INTRODUCTION AND RESEARCH DESIGN

1.1 Introduction

The financial policy in India is influenced by the objective of restoring sectional balance within credit disbursement and for channeling to the weaker sections within these sectors. Priority sector bank lending has been an instrument of this financial policy. The Bank Company Acquisition Act 1969 leading to the Nationalization of the 14 commercial banks has implicitly made it clear in its preamble.

“The banking system touches the lives of millions and has to be inspired by larger social purpose and has to sub-serve national priorities and objectives such as rapid growth of agriculture small scale industries and exports raising employment levels, encouragement of new entrepreneur and development of backward regions. For this purpose it is necessary for the Government to take direct responsibility for the extension and diversification of banking services and forth working of a substantial part of the banking system”.

There has been a substantial reorientation of banking policy after the nationalization of banks in 1969. This has been accomplished through social orientation of banking and administrative intervention by way of stipulating targets, sub-targets, credit guarantee and refinance facilities for financing the preferred sectors of the economy known as priority sectors, where agriculture, small industries, small
business and small transport operators, retail traders and education were given priority status.

1.2 **Need for Priority Sector Lending**

The objectives underlying the priority sector lending relate to ensuring the assistance from the banking system flows in an increasing measure to those sectors of the economy which though contributing significant proportion of national product have not received adequate support of institutional finance in the past. This inter-alia implied flow of required funds to various sectors of the economy in accordance with the national planned priorities. The social control on banks was imposed as a measure to employ prudently and socially desirable channels with the objective of achieving economic growth combined with stability and social justice.

Even decades after independence, more than 70 percent of borrowing by cultivators was from informal sector. Lending from commercial banks was directed towards large industrial houses. Agricultural sector, small scale industries and weaker sections were more neglected because of both risk factor and urban bias. Although co-operative sector was there to serve the needs of agricultural sector it was unable to meet the credit demand of farm community. There was a need for ensuring an equitable and purposeful distribution of credit keeping in view relative priorities of developmental needs.
1.3 The Thrust Areas of Priority Sector Lending

The edifice of the priority sector lending that has emerged in the period after the nationalization of banks in 1969 is based on the following pillars.

1. The system of priority sector lending has envisaged setting up of targets and sub-targets for financing of specific sectors. The share of priority sectors in total banks advances is 40 percent. Sub-targets for agriculture and weaker sections are fixed at 18 percent and 10 percent of total advances respectively.

2. The interest rate policy under priority sector and non priority sector has been stipulated. Concessional rates of interest for the priority sector advances and relatively higher rate of interest for other sectors have been special features. This is known as cross subsidization policy. Here the losses arising on concessional loans are met out of the profits from other loans. This has facilitated flow of credit to the weaker sections of the society and neglected sections of the economy at relatively lower rates of interest.

3. Financing of loan accounts under priority sector may entail risk of default. Hence a separate insurance scheme guaranteeing a part of the loan of commercial banks was introduced in 1970 and the DICGC of India was established. The Corporation also provides deposit insurance to the depositors up to a prescribed limit. The Corporation operates various credit guarantee schemes relating to guarantee support to eligible credit institutions for
their priority sector advances to small borrowers and small scale industries.

4. Priority sector lending implies deliberate diversion of funds of the banks from the other sectors and that too at lower interest. To mitigate the ill effects of this on bank resources and on profitability the schemes of refinance were formulated by NABARD in particular. Its advances about 42% to 45% of the ground level rural credit disbursed by banks.

1.4 Changing Criteria of Priority Sectors

In the post nationalization of 14 commercial banks in 1969 period the Reserve Bank of India was compelled to lay down targets for lending to specified sectors. Each major bank was given targets for lending to these sectors. A more comprehensive definition of priority sector was adopted in 1977. These were mainly in terms of sectors. It was realized in the early 1980s that even within priority sectors credit flow was more to the affluent sections. So the concept of weaker section was adopted within priority sector. It was categorically stated that the maximum benefit should be available to these weaker sections. By 1980s definition and quantitative targets had fully crystallized.

There emerged the political interference to make use of these developments for vote bank politics for misuse of credit. As a result neither banking institutions nor the neglected sectors and sections were benefited. Thus the priority sector lending was effected. Financial sector reform became imperative. Thus the Narashimhan Committee
suggested for bringing down the priority sector target from 40 percent to 10 percent. This was not accepted by the Government.

1.5 The Pre and Post Reform Period

Following are some of the major features of priority sector targets and classifications.

- Targets of 40, 18 and 10 percent of net bank credit for total priority sector credit, sub targets of agricultural and weaker sections respectively remain same in both the periods.

- Targets of 12 percent of export credit and 10 percent of SSI credit have been introduced for the foreign banks which were not there earlier even for domestic banks.

- In the pre-reform period agricultural credit was earmarked directly for farmers but majority of whom, were small and marginal farmers. Agricultural credit was mainly for agricultural purposes, production, storage and transportation of agricultural or allied product.

- In the post reform period ceiling of short term credit to be considered under priority sector has been increased to Rs. 1 lakh. Earlier credit to plantation crop was restricted to only small and marginal farmers, but it is given irrespective of size.

- In the category of direct advances to agriculture new acquisition of jeeps, pick up vans, mini buses, etc., have been included. These naturally will not be acquired by small and marginal farmers.

- Indirect finance to agriculture was not a part of priority sector target earlier. Now finances to dealers, commission agents, non-
banking financial companies, state electricity board and investing in selected bonds and depositing in apex level are not going to help farmers directly.

- Inclusion of food and agro processing in the priority sector will give impetus and boost up the production of food crops.
- Scope of small business under priority sector has been expanded to include business under enterprises with original cost price of equipment used for the purpose of business up to Rs. 10 lakhs from Rs. 2 lakhs earlier.
- Professionals like accountants and solicitors are included in priority sector. These are not employment generating activities. They do not belong to weaker sections either.
- Transport and road network are included in priority sector.
- Housing was earlier exclusively for very poor segments. Now the ceilings up to Rs. 5 lakhs which can very well cover requirements of middle class people even in urban areas.
- Education loan is considered under priority sector loan. Similarly consumption loan too is covered by priority sector credit.

