Chapter II

CONCEPTS AND REVIEW OF LITERATURE
CHAPTER-II

CONCEPTS AND REVIEW OF LITERATURE

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2.1 INTRODUCTION

This chapter deals with various concepts, variables and a review of number of empirical studies on operations and management of rural banks. Since the meaning and context of banking has undergone a change, it is essential to evaluate its performance in the changed context. It is worthwhile to review the past studies relevant to the topic in order to assess the performance of commercial rural banks at present.

2.2 CONCEPTS

2.2.1 Banking

The banking regulation act of 1949 defined a bank “as a company which carries on the business of banking, accepting for the purpose of lending or investment deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise.”

2.2.2 Commercial Banking

A general non-definitive term, denoting those banks in private or public sector which conduct a general rather than a specialised type of business. These banks accept deposits on varying terms including demand deposits; and their

lending to private sector business traditionally for non-fixed capital purpose usually accounts for the greater part or their assets.²

2.2.3 Nationalised Commercial Banks

Fourteen commercial banks with deposits exceeding Rs.50 crores were nationalized on July 19, 1969 by the Government of India and on April 15, 1980, six more commercial banks were nationalized through a Presidential order. At present 19 nationalised banks are functioning in the country.³

2.2.4 Private Sector Banks

In the banking sector, there are 23 old private sector banks and 8 new generation private banks. The aggregate deposit of old private sector banks was Rs.73,549 crore which is 7.2 per cent of total deposits during 2000-01. The private banks are the pioneers in information technology investment, introducing new concepts like Sunday banking, any time banking, flexibanking and the like. At present 30 private sector banks are functioning in the country.⁴

2.2.5 State Bank of India

The organised banking in regulated form started in 1921 when the Imperial Bank of India was constituted under a Special Act. In 1995, the Imperial Bank of India was converted into State Bank of India. It is regarded as a red letter day in the annuuals of Indian Banking. With the establishment of the State Bank of India, the Government associated banks were made subsidiaries of the State Bank of India. At the time of the take over, subsidiaries were eight since the amalgamation of State Bank of Jaipur and State Bank of Bikanar in 1963, the number has gone down to seven.\(^5\)

2.2.6 Rural Bank

The rural banking has become high cost operation because of the low spread between the cost of funds and the rate of yield on advances. The situation worsened because of low interest rates and loan waiver schemes. Also, the relatively lower volume of business handled by the rural branches.\(^6\)

2.2.7 Lead Bank

A particular nationalized commercial bank has to assume the major role in the development of banking and credit in the concerned district but it is not

5. Gadgil Study Group of the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development, RBI, Mumbai, 1981, p.84.

expected to have a monopoly of banking business in that district. It is required to act as the consortium leader. After identifying under-banked areas and areas suffering from credit gaps, it has to enlist the co-operation of other banks operating in the district.  

2.2.8 Banking System

The expression 'banking system' or 'banks' means (i) The State Bank of India and its subsidiaries, (ii) nationalized banks, (iii) banking companies as defined in the banking regulation act 1949, (iv) co-operative bank as far as scheduled commercial banks are concerned and (v) any other financial institutions notified by the Central Government in this behalf.  

2.2.9 Branch Expansion

This means expanding the banking facilities in rural and semi-urban areas in keeping with the national objectives. Nationalised banks took the cake, opening 914 branches in the three-year period between 1998-99 and 2000-01. The total number of branches had risen to 67,929 as on March 31, 2001.

2.2.10 Variables

a) Deposits

Deposits are money held in banks and similar deposit-taking institutions that are transferable by cheque or withdrawal in cash without notice.\(^{10}\) In ordinary usage, after meeting the regular recurrent expenses, the money put in by a person in a bank by opening a deposit account is called "Deposit".

b) Advance/Credit/Loan

Bank loan commonly means any advance made by a bank. A bank advance specifically in the form of a loan is credited in full to the borrower’s account at the outset and the interest liability may be a fixed sum calculated on the initial loan and its duration. But in the case of personal and term loans, there is a provision for repayment by regular instalments.\(^{11}\)

2.2.11 Priority Sector Credit

Reflecting the changes as of March 2001, the priority sector credit of the banks comprises the following:

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.

