions given to the bank are "Any one of the partners will operate the
account for and on behalf of the firm." As the productive activity gathers some momentum, travelling for the purpose of sales promotion becomes essential. One of the friends, therefore, comes to the bank with his wife, draws a 'self' cheques and goes on a business tour. On his return, the expenses are debited to the profit and loss account of the business. This is repeated, on a different occasion, by another couple. A comparison of the expenses made by the husbands, is however, inevitable among their wives. A comparison of the time devoted by each husband to the industrial unit is also made; and somehow a feeling is developed in the mind of one of the partners, that the husbands of other partners are cheating the firm. This gives rise to suspicion and disputes, and the relations between the partners and their husbands are strained.

Each family feels that the other two are making a private gain at the expense of the firm. Eventually, all are doing the same thing, i.e. drawing on the bank account and spending the money on personal luxuries. Culmination of this distrust is reached and one of the partners gives notice to the bank asking to stop payment to the other partners. The remaining partners also issue similar notices prohibiting the former to withdraw from the account. Naturally, the account become standstill, the debit balance in the account goes on increasing on account of application of interest; and the installments of term loan are delayed.
In bigger industrial units, with a higher capital investment, and a larger number of workmen, a different problem is to be encountered. Such units suffer on account of frequent strikes and lockouts. Since in India, any seven persons can form a trade union, there is multiplicity of unions with different ideologies, union rivalries and domination by outside professional leaders. In a factory with too many unions only a part of the total labour force is working; and others are on strike, outside the factory gate. A visit to an industrial estate in each town shows a number of red flags hoisted on the factory gates, and groups of workers standing idle outside the factory campus. All these workers hope to get an increase, in the wages, dearness allowance, and bonus, irrespective whether they work and produce anything or not.

CAUSES OF FAILURE OF SMALL SCALE INDUSTRIES:

It should be stressed that the foregoing account is based on the study, observation and experience the author has had of several small-scale industrial units. During the course of this work, the working of several small-scale units was studied, a number of entrepreneurs were examined and quite a large number of bankers were consulted on this subject. The major weaknesses of the small scale industrial units, as revealed by our survey can, therefore, be summarized in a generalised form viz., -
a. Lack of entrepreneurial ability, and knowledge of accounting, marketing and finance on the part of the entrepreneurs.

b. Distrust among the partners and their competitive, rather than complementary behaviour with each other.

c. The desire of the entrepreneurs to increase the standard of living overnight, mainly through borrowed money i.e. diversion of business funds to the personal use.

d. Strained labour relations.

e. Exploitation by the corporate buyers.

Of these, the first three are human weaknesses. They exist everywhere, and more so in the Indian society. They can be removed only with the development of progressive thinking in the community. The fourth weakness again, is a problem of human relations; and arises out of the illiteracy of our industrial workers and out of the selfish motives of our trade union leaders. Improvement in the labour relations would be possible only with the training of the industrial workers and their union leaders.

The most serious problem, in our opinion, is the exploitation of the small-scale sector by corporate sector. The
very existence and progress of the small scale sector depends to a great extent on the helping hand it receives from big companies. The big companies who purchase material from the small units do not however, pay even after 120 to 150 days from the date of supply. The small entrepreneurs are, therefore, found in a tight corner throughout the year. It is worthwhile to narrate an episode, which the author has experienced in the recent past.

A couple of years ago, when the banks were facing the problem of excess liquidity, I approached a big corporate account and expressed the desire of our Bank to lend a few crores of rupees to the company. The finance executive, however, gently refused to borrow from us. "There are at present" he said, "eleven banks who have been financing us; and we do not have at present, any plan of expansion to borrow from you. If at all you want to lend your money, you may lend it to our suppliers. We would be utilising that credit by delaying the payments for the supplies we receive from them." Such an admission, in plain words, by the finance executive of a large company shows how the numerous small scale industrial units in the country are financially embarrassed. There is no doubt that the credit extended by banks to the small scale sector, is ultimately utilised by the financial giants, leaving the actual borrowers in financial distress.
During the last decade or so, the banks have been providing liberal financial assistance to the road and water transport operators. With a view to providing employment opportunities to the educated unemployed, the Government has prepared half a million jobs scheme; and the state government has set up a separate financial institution for providing the 'seed capital.' Under this scheme, any person who has passed the secondary school certificate examination, can fill in the form for securing financial assistance. He can choose any business, and can apply for a loan from a nationalised bank.

