CHAPTER 1

INTRODUCTION:

In the modern economic set up banking occupies a significant place. Its importance has increased after the introduction of new economic policy in 1991. In the today’s economic scenario we can not think of any business activity without the help of banks. The Indian banking sector has played a commendable role in fueling and sustaining growth in the economy. In the present set up of liberalization, privatization and globalization banking sector has experienced a lot of changes. The most recent trend of mergers and acquisitions is the result of increasing competition among the banks resulting in to innovations and diversification of products. In the recent years the working of the commercial banks has changed significantly so as to meet the necessities of the changing situations. Enhancement in the services offered by the banks has become a different experience today. Adoption of information technology has become an essential part of the banking business in the recent years. Use of computer, Internet, ATM, Credit card, Debit card have become the needs of today’s banking system. The important recent developments in the banking sector are lifestyle marketing, customer relationship management, e-banking, tele banking, mobile banking, home banking, cyber banking, internet banking, any where banking, phone banking, door step banking, wealth management, insurance and equity trading etc. In today’s competitive scenario banks need to price their services in such a way that it should be reasonable and fair from customer point of view as well as from banks profitability point of view.

Bank's are critically important for industrial expansion, agricultural development and corporate governance of firms and allocation of capital. The efficient mobilization and allocation of funds by the banks, lowers the cost of capital to firms, strengthens capital formation and stimulates productivity and growth. The banks are the veins of trade, commerce, industry and business.
They play a fundamental role in the overall development of a country. A full-fledged banking sector is both a necessary and sufficient condition for the development and a growing economy provides its banking sector the indispensable energy for continued growth. The banks are also very significant as they play an important role in eliminating the paucity of capital by stimulating the savings and investment savings and investment is recognized as an important determinant of economic development. The rate of capital formation in the economy is depending on the pattern of saving and investment of the people. The main objective of saving and investment is to increase the efficiency of the available resources and make it available for the productive investments. This leads to the creation of new enterprise and employment opportunities. For rapid growth and development of the economy, saving and investment is a must. The underdeveloped and developing countries due to low level of savings face the problem of the shortage of capital. And to solve this problem increasing the amount of savings and investment is required. The banks encourage the habit of saving among the people and mobilize the small savings and make them available for different types of productive investment. By encouraging savings and investment, the banks increase the productive efficiency of resources and thus contribute to general prosperity and welfare by promoting economic growth and development.

Indian banks, which are functionally varied and geographically widespread, have played an imperative role in the socio-economic progress of the country. The Indian banking system had gone through a series of crises and resultant bank failures. Its growth was quite low during the first half of this century. After independence, the Indian banking system has recorded rapid progress due to number of reasons, such as, planned economic growth, increase in money supply, growth of banking habit, control and guidance of the RBI and above all nationalization of banks in July 1969. The development of agriculture in the country accompanied by the successful experience of green revolution and distribution of small-scale industries across the country was due to the expansion of the activities of the banks. The banks are also responsible for the
huge employment creation and export prospective growth of large number of small, medium and big industries. Similarly the growth of entrepreneurs in wide ranging fields was the result of the expansion in the activities of banks. Banking sector play an imperative role as the depository of liquidity and as a significant channel for flow of funds from the surplus sectors to the deficit sectors and as the back bone of the payment and settlement systems.

Before the nationalization of commercial banks in the country they remained restricted to the urban areas and met the financial requirements of big industrial houses and the privileged class. They were not interested in lending to the neglected sectors of the economy like, agriculture, small scale industries and weaker sections. The public sector banks are extending credit to the agriculture and the farming community since their nationalization in the year 1969. Earlier it was the sphere of co-operative Credit Societies and the money lenders. Nationalized banks were always unconvinced about farm financing because of low returns on higher degree of risk. Bank management was looking to this sector with substantial amount of indifference. Similar were the case with other activities like small scale industries, weaker sections and other borrowers with small means etc. Over the years the condition has changed appreciably. Since the nationalization of commercial banks in the country they have shifted their concentration from class banking to mass banking. They have also been entrusted with the important task of meeting the financial requirements of the priority sector and weaker sections of the economy. The RBI directs them, to devote 40% of the bank finance to the activities coming under the priority sector. In the recent years the working of the commercial banks has changed significantly so as to meet the necessities of the changing situations. The working of the commercial banks needs to be flexible to enable them to face new economic problems and policy to play their useful role in the economy.

