CHAPTER I

PROBLEMS AND PROSPECTS OF PRIORITY SECTOR LENDING
BY COMMERCIAL BANKS

(A Case Study of Small Scale Industries in Bangalore District)

Introduction:

Banks play an important role in the modern economy by providing necessary credit to different sectors of the economy. In recent years they have been assigned the responsibility of financing what are called the priority sectors. The word priority sector is used for those segments of the Indian economy whose development is considered essential for the economic growth of the country and attainment of 'social justice', but which had received only indifferent attention from the private sector banks.

In the process of development, certain sectors lag behind, but the development of these sectors is essential for accelerating growth. These sectors lag behind because they lack financial resources. As the banks are urban biased and profit-oriented in their approach they are less likely to finance these sectors because the latter are: (1) less profitable, (2) lack collateral securities, and (3) are high-risk sectors for lending. Without providing necessary assistance to these sectors it will not be possible to accelerate the growth of the economy. In India,
agriculture, small scale industries and exports are identified as the priority sectors. Priority sector lending implies priority in the allocation of funds at concessional rate of interest, margins etc., to units of the priority sector identified as such.

Small scale industries\textsuperscript{1} form an important sector of the Indian economy. In 1997-98 they accounted for 40 per cent of the industrial output and 35 per cent of the exports. They provided employment to 160 lakh workers\textsuperscript{2}. The prime objective of planned economic development is to make more efficient and judicious use of scarce resources in order to achieve economic development. In a country like India, human resources constitute a major resource, which is also relatively abundant and entrepreneurs are capable of making only small investments. Small industries, which are labour intensive and capital saving play a vital role in the utilisation of these abundant resources and thereby help promote economic development of the country.

Case studies undertaken by the study group of the National Credit Council showed that:

\textsuperscript{1}Investment limits for SSI and Ancillary industrial undertakings were raised to Rs. 3.00 Crores from Rs. 60.00 Lakhs and Rs. 75.00 Lakhs, respectively. The limit for tiny units was raised to Rs. 25.00 Lakhs from Rs. 5.00 Lakhs. (For more details see Annexure-I).

\textsuperscript{2}Office of the Development Commissioner, SSI, Ministry of Industry, Govt. of India, Annual
(1) The credit extended by commercial banks was not widely disbursed and there are credit gaps particularly in the case of small borrowers.

(2) There was potential demand for credit by small borrowers, but the non-existence of institutional facilities resulted in their approaching moneylenders and traders.

(3) Co-operatives, which were already in existence, were not in a position to provide adequate finance to these sectors (G.O.I. 1969: 81-6).

Also in view of the planned effort for economic development of the country it is necessary to have institutions, which can sub-serve the social and economic objectives of planning. Government's accepted policy envisages that the benefit of development must accrue more and more to the relatively less privileged classes of society and that there should be a progressive reduction in the concentration of income, wealth and economic power. In this context, it is necessary to make credit facilities available to high priority sectors like Agriculture, Small Scale Industries and Exports. At present other priority sectors include other small business and service sector. In the context of the failure of the large industries to solve the worsening problem of unemployment and poverty which is the result of the concentration of economic power in the hands of few and increased inequalities in the distribution of income and wealth, agriculture (especially small farmers), small scale industry and other priority
sector play a major role in solving these problems. This has been recognised throughout the world by the policy makers, governments as well as academicians and researchers. As these sectors can be developed with limited available capital and light technology, it permits more population to participate in gainful economic activities with which we can solve the problem of poverty, reduce the inequalities in the distribution of income and wealth at the national level and unemployment problem at the individual level.

Since 1950s the Government of India have appointed a number of Committees to look into the financial needs of the different sectors of the economy and to assist the government and the Reserve Bank of India in allocating credit among different sectors and to determine the relevant priorities. The All India Rural Credit Review Committee (RBI, 1986), the study group of the National Credit Council (RBI, 1968-69), the Banking Commission (1972) and the Agricultural Credit Review Committee (GOI, 1986), in one or the other way have emphasised the role of commercial banks in providing credit to the priority sectors, as the co-operatives which are providing such assistance were not in a position to meet the needs of these sectors adequately.

At the end of July 1967, the Reserve Bank of India urged the commercial banks to enlarge their assistance to priority sectors. Also a concessional rate of
4.5 per cent interest was charged on borrowings of commercial banks from the Reserve Bank of India equivalent to priority sector lending. So emphasis has been laid on the banks moving away from security-oriented lending to purposive, productive and incremental income-oriented lending.

