CHAPTER VI
SUMMARY, POLICY IMPLICATIONS AND SUGGESTIONS

6.1 PROLOGUE

During the long phase of centralised planning in the post-independence period in India, the proposition that "banking operations shall be governed, not merely by considerations of profit but also by the social needs of the weaker sections of society", enjoyed an axiomatic status. But even there, the manner and extent to which the 'Social Service' obligation should be allowed to encroach on the 'Profit motive' and further, how the social service obligation should be effectively carried out to maximise 'Social benefit', were all matters of intense debate. More so, with India changing course in mid 1991, and moving decisively in the direction of a market economy, this debate acquired relevance. Indian Political leaders and bureaucrats have time and again dispelled all fears about a possible policy reversal in the ongoing banking sector reforms. The Governor of the Reserve Bank of India had on many occasion reiterated that the share of priority sector lending to net bank credit of scheduled commercial banks would not be scaled down below the stipulated 40 percent target, contrary to the recommendation of the Narasimham Committee (1991) to gradually lower it down to 10 percent, over a period of time. In fact, foreign banks operating in India were asked to step up their contributions towards the priority sectors.

The post-nationalisation phase of commercial banking in India had witnessed unprecedented growth in rural branch network; rise in deposits and advances as well as in the opening up of new banks and banking services. However,
concomitant with a sizable flow of credit to the various sectors of the economy, there had also been a significant rise in the number of non-performing assets. This had led to falling profits and erosion of the capital base of the banking system. Most of the non-viable public sector banking institutions had looked up to the State to rescue them from liquidity and financial crises. A fallout of this benevolent act of the State had been the susceptibility of these institutions to the polity, insofar as the allocation of credit, which had more often than not been due to social and political compulsions.

Critics of social banking have become more vocal ever since the economy had been deregulated and been gradually left to market forces. At the same time, protagonists of social banking are hopeful that this activity can be gainfully pursued, provided certain inherent institutional and ethical constraints are not only identified but also weeded out. This had prompted the researcher to conduct an empirical study of social banking, with the purpose of identifying the impediments to successful banking.

6.2 MAIN FINDINGS OF THE STUDY

It was inferred that alongside an impressive growth of commercial banks and related banking activities since nationalisation, there had been a steady rise in the size of non-performing assets, which had debilitated the capital base of the banking system. The quantitative gains had not been correspondingly matched with a high degree of qualitative performance in respect of priority sector advances and their recovery. This is evident from the macro analysis of data pertaining to commercial
banking in India and Tamil Nadu, as reported in sections 5.1 and 5.2, more so with reference to priority sector lending. The fact that the size of non-performing assets stood at Rs 39,553 crores at the end of March 1994 and that there had been a steady decline in the recovery position of commercial banks priority sector lending to industries in Tamil Nadu, does confirm the above inference.

The 'targeted approach' to lending adopted by scheduled commercial banks for achieving social ends had inadvertently compromised on aspects such as the quality of loan, viability of the proposed investment and creditworthiness of borrowers. There had been no proper scrutiny or appraisal of investment proposals. Added to it, political compulsions, policy constraints and state intervention in the administration of banks, had further eroded the efficacy of the commercial banking system. Developments in the Indian banking sector that have taken place in the recent past, wherein for loss making public sector banks the Government had so far made budgetary provision to the tune of Rs 11,300 crores towards recapitalisation of banks does vindicate this observation.

Moreover, Central Bank's recent imposition of prudential norms for capital adequacy, asset classification and income recognition, as measures to strengthen the capital base of the banking system, had deterred commercial banks from lending for investments that are risky and bear high transaction costs. It was required that the 8 percent capital adequacy norm had to be achieved by March 1996, while assets were to be classified as standard, sub-standard, doubtful and loss assets. Provisioning was required against sub-standard, doubtful and loss-assets which together constituted approximately 25 percent of the total non-performing assets
(NPAs) at the end of March 1994. This explains for the conspicuous decline in the shares of priority sector advances in recent years where the share had dropped in March 1994 from the stipulated 40 percent to 34 percent and 37 percent respectively for scheduled commercial banks and public sector banks. (See tables V-1 and V-2)

A notable observation made from table No. V.5 on the recovery position in respect of priority sector lendings in Tamil Nadu, pertained to the relatively better performance of the agricultural sector. Land in Chengalpattu District is fertile and predominantly irrigated with assured power supply and availability of inputs. One could infer that farming and farm related allied activities are commercially viable and therefore farm sector borrowers are essentially creditworthy.