In the post nationalization period the banks are penetrating to the rural areas in order to broaden their area of business, to search for affluent customers and bring them under the banking umbrella providing financial services to the rural
poor is enabling the “banking with un bankable”. Even the small and marginal farmers have become the successful customers of the banks with the acceptance of modern techniques and new trends in the agriculture. This development has resulted in bringing micro finance to the front of the banking sector. All these events have created new opportunities and challenges before the banking sector.

The present day’s banks function in a highly competitive environment in globally integrated markets with a lot of influence of technology. Banks have changed their style of functioning from local to global. The trend in banking has changed from a cash economy to cheque economy and from there onwards to a plastic card economy. Tomorrow’s banks are regarded as financial boutiques offering a variety of financial and other services through their subsidiaries such as mutual funds and merchant banks along with performing their traditional functions. The bureaucratic banks of yesterday have become digital banks today.

The main challenges for the banks today are –

K Mobilizing sufficient resources to meet rapidly mounting credit demand.

K Act in accordance with BASEL – II norms.

K Increasing and maintaining the quality of asset portfolio.

K Reducing their NPA levels through better recovery management. This is key to the stability of the banking sector. Cost and recovery management supported by enabling legal framework hold the key to future health and competitiveness of the Indian Banks. Improving recovery management is in India requires prompt and effective actions in legal, institutional and judicial processes.

K Increasing the resource mobilization efforts through increasing their rural and semi urban reach.
K Reducing their transaction cost and cost management. Cost control is a key to sustainability of bank profits as well as their long-term viability.

K Become more customer centric, offering wide range of products through multiple delivery channels.

K Technological intensity of banking in one important area where the Indian banks need to do significant catching up. Investment in technology for better MIS, product development, risk management, funds management and customer service is very essential for the better performance of the banks.

K Pay better attention to profitability, together with cost reduction and increasing fee-based income.

K Experimenting the innovative products and services like the D-mat accounts, all types of plastic cards, etc.

K Heading towards the universal banking from a regime of large number of small banks to small number of large banks. The new era is going to be one of consolidation of the banks.

K The banks have to develop market discipline for the purpose of transparency and market disclosure of critical information describing the risk profile, capital structure and capital adequacy.

K Human development issues play a major role in the governance of the banks. These are the major issues related to the management.

K Risk management by the banks is another important challenge in front of the banking sector. Banking in the modern economies is all about risk management.

K Corporate governance of the banks has become important due to intensified competition, banks struggle to retain their client base and regulators move out of controls and micro regulation.
The solution to meet these challenges lies in putting in place the necessary systems and skilled staff, training and equipping the workforce and making all out efforts to motivate and retain staff with expertise.

1.1 Meaning of Banks

"Bank is an institution which accepts deposit from the public and in turn advances loans by creating credit".

The following definitions of bank throw light on the important functions performed by banks –

- Bank is an institution that deals in money and its substitutes and provides other financial services. Banks accept deposits and make loans and derive a profit from the difference in the interest rates paid and charged, respectively. Some banks also have the power to create credit.

- "Encyclopedia Britannica"

- Bank means bench or table for changing money – "Greek History"

- Banking is defined as "Accepting for the purpose of lending or investment of deposits of money from public repayable on demand or otherwise and with drawable by cheques, draft, order or otherwise – "Indian Banking regulation Act 1949"

- "Banking" in the full modern sense, of taking money on deposit and lending out on interest, is of comparatively recent origin. – "The international standard Bible encyclopedia" (Kaptan S.S. & Choubey N.S. 2003, P. 2)

The above definitions of the bank reveal accepting deposits and lending money as the two important primary functions performed by the banks. In the olden days the banks were regarded as merely purveyors of money, but today they are also the creators or the manufactures of money in the system. (S.S. Kaptan 2002)
Background and Development of Banking

Economists do not have uniform opinion about the origin of the word bank. According to some economists the word bank is derived from Greek word ‘bengue’ means a bench and according to others it is derived from the German Word ‘bane’ means a joint stock firm. The word bank has been in use from the Middle Ages in relation of money leading.

