Rural Banking: Shifting Paradigms

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Abstract: This article is a preprint of the 2005 publication in Professional Banker and examines the shifting paradigms in rural banking in India. It highlights the transformative effects of accessible credit on rural livelihoods. Despite governmental initiatives and an expanded banking network, challenges persist, including low credit-deposit ratios, inefficient loan processes, and financial exclusion. Reflecting on historical reforms, the article calls for a more inclusive rural banking system to balance development between rural and urban sectors.

Keywords**:** Rural Banking, Microfinance, India, Economic Development, Financial Inclusion

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Sivamma is a 36-year old woman from the Guntur district of Andhra Pradesh. She runs a small scale hair business employing 250 women who collect human hair from nearby villages in exchange for little toys for children. The collected hair is sold to a leading hair exporter based in Chennai, wherefrom it eventually goes to several western countries for fabrication as wigs and hairpieces.

*It was some five years back when Sivamma approached Spandana, a microfinance initiative based in Guntur for a loan of Rs 2000. Today, her return on investment is more than a hundredfold (Rai, 2004). She owns a cemented house, a gas connection and is also providing higher education to her two children (*Ramachandra, 2005). *Sivamma does not hide her gratitude to Spandana for the enormous role it played in changing her life: "Besides being timely, these loans made me work hard, for how else I would have been able to return their installments on time? The pressure induced me to take risks which turned out in my favor. It is primarily through such continuous support that my income has gone up; I have also been able to improve my dwelling and procure a number of additional household items."*

The story per se, depicts the changing facade of rural India. Today, an increasing number of villagers are taking interest in non-traditional ways of earning livelihood. Low-cost technology and some strong initiatives in the recent years (by few private and public players) have given a good thrust to the otherwise ailing rural economy. Recent initiatives of the central and the various state governments also underline their sincere commitment towards agriculture and rural development. With a planned allocation of Rs 2,600 crore towards accelerated irrigation benefit programme, Rs 8,000 crore for rural infrastructure development fund and a commitment to double the agriculture credit within three years, the government has portrayed that agriculture remains an area of prime concern (Indian NGOs, 2005).

However, all good policy measures aside, one notable feature of the Indian economy has been the flawed and lopsided implementation at operational levels. The former Prime Minister Rajeev Gandhi had once derisively remarked that the rural sector received only 15 paise for every rupee spent for its welfare and development – the rest was gobbled by politicians, bureaucrats and other intermediaries.

1. THE CONUNDRUMS OF RURAL BANKING - A RETROSPECTIVE ANALYSIS

The last five decades of economic pursuits have not been able to bring about a remarkable change in the lifestyle of the rural population. While the rural sector spawns the more productive manufacturing and the services sector, its own plight remains one of prolonged and protracted misery.

1.1 Exiguous savings

The low quantum of rural savings highlights the general disregard to the concerns of the rural economy. While 48% of the public sector banks are in rural India, 58% of the rural households still do not have any bank account and only 21% avail credit from a formal source. A little over 1% of rural households take up loans from financial intermediaries to finance unforeseen expenses. Approval for such loans takes around 6 to 8 months and is quite often carried with bribery to the concerned officials.

The rural banks have 30.2% of the total number of deposits in the banking system but muster only 14% of the total deposit liability. In the year 2001, the per capita deposit in the rural sector was only about 10% of the national per capita income (Bandhopadhyay, 2004).

1.2 Appalling credit scene

Investments require availability of sound credit delivery mechanisms. The liberalization policies since 1991 have fostered greater economic activity and facilitated the availability and expansion of credit for housing and consumption purposes.

Institutional credit to the rural sector has witnessed a very discouraging trend over the years. There has been a post-reform decline in the performance of banks, in lending credits to agriculture and allied activities. The total lending by commercial banks for agriculture falls below even their out-standings in personal loans portfolio comprising loans for housing, consumer durables, etc.

