CHAPTER III

FUNDS MANAGEMENT — A REVIEW

The importance of funds management and study of profitability in co-operative sector has been keenly felt only in recent years. There is a concept that the co-operative sector stands for mutual service alone and not for profit. But reasonable return on capital is essential for any concern for its growth and development. This chapter, therefore, describes the theoretical structure of:

1. Sources and applications of funds
2. Sources and applications of income and
3. Review of literature.

Conceptual Framework

Before analysing the sources and applications of fund one should examine the concept of 'fund' or 'working capital'. As per the statistical statements relating to the Co-operative
Movement in India till 1969-70, working capital was considered as the total of paid-up share capital, reserve fund and other reserves, debentures, deposits and other borrowings. Thus it includes all the major items on the liabilities side of the Balance Sheet. But it does not include other sundry liabilities and current year's profit if they are not appropriated.

The Kerala State Co-operative Societies Act 1969 defined it as follows:-

Working capital includes such portion of the reserve fund, other reserves appropriated out of profits, paid-up share capital, loans and deposits received by a society as has not been locked up in buildings and other fixed assets.

This definition, more or less, is the same as the previous one, except that it excludes fixed assets and further it is not clear whether short-term borrowings such as overdraft and cash credit are included.

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1 An Annual Publication, Published by Government of India prior to 1942, which was transferred to Reserve Bank of India, in March 1942, with effect from the issue for the year 1940-41.
Both the definitions take into account that portion of the current year's profit which is added to various reserves, if it is appropriated at the time of preparation of final accounts. However, both the definitions of working capital exclude current liabilities or short-term credit.

These definitions indicate the major source of funds. The first one considers the total funds under the heads identified as working capital. The second one considers the amount available after excluding the amount locked up in fixed assets. This may be relevant and important in some organisations where fixed assets are heavy. But in a banking organisation, especially in Agricultural Development Banks, fixed assets represent only a fraction of total funds.²

The sources of funds according to these definitions consist both short-term and long-term. But they neither represent the financial structure (because short-term credit or current liabilities are not considered in the definition of working capital).

² Fixed assets represent only 0.55 per cent of working funds (see Appendix III).
liabilities are not taken into account), nor capital structure (because short-term source like deposits are not taken into account). They do not even represent the working capital as it is generally understood. In general, working capital has two versions — net or gross. Net working capital is the difference between the current assets and current liabilities whereas gross working capital represent the totality of fluctuating funds invested in the entire current assets. However, working capital is generally understood as net working capital in the financial circles.

In the Statistical Statement relating to the Co-operative Movement in India, published by Reserve Bank of India (RBI) from the 1970-71 issue onwards, "Working capital has been redefined to represent total of all items appearing on the 3

According to Weston and Brigham, Financial Structure refers to the way the firms' assets are financed. It is the entire right hand (liabilities) side of the Balance Sheet. Capital structure is the permanent financing of the firm represented primarily by long-term debt, preferred stock, and common equity, but excluding all short-term credit.

liability side of the Balance Sheet excluding the contra items and accumulated losses.\(^4\)

The latest definition of RBI can be considered an improvement over the above two, as it covers the entire liabilities side of the Balance Sheet and thus the total resources of funds\(^5\), both long-term and short-term. Hence it refers to the financial structure. Financial structure of an organisation gives an idea of the nature/source and size of funds employed in the organisation. Further, this definition indicated the solvency position of the organisation as it takes only the funds sunk in total assets. It, therefore, excludes contra items, which are in the nature of offsetting each other and accumulated losses. Hence it is suggested that the term working/total funds may be used.


\(^5\) "There is a distinction between cash resources and funds. The former refers to resources in cash only, whereas the latter is wider in its application and covers all arrangements for resources whether in cash or on credit basis".

rather than the term working capital. Thus, in this study, the term working fund has been used in the sense of total resources.

As the study is mainly concentrated on primary banks, it is worthwhile to give a brief discussion on the Co-operative Societies Act of the State.

The term funds management in this study includes the entire management of mobilisation of money, its deployment to beneficiaries and its recovery from them. Thus the entire flow of funds and its connected activities are covered in this study. The flow of funds of the entire structure can be depicted by the flow chart given below.