The above changes in the post bank reform era have led to the following aspects of priority sector credit by banks as of March 2001.

a) Agriculture (direct and indirect)

b) SSI (including the setting up of industrial estates and covering units with original cost of plant and machinery not exceeding Rs. 10 million)
c) Small business (original cost of equipment used for the business not exceeding Rs. 1 million and a working capital of Rs. 50,000)
d) Small road and water transport operators owning 10 vehicles.
e) Retail trades (up to Rs. 50,000)
f) Professional and self employed persons (up to Rs. 50,000)
g) State sponsored organizations for scheduled castes and scheduled tribes.
h) Education (educational loans granted to individuals)
i) Housing loan (direct and indirect) upto Rs. 50,000.
j) Consumption loan under the consumption credit scheme for weaker sections.
k) Refinance by banks to RRBS.
l) Micro credit (direct and indirect)
m) Software industry (up to Rs. 10 million)
n) Agro and food processing sector and
o) Venture capital.

1.6 Priority Sector Lendings by Commercial Banks Blockwise Allocation Plan – Haveri District

The Haveri District Credit Plan for the period 2008-09 to 2011-12 provides some significant trends for the seven blocks relating to the 7 talukas of the district. The following table provides the details.
<table>
<thead>
<tr>
<th>Year</th>
<th>Byadagi</th>
<th>Hanagal</th>
<th>Haveri</th>
<th>Hirekerur</th>
<th>Ranebennur</th>
<th>Savanur</th>
<th>Shiggaon</th>
<th>District Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>45.67</td>
<td>80.43</td>
<td>98.03</td>
<td>63.63</td>
<td>105.31</td>
<td>40.51</td>
<td>52.65</td>
<td>486.23</td>
</tr>
<tr>
<td>2009-10</td>
<td>80.18</td>
<td>71.42</td>
<td>97.69</td>
<td>80.95</td>
<td>130.82</td>
<td>43.98</td>
<td>64.75</td>
<td>569.79</td>
</tr>
<tr>
<td>2010-11</td>
<td>84.71</td>
<td>95.35</td>
<td>138.76</td>
<td>97.25</td>
<td>149.18</td>
<td>56.22</td>
<td>59.16</td>
<td>680.64</td>
</tr>
<tr>
<td>2011-12</td>
<td>77.62</td>
<td>93.45</td>
<td>156.71</td>
<td>113.75</td>
<td>188.02</td>
<td>55.32</td>
<td>67.66</td>
<td>752.53</td>
</tr>
</tbody>
</table>

• The priority sector loans allocation for all the seven blocks (talukas) have gone up continuously during the 4 years from Rs. 486.23 crore in 2008-09 to Rs. 752.53 crore in 2011-12.

• Blockwise a trend of continuous rise in the priority loan allocation is observed in case of Haveri, Hirekerur and Ranebennur. However in case of other 4 blocks a trend of small variation in the amount of priority sector loan allocation during the 4 year period is observed.

• Priority sector loan allocation in case of Ranebennur block is much higher compared to the other 6 blocks. Other blocks where the allocation of priority sector loans are substantial, are Haveri, Hirekerur and Hangal as could be seen from the figures in the above table. Further it is clear that priority sector loan allocation is relatively much lower in case of Savanur, Shiggaon and Byadagi blocks compared to other blocks.

1.7 Bankwise and Sectorwise Credit Plan 2011-12 Priority Sector Loans in Haveri District

The involvement of different groups of banks in priority sector lending for different sectors in Haveri district provides some significant trends during the latest year 2011-12. The following table provides the details of priority sector loans provided by (1) Commercial Banks, (2) KVG Bank, (3) Cooperative Banks (DCC/PACARD) and (4) KSFC. These banking institutions have been providing priority sector loans to (1) Agril and Allied Activities, (2) SSI and Non-Farm Sectors and (3) Other Priority Sectors. The following table provides the details of priority sector loans to the above sectors.
Table-1.2
Vijaya Bank, Lead Bank Office, Haveri

Summary of District Credit Plan 2011-12, Haveri District

(Amt. in Lakhs)

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Institutions</th>
<th>Agril &amp; Allied Activities</th>
<th>SSI &amp; NFS</th>
<th>Other Priority Sector</th>
<th>Total Priority</th>
<th>Percentage Share</th>
<th>Non Priority</th>
<th>Grand Total</th>
<th>Percentage Change over DCP 2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Commercial Banks</td>
<td>29102</td>
<td>2550</td>
<td>8598</td>
<td>44470</td>
<td>59</td>
<td>3391</td>
<td>47861</td>
<td>48</td>
</tr>
<tr>
<td>2</td>
<td>KVGB Banks</td>
<td>17588</td>
<td>325</td>
<td>2448</td>
<td>20361</td>
<td>27</td>
<td>4370</td>
<td>24731</td>
<td>-6</td>
</tr>
<tr>
<td>3</td>
<td>Co.op Banks (DCC/PCARD)</td>
<td>8982</td>
<td>508</td>
<td>81</td>
<td>9571</td>
<td>13</td>
<td>106</td>
<td>9677</td>
<td>-77</td>
</tr>
<tr>
<td>4</td>
<td>KSFC</td>
<td>-</td>
<td>850</td>
<td>-</td>
<td>850</td>
<td>1</td>
<td>850</td>
<td>850</td>
<td>41</td>
</tr>
<tr>
<td>5</td>
<td>Total Amount</td>
<td>55672</td>
<td>4233</td>
<td>15347</td>
<td>75252</td>
<td>-</td>
<td>7867</td>
<td>83119</td>
<td>9</td>
</tr>
<tr>
<td>6</td>
<td>Total No. of Accounts/Units</td>
<td>120247</td>
<td>3658</td>
<td>7844</td>
<td>131749</td>
<td>-</td>
<td>15527</td>
<td>287276</td>
<td>99</td>
</tr>
</tbody>
</table>

Commercial banks are at the forefront in supplying maximum amount of priority sector loans compared to other banking institutions in the district of Haveri. These different institutions provided a total amount of Rs. 44470 lakhs of priority sector loans in 2011-12. This amount of priority sector loan constituted 59 percent of the total loan advanced by them during the year which stood at Rs. 47861 lakhs. The total loan provided by commercial banks was higher by 48 percent over the previous year 2010-11.

