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Flawed Bank Credit in Kerala: A Negative Impetus to Economic Change

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Abstract

Obviously, most of the bank officials criticise target oriented lending as it dilutes the acts of chalking out eligible borrowers and monitoring proper credit utilisation. Eventually, it results in loan default and utilization gap. Ensuring proper scrutiny of loan applications, sanctioning of adequate credit and assessment of the impact of credit on the employment, income and asset of the borrowers are inevitable to calibrate the system of banking and its impact on the economy as a whole. Believably, the study found that sizeable number of borrowers are diverting their borrowings for purposes other than those specified while obtaining sanctions from the banks. Again, the impact of bank credit on income and assets generation of borrowers is also found to be meagre.

Keywords: *Credit Diversion, Micro Small and Medium Enterprise (MSME), Asset Generation, Credit utilization*

1. Introduction

Availability of timely and adequate credit at low cost is considered important to the borrower, either agriculturists or MSMEs. But the accessibility of credit by these categories is prone to problems due to the inability to arrange for collateral security and or third party guarantee. Similarly, there are divergent views on the extent to which they are using the credit for the purposes for which it was sanctioned. One of the avenues through which the welfare of the poor and unemployed could be improved is by better access to credit and financial services. But the figures show that only 5.2 per cent of India's 650000 villages have bank branches and just about 40 per cent of the population across our country has bank accounts (RBI Bulletin, Sept. 2009). Out of 89.3 million households in the country, 45.9 million farmer households are indebted to formal sources of which one third also borrow from informal sources (National Sample Survey, 2003). Farm households' not accessing credit from formal sources as a proportion to total farm households is especially high at 95.91 per cent, 81.26 per cent and 77.59 per cent in the North, Eastern and Central regions respectively (Report of Committee on Financial Inclusion, June 2008).

The lending procedure of commercial banks starts from processing of the loan application. The application form is processed with the help of project appraisal report, feasibility report, financial viability appraisal of securities and the legal documents received along with the loan application. If the project is found to be technically feasible, financially viable and the legal documents satisfy the requirements stipulated by the bank concerned, sanction of loan is granted. The prospective borrower has to bear a certain amount towards cost of borrowings. This normally includes processing fee, documentation fee and travelling expenses. The loan sanctioned must be disbursed within one month of the date of sanction. Eventually, a sanctioning letter, describing the terms and conditions of the loan, is issued to the borrower. On receipt of such acceptance, the bank will brief the borrower regarding the disbursement formalities required to be complied with. Monitoring of the loan is another function of a bank after its disbursement. Negligence in monitoring a loan is less excusable than an error at the appraisal stage. Pre-disbursement monitoring, post-disbursement monitoring and follow up of the advance are mandatory as the borrower has a tendency to delay repayment to meet some other pressing commitments. Similarly, the borrower would use money for some other urgent purpose instead of servicing a loan, which is otherwise known as loan diversion. It is expected that all the borrowers utilize the loan amount for the purpose for which it was sanctioned. Though this is one of the cardinal principles behind sanctioning a loan, most of these borrowers do not actually adhere to this. Moreover, most of the bank officials are critical of target oriented lending imposed on them. So in order to fulfil the target, they fail to chalk out eligible borrower and eventually the concerned borrower diverts the loan amount. This gradually results in wilful default and utilization gap. The present paper focuses on the utilization of bank credit by agriculture and MSME borrowers in the public and private sector banks in Kerala.

2. Objectives, Study Setting and Methodology

The study intends to examine – whether the bank credit availed by the borrowers consisting of agricultural and Micro, Small and Medium Enterprises (MSMEs) have been utilised by them effectively; the extent of credit diversion, if any; and the extent of income and assets generation in the pre and post loan period.

All the public sector banks and private sector banks (except new generation and foreign banks) in Kerala constitute the universe for the study. The borrowers and branch managers of the sample branches were the respondents. Multistage systematic random sampling technique was employed for selecting the sample. In the first stage, the State of Kerala was divided into three zones- south, central and north- for selecting one district each representing these zones. The districts were selected by considering the volume of banking business and number of branches. Accordingly, Thiruvananthapuram (representing the south), Ernakulam (representing the central) and Kozhikode (representing the north) were selected. In the second stage, one bank from the public sector and one bank from the private sector were selected from each of the three sample districts, based on the volume of business and number of branches.