Banking is considered as a very old activity. Banking was practiced even in the pre historic period. In ancient Greece, around 2000 B.C. the famous temples of Ephesus, Delphi and Olympia were used as depositories for the surplus funds of people and the temples acted as the financial agents. But over the period of time the assurance of the people in temples was shattered due to disbelief in religion. Traces of credit by compensation and by transfer orders are found in Assyria Phoenicia and Egypt before the system attained full development in Greece and Rome. In Rome the bankers were called Argentarii, mensari or Collybistoe. The banks were called Jabernoe Argentarive. Some of the banks carried business on their own account and others were appointed by the government to receive the taxes. They use to accomplish business on modern lines by use of cheques and drafts. These banks were also receiving and lending money for a period of 3 to 4 years on the security of land.

Private individuals mostly did the banking business the early periods. Many countries either for the purpose of facilitating commerce and trade or to serve the govt. established Public banks. The earliest bank established is the bank of Venice. Which was established in 157. During 1404 a public bank was established in Barcelona. It used to exchange money receive deposits and discount bills of exchange both for the citizens and foreigners. The bank of Geneva came in to existence in the year 1407.

1.2 Banking in India

Banking industry in India, during the course of its evolution and growth, has traversed through innumerable twists and turns. The industry has emerged
victorious against all odds, by the sheer strength of its teeth. It has braved many challenges, weathered many storms, withstood many onslaughts and has emerged as one of the dynamic and vibrant industry. The secret of success lies in its ability to adapt to changes in the most admirable manner. (Dr. Sukhdev Sing 2006 P. 33)

**History of Banking in India**

In India, the pre-historic Indus scriptures refer to the money lending activities in the Vedic period. The members of vaishya community used to carry out the banking business during the smriti period and Epic age. Manu the great law giver of the time says that earning of interest is the business of vaishyas. The books of manu contain reference regarding deposits, pledges and policy of loans and rate of interest. Banking in those days largely meant money lending. The banker of the smriti period performed most of those functions, which banks perform in modern period.

**Development of Joint Stock Banks in India**

Banking on European lines started in India when two British managing agency houses, namely Ferguson and Co, and Alexander and Co, set up three banks. General Bank of India established in 1786 was the first joint stock bank. This was followed by the origin of Bank of Hindustan and Bengal Bank. The bank of Hindustan continued till 1806 and the other two failed.

**Precedency Banks**

With the sanction of the British Parliament, the Precedency Bank, Bank of Bengal was established in 1809 as the first presidency bank. One fifth of its capital was contributed by the state and remaining by the East India Company. The establishment of Bank of Bombay in 1840 followed this and the bank of Madras in 1843 as presidency banks bringing their total number to 3. The presidency Banks continued till the year 1920. The Presidency banks did not much progress in the sphere of banking in India.

**The Establishment of the Imperial Bank of India**
The Imperial Bank of India came into existence on 12th January 1921 by amalgamating the three Presidency banks. It acted as the Central Bank of the country, as a treasurer of the government, as an agency of note issue and as a banker’s bank till the RBI came into existence. RBI came into existence on 1st July 1935 under the RBI act of 1934. With this the role of Imperial bank was diluted and thereafter it functioned as the leading commercial bank of the country and agent of the RBI. The nationalization of the Imperial Bank of India led to the birth of the State Bank of India from 1st July 1955 as a major public sector bank of the country. Eight banks set by the east while princely states of Bikaner, Jaipur, Indore, Mysore, Patiala, Travancore, Hyderabad and joined the State Bank of India group as its subsidiaries.

The Formation of RBI

With the passing of the RBI act of 1934 the Reserve Bank of India came into existence on 1st July 1935 as the private share holders bank with a fully paid up capital of Rs. 5 Crores divided into shares of Rs. 100 each. Of these 5 lakh shares, the Directors of the bank and the remaining by the private share holders subscribed 2200 shares. It took over all the functions performed by the Imperial Bank of India. But in the later years it was felt that in view of the need for close integration between the Bank’s policies and those of the Government, the question of state ownership of the bank was raised. Accordingly in terms of the Reserve Bank (Transfer to public Ownership) act 1948, its entire paid up capital was transferred to the central government and RBI was nationalized in 1949.

Indian Banking in the Post Independence Period

Indian banking in the post independence period can be divided into three phases.