M. Narasimham Committee (1992) suggested that the system of directed credit programme should be gradually phased out and that the credit programme should cover a redefined priority sector, consisting of small and marginal farmers, tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections. The committee proposed that the credit target for this redefined priority sector henceforth be fixed at 10 per cent of aggregate bank credit, which the Committee observed, would be broadly in line with the credit flows to these sectors at present. With regard to the large and medium farmers and Small Industries now enjoying the benefit of concessional credit and to whom the direction would no longer apply, a preferential refinance from the Reserve Bank of India has been suggested. The Committee believes that the distributive justice should be attained by fiscal instruments rather than the credit system. So directed credit programme should not become a regular feature but can be made use of in extra-ordinary situations to correct imperfections in the credit market.
According to the Committee, the growth of agriculture and small scale industries in India has now reached a point where the productive requirements of these sectors could be met by banks on the basis of their commercial judgements. Two decades of such preferred credit is a long enough period to evaluate the impact of priority credit, the necessity of its continuation, particularly in respect of those who are able to stand on their own feet. In the opinion of the Committee, the directed credit should be limited only to the really needy such as small and marginal farmers and tiny sector industries (1992: 43-4).

The Committee set up by the Reserve Bank of India (Chairman, P.R Nayak, 1991) to look into the various aspects of credit requirements of the small scale industries sector submitted its report in September 1992. The terms of reference of the Committee included examination of:

(a) the adequacy of institutional credit and its timely flow to the small scale industries, village and tiny industries,
(b) the need for modifications/relaxations in the norms prescribed by the Tandon/Chore Committees in so far as the SSI is concerned.

The Committee has suggested that small unregistered units with credit limits of not more than Rupees One Lakh should have the first claim on the priority sector credit to small scale industries and the new priority sector credit dispensation (R.B.I., 1991:118).
Different Schemes under Priority Sector Lending:

The priority sector lending includes lending to agriculture (direct and indirect), small scale industries, transport operators, self-employed persons, rural artisans and the weaker sections. The weaker sections within the priority sector comprise: (1) small and marginal farmers with land holdings up to 5 acres, landless labourers, tenant farmers and share croppers, (2) artisans, village and cottage industries enjoying credit limits up to Rs. 25,000/-, (3) Integrated Rural Development Programme (IDRP), Differential Rate of Interest Scheme (DRI) and Self-Employment Programme for the Urban Poor (SEPUP) beneficiaries and (4) beneficiaries belonging to Scheduled Castes and Scheduled Tribes. In accordance with the guidelines recently issued by the Government of India, Ministry of Rural Development. Now the Swarnajayanthi Gram Swarojgar Yojana (SGSY) has come into force replacing all the earlier programmes viz., Integrated Rural Development Programme (IRDP), Training of Rural Youth for Self-Employment (TRYSEM), Development of Women and Children in Rural Areas (DWCRA) and so on.

Trends in Priority Sector Advances:

Priority sector advances of public sector banks increased from Rs. 441
Crores (14.6 per cent of the total advances) as at the end of June 1969 to Rs. 91,318 Crores (41.8 per cent of the total advances) as at the end of March 1998. Out of that, agricultural advance which was Rs. 162 Crores (5.4 per cent) as at the end of June 1969 has increased to Rs. 34,304 Crores (15.7 per cent) at the end of March 1998.

The share of small scale industries in priority sector advances as at the end of March 1967 was Rs. 177.9 Crores (6.6 per cent) and has increased to Rs. 38,109 Crores (17.5 per cent) at the end of March 1998. Other priority sector advances (small transport operators, self-employed persons, rural artisans etc.) were Rs. 22 Crores (0.7 per cent) as at the end of June 1969 and has increased to Rs. 18,881 Crores (8.6 per cent) at the end of March 1998.

**Review of Literature:**

There are many studies regarding the impact of priority sector lending to agriculture. They have concentrated on individual schemes (IRDP, DRI, Service area approach as such). Also there are plenty of studies on the role of credit in alleviation of poverty (NCAER, 1972), Planning Commission Draft VI Plan, Rao and Aziz (1989), Gunashekaran (1985), Krishnamaraju (1992), Rao, Malya and Kurian (1980).
But not many studies are there which throw light on priority sector lending to small scale industries. A study conducted by Arundati (1991:168), is a macro level study, which concludes that there is growth in the credit to small scale industries in absolute values, but in percentage terms this growth is insignificant, and also declining.

Some studies have analysed the impact of government policies on small scale industries. The findings of these studies are the following:

1. The average size of investment on fixed assets, annual turnover and employment were found to be larger in Bangalore District than those in other three districts namely, Mysore, Dharwad and Gulbarga (Tiwari, and Others, 1991:198).

2. The units in backward regions have financial constraints and therefore, more liberalisation in the scheme of financial incentives is required. For, financial incentives have brought up labour-intensive units (Bharathan, D. 1990).

3. (a) Units displayed wide variations in output per rupee invested in productive capital.

