CHAPTER I

INTRODUCTION AND IMPORTANCE OF THE STUDY

Economic Development of a country to a great extent depends upon the development of three main sectors, viz., agricultural sector, industrial sector and service sector. The contribution made by these sectors to the national income largely determines the phase of economic development of a nation. In India, the rural sectors particularly agriculture, cottage and small-scale industries subscribe a major portion to the national income. Provision of timely and requisite credit to these sectors not only increase the production and productivity in these sectors but also accelerate the tempo of economic development of the country. The relationship between credit and agricultural growth has been well established by empirical studies. Realising the potential influence of credit upon the productivity in agriculture and other rural sectors, the government of India's strategy for rural development envisages provision of adequate credit to the said rural sectors for enhancing production and productivity in rural economy. Therefore, the banking policy of government of India has mainly aimed at the refinement of rural economy. Traditionally, the villages had a non-institutional source of credit from the money lenders. As they had charged exorbitant rate of interest, legislative measures have been undertaken to curb their activities. In India more than 74.30 percent of population live in villages.

Among them more than 37 percent are below the poverty line. To help these downtrodden, the government of India has introduced institutional credit. Since 1904, co-operatives have embarked on the domain of rural credit but the credit extended by them has been found inadequate for the enormous task of rural refinement. Hence, commercial banks were directed to meet the credit requirements of the rural population. However, the commercial bank credit was not adequately made to rural borrowers till the late 1960's. In 1951-52, it was estimated that the total amount borrowed by cultivators from different sources were 0.9 percent from commercial banks, 3.1 percent from co-operatives and 69.7 percent from money lenders. In 1961-62, the share of commercial banks lending to cultivators declined to 0.6 percent. This declining trend continued even after 1960 due to lack of initiative on the part of the government to enlarge commercial bank's credit facilities to the rural poor. It is only from 1967, the government of India has taken active steps to involve the commercial banks in the country's chore of rural development. It brought the commercial banks under social control for equitable and purposive distribution of credit. In February 1968, the government of India set up National Credit Council to examine the credit


demand from various sectors periodically. This council established the Gadgil study group on the organisational framework to enforce social objectives. The study group tendered its report in 1969 recommending the adoption of area approach and priority lending to the thereto neglected sectors of the rural economy like agriculture. As a follow up the commercial banks enlarged their credit to rural areas explicitly to agricultural sector under social control. Not satisfied with the performance of commercial banks in this direction, the government of India nationalised 14 major scheduled commercial banks on 19th July 1969. The nationalisation gave the necessary impetus to investment of bank funds in accordance with the government policies and objectives. An attempt was also made towards streamlining the lending operations of the banks in rural areas to ensure planned and orderly flow of credit for development. In 1970, the Reserve Bank of India had directed the banks to adopt area approach for financing agriculture distinctly to avoid scattered lending and ensure better supervised credit. Area approach concept led to the formation of Lead Bank Scheme, under which the banks undertook lead role in deployment of credit for the development of its lead district. The lead bank scheme complemented the village adoption scheme which was in vogue both in the lead bank and non-lead bank districts. Under Village adoption scheme the banks had adopted some or all villages in their command area for intensive deployment of credit through planning. Under lead bank scheme district is advocated as a unit of area approach and the banks have adopted some or all the villages in its command
district for exhaustive financing and served as an effective machinery for bringing about the required co-ordination between banks and the developmental agencies of the State government operating in the lead district. The establishment of Regional Rural Banks (RRBs) in the year 1975 was yet another measure undertaken by the government to have specialised agency to make credit exclusively to the weaker sections of the community. At present there are 196 such banks established all over the country having a network of about 14,405 branches. Thus multi-agency system of banking became operative to meet the credit requirements of the rural sector. Under this multi-agency approach, institutions like co-operatives and regional rural banks operated at the grass root levels which are supported by central co-operative banks and regional offices of commercial banks and regional rural banks at the district level, with Reserve Bank of India at the national level. The multi-agency approach also failed due to the existence of number of agencies retailing credit in an uncoordinated manner resulting in multiple financing, overfinancing, underfinancing and diversion of scarce resources to unproductive purposes. As a result of all these measures the number of rural and semi-urban branches of commercial banks increased from 5175 on the eve of nationalisation of commercial banks (June 1969) to more than 42,000 branches in December 1988. The total advances of all


scheduled commercial banks increased from Rs. 4690 crores in 1970-71 to Rs. 25270 crores in 1980-81.

The Reserve Bank of India in 1980 encouraged the banks to carry out the village adoption scheme, resolving that in the village adopted by one bank not only that bank will lend comprehensively, but other banks can also extend credit in that village. In order to reduce the incidence of poverty, government also sponsored special employment programmes in the rural and semi-urban areas. Banks have played significant role in providing credit support for these programmes as well. Specialised agencies like DRDAs and DICs have been working in close co-ordination with the banks in the successful implementation of these schemes. New dimensions were thus added to the lending operations of banks, particularly in view of magnitude of credit deployed in the rural areas and for a variety of purposes. As a result, the share of commercial banks to rural credit increased to 28 percent in 1981-82 while that of the professional money lenders and agricultural money lenders declined to 16.9 percent during the same period. In July 1982, National Bank for Agriculture and Rural Development was established and it took over certain refinance function from Reserve Bank of India. With a view to encourage banks to involve in


rural lending, credit guarantee cover was also introduced for small loans and advances to the small-scale industries sector. In 1984, the Reserve Bank of India directed the banks to serve population residing within 10 miles radius. In response to the measures taken by the government of India and the Reserve Bank of India, commercial banks further increased their deployment of credit in rural areas from Rs.25720 crores in 1980-81 to Rs.62445 crores in 1986-87\(^{10}\).