First Phase 1950-1969:

The Indian Banks during this phase followed traditional banking with very little innovations. Therefore, the important need during this period was the re-
organization of the banking system. In order to achieve this, government took various steps. The passing of the Banking companies Act in 1949 was one of the important steps in this direction. Since then the Indian banking system has developed in many respects. It has not only grown geographically, but also structurally and functionally. In 1950-51, there were 430 commercial banks but the number, over the years has declined rapidly due to RBI’s policy of mergers and amalgamations of small banks with big banks as a measure of enlargement of the banking system. In 1960-61 there were as many as 256 small non-scheduled commercial banks but in 1980-81 there were only 4 such non-scheduled banks. There were 291 reporting scheduled commercial banks in the country during the year 2002-03. There was fast decline in the importance of non-scheduled commercial banks during this period. The banking regulation Act provided extensive regulatory powers to the RBI and with that it became possible for it to carry out various structural reforms in the banking system. The commercial banks made a considerable progress in deposit mobilization during this period. The period also experienced a change in the lending policy of commercial banks. For long the major part of their credit had gone to commerce and large and medium industries. During the period under reference not only the commercial banks credit to industries increased, the banks also developed an interest in term lending. In order to provide some protection to the depositors, an important step in the form of establishment of the Deposit Insurance Corporation was under taken in January 1\textsuperscript{st}, 1962.

**Bank Nationalization in 1969**

The Nationalization of 14 major commercial banks with deposits of Rs. 50 Crores or more in July 1969 was a historic event in the history of Indian banking. Nationalization was done on the ground that the commercial banking system did not involve itself in the planned development of the nation. Big industrialists and large business houses to build private industrial empire controlled Indian banking. Small industries and business units were incessantly and at all time ignored and starved for the funds. The banks never
took agricultural credit seriously. Public funds were used to hold up anti social and unlawful activities against the interest of the general public. The various objectives of the bank nationalization were,-

- Accelerating the speed of development and reducing the gap between advanced and backward areas by utilizing the resources mobilized by the commercial banks.

- The banks should serve farmers in promoting agricultural production and rural development in a better way.

- The other objective was to control the provision of credit for unproductive and speculative purposes.

- Eliminating the control of big industrial groups on banks.

- Providing more amenities to small entrepreneurs.

- Create a right environment for development of adequate professional management in the banking field.

- “The justification of priority sector lending was one of the causes for nationalization of the top 14 banks in 1969”.

Rapid Expansion Phase 1970-1984

The importance during this period had been on the diversification of the banking system in terms of expansion of branches, deposits and advances on the one hand and on the other hand social banking. The introduction of Lead Bank Scheme and District Credit Plans, setting up of Regional Rural Banks in 1975 were important measures adopted for the development of rural areas. Deposit mobilization and branch expansion continued during this phase.

The government nationalized six more commercial banks in the year 1980. Being the public sector banks these banks were expected to support all the government sponsored programmer. They were also expected to follow the
policy decisions of the government, ex attainment of priority sector loans up to 40%, rural credit deposit ratio of percent and weaker section credit ratio of 25 percent of the total priority sector credit.

**Consolidation Phase – 1985-1990**

Slow down in branch expansion, more importance to internal control and earning more profit were the main features of this phase. The number of bank branches increased from 52,721 to 58,914. Deposits increased at a rate of 17.7% and credit by 14.6% and the increase in profit had an annual growth rate of 51.7%.

**Post Reform Period Since 1991**

The Indian banking system has experienced many changes since the introduction of the financial sector reforms introduced in the 1991. This phase can be considered as “second banking revolution”. During this period the country was caught into deep economic crisis. The government decided to introduced various measures of reforms and banking sector reforms were part of this package. The government appointed a committee on the financial system under the chairmanship of M. Narasimham in August 1991. Which submitted its report in 3 months. The government also appointed the committee on the banking sector reforms under the chairmanship of M. Narasimham and it submitted its report in April 1998. The various recommendation of the committee were, prudential regulation and supervision of banks, rehabilitation of public sector banks, reduction in SLR and CRR, deregulation of interest rates, phasing out directed credit and inducing competition in the banking sector improve their performance. The different reform measures have brought healthy competition among the banks. The banks realized the need to improve customer service to a much higher level in order to survive in this competitive environment. A note worthy feature of the banking reform, growth of newly licensed private sector banks, some of which have attained globally best standards in terms of technology, services and sophistication. In many respects
related to performance, these domestically promoted banks have surpassed the branches of foreign banks have surpassed the branches of foreign banks in India and would be a role model for other banks.