   (b) Units recording profits over 50 per cent on capital invested accounted for roughly a sixth of the number reporting profits.
(c) Commercial banks played a major role providing around 75 per cent of the short-term borrowings of the units (NCAER, 1972).

4. (a) The major share of total bank credit to small scale units in the country (52 per cent) has gone to four states namely, Maharashtra, Tamil Nadu, Gujarat and West Bengal.

(b) Financial credibility on the part of the small scale units is a must to induce greater finance by banks (Pareek, H.S., 1978: 259-62).

5. Bala's study (1981:302) shows that the smaller the size of the units, the lesser was its ability to borrow from institutional sources. A survey made by the Reserve Bank of India found that this was so in India as a whole.

6. Studies carried out by Sandesara (1988:649) revealed that, assisted units had higher labour productivity, higher surplus and higher average wage than non-assisted units in a majority of industries.

It is estimated that this sector accounts for nearly four-fifth of the total workers employed in manufacturing. In the above-mentioned studies pre and post loan framework has been made use of. There are some more studies (Gunasekaran (1985); Rosen, George (1988); Krishnamaraju (1992); NCAER (1972) and others are based on secondary data alone. They do not give us micro picture of the situation.
Available micro studies have covered these aspects partially. The study on the problems and prospects of priority sector lending as a whole with reference to small scale industry is very much necessary. There are case studies of Rajasthan (Pareek, H.S. 1978), Ludhiana (Singh, 1990), Tirunelveli (Barathan, D., 1990), and Bombay (Doodha, 1965). NCAER (1978) has collected primary data from 250 selected units all over the country. However, not many studies are available on Karnataka experience. There is one study (Tiwari, K.V., et al., 1991), which evaluates the Karnataka State Finance Corporation's assistance to small scale industries. But it has not dealt with the extent of priority sector lending by commercial banks, its impact, utilisation and recovery. Hence, there is need for a more comprehensive study on Karnataka. It is proposed in the present study to carry out a comprehensive study of priority lending with particular reference to small scale industrial sector in Bangalore District.

**Objectives:**

The main objective of the proposed study is to examine the various aspects of priority sector lending to small scale industries by public sector banks. More specifically the objectives are:

1. To assess the extent and purpose of credit channelled to priority sector and especially to small scale industries.
2. To assess the extent of utilisation and the extent of recovery of loans provided to small scale industries.

3. To examine the impact of credit on employment and profits of the borrowing units and to compare this with the unassisted units.

4. And to assess the prospects of priority sector lending in the light of the new economic policy and to make some policy recommendations.

**Hypotheses:**

The proposed study will verify the following hypotheses:

1. The proportion of credit channelled to small industries has been increasing over time.

2. Loan utilisation rate has declined over time.

3. (a) The rate of loan recovery has declined over time.
   (b) Loan recovery and rate of profit are directly associated.

4. (a) Availability of credit has increased the level of employment.
   (b) Availability of credit has increased the profit rate.
Theoretical and Analytical Framework:

The process of development can be accelerated by identifying constraints to development and releasing such constraints. Experience has it that certain sectors lag behind because of lack of resources especially financial resources. The strategy of development should be to provide finances to such sectors. Theoretically, the third world economies are characterised by dualism, having organised and unorganised sectors. The organised sector is supposed to enjoy monopoly and operate under the oligopolistic market conditions. But since the enterprises operate in the oligopolistic market conditions, they restrict output with a view to maximising profit. Also the equilibrium output level in their case is produced not at the minimum cost but at the level, which is above the minimum cost. Hence in the organised sector not only output is less than optimum but it is also produced under inefficient conditions. On the other hand, in the unorganised industrial sector, since the number of firms is very large, one can say that they are working under competitive conditions. Therefore, output in this case is of optimum level and produced at the lowest possible cost. But since they are starved of financial capital, their average cost curve is likely to be slightly above the cost curve that otherwise obtained when financial capital is provided to them. The rationale of providing financial capital to these units, therefore, is derived from the fact that they produce optimum output at minimum
The banking sector which channelises concessional credit to the small scale industries sector, will be expected to function as a discriminating monopoly, that is, it should advance credit at concessional rate to the small scale industries sector and compensate this loss by charging higher rates to the organised sector units. By means of such a cross subsidisation process, the banks will not only support the weak enterprises but also maximise their own profits by functioning as discriminating monopolists.

Banks have to depend on public deposits to provide finance to different sectors. They try to earn reasonable profit in their transactions. Also they are supposed to provide certain amount of their deposit to priority sectors at concessional rate of interest as directed by the Reserve Bank of India. While doing this, it is very much necessary for the banks to manage the funds in such a manner, that it leads to the development of the bank, beneficiaries and the state. That too while lending to SSIs it is a must on the part of the bank, to take into consideration financial viability and technical feasibility of the beneficiaries.