![Flow Chart]

In the beginning each primary bank used to raise funds independently through debentures, deposits, loans etc. This leads to some difficulties. Consequently the central (state level) bank has come into existence to centralise the issue of debentures and to co-ordinate the activities of these banks. After the establishment of the apex bank, the primary banks usually borrow from the apex bank and lend to their member borrowers. Thus the primary bank is an intermediary between the apex bank and the ultimate borrowers. The sources and uses of funds of primary banks are discussed below with the help of a theoretical statement of sources and applications of funds (Table 3.1) and a statement of sources and applications of reserves (Table 3.2).
Finances of Primary Banks

As the study is mainly concentrated on primary banks, it is worthwhile to have a theoretical analysis of the sources and applications of funds of these institutions. The principal object of a primary bank is to raise funds to be lent to its members. The primary banks are the voluntary associations of farmers who want to borrow long-term loans on mortgage of lands and are registered under the Co-operative Societies Act of the State.

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Table 3.1
Sources and Applications of Funds

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* Paise rounded to nearest rupee

Sources of Funds

As stated earlier, the sources of funds of primary banks consist of paid-up share capital, reserve fund and other reserves, borrowings from the apex bank, deposits and other current liabilities. The nature of some of the important sources is explained below:

1. Building fund
2. Staff benefit fund
Paid-up Share Capital

The borrowing power of a member is linked to his share capital held in the primary bank. The primary banks are collecting 5 per cent of loan amount as share capital. This amount is not repayable during the period of a loan. This source constitutes nearly Rs.6 for every Rs.100 source.

Reserve Fund and Other Reserves

According to the Kerala State Co-operative Societies Act 1969, not less than 15 per cent of the net profit is to be transferred to reserve fund. The balance of the net profit may be utilised as per their bye-laws. Normally, this amount is allocated to the following:

1. Payment of dividend not exceeding 10 per cent on the paid-up value of each share
2. Co-operative education fund
3. Dividend equalisation fund
4. Building fund
5. Staff benefit fund
6. Depreciation reserve
7. Bad debt reserve
8. Common good fund
9. Agricultural credit stabilization fund etc.

For every Rs.100 source a sum of Rs.2 is maintained as reserve fund and other reserves.

Deposits

The primary banks are not allowed to accept deposits like other Co-operative Banks. But they may, however, be allowed to accept deposits to a limited extent from special sources and with special objects. The item deposits here represent the amount borrowed from members and non-members — mostly employees. It includes staff security deposits, pending admission to membership and loan deposits. Loan deposits are amounts received from borrowers to be adjusted later against their loan instalments. This constitutes only less than 1 Rupee for every Rs.100 of source.
Borrowings

The major source of fund of primary bank is the borrowings from the apex bank. This constitutes nearly Rs. 82 for every 100 rupee fund. This amount is provided by the apex bank at a pre-determined rate. The eligibility of borrowing is subject to change according to the overdue percentage.

Other Liabilities

The other liabilities include interest due for payment to the apex bank, dividend due to shareholders and bonus etc. outstanding. Out of every Rs. 100 this constitutes nearly Rs. 9.

Applications of Funds

The application of fund consists of loan given to members, investments, cash and bank balance, fixed assets and other assets. The nature of the important applications of funds are explained below:
Cash and Bank Balance

Cash and bank balance represent the idle funds. This consists nearly Rs.3 for Rs.100 of total resources. It must be remembered that major part of the working funds are obtained at a cost and keeping them idle is not a prudent policy. It may be argued that the figure appearing is at the end of the year when the resources are more. Even then, if the recoveries are quickly remitted to the apex bank, it may utilise them for payment of liabilities without resorting to cash credit or, at least, may keep in call deposit with which bank earns reasonable rate of returns.

Investments

This item includes primary banks' contribution towards share capital of apex bank, investment of their reserve fund and other reserves, deposits of surplus funds, if any. The primary banks, generally, invest their reserves in the apex bank as they are precluded from making investments in any other institution. However, the Registrar of Co-operative Societies may permit them to invest in others. Accordingly, they have investment in
Government Securities and other Trustee Securities. Out of every Rs.100 source a sum of Rs.5 is in the form of investments.

Loan Outstanding (Credit)

These are the amounts due from member borrowers at different due dates. Out of Rs.100 this accounts nearly Rs.82. This is the major application of funds.