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c) Small business with original cost of equipment used for the business not exceeding Rs.1 million and working capital limit of Rs.50,000.
d) Small road water transport operators owning upto 10 vehicles.
e) Retail traders (Upto Rs.50,000).
f) Professionals and self-employed persons (Upto Rs.50,000).
g) State sponsored organisations 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 loans under the consumption credit scheme for weaker sections.

2.2.12 Norms

As on March 1991, agricultural advances of the PSBs were Rs.15,857 crores which increased to Rs.53,685 crores as on March 2001. Even as on March 2001, the ratio of agricultural advances to NBC was short of 2.35 per cent of the 18 per cent stipulation. (This ratio was to be achieved by March 1990 as per the RBI's directives). The ratio of direct agricultural advances of the PSBs to NBC got reduced from 13.66 per cent in March 1994 to 11.10 per cent in March 2001. As on March 2001, in the case of 13 PSBs, the direct agricultural advance to NBC was less than the All-India average of 11.15 per cent.¹²

2.2.13 Small Scale Industries

The industrial policy resolutions of August 1991 defined the small scale industry units as those with investment ceiling in plant and machinery at Rs.35 lakhs later raised to Rs.60 lakhs; those ancillary units with investment ceiling at Rs.40 lakhs later raised to Rs.75 lakhs and those units with investment ceiling at Rs.2 lakhs later raised to Rs.5 lakhs.¹³

2.2.14 Other Priority Sector

This includes the credit to transport operators, small business, professionals, self-employed, consumption loan, housing finance, and others. The share of this sub-sector to NBC of the PSBs has been continuously increasing during the reference years, it stood at 11.8 per cent as on March 2001 as against 7.4 per cent in 1994.¹⁴

2.2.15 DRI Scheme

The differential rate of interest scheme was introduced in 1972. With a view to providing financial assistance at concessional rate of interest at four per cent to the eligible weaker sections of the community, intended to cover all the

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parts of the country by 1977.\textsuperscript{15} The amount of loan outstanding went up to Rs.24,895 crores in March 2001.\textsuperscript{16}

2.3 REVIEW OF LITERATURE

Numerous research studies have been conducted with regard to the role of banks in the field of development. Here an attempt is made by the researcher to review some of the earlier studies having relevance to the present study.

Reddy\textsuperscript{17} pointed out that three important principles stood out as essential for credit advancement to farmers: (i) The quantum of credit should be rationally determined. It should take into account the normal savings of a big farmer which was supposed to be ploughed back for agricultural operations as against the total demands of small subsistence level farmer. (ii) timeliness of advancement, that is the credit needs of the cultivator should be met before the actual farming operations started. (iii) cultivators could repay the loan out of the sale proceeds of the crops after harvest.

\begin{itemize}
\item \textsuperscript{15} "Credit Planning for Priority Sector", \textit{Bank of Baroda Weekly Review}, Vol.17, November 30, 1979.
\item \textsuperscript{16} Report on Trends and Progress of Banking in India, \textit{RBI Bulletin}, 2001, p.29.
\end{itemize}
Pai\textsuperscript{18} in his study warned the State Governments against the writing off bank loans in contravention of the established State procedures and norms. The rot had started with loan melas conducted by Central Government leaders. There were blatant violations of banking laws and norms.

Rajendra Singh\textsuperscript{19} in his study on mounting arrears of agricultural credit outlined that heavy and mounting overdues and poor recovery performance posed a serious threat to the process of institutionalising rural credit. The factors responsible for this state of affairs, according to him, were defective appraisal of loan applications and inadequate monitoring of credit utilisation, impact of natural calamities, mis-utilisation of credit and weaknesses in recovery procedures. The banks had then no powers to exert pressure on defaulters.

Kewal Kumar\textsuperscript{20} in his book 'Institutional Financing of Indian Agriculture with special reference to Commercial Banks' stated that the development of agriculture was the kingpin of India's development. This study included vivid descriptions of the problems of agricultural finance as it was the much needed

\begin{footnotesize}
\begin{enumerate}
\item Kewal Kumar, \textit{Institutional Financing of Indian Agriculture with Special Reference to Commercial Banks}, Deep & Deep Publication, New Delhi, 1987, p.74.
\end{enumerate}
\end{footnotesize}
input for the development of agriculture. He advocated that an integrated credit policy for the future should be adopted by the institutions supplying agricultural finance, as the provision of agricultural credit in the context of modernization of agriculture had become a necessity.