Banks finance only viable projects. There are various techniques involved in the appraisal of the viability of the project, which depend on several factors.
One of the important factors is that any project if implemented on commercial basis should result in generation of adequate profits. When the entrepreneur approaches the bank for credit, the project report will be appraised considering certain parameters stated below:

1. Commercial viability
2. Technical feasibility
3. Financial viability
4. Economic viability

1. **Commercial Viability**: A commercial venture is profitable only when it is capable enough to tap sizeable market. The enterprise will be commercially viable if it precisely assesses the demand for the product. The demand assessed at the planning stage should be realistic. Many projects have failed due to lack of proper market survey, which is an important factor to be considered while assessing the demand. The deciding factor for assessing the demand for the product is demand and supply gap and seasonal fluctuations.

2. **Technical Feasibility**: Technical feasibility deals with whether the desired output can be achieved with the available facilities. Following factors are to be considered for evaluating the technical feasibility of the project:
(a) Manufacturing process
(b) Location
(c) Land and Building
(d) Plant and Machinery
(e) Plan Layout
(f) Raw Materials
(g) Labour
(h) Power

The entire production flow chart from the state of raw materials to finished product has to be examined in detail.

Location has its own influence on the success of the SSI unit. The proximity to market, availability of raw materials, skilled labour, power, etc., are the vital points for the success of a project.

Land and Building: The entrepreneur should be advised to start the activity in a rented building. Many projects have failed because of heavy investment on land and building.

Plant and Machinery: Plant and machinery should be in accordance with the technology and market demand.
Plant Layout: The machinery should be installed in such a way that there should be easy flow of material from one machine to another.

Raw Materials: Raw materials play a very important role in the production process. Regular and adequate supply of raw materials at reasonable price has to be ascertained before granting the credit.

Labour: SSIs require skilled, semi-skilled and unskilled labourers. Arrangements should be made by the entrepreneur to employ all categories of workers.

Power: Without power, production cannot be carried on. The power requirement and the cost of power should be correctly ascertained. Before considering the loan, it should be ensured that the concerned authorities sanction the power.

3. **Financial Viability:** The financial viability deals with the total project cost and the means of financing the project.
4. **Economic Viability:** Operating profit, break-even point, gestation period are to be taken into account to assess the economic viability of the unit. The entrepreneurs have to survey the market regarding input-output linkages. After examining the viability of the project, one should prepare the project proposal giving details regarding all the aspects. The entrepreneur can approach Small Industrial Service Institute (SISI) for guidance regarding these matters. SISI provides proper guidance for the entrepreneurs regarding all these factors.

**Asset Liability Management (ALM):**

Availability of credit at right time in adequate amount on appropriate terms has a bearing on production. In the process of widening and deepening of credit the health of the credit institutions is increasingly strained.

Banks in the process of providing financial services assume various kinds of financial risks viz., credit, interest rate, foreign exchange and liquidity risks. To some extent this could be eliminated through sound business practices and also through a combination of product design and pricing. Till now banks were concentrating solely on asset-management with liquidity and profitability being regarded as two opposing considerations. So, given certain liquidity levels,
banks have to distribute the remaining assets in such a way as to get maximum returns.

As a result of liberalisation and deregulation of interest rates, there is a sort of interest war between competing banks. Hence, today interest rates are market driven which has resulted in narrowing down of interest spread, (i.e, interest income minus interest expended). Net interest income (spread) of public sector banks as a percentage to assets has shown a decrease of 25 basic points from 3.16 in 1996-97 to 2.91 in 1997-98. This has led to liquidity crunch and forced the banks to go for costly source of funds, which has a direct bearing on profitability of banks. To avoid liquidity crunch, there should not be any mis-match of assets and liabilities. So, this should be dealt scientifically for which commercial banks have to undertake a comprehensive asset-liability management.

The monetary and credit policy for the second half of 1997-98 emphasised the need for banks to have a comprehensive ALM system. This encompasses a process of continuous management of assets (in terms of planning, organising and controlling) and liability volumes, rates and yields and incorporating the maturities of assets and liabilities into consideration as well. This requires gathering of enormous data, market research and quick empirical reports to enhance the Management Information System (MIS). For this purpose,
commercial banks have Funds Managers (FMs), who have to assess the mis-
matches in various time periods, which are called different maturity time buckets.