Fixed Assets

Fixed assets of the bank include land, building, car, furniture etc. The investment in fixed assets in the case of Agricultural Development Banks is less than Rupee 1 for every 100 Rupee application of fund.

All Other Assets

All other current assets are included under this head. This includes interest overdue, interest accrued but not due on loan outstanding etc. Interest items, both overdue and accrued but not due are mainly responsible for their substantial size. It nearly comes to Rs.9 for every Rs.100 fund.
Sources and Applications of Income

The sources of income to primary banks are as follows:

1. Interest on loan outstanding
2. Miscellaneous income

The usual items of expenditure (applications of income) are:

1. Interest on funds borrowed
2. Establishment charges
3. Administrative overheads.

A brief explanation of the items of income and expenditure is given below:

Interest on Loan

This is the major source of income of primary banks. This includes income as interest for the loan given to beneficiaries and the penal interest received for overdues other than interest on loan outstanding. Thus, it includes interest income from loan will be Rs.93.

Miscellaneous Income (Non-interest Income)
### Table 3.2

**Sources and Applications of Income**

<table>
<thead>
<tr>
<th>Applications of income</th>
<th>Sources of income</th>
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<tbody>
<tr>
<td>Interest paid and payable</td>
<td>76 Interest received and receivable</td>
</tr>
<tr>
<td>Establishment charges</td>
<td>10 Miscellaneous income</td>
</tr>
<tr>
<td>Administrative overheads</td>
<td>4</td>
</tr>
<tr>
<td>Profit</td>
<td>10</td>
</tr>
</tbody>
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| 100 |
| 100 |

*Paise rounded to nearest rupee*

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**Miscellaneous Income (Non-interest Income)**

The term miscellaneous income includes all other income other than interest on loan outstanding. Thus it includes interest on investments, dividends, application fee, administration fee and valuation fee. The dividend is received for the share investment in apex bank. An application fee of Rs.5
is collected from each farmer. The administration fee is collected at the rate of Rs.2 per thousand, subject to a maximum of Rs.100. For the valuation of mortgaged property a valuation fee is also charged. A contribution of Rs.7 has come from all these together for every 100 Rupee total income.

The items of expenditure are narrated below:

**Interest on Borrowings**

This is the interest paid on funds borrowed from the apex bank. This is the major item of expenditure. The rate is fixed by NABARD and subject to variations. Of every Rs.100 income Rs.76 are utilised for payment of interest.

**Establishment Charges**

This is the second major item of expenditure for primary banks. This includes pay and allowance, bonus, provident fund, gratuity contribution to staff etc. This nearly comes to Rs.10 for every Rs.100 income.
Administration Overheads

Administration overheads include TA and DA to directors, rent, rates, taxes, stationery, maintenance of fixed assets, postage and telephone, telegram and provision etc. Out of 100 Rupee income Rs.4 is spent for administrative overheads.

Thus the total expenses come to nearly Rs.90 and the balance of Rs.10 is available as profit for dividend and reserves. The actual position of the primary banks and changes during the period of study are explained in the subsequent chapters.

Review of Literature

It is relevant to refer briefly the previous studies made in the related areas of the subject. Literature on Agricultural Development Banks can generally be found in books of Co-operation, Agricultural Finance, Rural Credit and Banking. Much of the available literature on Agricultural Development Banks in India are official. The literature available through private publications is not very significant, though much literature is produced in the above fields.
About the official studies on Agricultural Development Banks, various Committees and Commissions on Co-operative Credit, Agricultural Finance and Rural Credit, right from Nicholson (1892) to Khushru Committee (1989), either covered elaborately or touched incidentally depending on their terms of reference. The important recommendations and extracts from these reports are given in the relevant chapters.

About individual studies Laud⁶, Choubey⁷ and Nakkiran⁸ devoted a chapter each in their books on co-operative banking, wherein they have dealt with the theory and practices of land development banking in India. Studies especially on Land Development Banks are few in number. Hussain⁹ studied the working of these banks in Madras State in their early stages. Ghosel¹⁰

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⁹ Hussain Syed, Co-operative Land Mortgage Banks, All India Co-operative Institutes Association, Madras, 1941.
¹⁰ Ghosel S.N., Agricultural Financing in India – with Special Reference to Land Mortgage Banks, Asia Publishing House, Bombay, 1968.
studied the working of Land Development Banks in India. Mathur reviewed the progress of these institutions in India. Besides these All India Studies, there are a few State level studies. Elavia's study on these banks in Gujarat state examined the problems faced by these banks besides evaluating their performance. Obul Reddy analysed the working of Agricultural Development Banks in Andhra Pradesh and stated the need of a well-designed management information system. The suggestions and extracts from these studies are also included in relevant chapters.