The State Bank of Travancore (SBT) and Federal Bank were the banks in the public sector and private sector, respectively, fulfilling the selection criteria in all the three zones in Kerala. Thus, The State Bank of Travancore and The Federal Bank constitute the sample banks. There were 172 SBT branches and 128 Federal bank branches in the three selected zones in Kerala. In Thiruvananthapuram, there are 89 SBT branches and 35 Federal bank branches, in Ernakulam 62 SBT branches and 72 Federal bank branches and in Kozhikode 21 SBT branches and 21 Federal bank branches. In the third stage, for selecting the sample branch, 10 per cent from each zone of SBT and Federal bank were selected systematically. Thus, 17 SBT branches (9 from the south, 6 from the central and 2 from the north) and 13 Federal bank branches constitute the sample branches. The branch managers of these 17 SBT branches and 13 Federal bank branches (i.e. a total of 30) were the respondents, representing the officials for the study.

In the fourth stage, the sample borrowers (consisting of agricultural and Micro, Small and Medium enterprises (MSMEs) borrowers) were selected. There were 180808 Agricultural borrowers and 14214 MSME borrowers in 17 selected SBT branches in all the three zones of Kerala as on 31st march 2009. The corresponding borrowers in the 13 Federal bank branches during the period were 27493 and 6274 respectively. For the intensive study, 300 agricultural borrowers (270 from SBT and 30 from Federal bank) and 300 MSME borrowers (208 from SBT and 92 from Federal bank) were selected conveniently by considering the proportion of the number of agricultural and MSME borrowers from the three zones of 17 branches of SBT and 13 branches of Federal Bank. Thus, a total of 600 were the respondents, representing the borrowers for the study. The data collected were classified and examined using statistical tools, viz. average, percentage, Chi-square, Wilcoxon Signed Rank Test and Mann-Whitney Test.

3. Hypotheses

$H_0$1. The borrowers of the public sector and private sector banks in Kerala are not using the credit for the purposes for which it was sanctioned.

$H_0$2.There is no significant difference between the amount of monthly income generated before the credit and after the credit among the borrowers of public sector and private sector banks in Kerala

$H_0$3. There is no significant difference between the value of assets acquired before the credit and after the credit among the borrowers of public sector and private sector banks in Kerala

4. Results and Discussion

4. (A). Utilization of Credit (Discussion of first Hypothesis)

While sanctioning a loan it is expected that all the borrowers utilize the credit for the purpose for which it was sanctioned. But most of the studies conducted in the area revealed that a sizeable percentage of the borrowers were using the credit for other purposes and these purposes were by and large unproductive. The perception of borrowers and bank managers with regard to utilization of loan amount is assessed as under:

4. (A) 1. Perception of Borrowers

The analysis made regarding the utilization of credit by agriculturists and MSMEs in the public and private sector banks in Kerala reveals a different result that a large majority of the borrowers (63.8%) utilized the credit for the purpose for which it was sanctioned and the rest (36.2%) diverted the credit (Table 1).

Table: 1 Utilization of Loan Amount (Opinion of Borrowers)

Opinion	Public sector bank				Private sector bank				Total
	South	Central	North	Total	South	Central	North	Total	
Yes	152(68.8)	113(55.9)	22(40.0)	287(60.0)	12(40.0)	65(91.5)	19(90.5)	96(78.7)	383(63.8)
No	69(31.2)	89(44.1)	33(60.0)	191(40.0)	18(60.0)	6(8.5)	2(9.5)	26(21.3)	217(36.2)
Total	221(100)	202(100)	55(100)	478(100)	30(100)	71(100)	21(100)	122(100)	600(100)

Source: Primary data. Figures in parenthesis are percentages to respective totals.
Public sector banks- Chi square (df= 2) = 17.655; p value = .000*
Private sector banks- Chi square (df= 2) = 35.520; p value = .000*
Public and Private sector banks- Chi square (df= 1) = 13.842; p value = .000*
* Significant at 1 per cent level. 99% Confidence limit = 32% to 40%

The sector wise analysis also finds no wide variation (Table 1). But the Chi-square test calculated separately for the public sector and private sector banks and also between the banks show a significant variation in the opinion among borrowers ($p < 0.001$). The foregoing analysis clearly establishes the fact that the borrowers of both public sector and private sector banks are using the credit for the purpose for which it was sanctioned with

99 per cent confidence limits of the proportion varying from 32 per cent to 40 per cent (i.e. if we put the question to the entire population not less than 32 per cent will state in the same direction, but not more than 40 per cent). Hence, the null hypothesis stating that the borrowers of public sector and private sector banks in Kerala are not using the credit for the purposes for which it was sanctioned stands rejected.