For asset-liability management 90 per cent of the savings bank account is
considered as core asset, for current account it depends on area and bank. Time
buckets are classified as follows:

<table>
<thead>
<tr>
<th>Buckets:</th>
<th>1 day to</th>
<th>14 days</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 days</td>
<td>to</td>
<td>28 days</td>
</tr>
<tr>
<td>29 days</td>
<td>to</td>
<td>90 days</td>
</tr>
<tr>
<td>91 days</td>
<td>to</td>
<td>180 days</td>
</tr>
<tr>
<td>181 days</td>
<td>to</td>
<td>1 year</td>
</tr>
<tr>
<td>Above 1 year</td>
<td>to</td>
<td>3 years</td>
</tr>
<tr>
<td>Above 3 years</td>
<td>up to</td>
<td>5 years</td>
</tr>
<tr>
<td>and above 5 years</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For determining volatility in time buckets trend analysis, market analysis
and residual maturity pattern (i.e., how many days left for the maturity of an
asset) are taken into consideration. To do this, enormous data needs to be
collected. There is a problem regarding the collection of data and lack of
accuracy in data collection is another drawback. But scientific management of
assets and liabilities will not only improve banks credit management processes
and increase profits but also enable them to develop mutually beneficial relationships with customers.

So, in order to know the implications of these constraints under which the banks have to work, we consulted banking personnel at different levels (administrative and supervisory). They opined that ALM is a must for the proper management of bank funds, as it belongs to public. Now, they are having separate division consisting of experts to look into the management of ALM and they are doing it in a successful manner and they also assured that ALM would not have any adverse effect on priority sector lending.

Small scale units are mostly the units started by persons with meager means. In such cases, once for all capital lending by State Finance Corporation or own resources are available to the entrepreneur. But having started the unit the entrepreneur faces the working capital problem. Considering his means, the working capital requirements of the small entrepreneurs are much larger because his enterprise is both labour and raw material intensive. Since he uses more labour and more value of raw materials per unit of fixed capital, he naturally faces the working capital problem.

Besides, owing to uncertainty regarding the availability of raw material on time, which is essential for meeting the day-to-day demand schedule
promptly, the entrepreneur tends to stock large inventories of raw-material. Besides, because of competition from the large entrepreneurs the small industrialist when approaches the raw-material supplier for the requirement, the supplier has a tendency to charge higher rates. Therefore, to obtain economies of scale the small entrepreneur is forced to buy raw material in bulk and stock it.

Because of all the reasons stated above, small scale entrepreneurs require large amount of Working Capital. Since the Working Capital requirement is large, any increase in its cost is likely to impose a heavy burden on the production cost. This being the situation, the cost of credit constitutes a very important position in determining the production cost and profit margin of SSI’s.

**COST AND BENEFIT OF DIFFERENT SOURCES OF FINANCE**

The Indian financial system, which refers to the borrowing and lending of funds or the demand and supply of funds, consists of two parts, viz., the Indian Money Market and the Indian Capital Market. The Indian money market is the market in which short term funds are borrowed and lent. The capital market in India, on the other hand is the market for medium and long term funds. As our study deals more with the working capital problem, let us
focus our discussion on Indian money market, which provides working capital funds.

The Indian money market is relatively underdeveloped, and cannot be compared with such advanced money markets as the London and New York money markets. The Indian money market is divided mainly into two sectors namely organized sector and the unorganized sector. The organized sector of the money market consists of commercial banks, which includes private sector banks, public sector banks and foreign banks. The unorganized sector consists of indigenous bankers or money lenders including non-banking financial companies.

Channels of funds for small firms also include entrepreneur’s own funds (from their personal savings, or from proceeds of sale of their assets as such), loans from their relatives and friends. Dhar, P.N., (1958:41), in his survey in Delhi found that “the only source of internal finance consisted of relatives, friends and traders.” In the survey of handloom industry in Karnataka and Sholapur also, it was found that “on the whole, master weavers and money lenders constituted the major source of funds both in urban and rural centers” (NCAER, 1959).

Generally, small entrepreneurs accumulate capital funds from their own
savings. As the aggregate savings of the people in the country are very low because of low per capita income, this provides a meager source of funds for investment. But as the majority of the entrepreneurs who come forward to start small scale units are financially poor, and as they have to depend on the unit for their livelihood they will not be in a position to invest more. So they can accumulate only small amount of capital that too with great hardship. When compared to other sources of finance, the cost they incur here is the interest income that they would get if the same amount had been kept in fixed deposit or lent to some one else. Apart from this they have to take risk and bear the liquidity cost. The point made by the Society for Social and Economic Studies (1959:25), that "the dearth of capital resulted from a low income level, a small capacity to save and hence a lack of capacity to invest" is quite apt here.

After pooling the money, which they have, small entrepreneurs turn to their relatives and friends for financial assistance. This source can be generally used for fixed capital purpose, because working capital needs will be there throughout the process of production for which they cannot relay on relatives and friends. Also the financial position of their relatives and friends is somewhat the same as those of the entrepreneurs. Even here they have to pay interest at a rate that exists in the unorganised sector of the money market, which is normally higher than that of the bank interest rate. Again lenders may
demand the money back at any time of financial crisis of the business, which make things worse. So the small entrepreneurs cannot consider this source as a reliable source of credit.