Despite the dismal recovery performance and growing number of non-performing assets (NPAs), the lender banks were able to sustain the flow of credit to the priority sectors, particularly for state sponsored credit programmes, through refinancing from NABARD and annual budgetary allocations of the State. The need for recycling credit through timely recovery of loans had been ignored and instead banks strived to achieve loan targets set by the Central Bank. A cross section of defaulters who were interviewed admitted that they possessed sizable assets, the value of those assets ranged from Rs 71,409 to Rs 74,540 respectively for the two groups of borrower households. (see Table V-8b and V-13b). Regardless of belonging to the richer class of the village community, they were beneficiaries of subsidised credit advanced by the rural and semi-urban branches of lender banks. Actually 173 beneficiaries out of a total of 300 belonged to the land owning class
of borrowers. This certainly confirms the allegation of wrong identification of borrowers, largely due to external pressures on banks in selecting the loan beneficiaries. In fact, 14 percent of farm sector borrowers and 23 percent of non-farm sector borrowers did confess that they were granted loan solely on recommendation. It goes without saying that the lender banks had neither assessed the viability of the investment proposals nor the creditworthiness of the borrowers.

From our discussion on household indebtedness, it was found that there was a strong presence of formal and informal credit agencies in rural centres which had sustained the flow of credit. This is no doubt characteristic of the rural financial market in Tamil Nadu, a fact that was earlier brought to light by Wiggins (1992) in his study on rural banking in Madurai District. The reason advanced by respondents was that despite significant inverse correlation between new loans and overdues, the flow of funds was not affected due to the strong presence of informal lenders.

Further, it is gathered from the study that in the event of multiplicity of lending, successful recovery would depend on the extent of supervision or monitoring of the end use of credit and the peer pressures that are likely to be exerted on the borrowers. The sample borrowers had attributed inadequate credit; delays in disbursement; lack of timely and expert technical advice and failure to monitor the use of credit as vital causes for delinquency and default. (see Tables V-10b and V-15b). It is rightly said that 'credit delayed' is 'credit denied' and 'timeliness' along with 'adequacy' are qualities of good credit. In the absence of
these pre-requisites and proper follow-up measures, it is most likely that the borrowers would default.

From the empirical analysis of household income and expenditure (see Tables V-10a, V-10b and V-15a, V-15b) it did appear that the borrowers could have repayed the bank loans through their surplus earnings. Generally they were well-to-do farmers and practically all of them generated surplus over expenditures ranging from Rs 1,903 to Rs 7,015. By judicious management of finances, they should have been able to pay off their liabilities which averaged around Rs 4,003 to Rs 5,930. Instead, the measure of repayment capacity of borrowers had belied this possibility by indicating that other debt obligations of the sample households had offset the gains and affected the repayment of commercial bank loans, leading to delinquency and default.

The importance of 'Timeliness' and 'Adequacy of Loan', rather than concessionality, had been reiterated by the borrowers, as essential qualities of a loan. This was in conformity with the findings of Christen R. Peck (1984) and Vyasulu and Rajasekar (1991); besides it is also in agreement with the suggestion given by the Khusro Committee (1989) that default can be checked if adequate credit is given on time, along with effective supervision. While Christen R. Peck had stated that the key determinant of the borrowers default is the probability that the borrower would receive an adequate and long-term flow of credit from the lender, Vyasulu and Rajasekar had reported on the problem of inadequate and untimely loans to small and marginal farmers.
It is also evident from the study that socio-cultural and attitudinal factors had greatly influenced the allocation and repayment of subsidised credit. It had been reported by Muthayya and Prasad (1984) in their study covering five Indian states, that attitudinal factors, when guided by moral and ethical values, greatly influenced the repayment of loans. From our study, it is also inferred that the decision to repay the loan was influenced by moral and ethical values.

The borrower's inability to repay the loans was also due to compelling social demands of the family to meet the expenses on marriage and religious ceremonies and because of large scale borrowings from informal sources of credit. (as inferred from Tables V-9 and V-14). These social commitments had inevitably led to the fungibility or interchangability of loans and consequently to delays and default in the repayment of bank loans by the borrowers.

Finally, the lender bank's inability to adopt independent and flexible policies along with tenable strategies, such as personalised banking, selection of beneficiaries and credit appraisal, that are so vital for effective lending and recovery management, had further accentuated the problem of loan delinquency and default.

6.3 POLICY IMPLICATIONS

'Targeted-lending' had more often than not benefited the wealthier class of borrowers while the 'supply-led' approach to priority sector lending had failed to generate viable institutions and credit programmes. Hence, the 'Social' and 'Economic' costs were high, as evident from the high transaction costs and erosion
in the profit earnings of banks due to non-recovery of loans. Moreover, mis-utilisation of loans had failed to generate tangible income earning assets.