4. (A) 2. Perception of Bank Managers

Unlike the opinion of borrowers, most of the bank managers (86.7%) found diversion of the loan amount by the borrowers. The sector-wise analysis also finds no significant variation (Table 2). The Chi-square tests worked out for the banks separately and between them also find no significant variation in the opinion among managers (p>0.05).

Table 2: Utilization of Loan Amount (Opinion of Bank Managers)

Opinion	Public sector bank				Private sector bank				Total
	South	Central	North	Total	South	Central	North	Total	
Yes	-	1(16.7)	1(33.3)	2(11.8)	-	-	2(50.0)	2(15.4)	4(13.3)
No	8(100)	5(83.3)	2(66.7)	15(88.2)	3(100)	6(100)	2(50.0)	11(84.6)	26(86.7)
Total	8(100)	6(100)	3(100)	17(100)	3(100)	6(100)	4(100)	13(100)	30(100)

Source: Primary data. Figures in parenthesis are percentages to respective totals

Public sector banks- Chi square (df= 2) = 2.550; p value = 0.475*

Private sector banks- Chi square (df= 2) = 5.318 ;p value = 0.107*

Public and Private sector banks- Chi square (df= 1) = 0.0835; p value = .773*

*Not significant at 5 per cent level.

4. (B). Extent of Loan Diversion

The more the loan amount diverted, the more will be the chances of over dues. So an enquiry into the percentage of loan diversion is noteworthy. The perception of borrowers and bank managers with regard to the extent of loan diversion is assessed as under:

4. (B) 1. Perception of Borrowers

The analysis of the perception of borrowers as to the percentage of loan amount diverted given in Table 3 reveals that 38.2 per cent of the borrowers diverted below 20 per cent of their loan amount and 33.6 per cent diverted 30 to 40 per cent. While analyzing the sectors separately, 38.2 per cent of the borrowers in the public sector banks diverted 30 to 40 per cent of their loan amount, whereas, 73.1 per cent in the private sector banks diverted below 20 per cent. Though the above view tested with the chi-square found a significant variation in the opinion among borrowers belonging to the public sector banks ($p < 0.05$) the chi-square for the private sector banks and between the public and private sector banks found no significant variation in the opinion (p>0.05).

Table 3: Extent of Loan Diversion (Opinion of Borrowers)

Extent of loan diverted (%)	Public sector bank				Private sector bank				Total
	South	Central	North	Total	South	Central	North	Total	
Below 20	21(30.4)	24(22.5)	24(69.7)	69(33.5)	16(77.8)	5(83.3)	1(50)	22(73.1)	91(38.2)
30-40	46(66.7)	20(22.5)	7(21.2)	73(38.2)	1(5.6)	1(16.7)	-	2(7.7)	75(33.6)
Above 40	2(2.9)	45(13.5)	2(6.1)	49 (8.4)	1(5.6)	-	1(50)	2(7.7)	51(8.3)
Total	69(100)	89(100)	33(100)	191(100)	18(100)	6(100)	2(100)	26(100)	217(100)

Source: Primary data. Figures in parenthesis are percentages to respective totals.

Public sector banks- Chi square (df =4) = 78.193; p value = .000*

Private sector banks- Chi square (df = 4) = 6.434 ;p value = .1690*

Public and Private sector banks- Chi square (df = 2) = 5.162; p value = .0757*

*Significant at 5 per cent level. *Not significant at 5 per cent level

4. (B) 2. Perception of Bank Managers

The perception of bank managers as to the extent of loan diversion reveals that 42.3 per cent of the borrowers have diverted below 20 per cent of their loan amount while 46.2 per cent have diverted 20-30 per cent.