Rural centers have a low Credit/Deposit (CD) ratio of 42% compared with that of 69.5% at urban centers. The financial reforms have ensured a relatively better credit availability rate in the urban areas compared to the rural ones. The CD ratio of the rural sector is still somewhere around the figure it was at the time of nationalization of banks (37.2%) (Jagan Mohan, 2004). The rural or the semi-urban branches have been fairly successful in mobilizing the rural populace towards greater savings. However, several flaws and loopholes still exist in providing them sound credit facilities. The low CD ratio of the rural sector indicates that banks are not playing a significant role in credit expansion in this segment. Despite the widespread banking network in the rural sector, there is a continued migration of rural savings to the urban sector, resulting in a palpable rural-urban imbalance (Jagan Mohan, 2004).

It would not be an exaggeration to acknowledge the serious exclusion of the agriculture sector from the general economic reforms initiated in 1991. The experience over the last five decades underlines the vulnerability of Indian economy to the whims of agricultural productivity. For instance, a negative growth of 4.4 per cent in the agriculture sector affected the Indian economy to an extent that the economic growth fell to a low 3.7 per cent in 2002-03 as against 5.6 per cent during 2001-02.

1.3 Did the government play a positive role?

Way back in 1975, the central government had appointed the Narasimhan Committee that suggested an array of measures to improve the bedeviled credit delivery system in the rural sector. The committee took serious note of the attitudinal, procedural and institutional factors that choked the growth of rural banking (Jagan Mohan, 2004). It disapproved the unprofessional attitude of bank employees, the cost structure of the commercial banks and the lack of a professional approach in the co-operative credit system. While the banks successfully mobilized savings from the rural and semi-urban sector, the infrastructure development from most of the rural money were carried out in urban regions. As a sequel to this biased approach, a wide disparity was observed in their economic development (Devarajan, 2001).

To encourage the development of formal financial institutions in rural India and to ensure greater participation of the rural populace in income generation, the Narasimhan committee recommended creation of Regional Rural Banks (RRBs). The RRBs were set up under an act of parliament in 1976 with the primary objective of providing thrust to the rural economy by promoting agriculture, trade and commerce and extension of loans to poor farmers and small entrepreneurs (Bankers India, n.d.). However, in contrast to all expectations, the RRBs failed to prove the purpose of their formation. Inadequate funds, biased policy measures, lesser attention to agricultural development, poor infrastructure, lack of sincere work culture were some of the reasons that did not give the RRBs the thrust that they needed.

The above facts not only underline the failure of the organized financial sector of the country which has all through been unsuccessful in meeting the credit gap in the rural segment, but also depict the continued reluctance and apathy towards improvement. Political infringements at local levels, bureaucratic delays and red-tapism, directed and subsidized lending, cumbersome procedures and lack of statutory backing for recoveries have been the major impediments to the growth of banking in the rural sector.

The trends over the years have clearly shown that the banking system in India finds a more profitable business in the urban regions compared to that in the rural ones. The failure of the formal delivery channels in bridging the credit gap has only spawned the well organized informal delivery channels that lend at rates ranging from 24-36 per cent per annum, depending on the risk profile of the borrowers. A 1997 Price Waterhouse Coopers study revealed that 78% of the rural households depend on non-formal financial sources like local money lenders, chit funds, etc. due to better delivery mechanisms offered by them, ease in purchase and greater flexibility in repayment (Bandhopadhyay, 2004).

The early decades of governance saw a socialistic pattern of growth. In lieu with the governments' populist policies, the public sector enterprises were encouraged to offer cheaper credits to the needy. Due to lack of enough statutory controls there was a general propensity for credit by the non-target group of beneficiaries. These skewed policies failed to achieve the desired results and led to deliberate evasion of repayment by defaulters. Such loans also got written off for reasons political as well as administrative. The credit culture was thus badly spoiled in the rural sector (Manjunath, 2004).

2. THE CHANGING TRENDS IN RURAL BANKING

The last few years have seen an increasing tendency among the urban banks and financial institutions to switch focus to the rural sector. The increased liberalization for private players, lesser number of non-performing assets (compared to other segments), low cost of operations and cheaper labor are some of the benefits the rural India has to offer.

2.1 New wine in old bottle

The liberalization policies of 1991 and the subsequent revolution in computing technologies have made the market more vibrant and sensitive to customer requirements. Competition has seen an exponential increase with more and more players entering the fray. With rising number of foreign investments, use of sophisticated tools for business development and a concerted focus towards better profitability and growth, a large number of banks are entering the rural segment today.