The study of B.N. Choubey on ‘Agricultural Banking in India’ offered a detailed description of the various institutions which were actively engaged in the task of financing agriculture. But after reviewing the impact of the institutional credit on agriculture, it was observed by the author that despite the complexity of institutions like co-operative, commercial banks, RRBs and NABARD, the agricultural sector still was suffering for want of adequate funds.

N.S. Sridhar studied the provisions of banking facilities in all parts of the country, both urban and rural and in all segments of the community-industry, agriculture and the rural poor. He found that the profit goal was tempered with ‘social gain’. Performance of commercial banks, particularly the public sector banks, came to the judged on the basis of the twin objectives of profitability and social gain, the latter objective often engulfing the former objective in the rural sector.


Desai\textsuperscript{23} observed that banks played a key role in rural development. Wealth was created as a result of the application of human effort, both passive and active. The bankers, who thought of rural development, planned it in all its details, mobilised the material and human resources for the projects and benefited by the integrated development of the command area of their operations. The characteristics of banking were knowledge, vision, meticulous micro-level planning, drive, dynamism and translation of the plan into a reality.

N.P. Srinivasan and Saravanavel\textsuperscript{24}, stated that the National Bank for Agriculture and Rural Development” (NABARD) had initiated several steps to accelerate the flow of institutional credit to the rural and village industrial sectors. However, the process of organisation and development of non-farm activities in rural areas were gigantic and complex in nature. The flow of credit to rural area and their viability were constrained by:

i) Proper integration of promotional programmes with other areas, especially IRDP areas.

ii) Restructuring of organisational base at the district level to make it more effective and result-oriented.


\textsuperscript{24} N.P. Srinivasan and P. Saravanavel, \textit{Development Banking in India and abroad}, Kalyani Publication, New Delhi, 1988, p.213.
iii) Strengthening and expansion of co-operative form of organisation and

iv) The overdues, both natural and unnatural, caused by socio-economic and political considerations.

A.K. Srivastava\(^\text{25}\) noted the integration between the forces of economic, social, cultural and political changes in implementing the IRDP in the State of Punjab. He concluded that while making the plan for integrated rural development of a block, full advantage was taken of all schemes which were in operation in the area. The State Governments, should in fact, give special attention to those blocks if the objective of full employment was to be achieved within a definite time frame.

Ram Davar\(^\text{26}\) in his work, "Institutional finance to Small-Scale Industries", stated that small-scale industries were instruments of socio-economic transformation of the rural sector. He opined that despite the efforts of Government, small-scale industries still suffered for want of funds. He held that finance was the pre-requisite for the survival of small industries and could be made available by the Government through commercial banks.

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Kulkarni\textsuperscript{27} stated that while considering bank's costs and profits, social benefits arising out of bank's operations should be ignored. He claimed that profit maximization approach was out of place while referring to profitability of banks. He recognised that while fulfilling the social responsibility, banks should try to make the developmental business as successful as possible, reduce costs, improve banking system and increase the overall productivity.

Mahesh Vijapurkar,\textsuperscript{28} quoting from the Report of the Economic Research Department of the State Bank of India, pointed out that none of the aspects like knowledge of work, interest and availability of infrastructure were given due importance in the scheme for providing Self-Employment to Educated Unemployed Youth (SEEUYP). It was also observed that although some ineligible applications were returned to the District Industries Centre (DIC), the bank's branches could not send back may applications even if they were not found to be viable as often outside pressure was used to sanction loans.

G.P. Acharya\textsuperscript{29} found that banks played a key role in rural development. The service area approach of banks was welcomed by many as a distinct.


improvement over the approaches hither to adopted for rural development. Analysing the expectations and apprehensions which the scheme had raised, he said that it was another experiment to lift the rural masses. How far the approach succeeded would depend on how one faced the different constraining forces such as encroachment on the freedom of the customer, fear of monopoly, difficulty in allotment and transfers of the area and greater strain on the branch managers.