Karnatak Vikas Grameen Bank which is the Regional Rural Bank in the area provided a total amount of priority sector loan of Rs. 20361 lakhs which accounted for 27 percent of its total advances during the year 2011-12.

Cooperative Banks including the DCC Bank and PACARD provided a much lower amount of priority sector loan of Rs. 9571 lakhs during the year 2011-12 which amounted to 13 percent of their total advances.

Karnatak State Financial Corporation too provided priority sector loan of Rs. 850 lakhs amounting to 1 percent of its total advances during the corresponding period.

The total amount of priority sector loans provided by the different banking institutions during 2011-12 was Rs. 75252 lakhs. Total number of loan accounts under priority sector loans in the district covered by these banking institutions came to 131749 during 2011-12.
1.8 **Sectorwise Distribution of Priority Sector Loans – 2011-12**

All the banking institutions involved in priority sector lending in Haveri district have provided maximum amount of loan to Agriculture and Allied Activities compared to the other priority sectors. The total amount of loan provided by these institutions to this sector amounted to Rs. 55672 lakhs in 2011-12 in Haveri district. Small Scale Industries (SSI) and Non-Farm Sectors (NFS) were provided with a total loan of Rs. 4233 lakhs. The banking institutions provided a total amount of Rs. 1537 lakhs to other priority sectors during the year 2011-12. The total amount of priority sector loans by these financial institutions in Haveri district in 2011-12 was Rs. 131749 lakhs compared to non-priority loans of Rs. 15527 lakhs.

1.9 **Sectorwise Distribution of Priority Sector Loans in Haveri District – 2007-08 to 2011-12**

The data relating to various priority sectors receiving credit from the banks in Haveri district gives a very comprehensive and extensive details about the amount of credit availed of by these sectors during the 5 years from 2007-08 to 2011-12. The sector receiving the loans relate to,

I. **Agriculture**

- Crop Loans
- Minor Irrigation
- Land Development
- Farm Mechanization
- Plantation and Horticulture
II. Allied Activities to Agriculture

- Dairy Development
- Poultry
- SGP
- Others

III. Non-Farm Sector

IV. Other Priority Sector

The details of the amount of loan availed of by these sectors from the banking institutions in Haveri district are provided in the adjoining table.
### Table-1.3

**District Credit Plan at a Glance (Rs. In Lakhs)**

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Sector</th>
<th>Plan for</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2007-08</td>
</tr>
<tr>
<td>I</td>
<td>Agriculture</td>
<td>26364</td>
</tr>
<tr>
<td></td>
<td>Crop Loans</td>
<td>19717</td>
</tr>
<tr>
<td></td>
<td>Minor Irrigation</td>
<td>1356</td>
</tr>
<tr>
<td></td>
<td>Land Development</td>
<td>444</td>
</tr>
<tr>
<td></td>
<td>Furm Mechanization</td>
<td>3591</td>
</tr>
<tr>
<td></td>
<td>Plantation &amp; Horticulture</td>
<td>1028</td>
</tr>
<tr>
<td></td>
<td>Others</td>
<td>228</td>
</tr>
<tr>
<td>II</td>
<td>Allied Activities to Agriculture (AH)</td>
<td>1144</td>
</tr>
<tr>
<td></td>
<td>AH – Dairy Development</td>
<td>670</td>
</tr>
<tr>
<td></td>
<td>AH – Poultry</td>
<td>54</td>
</tr>
<tr>
<td></td>
<td>AH – SGP</td>
<td>57</td>
</tr>
<tr>
<td></td>
<td>Others</td>
<td>363</td>
</tr>
<tr>
<td>III</td>
<td>Non Farm Sector</td>
<td>1237</td>
</tr>
<tr>
<td>IV</td>
<td>Other Priority Sector</td>
<td>11489</td>
</tr>
<tr>
<td></td>
<td>Total Priority Sector</td>
<td>40234</td>
</tr>
<tr>
<td></td>
<td>Non Priority Sector</td>
<td>5159</td>
</tr>
<tr>
<td></td>
<td>Grant Total</td>
<td>45393</td>
</tr>
<tr>
<td></td>
<td>Of Which Govt. Programmes</td>
<td>9595</td>
</tr>
</tbody>
</table>

Source: Haveri District Credit Plan – Vijaya Bank Lead Office, Haveri.
The details in the adjoining table reveal the following major trends.

- Agricultural sector has received maximum amount of priority sector loans during the entire period of 5 years from 2007-08 to 2011-12. Crop loans have accounted for major share of the priority sector loan under agriculture followed by farm mechanization, minor irrigation, land development and plantation and horticulture.

- Sectors allied to agriculture have received next largest amount of priority sector loan. Of these, dairy development, poultry, SGP and others have received major share of priority sector loans.

- Non-farm sector has received third largest amount of bank credit under priority sector loans.

- It is significant to note that there is a continuous rise in the amount of advances made by the banks to different sectors under priority sector lendings during the 5 years from 2007-08 to 2011-12.

The total priority sector lendings by banks rose from Rs. 40234 lakhs in 2007-08 to Rs. 75252 lakhs in 2011-12 in Haveri district.