This application is then forwarded by the financial institution to one of the nationalised banks of the borrower's choice. The sanction of the loan is entirely left to the discretion of banks. If a bank sanctions a loan, it advances 75% of the cost of the project; The borrower has to bring in 15% of the cost of the project; as capital, and the remaining share of 10% is released by the financial institution as 'Seed Capital'. It has been the experience of banks that the applications which they receive from the financial institution are not processed at all. They are simply forwarded with a cyclostyled covering letter addressed to the Bank. On a through scrutiny it is noticed that -

a. The borrower has no experience of the business he proposes
to start. Most of the young boys who have just attained 18 years of age, wish to purchase a truck at a cost of Rs. 1,40,000/- and work as transport operators.

b. The demands for loans are fabulous in relation to the needs of the business.

c. They are unable to contribute the capital.

d. The recovery of loans is poor.

e. There are cases of double financing.

The following experiences would substantiate our observations:

In an application which was received through the financial institution, the borrower wanted to start a book-stall. The proposed shop was to be started in Bhavani peth, the area where wholesale market in gur, sugar, pulses, and corn is concentrated. He wanted to sell text-books of schools and colleges and his annual turnover in the first year was projected at Rs. 6/- lacs. The borrower hoped to sell text-books worth Rs. 50,000/- in May, when all the students are on the summer vacation, and nobody wants to read any book. It is needless to say that the application of this over-confident bookseller was rejected by the bank.
A similar application was received by one of the local branches of our bank through the financial institution. In a discussion with the borrower, the branch manager suspected that the borrower had borrowed money from some other bank. Within the next two days he, therefore, inquired with other banks and it was confirmed that the borrower had done so. The borrower had also taken the seed capital from some other financial institution. Our manager, therefore, rejected the application and returned it to the financial institution.

Surprisingly, one of the officers of the financial institution, called on the bank manager and asked the reasons for rejection. The bank manager told the facts to the officer, and stated that the loan was rejected to avoid the loss of the seed capital, which the financial institution might suffer unknowingly in the case of the same borrower. "Why unknowingly" said the officer, "we are doing it knowingly also".

The government financial institutions seem to have developed a strange but a progressive theory of lending. A person can start any business out of the borrowed money, can spend the money extravagantly on personal luxuries; and when he proves a failure in that business, he can reapply and get the seed capital once again. The Government financial institutions really seem to have taken a very broad view of forgiving the prodigal with an open heart. They should, however, remember
that the loss suffered by the bank and the financial institution is in the proportion of 75:10 respectively, and the banks cannot think of lending again to a borrower who has caused a loss to the bank in an earlier transaction.

FAILURE OF AGRO FINANCE:

The experience of bankers with regard to the financing of the agricultural sector is perhaps most unhappy. It would be interesting to outline the factors that retard the smooth financing of agriculture and other allied activities. The crux of the problem lies in the new structure that has evolved in our rural areas during the past quarter of a century. A close examination of this structure would explain the reasons responsible for poor recovery. The new structure in rural India consists of three tiers, viz.,

a. The affluent farmers and sugar kings,
b. The small farmers and
c. The landless labour.