V.K. Hardikar30 observed that banks were not following liberal credit policy in the matter of advances to agriculture and rural sector industries. The chairman and directors of banks were mostly industrialists and many of them were interested in sanctioning large advances to the industries with which they were connected.

H.V.R. Lengar31 said that he was not particularly excited by nationalisation, but apprehended the extent to which those sensitive financial institutions might be influenced by political factors. He was particularly apprehensive of the large advances in rural areas. He recalled the euphoria in Government circles after nationalisation. The targets set for agricultural credit was achieved but in the process, several banks burnt their fingers.

Pathak\textsuperscript{32} observed that many studies had shown that affluent landlords even after getting huge income did not repay. On the contrary small farmers repaid regularly despite in sufficient income. The bank should therefore impose deterrent punishment on wilful defaulters and allow concessions in genuine cases.

O.P. Chawla, et al\textsuperscript{33} in their study on impact of Differential Rate of Interest Scheme made an attempt to ascertain whether DRI lending was reaching the intended beneficiaries and whether the scheme was achieving the purpose of assisting these people to improve their socio-economic conditions. They concluded that majority of the borrowers had recorded positive changes in their economic position. The small changes in their occupational pattern were also positive. The non-DRI debt of these people had also declined to a considerable extent. DRI loans had replaced the money lender. Borrowers contacted by them felt that they were now treated better in their communities.

S. Krishnama Raju\textsuperscript{34} identified the impact of bank finance, on both the quantitative and qualitative improvements and on the weaker sections of the society in Andhra Pradesh. Important findings of the study were that there was a

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  \item \textsuperscript{34} S. Krishnama Raju, \textit{Bank Finance and Rural Development}, Discovery Publishing House, New Delhi, 1992, p.59.
\end{itemize}
positive relationship between the amount of loan disbursed and the household income, between employment and asset position of activities financed during pre-loan and post-loan periods. Among the three sectors namely agriculture, animal husbandry and tertiary sectors, the impact was less in tertiary sector. Returns to labour and returns on investment were positive in all the three sectors. The repayment performance was better in agricultural sector than in other sectors.

B.B. Tandon, et al.,\textsuperscript{35} in their study on 'Banking and Rural Poverty' remarked that rural banking and rural credit would not solve the problem of rural poverty, unless other essential components of infrastructure were provided. They observed that the period during which rural credit and infrastructure were available, rural development took place and percentage of number of persons below the poverty line sharply declined. Hence, what was required was to provide facilities and environment with the help of various development agencies, whereby credit should automatically flow into rural areas.

Sankareswaran\textsuperscript{36} in his study pointed out that the policy of the Governments was to dole out money or grant loans liberally to farm families so that the ruling party men could stay in power. This approach committed the


community and the country to perpetual indebtedness, affecting even future generations.

C.S. Rayudu and C.N. Krishna Naik\textsuperscript{37} in their work, "Management of Rural Banking", have attempted to assess the role of institutional agencies in the field of rural development in India. The main aspects examined in this study included the ways in which the rural credit was managed by several types of institutions exclusively established and operated, and the way in which they had been formed, the sources of funds, utilisation of funds, borrowings, institutional support, Government assistance and performance of financial institutions. Important suggestions given by them relate to development of adequate banking infrastructure, deployment of adequate amount of credit, sanctioning of multi-purpose and multi-term credit to a household, ensuring end use of loan, periodical and comprehensive survey of each household and formulating suitable deposit schemes to motivate the people to deposit more.

J. Chokka Rao\textsuperscript{38} in his study 'An Integrated Approach to Rural Development' remarked that the most important factor responsible for the tardy performance of IRDP was the lack of commitment and dedication on the part of


\textsuperscript{38} J. Chokka Rao, \textit{An Integrated Approach to Rural Development}, Financial Express dated 02.10.92.
officials connected with identification, formulation, appraisal monitoring and evaluation of various rural development schemes. At the same time, the dedicated officers were subjected to harassment and the end result was that the finance for implementing the scheme got diluted.

Varde\textsuperscript{39} identified the conditions of commercially profitable banking units consisting of standard complement of staff, the determination of the man-power requirements for an individual rural branch and the like. The rural branches operating in groups of 4 and 5 would function more effectively than a single individual branch. It was necessary as well as possible to make efforts to rescue the rural branches operating at a low volume of business and those having large volume of overdues. The location of a rural branch should be at the hub of activity.

