CHAPTER – II

OVERVIEW OF LITERATURE

2.1 INTRODUCTION:

This chapter brings out an overview of literature relating to the problem.

2.2 BROAD CLASSIFICATION OF LITERATURE:

The number of articles published in various periodicals, journals and books have been studied for understanding the various aspects of the problem.

Broadly, the literature can be divided into two parts, viz. the articles written with respect to rural credit system on banking, in general, and the articles written on regional rural banking in particular.

At first, these articles were studied mainly to understand the state of the rural banking in India vis-a-vis the position and the role of the regional rural bank scheme in the banking system.

2.3 REVIEW OF STUDIES RELATING TO BANKING AND ECONOMIC DEVELOPMENT:

We present below an overview of the literature related to banking, in general, followed by a review of the literature on rural banking.

Some economist who considered banking system, in particular, and financial intermediation, in general, as one of the most important activating factors causing economic development are being quoted herebelow.

A study and scan of the existing literature on the efficiency of Indian banks provides that there exists various studies that analyzed the efficiency of Indian commercial banks using most popularly used parametric technique of Stochastic Frontier Analysis (SFA) and non Parametric technique of data Envelopment Analysis.

It is usual to measure the performance of banks using financial ratios. Yeh (1996) notes that the major demerit of this approach is its reliance on benchmark ratios. These benchmarks
could be arbitrary and may mislead an analyst. Further, Sherman, and Gold (1985) note that financial ratios don’t capture the long-term performance, and aggregate many aspects of performance such as operations, marketing and financing.

Many studies have been conducted by researchers on NPAs in banking industry. The researcher has made attempts to present a brief review of the literature available, which are published in the form of research articles and technical papers published in the journals, magazines and websites in the related area.

Cole et al. (2009) concluded that financial literacy programme has no effect on the likelihood of opening a bank saving account, but do not find modest effects for uneducated and financially illiterate households. In contrast, small subsidy payment have a large effect on the likelihood of opening a saving account.

Deshpande 1998 attempted a case study of two commercial bank branches in Maharashtra command area for evaluating performance of commercial banks in financing agriculture. In this studied the non interest cost incurred by the sample beneficiaries revealed that in almost all kinds of loans cost of records shared was the maximum in rural branch. With regard to cost towards trips to bank, beneficiaries in rural branch did not incur any cost because of proximity of bank.

The literature available in the working and performance of WKGBs in India is a little limited. The literature obtained by investigators in the form of reports of various committees and working groups established by the Union Government, NABARD and Reserve Bank of India, the research studies, articles of researchers, bank officials, economists and the comments of economic analysts and news is briefly reviewed in this part.

A number of studies have been conducted to see the functioning and performance of regional rural bank in the country. The literature available in the working and performance of WKGBs in India is a little limited. The literature obtained by investigators in the form of reports of various committees, commissions and working groups established by the union Government, NABARD and Reserve Bank of India, the research studies, articles of researchers, bank officials, economist and the comments of economic analyst and new is briefly reviewed in this part.

Bhatia (1978) attempted to analyzed the economic performance of Indian Banking system as reflected in its output, price and profitability over the period 1950-68. The main
findings of this study are: i) the profit performance of Indian Banking System during the period 1950-68 has been satisfactory; (ii) the structure of banking system (represented by the number of bank offices and the deposit concentration ratio) during the period has an insignificant effect on its performance.

Evolution of an effective institutional credit structure, which can meet the credit needs of the rural economy, has been one of the basic objectives of credit policy in India. The reserve bank of India has policy of institutionalization of rural credit in India. All India rural credit survey report recommended the three tier cooperative credit system, viz. state cooperative bank, district central cooperative bank, and primary cooperative societies, at state, district, and village level respectively.

The adoption of financial liberalization reforms has been a very laudable initiative given the extent of financial repression that was prevalent prior to these reforms and the stifling effects of repression on both the financial sector itself and on the economy as a whole. The rural population in India suffers from a great deal of indebtedness and is subject to exploitation in the credit market due to high interest rates and the lack of convenient access to credit.