Of these, the affluent farmers own vast lands, ranging between 200 to 600 acres each. This land does not come under the purview of legislation on ceilings, because it was prudently parcelled among sons etc., long before the legislation was enacted. They own all the agricultural equipment, including a number of vehicles such as jeeps and cars. Farming is
carried out on a commercialised basis, and the income of these affluent farmers runs into six to seven digits. Over the past twenty-five years or so, they have accumulated vast wealth, partly because the income from agriculture was exempt from Income Tax for a long time, and partly because the agricultural labour is very cheap on account of the sizeable population of landless labour. A large section of this class enjoys vast financial power, and exercises profound influence over the other two classes; viz., small farmers and landless labour. This has enabled them to occupy seats in the boards of directors of sugar co-operatives. The whole group of directors exploits the small cane suppliers in a number of ways, and uses the finances of the sugar factory in its own way. The group, controlling the factory, may be called the 'sugar-kings'.

The sugar-kings also involve themselves in active politics, and capture seats in the District Central Co-operative banks, Zilla Parishads and Taluka Panchayat Samitis. The more powerful among them of course, contest the general elections, and become MLAs or MPs. The whole class of affluent farmers has secured a large portion of agricultural credit provided by the nationalised banks and it is regrettable to say that the experience of banks in this behalf is most unsatisfactory. It will suffice to state that a number of suits filed against the affluent borrowers are pending in the courts. It would be interesting to state a few cases to show how
they have cheated the banks.

One of the affluent farmers, who exercised considerable influence over the small farmers, took hundreds of small farmers to a nationalised bank in his locality. He made them apply for loans, and brought pressures on the bank manager and his higher management to sanction the loans. The amount of all such loans was disbursed by the bank in the individual names of small farmers; but it was noticed at a later stage that the entire amount was utilised for construction of an air-conditioned theatre owned by the affluent farmer.

The experience of sugar factories is still worse. One of the factories thus requested a bank to sanction loans for the purchase of trucks. These trucks were required for the purpose of transportation of sugarcane and sugar. Accordingly, the loans were disbursed and the chassis were purchased. But while building the body on the chassis, they were converted into the tankers for transportation of petrol. All this was done without the knowledge and permission of the bank.

In another factory, loans were sanctioned to a number of small farmers for growing sugarcane; and the factory had undertaken to deduct the amount from the canegrowers' bill and remit the same to the bank towards repayment of the loans. Later on, one of the directors requested for a personal loan which was refused by the bank. The result was that the Board
of Directors of the sugar factory passed a resolution stating that no co-operation be extended to the bank in the recovery of its loans.

The story of small farmers, who have borrowed money from banks, is equally unhappy, but on different account. It has been found that the recovery of these loans is difficult and in many cases, almost impossible. Many innocent and poor farmers have deceived the banks in the following ways; It has been noticed that -

a. the loans were taken in feigned names,

b. the loans were also obtained in the names of the deceased persons and

c. the persons who have guaranteed the loans also do not exist.

The range of misutilisation of farm credit is also very wide. It is reported that -

a. The farm animals which were to be purchased out of loans, were not bought at all;

b. The farm equipment, said to have been purchased also did not exist on the spot.
c. If it existed, it was hypothecated to two banks,

d. The wells which were to be dug, did not exist at all.

e. While supplying the equipment such as pump sets etc., the suppliers have overinvoiced the equipment so as to enable the borrowers to escape the payment of the margin money.

The dishonest tendency among quite a few of the rural folk, is also noticed when the bankers go out for recovery. They have to listen to the same excuses, viz.,

a. The borrower has gone to a nearby village for the weekly bazaar.

b. He has gone to another village to attend a marriage or funeral,

c. He has gone to the farm.

The borrower happens to hide himself in the standing crop. The prudent bankers, who have had enough experience of such excuses, have learnt to find out their borrowers at certain places. Rural customs require the heirs of a deceased, to arrange a lunch to the close relatives and nearby people, on the occasion of a death. The bankers have therefore, to
catch their borrowers on such occasions so as to obtain letters of acknowledgement of debt.