Table 4: Extent of Loan Diversion (Opinion of Bank Managers)

Extent of loan diverted (%)	Public sector bank				Private sector bank				Total
	South	Central	North	Total	South	Central	North	Total	
Below 20	2(25.0)	4(80.0)	1(50.0	7(46.7)	1(33.3)	3(50.0)	-	4(36.4)	11(42.3)
20-30	6(75.0)	-	1(50.0)	7(46.7)	1(33.3)	2(33.3)	2(100	5(27.3)	12(46.2)
Above 30	-	1(20.0)	-	1(6.7)	1(33.3)	1(16.7)	-	2(18.2)	3(11.5)
Total	8(100)	5(100)	2(100)	15(100)	3(100)	6(100)	2(100)	11(100)	26(100)

Source: Primary data. Figures in parenthesis are percentages to respective totals.
Public sector banks- Chi square (df = 4) = 7.714; p value = .010*
Private sector banks- Chi square (df = 4) = 3.392; p value = .495**
Public and Private sector banks- Chi square (df = 2) = .8905; p value = .641**
* Significant at 5 per cent level. **Not significant at 5 per cent level

The sector wise analysis also finds no considerable variation as to the amount of loan diversion (Table 4). Though the above view tested with the chi-square found a significant variation in the opinion among managers belonging to the public sector banks ($p < 0.05$) the chi-square for the private sector banks and between the public and private sector banks found no significant variation in the opinion ($p>0.05$).

4. (C).Impact of Credit on Income Generation (Discussion of Second Hypothesis)

While assessing the impact of credit on income generation in the pre-loan and post-loan periods among borrowers in the public and private sector banks in Kerala with the Wilcoxon Signed Rank Test, it found a significant difference ($p<0.05$). But no such difference was found in income generation between the public and private sector banks after the credit with 95 confidence limits. While analyzing the impact of bank credit on income generation with the Mann-Whitney Test, there was a significant difference between the income in the pre-loan period and post loan period of public and private sector banks in Kerala ($p<0.05$). Thus, the null hypothesis that there is no significant difference between the amount of monthly income before the credit and after the credit among borrowers in public and private sector banks in Kerala stands rejected (Table 5).

Table 5: Impact of Credit on Income Generation (Wilcoxon and Mann-Whitney Test)

Income	Public sector bank					Private sector bank					*P	**P
	N	Mean	SD	P25	P75	N	Mean	SD	P25	P75		
Before credit	478	54.2	12.5	8.3	45	122	6803	5506	1900	6050	.000	.000
After credit	478	72.2	14	8.5	60	122	7000	7806	2100	6200	1.00	

Note: N=Number, S.D= Standard Deviation, P25=Median, P75=75th Percentile
*P value as per Wilcoxon Signed Rank Test
**P value as per Mann-Whitney Test

4. (D). Impact of Credit on Asset Generation (*Discussion of Third Hypothesis)*

The impact assessment of credit on asset generation in the pre-loan and post-loan periods among borrowers in the public and private sector banks in Kerala with the Wilcoxon Signed Rank Test, it was found that there is a significant difference ($p<0.05$) between the asset value before the credit of public and private sector banks of Kerala, whereas, there was no significant difference ($p>0.05$) found asset value between the public and private sector banks after the credit with 95 confidence limits (Table 6). While analysing the impact of bank credit on asset generation with Mann-Whitney Test, there was a significant difference between the asset value in the pre-loan period and post loan period of public and private sector banks of Kerala ($p<0.05$). Thus, the null hypothesis that there is no significant difference in the asset generation before the credit and after the credit among borrowers in public and private sector banks in Kerala stands rejected.

Table 6: Impact of Credit on Asset Generation (Wilcoxon and Mann-Whitney Test)

Asset	Public sector bank					Private sector bank					*P	**P
	N	Mean	SD	P25	P75	N	Mean	SD	P25	P75		
Before credit	478	13521	59345	1900	6050	122	6803	6506	7100	8200	.000	
After credit	478	15835	75653	1800	6200	122	7000	6806	7800	9000	1.00	.000

*P value as per Wilcoxon Signed Rank Test

**P value as per Mann-Whitney Test

Note: N=Number, S.D= Standard Deviation, P25=Median, P75=75th Percentile

V. Conclusion

As found in the study, most of the borrowers (63.8 per cent) did not divert their loan amount. However, the diversion by the rest of the borrowers (38.2 per cent), whatever may be the magnitude of diversion, is to be discouraged. In future, lending by banks should ensure maximum utilisation of loan amount for the purpose for which it has been sanctioned. Indisputably, to strengthen the economic system, the departure of bank money from productive purposes should be curtailed at any cost. Moreover, the finding that the credit could not make any significant improvements in the income of the borrowers is highly alarming and demands a calibration in the banking sector as lenders, and the agricultural and MSMEs sectors as beneficiaries.

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