A number of factors have helped oversee this phenomenon. First of all, there is tremendous scope for infrastructure development in the rural sector. The last five decades of independence have not seen any noticeable improvement in the village economy. The credit-deposit ratio is low. As such, a huge market exists for the promising banks to lend credit at low rates. Although the overhead costs would be high (due to lesser businesses per head) - but the sheer volume of transaction would be a win-win situation for all the players involved. Secondly, compared to the urban sector there are lesser number of non-performing assets. Through better policy initiatives and sound strategic planning inroads could safely be made into the rural sphere.

2.2 New strategies in rural finance: a case study of ICICI Bank

The last few years have witnessed a spate in rural micro credit activities with more and more institutions moving towards the rural segment in search of new opportunities for revenue and profit. ICICI Bank is one such organisation that has been highly noticeable over the past few years in delivering highly innovative micro credit services to the rural populace. The bank has come up with viable and promising strategies to see a strong foray into the rural and semi-urban sector.

ICICI Bank is India's second-largest bank (after the State Bank of India) with total assets of about Rs. 1,327 billion (Sep 30, 2004) and a strong network of branches and ATMs across the country. It offers a wide range of banking products and services to corporate and retail customers through a variety of delivery channels. Investment banking, life and non-life insurance, venture capital and asset management are some of the major services of the bank. Its equity shares are listed in India on stock exchanges at Kolkata, Vadodara, BSE and the NSE. Moreover, it is the first non-Japanese Asian bank to be listed in the NYSE (ICICI Bank, n.d.).

The bank’s activities range from financially supporting a network of village internet kiosks to partnering with microfinance institutions in providing cheap loans. The Social Initiatives Group (SIG) of ICICI Bank is concerned with development and dissemination of appropriate financial services to the economically lagging rural populace. In this context, SIG is working towards providing four classes of micro-financial service: basic banking services, insurance services (covering life, disability, health and assets) and financial services including credit, equity and leasing and derivatives (Microfinance Gateway, 2003).

A guideline of the Reserve Bank of India (RBI) requires all private sector banks to allocate a minimum 18 percent of their net credit to the agricultural sector. In consonance with this requirement and also due to its own corporate commitments, the bank is aggressively pursuing its objectives for the rural sector. With a strong presence in the rural regions of Punjab, Maharashtra, Tamil Nadu, Andhra Pradesh and Uttar Pradesh, ICICI Bank has built a portfolio of over Rs. 2,000 crore during the last three years.

In its pursuit to reach a larger rural populace the bank is currently engaged in forming strategic alliances with existing microfinance institutions (MFI). Besides, the bank is also encouraging local entrepreneurs to start up new microfinance institutions as franchisees. In order to be more effective in its expansion policies the bank is investing in low cost technology networks that would help it keep the operational costs low.

In accordance with the new arrangement the bank is purchasing the high cost loans of existing MFIs and replacing them with newer loans at lower interest rates. To ensure repayment, the bank has opened an escrow account allowing the small borrowers the flexibility to repay as per their convenience and comfort.

The new policy measure ensures profitability to all the parties involved. The smaller borrowers are finding it convenient to repay the loans at lower interest rates, the micro finance institutions are economizing on resources, while the ICICI Bank is finding in it a profitable business opportunity to make inroads into the rural segment without making compromises on profitability, as full repayment is assured.

The bank also offers a variety of other products to the rural masses. Affordable loan schemes to purchase buffaloes or credit for small tea shops are on its product catalogue. Then there are schemes for life, non-life and even for weather insurance. Weather insurance products provide cover against all kinds of climatic uncertainties.

ICICI is also popular for its technology-intensive banking policy. The bank pioneered internet banking in India and has been instrumental in bringing newer technologies for the convenience of its customers. It has collaborated with a Chennai based company, n-Logue Communications to set up Internet kiosks, mobile ATMs, e-Choupals etc. at several parts of rural India. In an era of continuous technological advancement and sustained economic development, ICICI Bank is working hard to reorient itself in order to attract the highly prospective yet grossly neglected rural population of the country. With an active use of latest technological tools and applications, the bank has come up with viable strategies to provide financial services and products to the rural sector at comparatively lower charges and interest rates.

3. Conclusion

It is encouraging to see more private players foraying into the rural segment. A healthy competitive environment would not only ensure availability of cheaper credit, but also better facilities and services.