The number of suits filed in the courts is also growing. The decisions on the cases filed in 1971-72 are now out, and the decrees are passed in favour of the banks. The banks are however, finding it difficult to execute the decrees, because of the rigid nature of the security. If an auction of the mortgaged land is arranged on a certain date, arrangements are made by the borrowers in such a way that no bidder can dare to come forward to bid in the auction. On the other hand, the bankers have to run away so as to save their links and lives.

1) LOW MORALE OF BANKERS:

This, however, is only one side of the experiment of agricultural finance. On the other side, the level of integrity prevailing in the banking community is also diminishing. A number of branch managers working in rural areas have been found guilty for the breach of integrity. A branch manager thus joined hands with the supplier of pumps. The sets of documents, which were to be executed by the borrower were handed over to the supplier. The supplier used to get the documents executed by the borrowers, unknown to the bank. Each lot consisted of 30 to 40 sets of documents, and all the loans were disbursed by the bank. The total amount of
the loans was paid to the supplier who in turn, used to
distribute it among the borrowers. In this process, the
supplier paid much lesser amount to the borrowers. A large
portion was also deducted as the application money for the
shares of a sugar factory, which was yet to be started.
Above all, he did not supply the oil engines for which the
loans were made. It is reported that the profits were shared
by the two – the manager and the supplier.

Another branch manager who sanctioned agricultural loans up-
to rupees three crores, is reported to have made a lot of
money without the assistance of a middleman. On his dismis-
sal from the bank’s service, the manager started a night
club in the same town. The morale of the many rural branch
managers has thus gone down considerably. Indian banking
in the post-nationalisation period thus provides innumerable
cases of lack of honesty and low morale among the managers.

J) WORRIES OF BANKERS SUMMED UP

When judged in quantitative terms, the structure of the Indi-
an banking system appears to be strong, sound, diversified
and well knit. Beneath this structure are, however, hidden
several problems like dwindling profitability, political
interference and the growing frustration among bankers. A
wave of pessimism, therefore, pervades the minds of the
Indian commercial bankers from top to bottom.
k) HOW ARE BANKERS VIEWED:

The government on its part is also taking a lenient view of this problem. Their thinking in this regard is quite different. They are happy to see that the nationalised banks are somehow opening rural branches, are somehow mobilising deposits, and are somehow making paper profits, by lending money to the agriculturists and the neglected sectors. The Government is satisfied to see that it has fulfilled its pledge to the voters. The general public looks to the bankers from a different angle. They think that the bankers sit in magnificent glass cabins, are well paid, and therefore, have no worries. Neither the government nor the general public is, therefore, in a mood to listen to the worries of the bankers. The Reserve Bank of India on its part, solves the problems of banking through committees, but no committee has so far been appointed to inquire into the problem of motivation of the bankers.

RECOMMENDATIONS — (i) AVOID DIRECT FINANCE TO AGRICULTURE:

With a view to pointing out the worries of the lending bankers, we have already brought some of the problems to the forefront. We now propose to recommend certain lines of action which would help the development of Indian commercial banking on sound lines.

Our first recommendation relates to the field of agricultural
finance. Most of the countries have regarded this field as unsuitable for lending by the commercial banks. It has been pointed out that the traditional function of commercial banks is to provide short-term working capital to trade and industry, and financing of agriculture is no business of banks. This argument is based on two points. In the first place, the security offered in agricultural advances is very rigid, and the bankers have always thought it imprudent to lend upon mortgages. It is said that to be a good banker, one must know the difference between a mortgage and a bill of exchange. In the second place, the success in agriculture is always uncertain on account of the natural factors. The traditional bankers have, therefore, kept this field, outside the purview of bank lending.

We do not advocate a complete disassociation of agro-finance from the purview of bank lending. We only feel that direct financing of agriculture is unsuited to the commercial bank lending. The banks still do not have proper procedures, techniques and trained staff in this field. During the past few years the banks have recruited several agricultural graduates in their staff; but it has been noticed that these graduates lack the knowledge of economic and business principles. They know the types of soil, rotation of crops, methods of manuring and harvesting; and various diseases affecting the crop but they lack the basic knowledge of the business of banking. This category of staff has not been of
as much use, as it was expected to be. The banks are on the whole, lacking in trained staff that could handle the portfolio of agricultural finance satisfactorily. It is, therefore, recommended that the banks should be relieved of their responsibility of providing direct finance to agriculture.