The banks have found improvement in technology as an ideal tool to achieve this objective. Public sector banks were guided by the recommendations of the committee for upgradation of Banking Technology. Recognizing the importance of new technology the public sector banks have gone for computerization of their branches in the recent years. There are about 3,800 fully computerized bank branches in the country at present. At present as per the central Vigilance Commission directive the banks have been required to cover 70% of their business through computerization. The various reform measures have resulted in bringing considerable change and perfection in the Indian banking system. Banking has been opened up to the private sector. The other development are, the population served by per branch was very high at 65,000 at the end of the first phase and it came down to 15,000 per branch at the end of March 2000. Nationalization has resulted in providing more credit to the weaker sections under the objective of social banking the percentage of priority sector credit to the total bank credit has increased from 25% at the end of June 1971 to 34% as on March 2004.

The operating environment for banks in India has undergone rapid change in the recent years. Deregulation has opened up new opportunities for banks to increase revenues by diversifying into investment banking, insurance, credit cards, mortgage, financing, depository services etc. At the same time, liberalization has opened the area to new players and brought greater competition among banks. The growth of the capital market has accelerated the trend towards financial disintermediation. Competition has become stiffer due to advances in communication technology. Banks can reach their customers anywhere, any time and customers are also able to get instant access to their accounts from any corner of the world any time.

Recent Trends in Banking
In the recent years the public sector banks in India have been engaged in innovative banking. The Reserve Bank of India has given them considerable freedom to innovate in the promotion of a variety of financial services such as merchant and leasing, venture capital, mutual funds, factoring, housing, hire purchase business, consumer's credit, insurance etc. All these innovative services have resulted in increasing the responsibility of the banks to meet the various requirements of the customers.

1.3 Review of Literature

Many studies have been conducted on the banking sector. The various aspects of study are, nationalization of banks, importance of banks in the development of an economy, provision of finance by banks, banking sector reforms, recent trends in banking, use of new technology in banking, problems of banking sector etc.

Rajaram Das Gupta in his article “Priority sector lending – Yesterday, today and tomorrow” has observed that the priority sector appears as nothing more than several diverse items club together. He has advocated a new approach to priority sector lending, suggesting credit to a larger number of sector and sections including marginal farmers, cottage, industries, small trade and services and low to improve credit flow to small scale industries and food crop agriculture as well as temporary credit to assure credit to new industries and new professional by the non poor section (Economics and Political Week Oct. 12, 2002).

Nitya Chakravarty in the article “Credit policy and priority lending”. Has argued that under the priority sector lending the banking system should be able to identify and quality small scale industries that have potential for profit. He has suggested that the norms of 40% lending to the priority sectors should be strictly adhered to and the banks should deposit the shortfall in the prescribed percentage with NABARD (Yojana July 31, 1994).

N.B. Shete in his article “Priority sector Advances of banks during the post reforms period” has mentioned that the fixing of lending targets for priority
sector as a whole and sub targets for agriculture and weaker sections has had a very positive impact on the channeling of credit hither to neglected sectors of the economy while giving ample scope focuses to small borrowers to institutional credit (Prajnan Vol. XXXI No. 1, 2003)

P.K. Pandey in his article “Priority sector financing Better management required” has suggested that the recommendation of narasimhan committee to reduce the share of priority from 40% to 10% in the total bank credit needs second thought he has stressed need to overcome the problem of some of the disheartening features such as considerable inter-regional / or inter state imbalances, neglect of under banked nor then eastern states, commercial banks must step up their efforts in managing mobilizing deposits, advancing directed particularly to weaker sections and remote areas of the country. The urgent necessity is better management and of increasing operational efficiency and productivity of commercial banks (Abhiyan – Autumn – 1996)