'Multi-agency' approach to rural credit financing had given rise to multiplicity of loans resulting in easy accessibility as well as the mis-utilisation of loans by large segments of borrowers. The problem of fungibility of credit, or use of credit for purposes other than for which it has been availed for, had been overlooked by the lender banks. Hence, the loans availed had been squandered rather than used productively.

Inherent weaknesses in both the pre and post sanctioning stages of bank lending, beginning from the selection of borrowers till the use and recovery of loans, were largely responsible for the dismal recovery performance of the lender banks. The fallout of the State's socialistic ideology of 'equality' and 'justice' along with the populist measures enforced on banks by policy makers and political rulers have had a profound bearing on social banking in India. The failure lies rather on the administered system of lending and faulty implementation of credit programmes.

Unavoidable social obligations and family commitments had affected the borrower's capacity to save and therefore weakened the ability of the borrowers to repay the loans. Added to it, the borrower's perception of public sector banks as sources of cheap credit which need not be repayed, had also influenced the decision on loan repayment.
To conclude, the lender bank's casual attitude towards pursuing social banking and the borrower's apathy towards repayment of institutional loans had jeopardised social banking. Moral and ethical values did influence the borrower's decision on repayment of loans.

6.4 SUGGESTIONS

Having summarised the main findings of the study and listed the ensuing policy implications, the researcher has the following suggestions to make:

In the lines of what Bhagwati (1988) had said, it could be reiterated that administrative controls and intervention by the State should be minimum, selective, time-bound and prescriptive. Nonetheless, recognising the fact that the state and market are influential social institutions, it should be required of the State to provide adequate infrastructure and also strengthen the existing public institutions to ensure forward and backward linkages for institutional borrowers. This proposition is in agreement with the views of the New Institutional School of Economics on the role of the state.

Debts Recovery Tribunals should be set up for assisting banks recover loans disbursed under State sponsored credit programmes. For this purpose, the legal institutions would have to be revamped and small sized loans below Rs 25,000 should also be brought under the purview of the Recovery or Debts Due to Bank and Financial Institution Act, 1993.
Functional autonomy must be granted to Branch Managers of rural branches. This will enable them to work independently and efficiently without outside pressures and interference. Besides, a system for providing incentives and rewards to rural bank personnel must be introduced to retain them in rural centres.

Concessional or subsidised loans should be restricted exclusively for the marginalised sections of borrowers. Moreover, as an incentive, interest rebates and merit cards could be given to them for prompt repayments. Further, the bank personnel must inculcate in the institutional borrowers the ethics of repayments.

The hallmarks of institutional lending should be the provision of timely and adequate loan and flexibility in repayments. 'Targeted Lending' must be replaced by a system of 'Need-based' and 'Borrower-centred' lending. In other words, the banks' approach to rural development should be 'Demand -Led' rather than 'Supply determined'.
periodically to ascertain the credit needs of borrowers and exchange information about the beneficiaries of their respective branches.

Having recognised the presence of informal credit sources in rural centres, it is suggested that the services of the informal lenders, Non-Government Organisations (NGOs) and Self Help Groups (SHGs) could be made use of on a commission basis, to obtain information about the borrower's creditworthiness. Besides, they could also monitor and assist the banks in the recovery of loans.

Based on the success of rural banking in Bangladesh, Thailand and Indonesia, it is suggested that an alternative system of credit lending, i.e., group-financing, where the borrowers are made jointly liable for repayment, should be encouraged for mitigating the problem of asymmetries of information that exist between parties to a loan contract. This may improve the recovery climate and also act as a check on the problems of 'Adverse selection' and 'Moral hazard'.

6.5 CONCLUSIONS

Considering the magnitude and intricacy of the problem of loan delinquency and default, it will be worthwhile examining the extent of inter-dependency between the monetary and non-monetary factors that influence the borrower's decision to repay the loan. Moreover, attempts should be made by the lender banks to formulate an objective measure of the repayment capacity for better recovery management, by incorporating in the measure of repayment, social consumption and risk factors. Therefore, what is essentially needed is a wider perspective of
circumstances and factors which influence borrowers and condition their use of credit as well as their attitude towards formal credit institutions.

The success of social banking in India would nevertheless rest on the strength of the three pillars of modern banking viz liquidity, safety and profitability. Development is not merely an expansion of income and wealth but a process of enlarging people's capabilities. Hence, in the euphoria of economic liberalisation and reforms, banks should not neglect the credit needs of the marginalised sections of the society.

To sum up our discourse on viability of social banking, it may be argued that priority sector lending is an art. The overall success of social banking would largely rest on the borrower's entrepreneurial ability and ethical values that govern his actions. Alongside would also be the lender's professional integrity, ingenuity and independence, reinforced by a sense of personal commitment to achieve social goals.