CHAPTER 7

CONCLUSION

The study documents the long-term trends in financial intermediation by the principal player in Kerala’s credit system i.e., banking. The process of financial intermediation by the banking system, involving mobilisation of deposits from savers and disbursal of credit to investors, is considered to be crucial in the process of economic development. Among the indicators of the two way banking intermediation in a region or country, the ‘credit-deposits ratio’ is taken to be a readily available one.

Review of the historical growth of the State’s banking sector has brought out the existence of a relatively better banking infrastructure in Kerala particularly in the erst-while Travancore and Cochin States. The credit-deposits ratio of the commercial banking system during the period was quite high, implying better disbursal of credit or use of it within the region. The relatively better position of the region in banking infrastructure and the accompanied financial intermediation process is attributed mainly to the commercialisation of agriculture and other sectors that the region experienced during the period. The years noted for greater dynamism in the commercialisation process during the pre-independence period coincided with the spurt in the growth of commercial banks, indigenous institutional forms like chitties/kuries, etc. These institutional forms of finance developed largely in those areas where the commercialisation process was buoyant.

Developments in the land tenure system in the region also contributed to this. Consequent to the progressive land reform measures, there took place relatively better distribution of land in the Travancore and Cochin regions during the pre-independence period. It was also accompanied by an active land market. Land, being the primary form of asset, the relatively better diffusion of it in the region helped the emergence of credit market. This, together with the generation of surplus from commercial agriculture and trade helped the processes of financial intermediation.
Malabar, unlike Travancore and Cochin, was characterised by greater concentration of land and poor development of the land market. Both, in turn, prevented the emergence of a credit market there, the same extent. The commercialisation in Travancore and Cochin during the period was also accompanied by relatively better physical infrastructure, development of transport in particular, and social services and they too in turn further facilitated the emergence of financial superstructure in the region. With regard to this too, the position of Malabar was much behind.

Though the demand for both credit and instruments of saving followed these diverse processes in Travancore and Cochin, of the two the more important one was that of credit. Thus chitties/kuries and commercial banks emerged primarily to meet the credit gap that the commercialisation process brought with it. Being so, the C-D ratio, remained quite high. Not only the financial intermediation by the banking system was quite symmetric, but more importantly, the banking growth seems to have a symbiotic relation with the productive sectors of the economy.

The historically better C-D ratio of Kerala’s banking system could be seen during the more than one and a half decades since the early ’70’s also. The value of the C-D ratio remained fairly high for the period as a whole. It was ahead of all India average for majority of the years. However, there took place a significant break in the trend of the financial intermediation by the SCB system during the year 1987-88. The State, witnessed a persistent and sharp fall in the C-D ratio of its SCB system since then and the ratio reached a very low level over the one and a half decades. Compared to all India, the value of the ratio in the State has turned out to be much lower. Given the significance of the C-D ratio as a measure indicating the banking system’s role in an economy, the falling C-D ratio of the SCB system has attracted much public attention. Regarding the causes and consequences of the phenomenon, a good number of perceptions are being popularly held or hypotheses are being suggested. Kerala’s banking system, being embedded with the national banking framework, the falling tendency of the C-D ratio is taken to be indicative of outflows of financial savings to outside the State through the banking channels. Their operations in the State are blamed for helping to funnel resources to other regions/States and the latter is taken to be contributing to the falling tendency of the phenomena.

The study provides evidence to the fact that the decline in the C-D ratio of the SCB system that the State witnessed over the years is nothing unique; rather, it is an all-India
phenomenon. Being so, the popular perception that the falling C-D ratio in Kerala would imply drain of financial resources to other regions is not borne out from our study. As the C-D ratio of other States too was low, these States had no need to extract funds from Kerala.

The experience of the State in the falling tendency of the C-D ratio, however, stands out because the phenomenon of declining C-D ratio has started in the State relatively earlier and has been much sharper. The steadier and the much steeper fall in the ratio in Kerala, as compared to all India situation, signifies the State-specific factors, apart from the national economic policies in the making up of the receding C-D ratio in the State.

During the period noted for higher C-D ratio ie; prior to the late '80s, the trend growth of deposits as well as credit was quite impressive and was relatively higher than the corresponding all-India trend. The declining phase of C-D ratio, compared to the earlier phase, was characterised by marginal improvement in the deposits growth and significant fall in credit growth. Being so, the fall in C-D ratio during the '90s, was more an aftermath to the lower credit growth.