P. Ganesh in his article “Impact of priority sector advances of profitability of public sector banks in India has examined whether the priority sector advances have actually eroded profitability of the public sector banks. He has observed that concessional interest rate the subsidy rate and credit outstanding to priority sector have increased over the years his study has revealed that the income loss ration are substantially higher that the profitability ratios and the difference between have increased. The Author has observed that the consequent to the introduction of reforms in financial sector the banks began to step down the target for priority sector credited thus there was decline in the income loss ratios which subsequently increased the profitability ratios establishing the fact that the priority sector advances adversely affected the profitability of Indian public sector Banks (Journal of Financial Management and Analysis 16 (2) – 2003)

Anand Jaya S. (1999) in an interesting research work conducted on kerala state co-operative agricultural and rural development a bank analyses about the need and importance of providing the long – term credit by CARD banks.
Basu C.S. (2006) has analyzed the SHG-Bank linkage programme in the context of micro credit in India. At present the SHG-Bank linkage programme led by NABARD in India is one of the largest and fastest growing micro finance programmes in the world. He opines that the concept of trickle up economies like India where by the benefits are directly and usefully given to the poor.

Dharmaraj S. (2001) in his study on agriculture and rural economy in Tamil Nadu State analyses the prospect and retrospect with reference to the direct financial services rendered towards the credit needs of the rural sector. He points out that as along as the poor people at rural area are neglected that amounts to be the negligence of agriculture sector also. The cost of neglect of agriculture and the poor will be very high in the long economically, socially and politically.

Das Prasum Kumar and Baria B.G. in their research papers increasing the flow of credit to agriculture by commercial banks- the task ahead published in the Indian Banker journal analyze the various aspects concerning the flow of commercial banks finance to agriculture. In this paper they have analyzed the agricultural credit system in India and the role of commercial banks in agriculture credit dispensation.

Hundekar S.G. (2001) in his research paper has nicely analyzed the different phases of Indian Banking. He also speaks about the financial sector reforms and the future of the Indian banking system. According to him in the days to come the banks will have to go for greater specialization transforming the work culture, explore new avenues of income fetching services, financial analysis, break even analysis, greater reliance on non fund business, management of credit risks, developing marketing skills among the bankers to effectively market the banking products etc. All these future strategies will go a long way to build a sound banking system.

Hossain Alfaz MD. And Eresi K. (2001) according to this study express their deep concern for the nationalized banks. They believe that in the recent years
the nationalized banks are lagging behind due to the increasing competition from the foreign bank, private sectors banks, information technology and globalization. They suggest for a restructuring plan for the nationalized banks to improve their competitive strength.

James Rabindran (2006) in his study on provision of educational loans by banks explains about the difficulties faced by the banks in the recovery of these loans as they are given without insisting upon any collateral. He suggests for setting up of bureau of engineering and professional students (BEAPS) by the ministry of education to maintain database of the borrowers. He believes that such a provision will ensure an effective monitoring of the borrowers, preventing defaults and smooth recovery of the loans.

K. Padmnabhan (2002) in his research paper has analyzed the importance of providing institutional finance to agriculture to overcome the problem of rural indebtedness. He is of the opinion that the government has succeeded only partially in this task.

Khan Forook Mohammed and Singh Charanjit in their research paper effectiveness of DRT in recovery of banks dues published in the Indian Banker journal throw light on the problem involved in recovery of bad debts of banks and the role of DRT and DRAT in the recovery of loans.

Murali S. and Krishnaprasad P.S. (2006) shows their concern for ensuring qualitative credit growth through effective monitoring of advances. They are at the opinion that since the resent past there has been a burst in the lending activity of the banks due to increasing surplus funds with the banks and the looses suffered by banks in the investment and treasure activities. They believe that the credit growth should not result in the creation of non-performing assets and for this sake effective monitoring of the advances is necessary.

Nayak K.C. (2006) stresses for increasing the non-fund based income of the banks to take care of the profitability of the banks.
Pathrose P. (2006) in this study express his concern for the financing small and medium enterprises by the banks. He is of the opinion that SME’s play an important role in the overall economic development of the country. Therefore the banks have to view lending to SME’s as a profitable opportunity rather than an avenue for forced lending.

Phogat. M.S. (2006) analyses the provision of housing finance by the banks and the possible frauds. He suggests that the banks should take precautionary measures to overcome this problem. He also believes that housing finance is an area having a huge potential for deployment of the banks funds and is also the social responsibility of the government. He feels that the procedures followed by the public sector banks are very good and if followed properly the chances of fraud can be minimized up to a great extent.