Shravan Kumar\textsuperscript{40} in his study pinpointed several lapses and drawbacks of the rural development programmes. The funds instead of going to the needy found their way to some selected favourable families which were patronized by the local political leaders. The subsidy is the main attraction in Integrated Rural

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Development Programme. Even a big landholder presented himself as a small and marginal farmer by hiding his land holdings.

Karthikeyan⁴¹ in his article indicated that the priority sector advances could be made viable and purpose-oriented by adopting a planned strategy for.

i) realistic service area credit planning.
ii) adopting project approach in implementing the plans.
iii) availing maximum refinance from NABARD and SIDBI.
iv) timely follow-up and instituting appropriate action for recovery.
v) invoking DICGC guarantee wherever possible.

Moin Qazi⁴² said that the Nariman Committee had warned that the additional burden arising out of mass opening of rural branches would adversely affect the resilience and viability of banks to face unforeseen situations. What was needed was to strike a reasonable balance between the imperative need to extend banking facilities to rural areas and the prudent desirability to sustain the viability of banks. Apart from deployment of credit, there should be supporting infrastructural facilities like marketing, guidance regarding proper cropping patterns, training programme for rural artisans and technological upgradation of equipments used in villages.

Subash Garg\textsuperscript{43} in his study on 'Social Banking in Rajasthan' analysed the growth and performance of commercial banks in social banking. According to him, through efficient management of the resources improvement in work technology and proper deployment of man power, the banking system could play a significant role in the field of social banking.

R. Srinivasan\textsuperscript{44} who undertook a study on priority sector lending in India emphasized that for improved profit performance, man power productivity was the most significant factor. According to him, it had been proved that one unit increase in man power productivity raised profit by 1.5 units. While productivity of balance sheet items increased profit by 0.58 units and productivity of fund operation by 0.21 units, the Indian banks had lost the opportunity to upgrade the work technology mainly because of the resistance of labour. Neither most of the individual banks nor IBA had made any headway in convincing the unions that computerisation was to their long term advantage.

B.S. Sandhu\textsuperscript{45} concluded that though the State Bank of Patiala was rendering great service in the field of rural development in the district of Patiala


\textsuperscript{44} R. Srinivasan, Priority Sector Lending–A Study of Indian Experience, Himalaya Publishing House, Mumbai, 1995.

and Sangrur, the financing process of the bank suffered from a number of bottlenecks like complex banking procedure, lack of dedication and devotion on the part of bank officials, non-co-operative attitude and behaviour of bank personnel, non-participative attitude of people in general and that of IRDP beneficiaries in particular and absence of pre and post-supervision of utilisation of financial assistance given by the bank.

V. Rengarajan and N. Rajan\textsuperscript{46} in their study, "Infrastructure of Rural Credit—A Case for Link Roads" emphasized the need to give priority for provision of "link roads" in the context of planned deployment of credit in each one of the Indian villages. They concluded that it was a high time on the part of Central and State planning authorities to seriously think on the proper strategy for the development of infrastructure particularly in rural areas, taking cognizance of the country-wide massive credit planning exercise by the bankers for deployment of crores of rupees in Indian villages. For the bankers, any investment without adequate infrastructure would become infructuous leading to low generation of income to the borrowers on the one hand and high generation of overdues to the bankers on the other.

\textsuperscript{46} V. Rengarajan and N. Rajan, "Infrastructure of Rural Credit—A Case for Link Roads", \textit{IOB Quarterly New Review}, Vol.viii, No.2, April-June, 1996.
V. Rengarajan⁴⁷ emphasized the significance of micro financing in rural India to increase productivity, income and standard of living of the people. He stressed that when positive results were evident from the experiment in linking formal institution (Bank) with the informal ones (SHGs), similar innovations could be thought of for linking other informal types of social and religious institutions at the grassroot level with those of formal ones in India, provided they also contributed to the ultimate purpose of rural credit without waiting for either Bangladesh or Indonesia to launch.