The falling C-D ratio, looking differently, may imply asymmetric/lopsided financial intermediation by the banking system, where the credit disbursal function of the banking system fails to catch up with its deposits mobilization function. Apart from credit disbursal, the commercial banking system injects funds in the State through its investment in State government securities and associated bodies. Adding these investments with the credit disbursal by the SCB system does not make much difference to the total disbursal of funds in 

The marked deceleration in credit growth during the '90s was also being experienced by co-operative banking system. As there was relatively higher growth in co-operative bank's deposits, the C-D ratio of the co-operative system too had fallen during the '90s. The falling tendency of the ratio in the co-operative system also negates the contention that the commercial banking system operating in the State funnel resources from State and thereby contribute to lower credit use in the State.
The deceleration in credit growth that the banking system experienced could also be found with the credit disbursal activities of the All-India Development Financial Institutions. Given the backwardness of the capital market in the State, the fall in the credit growth of the above three financial intermediaries implies poor credit disbursal by the organised financial system as a whole in Kerala. Looking differently, it implies the emergence of lop-sided financial intermediation in the State.

The trend growth of the State economy during the '90s was much better than that of the earlier period. The growth in the State during the period was better than the corresponding all India growth too. Higher C-D ratio coinciding with slackness in economic performance during the '70s and '80s and vice versa during the '90s may signify lack of association between banking and economic variables in Kerala. Between credit and deposits, the degree of dissociation seems to be more with regard to credit. In India also, the unmatching growth behaviour of the two kinds of the variables was visible, but compared to the State, it was at a lesser degree. Better economic growth coinciding with deceleration in credit disbursal by the banking system in particular and the organised bank credit system in general would imply disintermediation by the banking system or growth of financial intermediaries other than banking intermediaries.

Apart from International trade, the region witnessed yet another mode of outward orientation - marked increase in migration over the years. Progressive increase in migration, particularly to Gulf since the mid '70s, was followed by substantial inflow of remittances to the State. Remittances from Gulf may partly explain the better deposits mobilisation by the SCB system from the mid'70s. The NRI deposits have shown much increase in Kerala over the years and now it accounts for about half of the total SCB deposits in the State. The share of it in total SCB deposits in India, compared to Kerala, is much lower. Also, its share in the State is showing a declining trend in recent years.

While the deposits linked to the external sector have shown much improvement over the years, the domestic deposits, notwithstanding the better performance of the economy during the '90s, have grown at a less impressive manner. The unmatching growth trends between the two may tend one to doubt about the degree and nature of association between the economy's performance and domestic deposits in recent years. Alternative asset forms including co-operative bank deposits, life insurance policies, post office saving deposits, chitties, etc. seem to have bearing on this. Institutions offering these assets have shown
dynamism during the '90s. Within SCB deposits, there took place significant shift in the term-wise composition of deposits. Term deposits have assumed much higher proportion in total deposits.

The fall in overall credit growth was felt in all the three broad sectors of the economy. Comparing the three sectors, the tertiary sector experienced better credit growth. Hence while the other two sectors show considerable decline in their share in credit, the share of service sector in credit improved. In India also, such a shift in the share of credit could be seen. The position of the State, however, was way ahead in the share of service sector credit and way behind in industrial credit. When the growth trends of credit to the key sectors are put against the backdrop of the growth trends in the corresponding economic sectors, lack of correspondence is found for all the three sectors. Among the sectors, however, the degree of inconsistency differs. It was more in industry than in the other two sectors, viz. service sector and agriculture.

In terms of the most commonly used indices i.e.; SCB agricultural credit per head and, per gross cropped area and also SCB agricultural credit as a ratio to agricultural income, the position of the State, compared to all India, is found to be better. Compared to the '80s, these indices declined during the '90s and hence the margin between the two got thin. The higher credit needs of perennial crops with long gestation period may be one of the reasons for the State’s better position in agricultural credit. Structure of agricultural credit by the SCB system shows increasing significance of indirect credit. Term wise structure of the same indicates the growing importance of short-term credit. Such a tendency of higher significance of short-term agricultural credit could also be seen with the co-operative credit system. The lower proportion of medium and long-term agricultural credit in Kerala while looking against the increased importance of commercial crop cultivation in the region is rather puzzling. This may be attributed to the lack of mechanization, lower provision of minor irrigation facilities to agriculture, etc.

Within the total SCB industrial credit, manufacturing accounts for the predominant share in both Kerala and India. Though the non-manufacturing industrial sector has made progress in their relative share over the years, their significance is still negligible. Considering the industrial sector as a whole, the unmatching growth behaviour between
banking and the corresponding economic subsectoral variables was more pronounced in the case of subsectors like construction, electricity, water, etc.