1.10 Bankwise Priority Sector Lendings in Haveri District

The six commercial banks covered by the study have provided a substantial amount of loans to priority sectors in Haveri district during the years from 2008-09 to 2011-12. The following six commercial banks provided priority sector loans as indicated in the adjoining table.
Table-1.4
Bankwise Credit Plan for the Year 2008-09 to 2011-12

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Banks</th>
<th>2008-09 (000’s)</th>
<th>2009-10 (000’s)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>TAgri</td>
<td>NFS/SSI</td>
</tr>
<tr>
<td>1</td>
<td>State Bank of India</td>
<td>470368</td>
<td>13510</td>
</tr>
<tr>
<td>2</td>
<td>State Bank of Mysore</td>
<td>323935</td>
<td>7770</td>
</tr>
<tr>
<td>3</td>
<td>Canara Bank</td>
<td>376510</td>
<td>11200</td>
</tr>
<tr>
<td>4</td>
<td>Syndicate Bank</td>
<td>297950</td>
<td>14080</td>
</tr>
<tr>
<td>5</td>
<td>Vijaya Bank</td>
<td>184840</td>
<td>2730</td>
</tr>
<tr>
<td>6</td>
<td>Karnatak Bank</td>
<td>25608</td>
<td>4500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Banks</th>
<th>2010-11 (000’s)</th>
<th>2011-12 (000’s)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>TAgri</td>
<td>NFS/SSI</td>
</tr>
<tr>
<td>1</td>
<td>State Bank of India</td>
<td>5825</td>
<td>1823</td>
</tr>
<tr>
<td>2</td>
<td>State Bank of Mysore</td>
<td>4268</td>
<td>303</td>
</tr>
<tr>
<td>3</td>
<td>Canara Bank</td>
<td>3230</td>
<td>276</td>
</tr>
<tr>
<td>4</td>
<td>Syndicate Bank</td>
<td>3904</td>
<td>94</td>
</tr>
<tr>
<td>5</td>
<td>Vijaya Bank</td>
<td>2617</td>
<td>219</td>
</tr>
<tr>
<td>6</td>
<td>Karnatak Bank</td>
<td>751</td>
<td>61</td>
</tr>
</tbody>
</table>

Source: Haveri District Credit Plan – For Different Years from 2008-09 to 2011-12 – Vijaya Bank – Lead Bank Office, Haveri.

Note: T Agri – Total Agricultural Credit; NFS/SSI – Non Farm Sector/Small Scale Industries; OPS – Other Priority Sector; TPS – Total Priority Sector
The details in the adjoining table indicate the following trends regarding the priority sector lendings.

- State Bank of India has led the other 5 commercial banks in providing maximum amount of priority sector loans.
- Canara Bank has provided second largest amount of priority sector loans during 2008-09 and 2010-11.
- State Bank of Mysore provided second largest amount of priority sector loans in Haveri district in 2011-12.
- Syndicate Bank ranked second in 2009-10 in terms of the total amount of priority sector loans in the district.
- Vijaya Bank provided larger amount of priority sector loan compared to Karnatak Bank during the period from 2008-09 to 2011-12.
- There has been a continuous increase in the amount of advances made by all the six commercial banks under the priority sector lendings during the period from 2008-09 to 2011-12.

1.11 Issues and Implications of Priority Sector Lendings

Priority sector lendings by banks both in terms of amount and sectoral distribution does give an impression that flow of credit to this sector has come down substantially despite expansion of scope / areas of priority sector definition. A good number of public sector banks are not able to reach the prescribed target of lending to agriculture and weaker section. The small and marginal farmers continue to be credit constrained.
Consequent to the introduction of reforms in financial sector the banks began to step down the target for priority sector credit. Priority sector lendings have invited arguments against the policy of the RBI and the Government of India in this direction. They relate to rising interest income loss, low recovery, affecting profitability and fund recycling capacity of public Sector banks. Further arguments against the priority sector lending relate to higher administrative cost and risk of delivering credit and the mounting NPAS of priority sector loan accounts. All these issues and the problem of viability of priority sector lending by banks have been discussed in the next chapter of the thesis.

1.12 Need for Research and Statement of the Problem

The social objective of nationalization of commercial banks was to concentrate more attention on the remote, backward and hilly areas of the country and on the higher to neglected sectors of the society, such as agriculture small and cottage industries, marginal farmers, landless labourers, SC/ST, self employed persons, village artisans, small traders, needy students and exporters. The post nationalization period witnessed a phenomenal increase in the operations of commercial banks in India particularly for the benefit of the higher to neglected sectors namely the priority sector. However some of the sub-sectors under the priority sector still remained neglected. They got a negligible share of the total finance secured by the priority sector out of the total credit advanced by commercial banks.
The priority sector lendings by the commercial banks are further constrained by some other inadequacies. Misuse of funds by some borrowers under the scheme and misdirection or diversion of funds to unproductive directions has been indicated by a few studies. Further the credit absorption capacity of a few borrowers has been found inadequate. There are the problems of inadequacies on the part of commercial banks in the administration of priority sector advances. A few banks have been faulted in the identification of right type of customers as beneficiaries under the priority sector lendings. Further the quality of supervision in the post disbursement period is poor in case of some commercial bank leading to accumulation of overdues. There is a general trend of opinion among the official of the commercial banks that high level of Non-performing Assets (NPAx) of commercial banks is largely due to directed credit like the priority sector lending.

The above issues of inadequacies associated with the priority sector lending by the commercial banks need a proper and an in-depth study for ascertaining the extent to which these inadequacies have been persisting with the scheme implementation by the concerned banks and if found vindicated the extent to which the constraints are affecting the scheme of priority sector advances to the beneficiaries. This major issue led the researcher to take up the present research study. Further case studies in the area of priority sector by the commercial banks in the study area have not been done. Hence the need for the present research was felt by researcher. The
study is an attempt to analyze and evaluate the implementation and the impact of the priority sector lendings in the study area. Hence the research study is stated as under “Priority Sector Lending”, by commercial Banks – A Case Study of Haveri District.