Regarding articles, the available literature is categorised as:

1. The studies relating to financial performance and profitability.

11 Mathur B.S., Land Development Banking in India, National Publishing House, Delhi, 1974.


2. The studies relating to overdues and
3. The studies in Kerala.

Financial Performance and Profitability

Karkal\textsuperscript{14} in his study on Profit and Profitability in Banking opined that profitability of banking organisations should be strengthened (increased) to ensure viability of the banking system. He expressed the view that an erosion (reduction) of profitability should not be allowed to take place because such erosions would lead to the stoppage of dynamic development functions of banks.

Varsh and Sampat\textsuperscript{15} analysed the profitability performance of Regional Rural Banks and stated that the general profitability of all RRBs improved. They concluded that the future of RRBs lies basically in declining the marginal and average operating cost curves.


Bhairav H. Desai\textsuperscript{16} conducted a study on the financial performance of Gujarat State Land Development Bank. Based on the study on annual financial statements of the Bank various selected ratios concerning the financial position, profitability and efficiency were worked out for a period of three years. He found that the bank is not working efficiently and profitability position is very poor. He stated that some surplus is essential for the growth of the institution and for meeting contingencies.

In a study conducted by Jivani and Upadhyay\textsuperscript{17} they stated that generally the aim of financial management is profit maximisation. However, the Agricultural Development Banks are considered as social banks and, therefore, profit is not the main or the only motive. Agricultural development is the main objective and supply of credit at comparatively lower rate of interest is the policy.


Prabhu⁰⁸ stated that the major problem today is how to improve the capability of the Agricultural Development Banks for undertaking larger and more qualitative lending.

Sant Dass⁰⁹, in his study, revealed that keeping idle money might create a chain of problem and, therefore, the banks should take all possible steps to avoid keeping of idle funds.

Narayanaswamy and Ramachandranⁱ⁰ stated that there is scope for increasing the profit and profitability, if proper attention is paid on areas like recovery, deposit mobilisation, branch expansion, reduction in manpower, operating expenses, building up of more owned funds and scientific management of funds.

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Krishnaswamy\textsuperscript{21} opined that though a co-operative society is not guided by profit motive it must earn a reasonable rate of profit on capital employed as a measure of efficiency.

According to Madhukar\textsuperscript{22} there is not enough evidence to indicate that size has anything much to do with operational efficiency and profitability. Some very large and very small public sector banks have registered satisfactory levels of performance.

Kadam\textsuperscript{23} conducted a study on the financial position of the State Co-operative Agricultural Development Banks in U.P., Gujarat, Bihar and Maharashtra. The methodology adopted was the computation of average annual growth rate for the selected variables like membership, share capital, reserves, lending,
interest on borrowings and lending, margin and cost of management. He found that there is no consistency in the growth, rate of variables between banks. He opined that in order to maximise the earning the banks need to reduce the cost of funds and, at the same time, deploy the funds where higher margin is available. He also stated that sound financial position of the Agricultural Development Banks is very important for its long run efficient operation.

Mahendra and Desai stated that viability of a particular investment is assessed in terms of financial rate of return which obtains on the investment, for the effective life of the asset financed by the investment. It may be noted that only financial analysis, and not economic analysis, is made for the purpose of assessing the return of the investment.

In his study on Fund Management of Regional Rural Banks,

Sinha tried to answer how best the funds of Regional Rural Banks were managed by reducing the cost of receiving and managing the same.

Rao analysed the cost structure of recovery of overdues and reported that salary and allowances paid to field supervisors formed the major component (50 per cent) and expenses incurred for hiring jeeps for recovery work is the next major component (40 per cent). He also estimated that the cost of recovery is one third of the total cost of management.