The success of the non-formal credit delivery systems speaks the point. Despite charging exorbitant rates from their clients their existence hasn't waned. Better service, lesser hassles, superior credit culture and a more direct approach towards clients have been the primary reasons for their success.

Only sound economic policies cannot bring the change. One great failing with the Indian economy has been the flawed implementation of government policies. For every rupee spent by the government, hardly few paise reach the rural economy.

A positive role on the part of government could help see more private participation and hence increased employment generation. Incentives in the form of proactive policies and tax reductions could encourage private players to invest in the rural sector (Kumar, 2005). Our experience over the last 14 years of economic liberalization has shown that greater private participation has only contributed positively to the development of the economy. Private participation has the capability to bring transparency and accountability in an economic system. Healthy competition and a free market environment could see flow of credit at lower cost.

The flip side is that banks incur a huge overhead cost in the rural regions. This is primarily due to low-value transactions and poor infrastructural facilities. However, an extensive use of technology, proper marketing strategies and outsourcing of some activities could give a fillip to rural banking. The role of the government would be again crucial.

EXHIBIT 1

USAGE OF BANKING SERVICES BY INDIAN HOUSEHOLDS (HHs) SOURCE: CENSUS OF INDIA 2001 (FIGURES IN CRORE)						
	TOTAL NO.	% OF HHs	RURAL	% OF TOTAL HHs	URBAN	% OF TOTAL HHs
TOTAL NO. OF HHs	19.19	100.0%	13.83	72.0%	5.36	28.0%
NO. OF HHs WHICH USE BANKING SERVICES	6.8	35.5%	4.16	30.1%	2.65	49.5%

Source: http://www.indiatogether.org/2004/apr/eco-ruralbank.htm

EXHIBIT 2

BANKING PROFILE AT METRO/URBAN/SEMI-URBAN/RURAL/RRBs (AS ON 31-03-2003) SOURCE: RBI QUARTERLY HANDOUT				
	NO. OF BANK BRANCHES	DEPOSITS (RS. IN CRORES)	CREDIT (RS. IN CRORES)	CREDIT/DEPOSIT RATIO
ALL INDIA	66436	1278667	759210	59.3%
METRO CITIES	8664	571852	474461	83%
TOP 100 CENTRES (INCLUSIVE OF METRO CENTRES)	15066	780291	575946	74.3%
URBAN CENTRES (INCLUSIVE OF METRO AND OTHER CENTRES)	19379	861875	599751	69.5%
SEMI-URBAN CENTRES	14813	240523	84683	35%
RURAL CENTRES	32244	176268	74755	42%
REGIONAL RURAL BANKS	14462	49778	22068	44%
COMBINED CD RATIO OF BANKS AT SEMI-URBAN AND RURAL CENTRES				38%

Source: http://www.indiatogether.org/2004/apr/eco-ruralbank.htm

EXHIBIT 3

DEBT PROFILE OF RURAL HOUSEHOLDS (IN PERCENTAGES) SOURCE: MINISTRY OF LABOUR, RURAL LABOUR ENQUIRY REPORT		
SOURCE OF DEBT	1993	1999-2000
GOVERNMENT	8.3	5.4
CO-OPERATIVE SOCIETIES	7.9	13.1
EMPLOYEES	11.4	6.9
MONEY LENDERS	27.6	31.7
SHOP KEEPERS	7.3	7.1
RELATIVES AND FRIENDS	12.4	15.1
OTHERS	6.2	3.5
BANKS	18.9	17.2

Source: http://www.indiatogether.org/2004/apr/eco-ruralbank.htm

EXHIBIT 4

FARMERS' RELIANCE ON THE BANKING SYSTEM			
YEAR	FARMERS DEPOSITS (RS. CRORE)	FARMERS' BORROWINGS (RS. CRORE)	NO. OF FARMERS ASSISTED (IN LAKHS)
1992	26211	17835	273
1993	29825	19493	257
1994	36583	19669	251
1995	43341	21334	198
1996	47433	23813	194
1997	53611	27448	188
1998	57442	29442	173
1999	78881	33094	169
2000	91009	36446	162
2001	99812	43420	195
2002	108233	47430	197

Source: http://www.indiatogether.org/2004/apr/eco-ruralbank.htm

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