1.13 Objectives of the Research Study

The research study has the following objectives:

1. To study the growth trends of the priority sector loans advanced by commercial banks to different categories of beneficiaries in the study area.
2. To examine procedural aspects of priority sector advances to the borrowers by the selected commercial banks in the study area.
3. To evaluate the utilization of loans by the borrowers under the priority sector lending by the selected commercial banks in the study area.
4. To assess the supervision and recovery aspects of priority sector loans provided by commercial banks in the study area.
5. To evaluate the impact of priority sector advances on the borrowers.

1.14 Hypotheses

The researcher has framed the following hypotheses relating to the priority sector lending by commercial banks in the study area.

1. Larger volumes of priority sector advances by commercial banks are made to farm sector.
2. The priority sector advances of commercial banks have not reached the targets during the last five years.
3. Borrowers have diverted the funds advanced by commercial banks under priority sector lending.

4. There is a positive impact of priority sector loans on the borrowers.

5. Priority sector loans advances are inadequate leading to additional borrowing from private sources.

6. Utilization of loans under priority sector is considerably low among borrowers.

1.15 Limitations

The study is conducted with the following limitations.

1. The study is confined to commercial banks in one district only. Hence the findings may not hold good for the banks in other districts with different socio-economic environment.

2. The number of commercial banks covered by the study is restricted to a total of 15 branches in the district for the intensive study of operations relating to priority sector lendings.

3. The total number of respondent borrowers is 150 with 10 borrowers each from the 15 branches covered by the study. The responses of these borrowers may not necessarily be similar with those borrowing from other branches / banks in other areas.

4. The data on the annual lendings is restricted to a period of 5 years only.
1.16 Methodology

The research study is an empirical survey. The research is carried out covering two types of respondents viz., (i) Bank official involved in the bank operations relating to priority sector lendings and recovery and (ii) borrowers of the commercial banks covered by the study. Personal interviews were held with the selected bank officials and the selected borrowers under the priority sector lendings in the study area. The information has been collected as per the well structured questionnaires addressed to the respondents. The questionnaires addressed to the bank officials and the borrowers have been prepared keeping in view the objectives of the research study.

1.17 Selection of the Area

The study covers all the seven talukas of Haveri district of Karnataka State. The district is predominantly agricultural oriented. However places like Haveri, Byadagi, Ranebennur are good commercial centers in the northern part of Karnataka state. The district is well served by good number of branches of commercial banks. The researcher selected the district for his research work on grounds of proximity to his work place and his familiarity with the economy of the district for the last many years.

1.18 Selection of the Banks

A total number of 15 commercial bank branches have been selected for an intensive study of the priority sector lending by the branches of the 6 commercial banks covered by the study.
Three branches (3) of each bank have been selected taking the total to 15 respondent banks in the district. The selected commercial banks are (1) Syndicate Bank, (2) Canara Bank, (3) State Bank of India, (4) State Bank of Mysore, (5) Vijaya Bank and (6) Karnataka Bank. Of these six commercial banks Karnataka Bank is the private commercial bank while the other five are public sector commercial banks.

Talukawise the branches of different commercial banks are selected for the study as specified below.
2. Hirekerur – Canara Bank and State Bank of India
3. Ranibennuru – Carrara Bank and State Bank of India
4. Shiggaon – Vijaya Bank and Canara Bank
5. Byadagi – Syndicate Bank and State Bank of Mysore
6. Savanur – Karnataka Bank and Vijaya Bank
7. Hangal – Karnataka Bank and Vijaya Bank

1.19 Selection of Respondent Borrowers

A total number of 150 respondent borrowers under the priority sector lendings by commercial banks have been selected for personal interviews relating to their borrowing and repayment aspects. A sample of 10 respondent borrowers, have been selected for each branch of the commercial bank covered by the study. Thus the total number of respondents selected from 15 branches is 150.
1.20 Sources of Information

The data is collected from both the primary and secondary source. The primary data is collected from the sample respondents of 150 borrowers belonging to different categories of priority sector. The information was solicited through a structured questionnaire on different aspects of loans under the scheme. Personal interviews were held with the selected borrowers and the veracity of the data was cross checked through searching questions.

The secondary data was collected from published sources of the respondent banks like their annual reports and balance sheets, etc. Other sources of secondary data included the publications of Reserve Bank of India, NABARD, etc. Reports of Committees and other government publications on banking and priority sector, etc., were referred to.

1.21 Data Analysis

The data collected from the primary and secondary sources has been computed and presented in suitable statistical tables. The same have been analyzed and interpreted to draw suitable inferences and conclusions.

The researcher has used simple statistical tools like percentages, average and growth indices, etc. Charts and graphical representations have been provided to highlight some significant trends.
1.22 Review of Literature

A good number of studies have been made by academicians, bankers and other experts in the area of banking and credit development in general and the priority sector lending in particular. A good number of research papers have been published providing sufficient amount of insight into the area of priority sector lendings by commercial banks in India.

The researcher has made a review of some of the research publications on the priority sector lendings which have a direct bearing on the present study and reviews have given necessary information and knowledge on the research topic.

Rajaram Dasgupta in his paper “Priority Sector Lending Yesterday, Today and Tomorrow” has advocated a new approach to priority sector lending. Suggesting among other things the reduction of mandatory credit to a larger number of sectors and section, including marginal farmers, cottage industries, small trade and services and low income housing. The Author has pleaded for incentives to improve credit flow to small scale industries and food crop agriculture as well as temporary credit to assure to new industries and new professions by the non-poor sections.

Commenting on the Narasimhan Committee suggestion for bringing down the priority sector target from 40 to 10 percent the author has observed that as expected the suggestion was not accepted and approved by political masters. Target of 40 percent was not touched, but monitoring of the fulfillment of target was not taken
seriously in the post reform period. There is a regular revision of priority sector list. It includes both new sectors, new segments and the entire focus of priority sector is lost. The author has been critical when he says that politicians, bankers and even central banking authorities seem to be happy as all are able to serve their own interests. He has extorted that a new approach is needed to ensure flow of credit to ‘priority’ sector for the benefit of banking industry, people and the economy.