Mr. Besant Kalian (1989) :- The paper makes an effort to first gather the major reforms measures and policies regarding the banking industry by the govt. of India and the Central Bank of India (Reserve Bank of India) during the last fifteen years. Secondly, the paper will try to study the major impacts of those reforms upon the banking industry.

The rapid growth of cities in the developing world has led the struggle for improved living standards and protection of the environment. Since 1950's the Urban Population throughout the world has more than tripled, from just over 750 million to about 3 billion, and by 2030 some 5 billion people will live in cities. In the developing world the urban population is projected to double from 1.9 billion in 2000 to be just under 4 billion by 2030 (M.L. Narasaiah - 2003:1)

From the above analysis it was concluded that total factor productivity change (TFPCH) in performance of nationalized banks Total factor productivity change (TFPCH) in performance of Regional Rural Banks averaged at 1.3 percent during 1991-92 to 2006-07 The decomposition of TFPCH showed that the mean technical progress increased at .9 percent whereas mean technical efficiency has shown a marginal increase 0.1 percent during that period.
The rural finance is a matter of credit concern in a developing economy like India where 70 percent of the total population depends upon agriculture for its livelihood. Over 40 percent of the GDP in India is contributed by the rural sector. The economic development of our country can be achieved only through the up-liftment of the village folk that mainly consists of farmers, agricultural labourers, artisans etc.

Risk management and income recognition is the basic principle to restore and enhance the financial strength of the banking industry. At International level this principle has constituted in 1974 by the Basel Committee to strengthen the supervisory standard and risk management strategies and suggested the assets classification and recognition norms. Reforms in the financial sector went through two distinct phases.

Banks perform many economically beneficial functions. These functions can be classified into primary and secondary functions. Among the primary functions of banks are:
1) acceptance of deposit; and
2) granting of loans and advances (www.nios.ac.in/rec).

Deposit mobilization as noted by Ekezie (1997) is one of the most important functions of a bank.

Although the relationship between financial development and economic growth has been extensively studied in the literature (see, e.g., King and Levine, 1993; Demetriades and Hussein, 1996; Arestis and Demetriades, 1997; Levine et al., 2000; Bell and Rousseau, 2001; Luintel et al., 2008), little is known about how finance impacts on income inequality.

Literature review is a study involving a collection of literatures in the selected area of research in which the scholar has limited experience. In the past, various studies relating to the financial performance of Regional Rural banks have been conducted by researchers Gunjan M Sanjeev (2009) conducted a study on Efficiency of Indian public sector banks and found that the efficiency of public sector banks not increased during the period 2003-07.

Rural banks are primarily created to play a special role in regional economic development in the Philippines. They generally serve small country-side borrowers and act as conduits of subsidized loans from the government and international donors. In 1952, the government enacted the Rural Banking Act and embarked on a program to enable rural banks to effectively compete with the larger universal and commercial banks and to increase investments in the regions.
Microfinance is the provision of financial service to the economically active poor who are hitherto un-served by the mainstream financial service provider. Microcredit is commonly defined in terms of loan amount as a percentage of average per capita income. In the context of Nigeria, with a per capita GDP of N112,800 (about $752) in 2008, loans up to N112,000 (around $750) will be regarded as micro loans.

RRBs though operate with a rural focus are primarily scheduled commercial banks with a commercial orientation. Beginning with the seminal contribution of Haslem (1968), the literature probing into factors influencing performance of banks recognises two broad sets of factors, i.e., internal factors and factors external to the bank.

The equation system is fitted using the 3SLS procedure. The results of the estimation process are contained in Table 5. As observed from the Table, the first hypothesis is borne out by evidence since the coefficient on the expense ratio is negative and statistically significant in the RoA equation.

Government of India has taken various steps for alleviating poverty since Independence. However, in spite of the various efforts, almost 27 percent of total population in India still continues to be below the poverty line. It is identified that most of the poor are in the rural areas. Further, along with this poverty scenario, no adequate employment has been generated in the labour market in India.