SUITABILITY OF INDIRECT FINANCE:

We however, recommend indirect financing of agriculture by the commercial banks. Banks may thus finance the distribution of seeds, fertilizers, pesticides, and other agricultural inputs and agro-equipment. They can also finance wholesale and retail trade in agricultural commodities. They may increase the tempo of indirect financing by subscribing to the debentures floated by land mortgage and district central or state co-operative banks. The banks can even go to the extent of providing term finance in an indirect way. This could be achieved by subscribing to the debentures floated by the Agricultural Refinance Development Corporation or the Agricultural Development Bank of India.

ii) RESPONSIBILITY OF CO-OPERATIVE BANKS:

We feel that direct financing of agriculture is better suited to the co-operative credit structure. Direct financing should, therefore, be entrusted to the three-tier machinery, comprising state co-operative banks at the apex level, district
central and land-mortgage banks at the district and taluka level, and the primary co-operative credit societies at the village level.

Suitability of co-operative banks arises mainly out of their lower operating costs. The costs which they have to incur on premises, furniture, stationery and staff, are lower than the costs incurred by commercial banks. Since the branch expansion by co-operative banks is cheaper, they should be encouraged to open branches in the rural areas, so as to provide direct finance to the agricultural sector. Another advantage with the co-operative banks is that they have been in this field for a long time, and over all these years, they have built up machinery for the appraisal, disbursement and recovery of agricultural loans. The managers of co-operative banks are certainly better acquainted with the intricacies of agro-finance than the commercial bankers.

The most distinct advantage has, however, been conferred on the co-operative institutions by the co-operative law. Thus under Section 19 of the Co-operative Societies Act, 1912, a co-operative society gets a first charge on the security even if it happens to lend subsequently. The legitimate right of having a prior claim on the security is thus denied to other lenders, who happen to have lent previously. This legal advantage available to the co-operative banks would enable them to administer the agro-finance more effectively than the commercial banks.
In view of the several advantages available to them, the district central co-operative banks should be entrusted with the provision of short and medium term finance to the Indian agriculture; and the area of term finance should be earmarked for the land mortgage banks.

While recommending the field of agro-finance for the co-operative banks, we are aware of the limitations of the co-operative movement. The co-operatives suffer, mainly from inadequate capital and reserves. The size of deposits mobilised by them is also very small, even though they are allowed by law, to quote higher rates of interest on deposits than the commercial banks. We are aware that the slender resources mobilised by the co-operatives would not enable them to finance the needs of agriculture. Their heavy drawings on the Reserve Bank of India would not also enable them to meet the credit demands of agriculture. We therefore, suggest that the resources of the co-operative banks be strengthened by a certain proportion of funds earmarked for agricultural sector, from the commercial banks.

STRENGTHENING RESOURCE OF CO-OPERATIVE:

The commercial banks may, therefore, be asked to set aside a portion of funds, to be diverted to the co-operative banks. The banks need not transfer their funds directly to the co-operative banks; but they can transfer the funds to a
centralised pool. The funds incoming to this pool may be managed by a separate organisation. In its functions and administrative set up this organisation would be quite akin to the Industrial Development Bank of India (IDBI). It may, therefore, be called the Agricultural Development Bank of India (ADBI). The ADBI would be responsible for the entire realm of agricultural finance in India. It should procure funds from commercial banks, or can float its own debentures. It may also draw on the Agricultural development (Stabilisation) Fund, and the National Agricultural Development (Long Term Operations) Fund, maintained by the Reserve Bank of India.