**D.N. Ghosh** in his article “Bank Profitability and Priority Sector Lending - From Populism to Impressionism” has observed that the curtailment of the target of priority sector lending to 10 percent as urged by the committee on financial system (Narasimhan Committee) will send an unfortunate signal to the dispensers of credit that the basic objective for which priority sector lending was developed being diluted. The author comprehends that policy makers in developing countries will from time to time find that they have to reconcile conflicting objectives, but they can not afford to let crucial economic agents such as banks and financial institutions, choose the easy way out of such situations.

**K.V. Patel and N.B. Shete** in their article “Priority Sector Lending by Commercial Banks in India – An Overview” have made an analysis of the priority sector lending by scheduled commercial banks between 1959 and 1980. They have analyzed the lendings both in terms of the volume of loans (year wise) and the share of different priority sectors in the total outstanding advances. The trends in
priority sector advances outstanding and share of different states in the priority sector advances etc are other aspects analyzed by the authors.

Based on their study the authors have observed that the analysis of the priority sector advances by the commercial banks gives mixed feelings quantitatively a very impressive coverage is achieved. They have however mentioned that qualitatively a very impressive coverage is achieved. They have however mentioned that qualitatively it raises the issues of quality of lending, cost of services and the tempo to be maintained in future. It is these areas in which the opinions and perceptions differ. Therefore it deserves the attention of the agencies and executives who are involved in this.

T.R. Bishnoi in his article “Policy Constraints and Banks Profitability Impact of Priority Sector Credit” has examined the impact of priority sector credit on public sector banks profitability during 1974-1986. The author has referred to the interest subsidy rates on credit to priority sectors, income loss and its impact on banks profitability etc. His findings have revealed that interest subsidy rates varied across the priority sectors and increased over the period. The author has found that the absolute interest income loss to public sector banks in increased from Rs. 33.44 crore in 1974 to Rs. 607.39 crore in 1986 due to combined effect of increase in interest subsidy rates and rise in the amount of priority sector credit. He has further observed that both the income loss rates are substantially higher than the profitability ratios in all these years and difference between them
has increased. The author has suggested that in view of these finding the entire gamut of priority sector scheme and system of credit delivery needs to be reviewed and revised in order to have some trade off between social and commercial considerations of priority sector credit.

K.M. Shahajahan in his paper “Priority Sector Bank Lending Some Important Issues” has perceived priority sector bank lending as an active instrument of our financial policy with an aim to restore sectional balance within credit disbursement and to channel credit to the weaker sections within these sectors. The author has however observed that banking sector reforms initiated as part of the priority sector lending policy to halt. The author has mentioned that the position of the poorer states in regard to priority sector targeting has been done by linking to total bank credit rather than to bank deposits.

Nitya Chakravarty in his article “Credit Policy and Priority Sector Lending” has objective of making banking system to provide for exemption of credit to agriculture and small industry in place of what was regarded oligopolistic situation where the system served mainly the rich in the urban and industrial sectors.

The extension of the geographical spread of banking was given prime importance because it acted as an instrument of deposit mobilization on the one hand and the provision of credit to the resources remaining-after meeting the statutory requirement (CRR and SLR) had to be apportioned between competing users in the country. The need for diverting an increasing proportion of credit to
sectors important for the national economy in terms of their contribution to growth of employment generation and broadening the base of income distribution was felt.

The author has rightly identified that agriculture small scale industry and small enterprise generally represented what came to be regarded as the priority sector expressing the concern about the inadequacy of credit to the priority sector. The author has mentioned that the real problem in priority sector lending is the lack of availability of timely credit. He has suggested for strengthening the resource position of the banks in rural areas. He has supported the view of standing committee of finance of Lok Sabha that the question of SLR and CRR should be thoroughly gone into to enable banks to plough more funds in the priority sector. He has stressed the need for making the banks to perform well and the bank should be able to identify good quality small scale industries that have potential for profit. The author has stressed the need for making the banks to perform well and the bank should be able to identify good quality small scale industries that have potential for profit the author has stressed the need for adhering to the norms of 40 percent lending to the priority sectors.

Satya Sundaram in his article “Priority Sector Lending: Problems and Remedies” has observed that all is not well with the priority sector lending. The political climate is undermining the efficiency of banks. He has made a scathing remark that Government
is forcing the banks secretly and unofficially to lend to those priority sector borrowers who do not meet the banking criteria.

Mr. Sundaram has indicted the banks in ignoring the need of the poor for the consumption credit. He says that one of the neglected areas in priority sector lending is consumption credit. He asserts that unless the borrower is physically strong he cannot undertake economically viable activity. The author suggests that consumption loan should be treated in relation to production loan. Another suggestion made by the author is to finance groups engaged in a similar activity in order to realize results from the loans granted.

The author has stressed the need for sanctioning priority sector loans to borrower only after improving their skills through training so that, they can use loans productively and repay them. He has also suggested linking the products with marketing and introducing business consciousness among artisans and other small units. The author has favoured for indirect financing of priority sector borrowers though unions like weavers, cooperatives and handloom development corporations, dairy cooperative, etc., instead of direct financing so that credit administration, supervision and recovery are easier. He has advocated for strengthening institutional framework for the successful implantation of priority sector lending by banks.