In his study on Financial Performance of Co-operative Banks, Indra Sena Reddy stated that the overall financial position and performance of Multipurpose Co-operative Rural Bank

is satisfactory and opined that it should improve its performance in respect of profitability and turnover.

Studies Relating to Overdues

According to Roy, repayment ethics forms an integral part of the principles of development banking. He is of the opinion that concerted efforts would be made by all concerned to educate the farming community regarding repayment ethics and repayment culture as a long-term measure.

Mishra and Aswathi reported that the accumulation of overdues was due to controllable and noncontrollable factors, which accounted for 35 and 65 per cent respectively.

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Singh and Sharma\(^\text{30}\) have indicated that the magnitude for overdues was the lowest with landless labourers. The poor recovery and high overdues in the case of small and marginal farmers could be ascribed to the diversion of funds for consumption purposes. However, the large and medium farmers did not repay in spite of having sound resource base.

Hemachand Jain and Choudhary\(^\text{31}\) have pointed out that the poor performance in the recovery of farm loans was due to maximising disbursement of loan by adopting target-oriented approach and succumbing to outside pressure for sanctioning loans either by ignoring the viability of the proposal or unrealistic assessment of incremental income.

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Balishter and Roshan Singh\textsuperscript{32} found that the recovery of loans advanced by the bank under the Integrated Rural Development Programme was satisfactory in all categories of families and this nullified the common impression that advancing of loans to weaker section would lead to accumulation of bad debts.

Raut\textsuperscript{33} indicated that the problem of overdues was mainly due to misutilisation of loans by the tribal farmers. The tendency to misutilise loan was due to the fact that the consumption priorities of tribal farmers were of more urgent nature than asset-building priorities.

Gurubachan Singh and Balwanth Singh\textsuperscript{34} reported that the extent of relative loan default was higher in the case of large farmers as compared to other categories of borrowers.

\begin{thebibliography}{9}
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Bisallah and Nagaraj\textsuperscript{35} have observed that the age of the borrowers and farm business income were negatively related to overdues, while the size of holding, family size and non-farm expenditure showed positive relationship.

Raj Kishore Panda\textsuperscript{36} has observed that the diversion of credit towards nonproductive purposes was more among the medium and large farmers than the small farmers.

Islam\textsuperscript{37} stated that the repayment behaviour of the pure tenant farmers was excellent, despite the emergence of high cost of capital to this group.


Bhavani Devi and Sitaraman 38 have found that income from farming as well as off-farm income had positive effect on the repayment capacity of the borrowers.

Viswanathan 39 stated that the overdues were to a large extent on account of wilful default which was either due to ineffective machinery or because of unfavourable recovery climate.

The study conducted by Ramesh Chand and Sidhu 40 showed that the application of discriminant function was quite efficient in classifying the borrowers into defaulters and non-defaulters. It was found that the higher the value of the ratio of dependents on the family, the more will be the capital expenditure and total borrowings. This will place the borrowers into defaulters' group and vice versa. On the other hand, the high level of education contributed towards non-default.


Narayanan observed that inadequate bank staff, vast area of operation entrusted with supervisors, inadequate transport facilities, insufficient travelling and dearness allowances, target-oriented, unscientific deployment of loans, inefficient credit management—all these have accounted for escalating overdues at the individual level.

Lekh Ram Mahlan and Bal identified the defaulters and non-defaulters on the basis of socio-economic characteristics of borrowers by using discriminant function. The 'extension contracts' and 'technology in use' had positive effect on the repayment behaviour of the borrowers.

Dangat and Radkar reported that the medium-and
long-term loans were diverted for the conduct of marriages, consumption and for construction of residential buildings in all the size groups of holdings in both the developing and the underdeveloped regions. Proper approval of loan proposal, follow-up and supervision after the disbursement of loan were suggested for effective financing of agriculture.

Naidu and Ramodra Reddy observed that credit users belonging to higher castes of the village, with larger holdings with higher percentage of educated family members and with higher educated status with large borrowed amount of loan and with higher farm and non-farm incomes had greater probability of becoming defaulters.

Balishter and Roshan Singh found that the lending of money borrowed from co-operatives to others was the major cause for the nonrepayment of loan among the large farmers. Lack of

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supervision by the society and noninsistence of timely repayment were the next important causes for wilful default.