Indigenous bankers or Money Lenders: Long before the formal establishment of the banking industry in India, indigenous bankers were providing credit to business and industry. In the beginning nearly 95 per cent of credit needs were met by these lenders. Even today they are playing prominent role in the supply of funds. As they do not come under the purview of the Reserve Bank of India, they charge a very high rate of interest, which will be a real burden on the poor entrepreneurs (interest rate is almost double that of the bank interest). They lend money against movable and immovable assets. One big advantage is, they are ready to lend money as soon as they are approached. On the other hand, the borrower has to wait for more than a week or even for months to get bank loans. The indigenous bankers are not worried about the purpose of borrowing as they lend money both for productive and unproductive purposes. Such lending may result in misutilisation of funds by the borrowers, which may lead to failure of the business. Another problem of this source of finance is that, in case of non-repayment of loans, the moneylenders take over the assets against which loan is lent. So there is the fear of losing the property also on the part of the borrower. This works as a deterrent on attempts to misutilise borrowed funds.
Review of available literature on financial sources of SSIs reveals some interesting points about costs and benefits of borrowing.

It is said “Informal sector enterprises generally have virtually no access to credit facilities from formal sector institutions and where credit is available from informal sources, interest rates are exorbitant”. (Sethuram, 1977a: 345). ILO studies have also highlighted this fact.

According to a study conducted by Thippaiah (1993), “It is found that 40.12 percent of the informal sector units borrowed by paying interest of Rs.5 per month on Rs.100 which comes to 60 percent per annum. 13.77 percent of the households paid 120 per cent interest on their loans. These are largely loans borrowed from the informal money markets. 19.78 percent of the households paid interest of Rs.12 to Rs.18 percent per annum, which are the usual lending rates of commercial banks. The rest (15.57 percent) obtained loans from friends and relatives, which are interest free.”

Small firms face some problems such as the following while borrowing from banks:

a) Small firms are not fully aware of the priority loan facilities.

b) Lenders have less knowledge about the affairs of small firms than of
large firms. Hence, they do not come forward to lend money to small firms. Small firms are also not in a position to prove their credit worthiness to lenders.

c) As the transaction cost tends to vary inversely with the size of loan, transaction cost for small loans will be more.

d) After applying for loans, they have to wait, some times for months to get the money.

According to Lakdawala, D.T., and Sandesara, J.C., (1960:70), bureaucratic procedures constituted one of the important impediments to the utilization of institutional resources. Mishra, T.N., (: 72), in his study in Saugar district found that “industrialists preferred a bania (Private money lender) to a co-operative bank for meeting their needs because of complicated formalities, cumbersome procedure and undue delay.” Ramakrishnan, (1975:36), in his study in Delhi found that entrepreneurs were prepared to pay or had paid higher rate of interest to non-banking sources to avoid bank formalities. Even with all these defects bank credit is one of the important sources on which SSIs can rely to meet their working capital requirements.

Under the above circumstances, bank loans provided to SSIs under priority sector are the only source of finance available to them at low cost with
convenient repayment schedule. As the priority loans are provided at concessional rate of interest it will not prove to be a heavy burden on the entrepreneurs.

Co-operative banks also provide working capital loans for the entrepreneurs in their area at low interest. But due to lack of funds they are not in a position to provide adequate funds for the SSIs.

Capital markets play a prominent role in mobilizing the savings of the people and channelising the same into productive investment purposes. It establishes a link between supply of and demand for credit in the economy. In India, till late 1970’s the role of capital market was almost insignificant, as the average amount of capital raised during that period accounted for Rs.80 to Rs.100 crores per annum. But in the later half of 1980’s and the beginning of 90’s India witnessed a drastic change in the field of capital market. Not withstanding this, small companies have less access to both internal as well as international capital markets. As regards share market the minimum capital required to register in the Share Market is Rs.5 crores, small scale industries whose capital investment limit is within Rs. 1 crore (at present) have no chance to utilize this opportunity also. Venture capital, which can play a key role in the development of SSIs are yet to find a place in this sector.
The figures for peak level investments is 1993-94 illustrate both the relative importance of inflows of overseas capital and their disproportionate distribution to large firms. GDR and Eurobond issues up to the end of October 1994 (i.e., 1991 till 1994) amounted to a close to US $ 6.2 billion issued by private sector companies in the domestic stock markets and US $ 8.4 billion disbursed by the Indian financial institutions. Nearly half of the GDR and Eurobond issues were accounted for by the top 20 companies of the Indian corporate sector although fast growing small companies are also beginning to take advantage of the opportunity (Charles Collyns, 1995). Large companies are provided with an opportunity to lower their cost of credit by increasing their equity share prices. SSIs are devoid of that opportunity also because they have less access to equity market.