**P. Ganeshan** in his paper “Impact of Priority Sector Advances on Profitability Public Sector Banks in India” has reexamined the observations of economists and bankers about the erosion of profitability of public sector banks due to priority sector advances. He
has emphasized the fact that concessional interest rate, the subsidy rate and credit outstanding to priority sector, have increased over the years. He has referred to the amount of interest income loss in 1974 at Rs. 34.12 crores which went up to the maximum of Rs. 973.25 crores in 1990-91, but declined to Rs. 108.24 crores in the year 1998-99. He has mentioned that the income loss ratios are substantially higher than the profitability ratio and the difference between them have increased. The author has referred to a significant fact that consequent to the introduction of reforms in financial sector the banks began to step down the target for priority sector and thus there was decline in the income loss ratios, which subsequently increased the profitability ratios thus establishing the fact that priority sector advances, concessional lending and cross subsidization of advances affected the profitability of Indian public sector banks.

Jayantilal Jain in his article “Towards a New Approach to Priority Sector Lending” has presumably argued that the Indian banking scene after liberalization in regard to the priority sectors is not likely to be significantly different in view of the paramount importance and needs of these sectors. Although one may expect changes in subsidy administration, concessional rates of interest and cross subsidization, stipulation of targets and sub-targets, rural structure of bank, etc.

The author has made reflections on the estimates of cost of funds and rate of return on priority sector lending. He presumes that a crucial issue relates to that of provision of risk cost and transaction
cost. The author says “if we take the estimates of transaction cost based on the average as found in the costing exercise of banking services, it works around 3.03 percent. However as per the report of the Agricultural Credit Review Committee the transaction cost would be around 6%. If transaction cost is worked out on the basis of present sectoral deployment of credit in banks. It is estimated to be about 4.35 percent. Thus we see that it varies from 2.9 percent to 6 percent and the extent of loss will also very depending on the rate assumed.

The author contends that no matter what method we use, it is not always possible to show that lendings under priority sector yield reasonable profits under most reasonable assumptions and also to prove that such lending do not result in losses for banks”.

**R.K. Pandey**a in his article “Priority Sector Financing Better Management Required” has commented that although there is a significant growth in directed credit / priority sector over the years by the commercial banks, lot remains to be done towards some of the neglected sectors such as exports, education, rural housing, consumption loan, etc. The author has expressed the view that the Narasimhan Committee recommendation of reducing priority sector landing to 10 percent of the bank credit had to be given a second thought particularly in view of the still unfulfilled social objective of bank nationalization. Mr. Pandey has observed that to overcome the problem of some of the disheartening features such as alliances, neglect of under banked north eastern states, Commercial banks
must step up their efforts in managing, mobilizing deposit, advanced directed (Priority sector) credit particularly weaker sections and remote areas of the country. The author perceives that the urgent necessity is not reducing the present share of priority sector credit from 40 to 10 percent but better management and of increasing operational efficiency and productivity of commercial banks by staff.

S. Ramachandra Rao in his article “Priority Sector Advantages - Evolution and Monitoring” has indicated the difficulties of monitoring the qualitative aspects of priority sector lending. It involves proper pre sanction appraisal of every loan which is not becoming possible due to the large number of small loans. Quality can improve only if the loans are properly given. The author mentions that the loans are target oriented and as they are coming up mostly during the last quarter of the financial year, the loans become poor quality loans and the skeleton staff at the rural branches will not find time to check up the end use of credit and nor can they recover the loans successfully. Further the author has referred to the unsatisfactory rate of recovery of loans. Over dues are mounting. The author feels that surveys of beneficiaries of priority sector advances could be conducted by bank and corrective measures should be taken on the basis of the findings of such studies.

The author has felt the need for redefining the priority sectors. He elaborates that priority sector advances at low rates of interest should be given only to the weaker sections and not to the affluent under the label of priority sector. This will help banks to improve
monitoring and supervision of these advances on the weaker sections and their own profitability.

V. Rangaswamy and A. Subbaiah in their paper “Analysis of Performance of Financial Agencies in Priority Sector Lending Under the Lead Bank Scheme in Kamarayar District by Using Kruskal-Wallis Test” indicate that performance differs significant results. The conclusions are indicated here.

1. The results of the Kruskal–Wallis Test indicate that performance differs significantly among the agricultural sector and the industries sector. The performance of public sector commercial banks is relatively poor in lending to agricultural sector.

2. The performance of private sector commercial banks is good and that of Pandain Grameen Bank is poor in lending to the industries sector.

P.C. Sarker and T.G. Nayak in their study “Patterns of Credit Outstanding in Priority Sector – A Regional Analysis” have made an analysis of the regional pattern of credit outstanding of the scheduled commercial banks in the priority sectors at two selected points of time i.e., June 1985 and March 1990. The findings of the study have been used by the authors in arriving at the following implicit implications.

- Specified credit targets can be achieved if laid down clearly for each bank.
- The regional balancing of credits can also be stated in quantitative terms for banks as a whole. This would be possible since Indian banks have branches all over the country in fairly good measure.
The authors have suggested that it is necessary to see that the All India character of branch banking is maintained to achieve regional balancing of bank credit.

**K.V. Patel and N.B. Shete** in their paper “Some Aspects of Recovery of Loans of Weaker Sections Under Priority Sector Lending” have observed that the repayment behavior aspects of the loans given to the weaker sections brings out very positive aspects of borrowers willingness to repay and banker’s promptness in making efforts for the recovery.

The authors have indicated that the recovery performance of loans in priority sector and more so in weaker sections is a function of two variable viz., incremental income from the activity financed by the bank and continuous supply of bank credit. The authors have concluded that all the partners in the development process viz., credit suppliers, credit users and suppliers of other inputs i.e. credit facilitators have very important role in fulfilling these conditions for effective recovery.

**N.B. Shete** in his paper “Priority Sector Advances of Banks during the Post Reform Period” has presumed that the priority sector agriculture finance at present is at cross roads. It suffers from a dichotomy in purpose and direction growth and accelerated food demand. Dynamic and conflicting changes appear to be operating in curtailing the current supply of priority sector credit while at the same time, financial requirements of agriculture and other activities are increasing in rural areas. The author has referred to National
Agricultural Policy announced by the Government of India which states progressive institutionalization of rural credit will be contained for providing timely and adequate credit to farmers, particular attention will be paid to removal of distortions in the priority sector lending by commercial banks for agricultural and rural sectors.