P. Devarajan⁴⁸ stated in his article that even in the present liberalized and competitive environment, rural banking was as relevant as it was before. To carve out an efficient and vibrant rural banking system in the direction of actualizing the overall organisational excellence, the Indian bankers must reorient their attitude and develop a positive outlook for rural banking to meet the emerging challenges.

S. Arunajatesan and S. Balaji⁴⁹ in their study entitled ‘Financing Agriculture–Need to Adopt an area-wise approach’, remarked that in the banking

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parlance, lending to agriculture meant extending finance to small and marginal farmers. But there were medium and large farmers whose landholdings accounted for nearly 44 per cent of the total cultivable area. This segment really offered a tremendous scope for secure lending by banks on commercial basis. Among these farmers, the younger generation was enterprising, forward-looking, knowledgeable, willing to adopt scientific and modern techniques and have an entrepreneurial drive to compete and succeed.

C.K. Mehrotra\(^{50}\) found that Linkage Banking–State Bank’s experience highlighted the significance of SHGs. According to him, banks were attracted to the concept of SHGs mainly on account of low transaction cost, high percentage of recovery and mobilisation of rural savings through an informal system. He concluded that SHGs might eventually be the only viable route for rural lendings and it called for proper orientation and sensitisation of the branch functionaries so that they adopted a positive and constructive approach in financing NGOs and SHGs.

N. Srinivasan\(^{51}\) in his study entitled, Budgeting for Rural Finance, pointed out that the 1998-99 budget devoted considerable time and space to the rural sector and several initiatives had been announced to boost different rural economic


activities. The budget sought to strengthen NABARD's share capital base by an additional Rs.500 crores. It also set a side Rs.265 crores for recapitalising the RRBs to improve the poor people's access to credit, NABARD had been asked to ensure the linkage of two lakhs SHGs over the next five years.

N.B. Sheta⁵² in his study entitled, “Changing Role of Commercial Banks in lending to Agriculture”, stated that the growth and development of agriculture in India had moved through at least three different phases. Historically, agriculture was viewed as a sector to user in self-sufficiency in foodgrain production, in which the market orientation was minimum. The second phase was the green revolution involving production oriented scientific development and stress on applying science and technology to enhance the production of basic crops. From this phase, it had recently moved into the third phase in which commercialization, hi-tech agriculture, processing, marketing and the like were given importance.

R.M. Chidambaram⁵³ in his study entitled ‘Marketing Mix for Viable Rural Banking’, vividly explained the six different components of marketing mix of a banker namely, place, product, price, promotion, people and procedure. He concluded that the lackluster performance of rural banking in rural India was unacceptable. Endeavouring viable rural banking was the joint responsibility of

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the RBI, the IBA, Central and State Governments, banks in the public, private and co-operative sectors and the society.

Das\textsuperscript{54} revealed the banks belonging to State Bank of India Group were, in general more efficient than nationalized banks. Furthermore, the in-efficiency that existed in public sector banks was more a result of both technical and allocative in-efficiency. The study also confirmed the significant negative relations between non-performing assets and efficiency and size and efficiency.

Saha and Ravisankar\textsuperscript{55} rated 25 public sector banks using data envelopment analysis. The result showed that the Corporation Bank, Oriental Bank of Commerce, State Bank of India, Canara Bank, State Bank of Hyderabad, Bank of Baroda and Dena Bank were to be consistently efficient banks.

Shanmugam and Lakshmanasamy\textsuperscript{56} identified that a high rank correlation among efficiency value computed in different approaches had also been observed. The estimated results indicated that the deposit was the dominant factor in determining the output of the banks in all the models.


A. Mukherjee, et al.\textsuperscript{57} made an attempt to explore technical efficiency and benchmark, in the performance of 68 commercial banks using data envelopment analysis. For this they utilized the data for the period 1996-99. It was found that in India public sector banks were more efficient than both private and foreign banks. Also the performance of public sector banks improved over the study period. Besides this publicly owned banks were rated uniformly in terms of self-appraisal as well as peer-group appraisal.

Vageesh (2004)\textsuperscript{58} found that rural credit would never be profitable at rates less than 24 per cent, given the cost of operations there. Agricultural loans could be provided at 6-9 per cent using technology. Rural credit would become attractive-on its own merit as a good business proposition.