Financial sector reform has been a major component of the structural adjustments being implemented in India since 1991. A key focus of these efforts has been on reforming the Regional Rural Banks (RRBs)—India’s state-owned development finance vehicles charged with serving the rural poor, especially microentrepreneurs, in the agricultural and nonfarm sectors.

The institution of Regional Rural Banks (RRBs) was created to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalised sections. Although the cooperative banks and the commercial banks had reasonable records in terms of geographical coverage and disbursement of credit, in terms of population groups the cooperative banks were dominated by the rural rich.

The state of Maharashtra occupies the most prominent position in the economic and banking map of India. It is the most economically advanced state in India. It contributes the largest share to national income. It is most urbanized and industrial state in the country. It is also
the birthplace of co-operative credit movement in the country and continues to have strong co-operative credit institutions, both at urban and rural centers.

You work for a local economic development agency for a living. Or you look into the workings of the regional economies across your state for a university business research center. Or you are a graduate student wanting to get a handle on the how-to of regional economic analysis. If your aim is to understand, explain or have some positive impact on a regional economy, you need to find, and make sense of, pertinent socioeconomic data.

It could be appropriate to review some of the works done by the former researchers in the field of Karnataka Vikas Grameena Bank n Agriculture development by beneficiary farmers to prepare a suitable background for the present study. It helps to acquire a broad general background in the given field. It provides basis for theoretical framework and insight into methods and procedures of research. Since very few related studies are available on profile borrowers of Regional Rural Banks.

This paper describes the changes caused by the global financial crisis in the strategic and operational choices made by local banks embedded in territories where Italian technological districts are located, which can be described as cases in which industrial policies have successfully promoted innovation.

Bahia and Nantel, (2000) developed Bank Service Quality (BSQ) scale to measure the quality perceptions in banking activities. Shafie and Azmi (2004), their working paper 001 stated that ARTER’s six dimensions (Compliance, Assurance, Reliability, Tangibles, Empathy, and Responsiveness) were conceptualized as a proposed framework for measuring quality of services in Islamic banks.

The overall growth of an economy is dependent to a great extent on the efficiency and soundness of its banking system. A sound banking system serves as an important medium for pushing economic growth by mobilisation of small savings of unproductive domestic sector and putting them to the productive use. Given the socioeconomic implications of the banking sector the analyses of relative efficiency of banks has gained popularity among people from banking sector, policy makers, researchers and academicians and other interested parties.

Pragathi Gramin Bank has been serving the rural population since past 27 years in Deodurga Taluk, Raichur district. Over the years it has evolved many saving products keeping in view the customers preferences. It has used campaigns, special deposit mobilization fortnight,
farmers clubs etc as saving mobilization strategies. Mainly bank officials are involved in such mobilization campaigns.

This section provides the overview of previous studies reviewed related to the determinants of the profitability of banks. Some studies were country specific and few of them considered panel of countries for reviewing the determinants of profitability. Overall these studies propose that the determinants of profitability for bank can be divided into two groups; internal and external factors.

This paper explores the impact of various forms and levels of ICT on the performance of rural cooperative banks using recent survey data from India. Findings from the research suggest that modern information technology serves to enhance both the efficiency and profitability of the rural credit institutions. Efficiency was significantly enhanced by the usage of moderate technology at the lower organisational level, e.g. stand-alone computers at the branch level, mobile phone usage at PACS (Primary Agricultural Credit Society) and field level.

In this study we discussed issues and challenges encountered in a computerization project being carried out by the ARB Apex Bank to connect rural and community banks in Ghana. The ARB Apex Bank embarked on the project to make the benefits of computer and networking technologies available to member rural banks. The study selected some rural banks engaged in the first phase of the project and sampled fifty respondents for questionnaires.

The rural environment in Ghana as in many African countries is characterized by lack of basic amenities and infrastructural facilities. Primary production in the form of agriculture and fishing dominate the rural economy. Farm operations and fishing expeditions are carried out with the help of simple tools, local varieties of crops and primitive fishing equipment.