**D. Raja Sekhar and Vinod Vyasulu** in their paper “Half Life of Credit Simulating Fund Flows in Priority Sector” have observed that while some liberalization in lending policies seems desirable, the guidelines of 40 percent loans to the priority sector must continue for the present. Such lending will not remain unviable at reasonable levels of recovery. The authors have further opined that with more professional functioning, the banks can maintain a recovery rate of at least 90 percent through better lending with reference to the quality of credit, productively increases can help contain costs and protect margins, thus enabling banks to remain viable and over time become profitable.

**Veeresh M. Kummu** in his work on “Profitability of Commercial Banks in the content of Socio-Economic Objective” stressed the importance of earning a reasonable return by the commercial bank for the savers and supply of funds to investors and generate adequate margin for itself after covering cost of services. Profits provide caution to the bank, support its credit risks and withstand any unforeseeable developments. The author has referred to the fact that a profit making bank can infuse confidence in public.
Commercial banks in India have been drained of their profitability since their nationalization due to money, social obligations stipulated by the RBI and the government of India.

Yong Sarah Zhou in his IMF working paper on Capital Flows and Economic Fluctuations: The Role of Commercial Banks in Transmitting Shocks has rightly perceived that the task of exploring the critical role of the banking system transmitting external financial shocks to domestic economic activities is extremely important for emerging market economy. Banks play a particularly important role in financial intermediations and the banking channel therefore is of particular significance as a conduit for domestic and foreign shocks.

The author has tried to highlight the significance of the role of commercial banks in the context of the Asian financial crisis during the 90s. The analysis considers the sudden capital outflow, which occurred in 1997 just prior to the crisis as a negative shock to the productivity of the banking sector as this shock drives up the cost of providing banking services. This shock according to the author is transmitting via the channel of lending spreads that banks charge to the firms and households. The increased lending spreads hit firms which rely on bank credit to hire labour to produce output, thus decreasing output and employment. On the demand side the increased deposit spread raise the effective price of consumption therefore, equilibrium consumption of demand deposits decrease. The author suggests that the decrease in deposits further reduces. The
author concluded that the costly banking system helps to propagate and amplify the capital flow shocks to domestic economics.

**G.M. Hugar** in his thesis “Financing of Agriculture by Commercial Banks in Karnataka – A Case Study of Dharwad District” has tried to assess the deployment of credit by commercial banks to agriculture in Dharwad district. He has found from his field survey that there have been wider inter block variations in the quantum of the total credit flowed to the different regions in Dharwad district in providing credit to agriculture and allied activities. His findings indicate that more than 50% of the agriculture credit has gone to Dharwad and Hubli blocks.

Further he has concluded that the performance of banks under credit plans in the district in providing credit for various agricultural and allied activities is not uniform.

The researcher has made some suggestions for improvements which have relevance for stream linking the credit deployment activities of the commercial banks.

**J. Paul Forester** in his article on Role of Commercial Banks in Project Finance has referred to the non-traditional roles like providing advisory services.

Project financing by commercial banks is traced to 1930. Project finance has been employed in almost all capital intensive industries. Project financing is commonly used in countries where domestic capital markets are small. The author has mentioned some constraining factors against the project financing by commercial
banks. They include international debt crisis, disintermediation of the largest and most credit worthy commercial bank customers, increased competition for deposits from money market, mutual funds increased competition from investment banks, the imposition of minimum risk based capital requirements and the general decline in commercial bank credit quality.

The author has concluded that the unbundling of financial services by commercial banks in the area of project finance has provided and will continue to provide new opportunities for commercial banks in the explosion of worldwide project finance needs.

**Subbaiah and Jeyakumar** in their article “Customer Service in Commercial Banks – A Theoretical View” have argued that a successful banker should treat the customers well. Growth and profitability of banks to large extent depends on the customer service. The authors have observed that the bankers should create awareness about the technology and innovative services to the customer. The authors have provided a very practical conceptual dimension of the customer of the bank. They have highlighted the concept referring to the aspects of service like customized care, uniqueness, service, orientation, tenderness, openness, managerial ability, effectiveness and responsiveness. They have referred to changing perceptions of the customers about the banks services to them. The authors have elaborated the types of customers confronted by banks and their rights.
The author’s suggestions for improving the customer services by the banks are quite relevant and useful to banks approaches towards the customer retention policies.

### 1.22 Organization of the Study

The research study is presented in the following six chapters.

**Chapter-I : Introduction and Research Design**

The first chapter provides an introduction to the topic of research. The chapter contains objectives and hypotheses of the study, need for research, methodology, limitations, etc. A comprehensive review of some relevant literature is presented in this chapter.

**Chapter-II : Evolution and Implementation of Priority Sector Lending by Banks**

The second chapter examines different aspect of the policies of priority sector, their implications and the practical significance of the policy parameters.

**Chapter-III : Profile of the Study Area and the Borrowers of the Priority Sector Loans in Haveri District**

The Chapter provides a brief account of the economic scenario of the Haveri district which is the study area. Financial and physical aspects of the commercial bank are covered by the study is provided in this chapter. Further a brief profile of the selected borrowers of loans under the priority sector lendings by the commercial banks in the study area has been provided.
Chapter-IV : Priority Sector Lending by Commercial Banks

This core chapter provides an analysis of the data obtained by the selected commercial bank branches relating to different aspects of priority sector lending in the study area.

Chapter-V : Priority Sector Borrowings, Responses of Borrowers – An Analysis

Another core chapter contains details of the borrowing under the priority sector lendings by the commercial banks. The data collected from the selected respondent borrowers have been analyzed here.

Chapter-VI : Summary of Findings, Conclusions and Suggestions

The details in this chapter provide a summary of major findings, conclusions and a few suggestions based on the study.