In spite of substantial increase in the credit deployed in rural areas by the banks during 1981-86, the gross value added in agriculture registered only a growth rate of 2.7 percent as against 5.9 percent and 7.4 percent in manufacturing and tertiary sectors respectively. The share of agriculture in the total net domestic product at factor cost (at 1970-71) price declined from 39.8 percent in 1981-82 to 35.4 percent in 1985-86. Production of food grains increased only marginally from 133 million tonnes to 155 million tonnes. In contrast, the aggregate advance for agricultural purposes from the co-operatives and regional rural banks and commercial banks recorded 41 percent rise from Rs.11554 crores to 16235 crores between June 1984 to June 1986\(^{11}\). This phenomenon of declining agricultural production and productivity is due to lack of conscious


efforts on the part of the banks to supervise the end use of extended credit and undue emphasis only on achievement of quantitative targets. Bank credit was not supported by essential inputs and infrastructural facilities. As a result of which credit could not achieve optimum results. Schematic, planned and intensive area development covering every sector and every section of the rural community were on the decline and scattered lending was increasingly resorted to, which resulted in multiple-banking, double financing, lop-sided credit deployment, absence of compulsion in the matter of village adoption and village credit planning and sectoral imbalances in the credit distribution. Apart from this, lack of post-disbursement supervision leads to declining recovery which also affected the ability of the banks to recycle the funds.

All these suggested toning up the lending style of the banks in the rural areas and ultimately in April 1989 Service Area Approach (SAA) under Lead Bank Scheme was introduced to overcome the weaknesses of the previous schemes. The service area approach has been in operation for over seven years now. Over these years the commercial banks increased their credit assistance from Rs. 116301 crores in 1990-91 to Rs. 306100 crores in 1997-98. The aggregate agricultural credit advanced by co-operatives, commercial banks and regional rural banks increased from Rs. 13022 crores in 1989-90 to Rs. 34274 crores in 1997-98. But the agricultural foodgrains production increased marginally from 176.39 million tonnes in 1990-91 to 194.13 million tonnes in 1997-98. The compound annual growth of agricultural foodgrains production
decreased from 3.54 percent to 1.73 percent during the same period\textsuperscript{12}. All these shows that after the introduction of service area approach also increase in the credit has not achieved the optimum results in agriculture. A few studies\textsuperscript{13} were being carried out so far to assess the performance of the service area approach by individuals as well as Reserve Bank of India. The studies conducted by individuals states that (i) service area approach has imposed additional responsibilities to the lead banks in terms of preparation of background papers on a blockwise basis to serve as support materials for branch credit plans, (ii) No efforts are taken to introduce new schemes based on the resource potential, skills and aptitudes of the persons and to exploit resources available in the service area, (iii) Lending is concentrated only in a few near by villages of the bank branches in actual implementation, even though credit plans are prepared villagewise, (iv) The targets fixed under the branch credit plans are based on the availability of funds rather than the development potential and demand for funds, (v) Branch managers face the non-availability of technical and environmental data of each of the scheme, (vi) There is no internalisation of new approach by the functionaries involved (vii) There is no seriousness on the part of the bank branches in the adoption of service area approach due to the relaxations made by Reserve Bank of India for the continued financing in the erstwhile villages covered by the bank branches and (viii) Non-public


\textsuperscript{13} Review of these studies are presented in Chapter II.
business working days are not utilised for the very purpose of attending the
development work of the villages allotted. The Reserve Bank study also found
that the service area approach has not been implemented in accordance with
the guidelines of service area approach, the village profiles prepared earlier
have not been upgraded, the performance budget of the branch managers have
not been dovetailed with the service area credit plans which have been prepared
independently and certain branch managers have not been provided requisite
guidance and support to their branches and have not carried out branch visits
regularly. These studies point out only the weaknesses of the service area approach
based on their observations. But no concrete study has been made based on
the aims and objectives of service area approach. Even if there is some attempt
to ascertain the performance of service area approach, they are not exhaustive,
covering each and every aspect of the performance of service area approach.
In order to fulfill these gaps, the present study has been carried out to examine
how far the service area approach scheme is successful in the distribution of
productive credit to the service area villages, in reducing the sectoral, individual,
village level credit imbalances, in avoiding scattered lending, improving the
recovery of the loans advanced by the banks and the ability of the banks to
recycle the funds. This study may be of very much useful to the government
and policy makers and to the society to take a policy view upon the continuation
or scrapping of service area approach under future credit planning.