It is the study of various literatures on the level of information technology, and customer satisfaction in the banking sector. It has also emphasis the way in which a customer has access to a bank’s services and products, mainly through the use of automated processes such as computerized banking (Cash and James T, 1994)

Indian Economy : As per the RBI report, the Indian economy continued to record strong growth during 2007-08, albett with some moderation. With adverse effect of global recessions on Indian industry and service sector, the Real GDP growth rate of India, has declined from 9.6% in 2006-2007 to 9% in 2007-08. But the overall growth of real GDP rate of the Indian economy during 2007-08 was noteworthy in the global context.
In the area of payments systems there have been significant advancements of technology on the customer transactions. India is one of the countries that has effectively tackled huge volumes of paper instruments in a cost-effective manner. The magnetic ink Character Recognition (MICR) cheque clearing system, cheque transaction system (CTS) is another innovative solution that has been developed to enhance the efficiency of paper-based clearing system.

An retrospect of the events clearly indicates that the Indian banking sector has come for away from the days of nationalization. The Narasimham Committee laid the foundation for the reformation of the Indian banking sector. Constituted in 1991, the Committee submitted two reports, in 1992 and 1998, which laid significant trust on enhancing the efficiency and viability of the Banking sector.

Joseph Schumpeter has given a significant place to the role of capital and credit system in his analysis of economic development, according to him,

*Is spontaneous and discontinuous change in the channels of the circular flow, disturbance of equilibrium which forever alters and displaces the equilibrium state previously existing.*

Schumpeter assigns the role of an innovator to an entrepreneur, but innovations are possible only if proper, timely and adequate credit facilities are made available by the banks. Therefore, for Schumpeter, extension of credit was an indispensable prerequisite of economic development.

Credit performs certain important functions in the economy. The essential function of credit consist of enabling in the entrepreneur to withdraw the producer’s goods, which he needs, from their previous employment, by exercising a demand for them and thereby to force the economic system into new channels. These new channels are created in the form of new combinations of economic activity, which create a disequilibrium in the economy, in the words of Schumpeter,

*In this sense, therefore, we define the kernel of the credit in the following manner. Credit is essentially the creation of purchasing power. The creation of purchasing power characterizes, in principle, the method by which development is carried out, in a system with private property and division of labour. By credit, entrepreneurs are given an advanced access to the social stream of goods for which normally they would have been compelled to wait till they accumulate their*
own resources. It temporarily substitutes, as it were, a fraction of this claim itself. Granting credit, in this sense, operates as an order on the economic system to accommodate itself to the purposes of the entrepreneur, as an order on the goods which he needs. It means entrusting him with productive forces. It is only in this way that economic development could arise from the more circular flow in perfect equilibrium. Creation of such credit is the most important function of banks and hence, along with entrepreneurs, “purveyors of credit” is the other key agent in the process of development.

Gerschenkron’s hypothesis is one of the most widely discussed and fairly recent explanations of the role of banking in the historical process of industrialization the industrialization of the once backward countries in particular.

In the entire analysis given by Gerschenkron, banking system is not the only factor considered to be effective in fostering economic growth through industrialization, but certainly it is the key factor playing an important role at certain stages of industrialization.

The conclusion from Gerschenkron’s analysis of English, German and Russian development experiences should be that at every stage of industrialization, banks not only can promote economic development but can even participate in it, provided the conditions are suitable and the banks themselves take the initiative.

**RECENT STRATEGY OF RURAL DEVELOPMENT:**

Until recently, most of the Third World countries, for whatever reasons, almost blindly imitated the developed Countries in pursuing policies for economic development with heavy accent on industrialization. Such a policy benefitted largely the urban people, because industries are usually set up in the areas with relatively greater infrastructural development. This industry-oriented growth policy of the third world countries has not significantly helped in the improvement of rural economic conditions. Experience shows that this unco-ordinated approach resulted in the failure of most of the efforts towards rural development.