Passan M.P. (2001) in his research paper has analyzed the various inefficiencies and problems of public sector banks. He shows his greater concern for the safety of the deposits of the depositors of various public sector banks. He calls for a strong political will to implement the various reform measures for initiating financial sector reforms in general and for restructuring public sector banks in particular.

Patel, Amrut (2006) in his study on financing small and marginal formers states that the flow of formal credit to these sectors is not satisfactory.

Dr. Reddy Y. V. Governor of RBI in his pre inaugural address “banking sector in global perspective” at bankers conference 2004 published in the IBA bulletin has highlighted the various aspects of Indian Banking and has analyzed the various challenges in front of the banking system to improve their performance in the global environment in order to prove their competitive strength.

Rawat G.S. (2001) has analyzed the growth and scope merchant banking services in India. The merchant bankers are acting as a most important link between the company raising funds and the investors. According to him in the recent years more and more financial institutions are showing an interest in providing this service to the customers.
Singh, Sukhdev (2006) studies the performance of the banking sectors in comparison to the benchmarks.

Many other studies have been conducted on the different aspects of banking like:


Thus different authors have studies banking in various angles to analyze the various aspects of banking industry and to give suggestions to overcome the problems faced by the banks wherever they are present.

1.4 Area Under Study

In present work "priority sector lending by commercial banks” in Dharwad district has been choosen for an in depth and comprehensive study. Dharwad district has made a tremendous progress in the banking system. District has an excellent network of banks, which has spread to every nook and corner of the district.

Banking Network

There are 21 public sector, 10 private sector, 6 new generation and one each of RRB, DCCB, KSCAPD, KSFC and KSIC banks with their 221 branches in the district. Out of these, there are 145 branches in urban, 25 branches in semi urban and 51 branches in rural areas. As per 2001 census there is one bank branch for every 7256 persons, which is much better than the national average of 16000. The vijaya bank acts as a Lead bank for the Dharwad District.

The Priority Sector
The concept of priority sector credit was formulated in 1968 with the beginning of social control over the banks. The national credit council pointed out that the mistreated sectors of the economy which did not have satisfactory access to bank finance but, due to their economic importance deserved due identification from the banking system should be treated as “Priority Sector”. Accordingly, at present the priority sector includes a variety of activities –

- Agriculture.
- Small scale and medium scale industries and other priority sector which comprises of –
  - Small business.
- Retail trade.
- Small transport operators
- Professional and self employed persons.
- Housing.
- Education.
- Micro credit.
- Weaker sections.
- Export etc.

The Present Work concentrates on the “Priority sector leding by commercial banks” in the Dharwad district for a period of eight years from 2001-02 to 2007-08.

1.5 Objectives of the study :
1) To study the growth trends in the advances by the commercial banks to the different priority sectors in the study area.
2) To examine the procedural aspects of priority sector lending by commercial banks.
3) To analyze the recovery of loans.
4) To find out the problems and to give suggestions to improve the priority sector lending.

1.6 Hypothesis :
1. Priority sector lending by commercial banks in the study area more in favour of farm sector.

2. Borrowers have willfully diverted the funds of priority sector advances to other purposes.

3. Inadequate amount of priority sector loans has forced the borrowers to depend on high interest cost sources like private money lenders.

4. Low utilization of priority sector advances is considerable among, the borrowers in the study area.

5. The recovery position in all the sectors is not satisfactory.

6. Priority sector lending has contributed to the economic development of the district.

1.7. Methodology

The present study is based on secondary information. The information has been collected from various published and unpublished books, magazines, newspapers, various publications of the department of statistics planning and evaluation, Government of Karnataka, the Dharwad district statistics and evaluation department. The main source of information has been District level Bankers Committee Reports compiled by the Lead Bank Office (Vijaya Bank) Hubli, Dharwad.

1.8 Needs and Importance of the study:

Availability of ample and timely credit at reasonable rate of interest is very vital to carry out different types of productive activities. In India, the institutional financial system for credit is consisting of commercial banks. The commercial banks account for around 98% of assets of the system. On the basis of their pattern of ownership the commercial banks are grouped into three different types. They are classified as, State owned Public sector Banks (PSBs), Private sector Banks owned by Indians and foreign banks. In all 27
public sector banks lead the commercial banking of the country. These banks account for more than 80% of assets from the commercial segment banks.