All the available sources of capital market concentrate on providing funds to medium and large scale industries only. Small scale units are too small to attract the attention of these constituents of capital market. As a result, they have no access to these sources of finance. Foreign Direct Investment has also made its way in the Indian capital market after the implementation of the New Economic Policy of 1991. But these investors are also attracted towards large and medium scale units instead of small scale industries, because the
information necessary to ascertain the viability of the SSIs is not available in our economy. And also SSIs are not in a position to prove their credit worthiness.

In a country like India, where small scale units are more in number and where majority of the units are proprietorship firms, collecting funds through shares is completely out of question. Such being the situation, banking institutions are the only source of credit available to small scale entrepreneurs. Apart from this, either they have to borrow from their relatives and friends or from the moneylenders. As moneylenders are from the unorganized sector of the money market they charge a very high rate of interest, which is an unbearable burden for the poor entrepreneurs. Even the economic position of the friends or relatives is not any better. Such being the situation, SSIs cannot rely on them also. The following statements from the Report of the Expert Committee on Small Enterprises headed by Abid Hussain support these points:

"The State of development of the venture capital industry in India is a cause for considerable worry. India has the dubious distinction of having one of the smallest venture capital industries in the world and is small even in comparison to its counterparts in Asian countries. The number of venture capital companies per 10 million capita is about 1 compared to more than 100 in Singapore. Overall, the relative share of credit to the small sector has fallen
from 13.0 percent of the gross bank credit in 1994-95 to 11.4 in 1995-96. This clearly constitutes a series of great alarm for the small scale sector, which is heavily dependent on the availability of bank credit for its health.

Undoubtedly, large companies are also affected by the stringent supervision of the banking system. However, they have more options to cope with short supply of credit. Credit worthy large companies have the choice to raise capital by commercial paper and certificates of deposits. Many of them have also established in-house finance companies as an additional means to raise resources. Finally, they can take recourse to international capital markets especially since India enjoys the confidence of overseas investors.

In the emerging economic climate in India, small companies will have to inevitably rely more on trade credit which has been their traditional source of finance as bank credit has become more difficult and other sources of finance such as the securities markets are out of reach or sources such as venture capital funds are yet to materialize. Their costs of debt will rise, as interest costs remain high. In periods of economic downturns, small companies will be extremely vulnerable as the costs of servicing debt rise.” (Hussain committee (1997)).
Scope of the Study:

Owing to the constraints of time and resources, it is proposed to restrict the scope of the study to some selected small scale industrial units located in Bangalore District. Since 22 per cent of the small scale industrial units of Karnataka are located in Bangalore District, we felt that a study of some of the selected units in this district will be representative of the State of Karnataka. The study examines the priority sector advances by public sector banks, which constitutes major part of the commercial banks.

Methodology:

In the present study we have collected and used both secondary and primary data. Secondary data regarding the extent of lending to different priority sectors by public sector banks (including small scale industries) was collected from the Reserve Bank of India Bulletins and other related publications. From the same sources data on over dues and repayment was collected. Information regarding priority sector lending was collected from different banks viz., RBI, State level Bankers' Committee, Lead Bank (Bangalore Division) and other public sector banks. Using an interview schedule, the field data was collected about credit requirements, its utilisation, and impact of credit on employment and profit from the respondent units.
SAMPLING PROCEDURE:

Karnataka being one of the industrialized states of the country, it had the distinction of having large and medium scale industries started both by private capital and state capital. The public sector units were mostly in the engineering and chemical industries and the private sector units were in cotton textile industry. In response to the demand for spare parts and other equipment, from large and medium scale industries, a large number of small scale industries emerged as ancillary units in the State.

An interesting feature of the SSIs is that they have a wide spread not only across the state but also across different industrial categories. It is because of this reason that the small scale industries are found in all the districts of the State and under all industrial categories. However, since Bangalore has developed as the major industrial center in the State, a large number of SSIs are located in this district. Thus, out of the total number of small scale units of 247103, 56203 (22.75%) units are located in Bangalore district. Of these, 18.41 percent of the units are located in Bangalore urban district and the remaining in Bangalore rural district. (Table 5.1).

RESPONSE RATE:
Having selected one hundred units for study, we contacted the entrepreneurs of these units by personal visits for data collection. But we faced some problems in the field such as the following:

1) Some entrepreneurs being busy did not find time to give interview.
2) Some were not available in the factory premises when we visited the units. Hence we had to visit the unit again to catch the entrepreneur.
3) Some entrepreneurs who were present were reluctant to share information out of suspicion and fear.

As a result 26 units in urban and 4 in rural areas did not respond. This gives us a response rate of 63 percent in urban areas 87 percent in rural areas. Obviously urban entrepreneurs were less responsive compared to rural areas. This was because many of the urban entrepreneurs were both busy and suspicious when compared with rural entrepreneurs. Pooling together the rural and urban units response, the overall rate works out to 70 percent.