Besides, the benefits from the programmes implemented by the Government were found to have been grabbed by relatively advantaged farmers and other elite of the rural societies. Appreciating the consequences of the faulty programmes and approach to rural development, the World Bank in 1978 identified the need for a comprehensive approach to rural development and
advised the member developing Countries to adopt the same. This approach is multi-sectoral, embracing a wide range and mix of activities like agriculture, poultry, dairying, fisheries, rural industries, trade, etc. It also encompasses improvement of health education, communication, housing and recreational facilities. It is to be noted here that the Government of India, through its plan Policy documents has accepted it.

This approach, integrated Rural Development Programme (IRDP), has helped to foster a sense of self-reliance among the rural people, which would ultimately improve the Physical quality of Life Index (PQLI) of the Rural areas.

Land being most important source of rural income, a perusal of the rural land ownership pattern in India shows $\frac{3}{4}$ of the rural households, who are mostly small/marginal farmers and agricultural labourers, own only around one-quarter of the rural cultivable land. This apart, the Indian National Council for Applied Economics and research has estimated that 63% of the rural households had no savings at all.

As in the vicious circle described by Nurkse, small capacity to save, resulting from low level of income, itself is the reflection of poor productivity which, in turn, is the result of small savings.

The Indian economy is predominantly an agricultural economy. This is explained by two major factors, viz. (1) a major proportion (42%) of its national income originates from the agricultural sector, and (2) about 73% of the total employment is provided by this sector. The All India Rural Credit Survey Committee (1954) has aptly described this fact as “India is essentially rural India and the rural India is a virtually the cultivators”.

Hence, it is necessary to develop the agricultural sector of the Indian economy. But unfortunately, even during the course of independence period, the agricultural sector has not been given its due importance.

Emphasizing the importance of agricultural credit in India, F. Nicholson has very rightly pointed out, “the lesson of history is that an essential of agricultural is credit…. One great fact is that the agriculturists must and will borrow”. Productivity of agriculture mainly depends upon the level of investment and it become obvious to create a rural credit system to cater to the needs of the rural population.
2.4 LITERATURE RELATING TO THE RURAL CREDIT AND EVOLUTION OF RRBS:

It is said in the Indian sub-continent that, “A farmer is born in debt, lives in debt and dies in debt”.

The central banking enquiry committee (1930) observes,

*Of most of the causes responsible for the low standard of living of the agriculturists and the continuous impoverishment of this class, even in areas, which are blessed with good seasons and normal crops, indebtedness must be given a high place*.

During critical studies of rural indebtedness, it was brought out that three types of problems are faced by the borrowers from the unorganized sources; firstly, high rate of interest and manipulation of accounts by the moneylenders lead to great increase in the burden of indebtedness; secondly, for non-payment of debts, the debtors would lose the land of the lender at low price; thirdly, when most of the indebted people could not pay-up the accumulated debt, it was necessary to give them some relief by liquidating a part of it, if not the full. In order the grapple with these problems, the then Rulers adopted a three-pronged approach, i.e. (i) by passing suitable legislation such as the legislation for regulating the moneylenders, e.g. Rules for adjustment of Debts (1872) and Acts of 1879, 1918, 1930, etc.; (ii) imposing restrictions on the transfer of property, particularly land, for which a number of acts were passed, e.g. The court of wards Act, 1879, 1872, and (iii) liquidating past debts – a number of Acts were passed in order to persuade the creditor and the debtor to come to a reasonable settlement in the matter of scaling down of debts, e.g. Rules for Adjustment of Debts during time of Warren Hestings and also the Acts passed in 1931 and 1940, etc.

AFTER INDEPENDENCE:

The Government of India adopted all these Acts with suitable amendments. At first, the government of India instituted the Rural Banking Enquiry Committee (1949), which suggested district central co-operative banks. Apart from this Committee, the Government of India set up as many as 20 more committees / Study Groups to intensively examine the problems of rural finance and make suitable recommendations following the recommendations of the All India Rural Credit Survey Committee (AIRCSC, 1954). Two special funds were established by amending the Reserve Bank of India Act, i.e. the National Agricultural Credit; (Long term
operations) Fund, and the National Agricultural Credit (Stabilization) Fund. The purpose of the first fund was to set up land mortgage banks and the second was intended to offer relief and guarantee in agriculture. The National Co-operative Marketing Development and warehousing Board was established in 1956.