Within manufacturing credit, SSI sector assumes relatively higher proportion in Kerala. Though Kerala's share in total industrial credit in the country is rather poor, the share of the State in all-India SSI credit is fairly good. Given the relatively much higher significance that the SSI sector enjoys in manufacturing credit in Kerala, the large and medium scale industries emerge as one of the crucial factors explaining lower absorption of credit in the industrial sector. The trend of credit growth in this sector shows slight improvement during the '80s, but it was followed by decelerating tendencies since the late '80s. Not only the relative share of the large and medium manufacturing sector is very low, but also the size of credit to the sector is much below the all-India standards. The trend of SCB credit to medium and large-scale industries seems to be following the performance trend of institutions providing long term loans to set up new projects and to modernize existing ones. In fact, the credit disbursal activities of AIFIs is worse than that of commercial banks. This may be one of the factors responsible for the fall in SCB manufacturing credit in the State. The lower credit absorption by the industrial sector shall be attributed to the smaller size of industry in general. The explanation also lies with the lop-sided industrial structure in the State. The State's industrial sector is characterised by the predominance of food and agro-based industries noted for their asset light nature and hence relatively lower demand for credit for working as well as fixed capital.

Though the SSI sector accounts for a larger share in Kerala, its relative significance too is coming down over the years. SSI credit is now showing a pattern similar to that of large and medium scale industries. Hence the overall credit to manufacturing sector has come down. The falling tendency of manufacturing credit, particularly to small-scale units, coincides with the buoyancy of the sector during the period. However, the SSI sector in the State is found to be subject to high degree of sickness.

Disaggregate analysis of SCB credit to tertiary sector shows the growing significance of personal loans. In the share of total tertiary sector credit, it is followed by trade, the miscellaneous category 'others', loans for professional services and transport in their order of importance. The subsectoral growth trend of tertiary sector activities, in its turn, shows increasing significance of non-tradeable service sectors. While loans to transport operators, professional services and a significant portion of personal loans meet
the credit needs of the emerging non-tradeable sub-sectors, the overall SCB credit growth in
the non-tradeable sub-sectors has been less than what could be expected from their
buoyancy and their relative significance in the economy. Partially it can be attributed to the
significance of community development and public administration in the income originating
from tertiary sector. A more plausible reason may be found in the increasing dominance of
skill intensive rather than capital intensive service sector. Yet another reason can be found
with the relatively higher significance of nonbanking financial intermediaries including
chitties in the State. Notwithstanding the relatively much higher interest that they charge for
their loans, these intermediaries are resorted to considerably by traders, and transport
operators- two potential credit users in the service sector. The credit disbursal practices of
the NBFIs, especially their flexibility is quite befitting the requirements of these two sub
sectors. It is the inadequacy of bank credit disbursed to these activities and their lack of
flexibility that gives the non-banking financial intermediaries the elbowroom to operate.
The prevalence of these institutions to a significant extent in the State would point at the
credit potential existing in the State and the same in turn would undermine the defense by
the banking system that the credit absorption capacity of the State is lower and they fully
meet the credit requirements in the State.

Spatial structure of SCB development shows the difference in socio-economic
conditions among sub-regions/ districts. These differences are reflected in their C-D ratios.
Historically, Kerala witnessed unevenness in banking growth among the regions,
particularly between Travancore- Cochin and Malabar. The unequal growth among the
regions in banking infrastructure growth and financial intermediation still persists. Between
deposits and credit, greater degree of skewness among the districts was found with the latter
and within that, with respect to the distribution of SCB industrial credit. It goes in
conformity with the inter district variation in industrial growth in the State. Districts, which
are noted for relatively higher industrial development, maintain better C-D ratio.
Agricultural districts also have better C-D ratio. But these districts have lower share in
deposits and credit of Kerala. While it is so with them, Pathanamthitta and Trichur, two
districts noted for higher incidence of migration experienced very low C-D ratio and it gives
evidence to the belief that migration and the resultant remittances play a crucial role in
bringing down the C-D ratio
Summing up, our analysis of the trend of financial intermediation by the banking system emerging in Kerala has established its asymmetric nature, characterized by higher deposit mobilization in relation to credit disbursal. The asymmetric growth behaviour is found not only between banking variables alone, but more significantly between banking and economic variables too. Diagnosis of the ingredients of growth of deposits and credit indicates that while the former was mainly consequential to outward orientation in the form of migration, the lower growth of credit was the net outcome of lower credit disbursal or credit use in almost all the sub sectors of the economy. While doing the analysis, our focus was to spell out how the nature of emerging financial intermediation in Kerala is and where the incongruous growth behaviour between banking and economic variables has taken place. Indeed, an exercise of this may partially throw light on the question of why the nature of financial intermediation has got asymmetric. The latter question of why the process of financial intermediation has turned out to be lopsided is still remains to be focused and addressed in detail. It requires further research taking into account not only economic, but historical and political factors, which have bearing on the nature of financial intermediation.