However since our target was to survey one hundred units, we decided to replace the units, which were not responsive. In this case we took care to substitute them by units of similar category, which were closer in geographical terms to the non-responding units. Obviously, this would disturb the randomness of the sample but since we took care to select in the second round
units, which were of the same category and located next door to the non-
responding units, we believe that the disturbance in the randomness of the 
sample would not be too much to invalidate the conclusions.

'Since a large proportion of units were located in Bangalore district it 
was considered desirable to draw the sample units from this district. The 
sample procedure followed was a multi stage purposive random sampling. In 
the first stage, the state of Karnataka was selected for the study on the ground 
that it represented the industrially developed states of the country. In the 
second stage, Bangalore district was selected because, in this district the largest 
proportion of Small Scale units are located and also because this is the only 
district where the large number of industrial categories were found. In the third 
stage, we selected the Categories of industrial units to be studied on a 
purposive basis. It was decided to cover eleven industrial category units 
because these happen to be the major industrial categories, which more or less 
cover all the units. In the fourth stage, we purposively divided the units into 
urban and rural because it was felt that the performance of the units and also 
their requirement would geographically differ from each other. We intended to 
examine the locational advantages as regards the availability of inputs (mainly 
raw materials and labour) and marketing facilities. In the final stage, the units 
for study were drawn randomly from rural and urban areas and from different
industrial categories. For data collection, an interview schedule was prepared (which is put as Appendix III) and was canvassed among the entrepreneurs.

For field study it was considered feasible on the basis of time and resources available to cover one hundred units of which seventy are from urban and 30 from rural, roughly, this was the ratio in which units were distributed between urban and rural areas. To give representation to the various industrial categories we also distributed the sample units accordingly in a rough proportion to the ratio obtains across the industrial categories. We collected the list of SSI units from the District Industries Center (DIC) and from that, sample units were drawn at random in the final stage.

At the stage of interview, some of the entrepreneurs had reservation about sharing some items of data such as sales value and profits. After they were told that the information would be treated as confidential, that the data would be used only for research purpose and that the identity of the unit would not be disclosed in the report, did the entrepreneurs agree to share such information. There were also cases of some entrepreneurs who posed a question as to how they would be benefited by the study as in any case they have to spend so much of their valuable time to answer the questions. In such cases, they were told that there may not be any immediate and direct benefit to
them from this study. But from the analysis of the information when policy recommendations are made about the problems faced by the SSI units like theirs, there is a possibility that these recommendations may find a place in the industrial policy of the state. It is this incentive which prompted the doubting entrepreneurs to share information.

Having said all this, it is difficult for us to assure that all the entrepreneurs have honestly shared the information and given precise data. There may be cases of under reporting and over reporting, due to some personal bias. We believe that under such circumstances the average of these categories of replies would cancel each other and give us more or less a correct picture of the condition of the units, which is closer to reality. The following statistical tools were used in the analysis of our data. To examine trends in lending, we worked out index numbers and then arrived at trend growth rates. In addition to the use of index numbers, we used simple averages and ratios in the analysis of the data.

Limitations of the Study:

The main limitation of the study arises on account of difficulties experienced at the data collection stage. It is worth mentioning these difficulties faced by the researcher for a better appreciation of the problem:
1. Entrepreneurs were afraid of giving exact data regarding their profit levels.

2. They tried to hide the information regarding the number of labourers, mainly to avoid prosecution under the Labour Acts.

3. During the survey we found child labourers working in the premises in many units, but the entrepreneurs were not willing to admit that fact.

4. The value of fixed capital reported may be very low because many of them have purchased second hand machinery.

**Chapter Scheme:**

The research carried out has been reported in the following Chapters:

Chapter 1 is an Introductory Chapter dealing with the identification of the research problem, objectives of the study, sources of data and methodology of the study.

Chapter 2 presents a brief account of the nationalisation of major banks and the general aspects of priority sector lending practices - International and Indian experience.

Chapter 3 presents trends of priority sector lending in India, as well as in the State of Karnataka, wherein we have also identified the various schemes under which financial assistance is provided.
Chapter 4 deals with the policy, programmes and performance of small scale industries at the national as well as state level in terms of number of units, investment, output, employment, export and so on.

Chapter 5 presents the profile of sample small scale units in Bangalore Urban and Rural regions.

Based on these studies, we have discussed the extent of utilisation of loans and also the extent of repayment and over dues of priority sector lending at national and state level (Karnataka) in Chapter 6.

Chapter 7 is devoted to assess the impact of priority lending on small scale industries in terms of performance and employment.

The impact of New Economic Policy on priority sector lending and in turn on small scale industries has been discussed in Chapter 8.

Chapter 9 is the concluding Chapter, which summarises the findings and draws policy implications.