In 1955, the imperial Bank of India was converted in to the State Bank of India for Rural credit. In 1963, the Government of India established Agricultural Refinance Co-operation, and Agricultural Finance Corporation in 1968. In the same year, Agricultural credit Corporation was also established.

**BETWEEN 1969 AND 1979 :**

The first period (1947-68) that has been discussed earlier was an era of the cooperatives. It is evident from the fact that out of 25 Committees / study Groups set up during this period, none was devoted to the commercial banks. The situation, however, changed during the period from 1969 to 1979. During this period, around 33 Committees / study Groups were set up, of which half were devoted to finding ways and means for involving commercial banks in a greater way in the field of rural finance. The single most important event of this period was the nationalization of 14 major commercial banks in 1969.

**SMALL FARMERS DEVELOPMENT AGENCY (SFDA) AND MARGINAL FARMERS AND AGRICULTURAL LABOURERS AGENCY (MFALA)**

In 1969, Dr. D. R. Gadgil had recommended the adoption of ‘area approach’ for the development of credit and banking on the basis of the local conditions and had further proposed the integration of the district credit plans. Accordingly, the lead bank scheme was introduced in december 1969.

In 1971, the Government appointed a working group to review the flow of institutional credit (popularly known as the ‘Narsimhan Committee), to the weaker sections of the community. The group stressed the need for promoting new institutions, which combined the local feel and familiarity as the cooperatives have, modern business organization commercial discipline, ability to mobilize resources and access to the central money markets which the commercial banks have. The Government of India accepted the recommendations of the
Narasimhan Committee and accordingly, the Regional Rural Banks Ordinance of 1975 was promulgated by the president of India on September 26, 1975. It was subsequently replaced by the Regional Rural Banks Act of 1976 on February 9, 1976. According to the preamble to the Act, the Regional Rural banks were set up:

*With a view of developing the rural economy, by providing, for the purpose of development of agriculture, trade, Commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly labourers, artisans and small entrepreneur and for the matters connected therewith and incidental thereto.*

The first five Regional Rural banks were established in the country on 2nd October 1975. By the end of June 1977, 48 regional rural banks were set up. On 23rd June 1977, the Reserve Bank of India appointed a Committee to review the working of the regional rural banks. The Committee was under the Chairmanship of Prof. M. L. Dantwala and it came to the conclusion that,

*This institutional innovation is well-conceived and if properly organized, would strengthen the internal rural credit structure --- such an institution is needed to make good some of the inadequacies in the existing rural credit system and the WKGBs should become an integral part of the rural credit structure.*

**DIFFERENTIAL RATE OF INTEREST SCHEME :**

In September, 1970, the Reserve Bank of India appointed a Committee on differential interest rated under the Chairmanship of Dr. R. K. Hazari. The Government of India accepted the recommendations of this Committee and initiate a scheme in 1972.

The public sector Banks have made satisfactory progress in respect of their lending under this scheme. The percentage share of institutional credit to Agricultural labourers and rural artisans was about 5%, whereas the corresponding average for the rural households was 29%.

**CO-OPERATIVE SOCIETIES :**

Out of the total number of 1,16,125 co-operative societies 43% (49,555) societies were viable and 50%(61,583) societies had full time paid secretaries.
So the performance of the Primary Agricultural Credit Societies in respect of the management was unsatisfactory.

Though the Government has tried to improve the performance of the primary Agricultural Credit Societies, all its attempts in this respect have failed. Hence, the need for establishing the Regional Rural Banks is justified.

**WEAKNESSES OF COMMERCIAL BANKS:**

Branch expansion has been done on a massive scale by the nationalized commercial banks. It can be seen from the published data relating to the same in the reports published by the Reserve Bank of India.

However, it is observed that the commercial banks appear to be more concerned with fulfilling the physical targets assigned to them in the credit plan. Hence, a large number of branches are opened in the last quarter of the year. Banks generally are not willing to go in to the interior areas.