FINANCING NEGLECTED SECTOR BY URBAN CO-OPERATIVE BANKS

Our second recommendation relates to the provision of finance to the neglected sectors. We feel that this field is suited to the urban co-operative banks in the cities, and the district central co-operative banks operating in district and taluka places. During the last decade or so, there has been a mushroom growth of urban co-operative banks in most of the cities. These banks lack the necessary capital and deposit structure, to deal with big business. They are therefore, engaged in small and sundry business. Such banks can strengthen their resources by drawing on the nationalised banks, in the form of debentures. It is observed that the cost of the personnel engaged by these banks is lower; and hence their cost of
operation is smaller than the cost incurred by the big banks; in handling a large number of small accounts. The small loans would then become viable.

A note of caution is, however, essential. While dealing with the loans to be extended to the neglected poor, the banks should ensure that the credit extended by them results in an increase in employment, production, incomes and the standards of living of the poor. Money, in other words, should be lent for production, and all consumption loans should be stopped forthwith.

**AVOID CONSUMPTION LOANS**

A dangerous tendency which the consumption loans are likely to produce is well explained by the Iron Law of Wages. The higher classes in any society have learnt to advance their standard of living by limiting the size of their families; but the poor have continued to be poorer on account of the large size of their families. Poverty in India, is therefore, going to increase manifold, and no amount of bank credit will serve as a corrective to the problem of poverty. As the great Cambridge economist has remarked, "we cannot change the world which is poor and unjust into the world which is rich and just."* It would, therefore, be unreasonable to expect the banks to relinquish poverty by granting consumption loans to the poor.

The chief merit of our recommendations is that we have assigned the functions to different types of banks according to their nature. We wish to reiterate that the function of commercial banks is to provide short term working capital to trade and industry; and that of the co-operative banks is to cater to the needs of agriculturists and the neglected sectors. Provision of term finance is, of course, the province of the term lending institutions. To ask the commercial banks to lend directly to agriculture would, therefore, spell danger.

Briefly, our recommendations can be shown on the following diagram:
ELIMINATION OF OUTSIDE INTERFERENCE:

Our third recommendation relates to the smooth lending operations in banks. In order to enable the bankers to base their decisions on economic viability of the scheme and the credit-worthiness of the borrower, the bankers should be given full freedom in assessing the proposals. In other words, interference from the political and social leaders should be stopped forthwith.

IMPROVEMENT IN QUALITY OF BANKERS:

Last but not least, we recommend that the quality of people to be appointed as Directors of nationalised banks, should be improved. The government should give up the old practice of appointing people, who have lost their seats in the politics. The quality and calibre of the persons should be tested by the Reserve Bank of India, before such persons are nominated as directors of banks. It should not be difficult for the Reserve Bank of India to evolve some criteria for selection and appointment of directors on the boards of nationalised banks.

CONCLUSION:

We believe that our recommendations are practical; and they can be implemented after a detailed study. We have no doubt
that they would contribute to the development of the Indian banking system on sound lines. The problem of frustration, and of providing motivation to the bankers is of course, a human problem. The human mind can never be satisfied even if any amount of incentives are provided. It is also very difficult to measure the unhappiness of the bankers in quantitative terms, and to provide the incentives accordingly. Nevertheless, we can create conditions and atmosphere in which the bankers can function more freely and smoothly.

The bankers are supposed to be honest and men of status in the society. That is why, the public at large, entrust their precious money to the banks for safe-keeping. The feeling of safety which the society at large derives is due to the fact that we have been able to maintain their confidence in us. Since the whole business is based on public confidence, we will not do even a slightest injury to it by lending their money recklessly. We would like to continue to enjoy our privileged position as the trustees of public funds. Inspite of the woe in our heart, we are making a headway in promoting the economic development of our country. We would do our best in disbursing the money in alignment with the national priorities. We might give up the traditional security-oriented approach to lending, but we should never give up the test of viability of the banking institutions. We should, therefore, see to it that every advance proposal is economically viable, and that it contributes to the growth of nation income.