Banks are the main institutional source of finance to meet the credit requirements of different sectors for different types of activities. By providing the loans they meet the requirements of trade, commerce and industry. Before the nationalization of major commercial banks in 1969. They had developed an uncaring attitude towards financing to the agriculture and allied activities, small scale industries and other services. Due to this these disregarded sectors had to depend upon the money lenders for finance, which was very exploitative due to high rate of interest. One of the objectives of nationalization of banks was to direct these banks to meet the necessities of these neglected sector constituted as priority sector. The present study is important because it throws light on the provision of the loans to the priority sector by the public sector commercial banks in Dharwad. The study also analyses the trends in priority sector lending by banks in the district and the recovery of loans. Uncovered loans result in increasing the overdues with the banks. The profitability of the banks gets adversely affected due to the high rate of over dues.

**Problems of priority sector lending:**

1. In their anxiety to reach the target of 40%, the banks went in for indiscriminate lending. In many cases, there was external pressure too on the banking sector to lend to weaker sections.

2. As priority sector loans were small accounts, the public sector banks were not to monitor the distribution, follow up and recovery of tiny loans, this increased their cost on the one side and adversely affected their profitability on the other.

3. The bank lending to priority sector was not uniform in all states. Actually, it was quite low in many backward states like UP, Bihar, Rajasthan etc. In order to attain 40% of the target for the country as a whole, the banks were stepping up their loans to the priority sector in the
more advance states. This has further worsened the regional imbalance in the country.

1.9 Limitations of the study:

1. The study takes into consideration the period of seven years only from 2001-02 to 2007-08.

2. Only the commercial banks are taken into consideration.

3. The provision of loan under the various government sponsored schemes is not included.

1.10 Organisation of the Research Study:

Chapter I: Introduction and Research Design:
The first chapter provides an introduction to the research topic. It includes history and development of banking in India, review of literature, importance of the study, objectives, hypothesis, methodology and limitations of the study.

Chapter II: Profile of Dharwad District:
Socio economic features of the district have been highlighted in this chapter. Demographic features and economic aspects of the district are also presented in this chapter.

Chapter III: Priority sector:
“Conceptual Dimensions of Priority Sector”
An overview this chapter shall provide the concepts and evolution of priority sector and the role of commercial banks in the Indian context. It provides information on the various activities coming under the priority sector and the various guidelines issued by the RBI for priority sector lending by banks.

Chapter IV: Priority Sector Lending:
This is one of the core chapter of the proposed thesis. Provision of priority sector loans by commercial banks during 2001-02 to 2007-08 is presented in this chapter.
Chapter V: Recovery of Loans:

This is another core chapter of the proposed thesis. The recovery of the loans provided by commercial banks during 2001-02 to 2007-08 is presented in this chapter.

Chapter VI: Problems and Suggestions:

Problems of priority sector lending and suggestions to improve are given in this chapter.

Findings of study and conclusion

Conclusion deals with findings of the study.
Conclusion:

In the modern economic set up banking occupies a significant place and its importance has increased after the introduction of new economic policy in 1991. In the present set up of liberalization, privatization and globalization banking sector has experienced a lot of changes. The working of the commercial banks has changed significantly so as to meet the necessities of the changing situations in the recent years.

The banks play a fundamental role in the overall development of the economy. By encouraging savings and investment, they increase the productive efficiency of resources and thus contribute to general prosperity and welfare by promoting economic growth and development. Indian banks, which are functionally diverse and geographically extensive, have played an imperative role in the socio-economic progress of the country. Before the nationalization of commercial banks in the country they remained restricted to the urban areas and met the financial requirements of big industrial houses and the privileged class only. Since the nationalization of the 14 major commercial banks in the country in the year 1969 they have shifted their attention from class banking to mass banking. They are penetrating to the rural areas to increase their area of business and also playing an important role in the progress of rural India and progress of the people.

Today the banking sector has experienced many changes and is experimenting with new products and services. The most recent developments in the banking sector are lifestyle, marketing, customer relationship management, e-banking, tele banking, mobile banking, home banking, cyber banking, internet banking, anywhere banking, phone banking, doorstep banking, wealth management, insurance and equity trading etc.