S. L. Shetty also points out that the rural branches of banks are generally starved off of requisite staff, which has come in the way of building up the necessary business potential.

A. Datta, Former Director of the Reserve Bank of India has criticized the branch expansion of commercial Banks. He points out that there has been unhealthy competition in opening of the branches and further states that the so-called rural centres are, in fact, urban or even metropolitan peripherals or industrial towns.

In all, 675 unbanked block headquarters were identified in the country during the year 1981-82, out of these 675 identified unbanked centres, regional rural banks were serving 170 block headquarters and 405 headquarters were served by the commercial banks. These were neglected by the commercial banks due to the lack of infrastructural facilities in those regions.

**UNEVEN SPREAD OF BANKING IN THE ECONOMY:**

Most of the studies pointed out that the banking facilities are generally more developed in the States which are economically and socially advanced and are less developed in the States which are relatively backword.

**DEPOSIT MOBILIZATION:**
Moreover, commercial banks still operate their branches in rural areas for mopping up deposits rather than for deployment of their funds. M. Y. Ghorpade, a member of the study group of National Credit Council, stated that the credit : deposit ratio is poor in relatively backward area because lending opportunities are better in developing area. This results in a flow of funds from backward to developing areas instead of vice-versa, worsening the problem of increasing deposits.

2.5 **LINE OF RESEARCH UNDERTAKEN**

Over the years, the theory of banking and the ownership pattern of banks have undergone a sea-change. Since Keynes General Theory, the neutrality of money thesis has been more or less abandoned by the economists. Rather, money is now regarded a exercising an important influence on the level of production and accumulation in the economy. Commercial banks, as dealers in money, have thus been recognized as vital agents in the process of economic development.

Thus, what Schumpeter identified as a source of new investment has gone to reality even in the rural context. It is now regarded that by planned direction of commercial banks lendings, more economic activities are possible to be created for relatively less developed sectors of the economy and also for the less developed segments of the population. Accordingly, the Government of India directed banks to extend their operations in the rural areas.

**RURAL BANKING IS WIDER THAN AGRICULTURAL BANKING**

It is true that agriculture is the largest sector of the rural economy, but it is not the total rural economy. Misunderstanding is that agriculture is often taken as a proxy for rural economy. It is also found that many regard agricultural finance as synonymous with rural finance. Rural banking / finance, in real sense of the term, includes, in addition to finance for agriculture, finance for rural entrepreneur, rural transport and marketing, rural trade, etc.

Rural operations of commercial banks in India started practically when the Imperial banks of India was directed to open new branches in the unbanked areas, following the recommendations of the Rural Banking Enquiry Committee (1950).
With a view to securing the twin advantages of the resources position and professional management outlook of the commercial banks, along with the familiarity of local conditions of the cooperatives, the Government of India established the Regional Rural Banks in 1976.

**IMPLICATION TARGET – ORIENTED C:D RATIOS:**

At the rural branch level, greater attention may be given to achieving the target rather than lending to the right persons for right type of activities:

**TRANSFER OF RURAL SAVINGS:**

About three decades back, Gunnar Myrdal, in his theory of underdevelopment, termed the ‘Process of fund transfer’ as ‘**back wash effects**’. The logic of such fund transfer, as shown by him, lies in the possibility of having relatively higher return from investing funds in the more developed areas. The data showed this tendency in commercial banks operation. The growth in the number of rural branches in the economy, the period 1972-80 was commendable. There is need to make further efforts to step up deposit mobilization and credit extension in the economy. Back-wash effects appeared in the economy.

The regional Seminar for Asia Agricultural Credit for Small Farmers held in Bangkok suggested two major criteria (among others) for judging the effectiveness of the rural credit system in any country. These are: 1) the credit system should generate adequate savings and mobilize them as deposits in order to accelerate the economic growth in a planned way, and (2)
the credit system should be able to satisfy all the credit needs of the rural people, in whatever nature (short/medium/long term) and in whatever from (cash or kind) it is necessary.