Munikrishna Reddy and Ramesh Kumar Reddy suggested that the banks should give utmost importance to education, farm size, social participation, urban contact, scientific orientation, economic motivation and innovativeness of the farmers while granting credit; because those characters had considerable bearing on the repayment performance of peasants.

Muniraj in his study on improving recovery performance through effective financing of agriculture stated that the mounting overdues is one of the reasons for the erosion of profitability of banks, as it impairs banks' ability to recycle funds and restrict their access to refinance agencies like NABARD.

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Bosale et al. conducted a study about the repayment position and factors responsible for overdues in Maharashtra. A sample of 120 farmers are randomly selected from eight villages of Kolhapur district. A functional analysis is conducted to estimate the contribution of different factors affecting the amount of overdues. They found that there is positive and direct relationship between overdues and amount borrowed and family expenditure. They also ascertained that one of the leading factors in increasing the amount of overdues is misutilisation of loan.

Balishter et al. in their study selected 150 farmers from 10 villages of Etah district in Uttar Pradesh to assess the extent of overdues and to examine the reasons for default. They stated that the main reason for overdues is the low increase in income and diversion of loan for unproductive purposes.

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Balishter et al. in their study selected 175 defaulters from six villages of Agra district who had received loans from Land Development Bank. They analysed the extent of current and old overdues and wilful default in different farm size group. They stated that the main reason for wilful default is the slackness on the part of bank officials who do not insist on timely repayment. They also found that the wilful default is high in medium and large farmers.

Marvar et al. analysed the overdues on agricultural credit in Yavatmal district in Maharashtra and reported that the main reason for overdues are crop failure, low income and fall in agricultural prices. They also found that there is positive and significant relationship between amount of loan, repayment capacity and overdues. Their analysis proved that per hectare amount of overdues increased with the increase in sizeholding because of misutilisation of loan.
Khatkar et al. conducted a study on the trend of agricultural credit and overdues in Haryana and expressed the view that the higher growth rate of overdues is an alarming situation for the co-operative institutions. He further stated that to overcome this problem there is an urgent need to avoid the underfinancing and to curb political interference for better recovery of loans.

Kerala Studies

Jose conducted a study on Tellichery Primary Bank and observed that there is discrimination in giving bank finance to small cultivators in all the schemes of the bank.

Suresh is of the opinion that the composition of loan


operations of co-operatives in Kerala is not conducive to the changing pattern of land utilisation and cropping behaviour in the economy. The study shows the increasing importance of long-term credit in Kerala and new challenges of co-operatives.

Harikumar conducted a study on Quilandy Agricultural Development Bank to know the procedural impediments in the long-term agricultural credit. He opined that there is lot of unnecessary procedural impediments which keep the farmers away from the bank.

Venkiteswaran and Janardhanan Pillai have observed in their study that the multiple structure of credit had led to a circular flow of cash from one financial agency to another agency, and it is doubtful whether the real income of the rural community increases with the increase in the flow of credit. They continued that diversion of loan can be controlled to a great extent by

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providing loan to nonagricultural purposes like rural housing.

Dharmapalan 57 analysed the reasons for mounting overdues in Kerala and opined that the recovery position can be improved if the employees of the bank sincerely attempt for it and the Board of Directors and other policy-makers help the employees properly.

It is thus clear that the studies on funds management on Primary Agricultural and Rural Development Banks in general are few and on primary banks in Kerala are very rare. Barring a few, almost all the studies suffer from the following deficiencies:

1. The available studies are in the form of case studies pertaining to a single organisation or a single aspect. Hence the findings of such studies cannot be generalised.

2. The studies do not cover the entire flow of funds.

The present study is an improvement over the earlier studies in the following respects:

1. This is an attempt to study the funds management of

Primary Agricultural and Rural Development Banks drawing samples from banks having different levels of overdues and different volume of funds from the entire state of Kerala.

2. The study is attempted at both micro and macro level and the term funds has been given a wider definition and includes all items in the liability side of the Balance Sheet excluding contra items and accumulated losses.

3. The funds management in this study gives a broader definition. It includes not only mobilisation and deployment of funds, but also the recovery of funds and thus cover the entire cycle of funds.

4. The study examines the intra variations (variations for the same bank over the years) and inter variations (variations between banks).

5. A standard is also developed for the comparison of efficiency and profitability of these primary banks.