Role of Banks In Agriculture & Rural Development

The banking sector has witnessed a huge growth in the recent years. However, despite such a growth, the credit flow by banks to the rural and agricultural sectors remains dismal, which, more or less, has resulted in financial exclusion of the rural masses. The rural and agricultural sectors have to play a very important role if a target of 8% GDP growth per annum as envisioned in the tenth plan is to be achieved. And the banks and the Chartered Accountants have a huge role to play in boosting the rural and agriculture sector through product innovation, broadening the reach, promotion of SHGs/Micro enterprises and providing know-how. This article provides an overview of the concept.

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In the last few years, the Indian economy has emerged as one of the fastest growing economies in the world. However, the vulnerability of the Indian economy with respect to the performance of the agricultural sector despite other macroeconomic indicators and sectors gaining in strength is well known. For example, the Indian economy grew at an estimated 3.7 per cent in 2002-03 against 5.6 per cent during 2001-02. This was largely because of the negative growth of 4.4 per cent in the agriculture sector. Many economists and policy-makers increasingly believe that the future growth of the domestic economy, to a large extent, will depend on the robust performance of the agricultural and rural sector. The manufacturing and service sectors cannot sustain the economy's growth if the rural sector underperforms.

The contribution of the banking and financial sector to the current economic growth of the Indian economy is very significant. This is reflected in the growth in aggregate deposits and advances for scheduled commercial banks, which stood at 15.4 per cent and 27.9 per cent during 2004-2005. However, the access of banking services to the rural, agriculture and the common man in general is not as promising.

As Mr. V. Leeladhar (Deputy Governor, RBI, on the occasion of the Commemorative lecture at the Fedbank Hormis Memorial Foundation, Ernakulam) said "Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are concerns that banks have not been able to include a vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services."

The focus of Indian banks on financial inclusion i.e. delivery of banking services at an affordable cost of the low-income groups has been dismal. In India, the focus of the financial inclusion at present is more or less confined to ensuring a bare minimum access to a savings bank account without frills to all. Having a current account/savings account on its own, cannot be regarded as an accurate indicator of financial inclusion.

Need For Banking in Rural and Agricultural Areas

The rural population in India suffers from a great deal of indebtedness and is subject to exploitation in the credit market due to high interest rates and the lack of convenient access to credit. Rural households need credit for investing in agriculture and smoothening out seasonal fluctuations in earnings. Since cash flows and savings in rural areas for the majority of households are small, rural households typically tend to rely on credit for other consumption needs like education, food, housing, household functions, etc. Rural households need access to financial institutions that can provide them with credit at lower rates and at reasonable terms than the traditional money-lender and thereby help them avoid debt-traps that are common in rural India.

Current Trends: A Pointer To Financial Exclusion

Rural Credit: The 2001 census reveals the low level of banking usage among Indian households in general (35.5%) and rural households in particular (30.1%). This reflects on the latent demand for gen-

Usage of banking services by Indian households (HHs)						
Source: Census of India 2001						
	Total No.	% of HHs	Rural	% of Total HHs	Urban	% of Total HHs
Total No. of HHs	19.19	100	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

eral banking needs in rural as well as urban segments.

The debt profile of rural households indicates that the major source of credit to rural households, particularly poor income working households, has been informal sector loans like money-lenders, which are usually at very high rates of interest. The terms and conditions attached to these loans impact the poor adversely.

This reflects the inadequate institutional credit flow to rural areas. As on 31-3-2003, rural and semi-urban centres had a Credit/Deposit (CD) ratio of 42% and 35% respectively as compared to a CD ratio of 69.5% and 59.3% for urban centres and national level. These trends broadly indicate that despite the widespread banking network in place, there is a continued migration of rural/semi-urban savings to urban/metro centres, thereby causing a banking divide between rural and urban areas.

Agricultural Credit: An equally important concern that needs attention is the flow of institutional credit to agriculture. The progress of agricultural credit in India has depended crucially on government intervention over the years i.e. package of incentives and policy measures, which the RBI and the Centre formulate and implement. The growth of commercial banks' lending to agriculture and allied activities witnessed a substantial decline in the 1990s as compared to the 1980s. Credit flow to the agriculture sector from all formal sources amounted to Rs. 70,810 crore in 2002-03 and Rs. 86,981 crore in 2003-04, much below the levels envisaged in the Tenth Plan. Agriculture's share in scheduled commercial banks' total outstanding credit as on 31st March 2005 was only Rs. 1,12,475 crore. The total agricultural lending by commercial banks is lower than credit in "personal loans" which stood at Rs. 2,66,988 crore, comprising advances for housing and consumer durables.

In recent years, retail advances have increased by 41.2 per cent in 2004-05 as compared to the growth of 27.9 per cent in the overall loans and advances of Scheduled Commercial Banks. As a result, their share in total loans and advances increased significantly during the year ended March 2005. However, according to a recent study, only 15 out of 85 banks registered an increase in return on assets as at the end of 2004-05 over 2003-04. Hence, the argument that rural credit drives down the banks profits and increases NPA is not justified. NPA in rural credit are far less and the rate of retrieval of rural credit NPAs is faster than other advances. The annual growth rate of farm credit is around 15% and this growth in rural advances essentially comes from advances like gold loans for agriculture and Kisan Cards. About 70% of the present rural credit stock of over Rs. 115243 crore is Kisan Credit Cards spread over 4.8 crore of such card holders. This shows the narrow focus of the banks towards short-term production loans rather than for term loans.

Debt profile of rural households (in %) *Source:Ministry of Labour, Ru ral Labour Enquiry Report*		
SOURCE OF DEBT	1993.94	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**
Shopkeepers	7.3	7.1
Relatives & Friends	12.4	15.1
Others	6.2	3.5
Banks	18.9	17.2

Post reforms, the banking system has mobilised more deposits from farmers and extended less credit to a declining number of farmers. These are reflected in the figures for farmer borrowings and deposits in the last decade as in Table A.

TABLE A

Changes in farmers reliance on the banking system

Source: Statistical tables relating to banks in India (RBI)

Year	Farmer Deposits (Rs Crore)	Farmer Borrowings (Rs Crore)	Total (Rs. crore)
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	36466	162
2001	99812	43420	195
2002	108233	47430	197

Many scheduled commercial banks are shying away from agriculture and priority sector lending even though the commercial banks have an excess investments portfolio beyond the required limits of 25 per cent. Furthermore, scheduled commercial banks are resorting to the soft window option of investing in the Rural Infrastructure Development Fund (RIDF) of NABARD. Table B illustrates the growing contributions to the corpus of RIDF received by NABARD by way of deposits from Scheduled Commercial Banks against their shortfall in priority sector/agricultural lending during the preceding year.

TABLE B

Deposits received under RIDF as on 31st March 2003
Source: NABARD Report 2002-03

Year	Total (Crore)
1995-96	350
1996-97	1042.30
1997-98	1007.04
1998-99	1337.95
1999-2000	2306.63
2000-01	2653.64
2001-02	3590.72
2002-03	3857.09
Total	16145.37

Policy Initiatives by Government/RBI

To meet the gap that existed in meeting the credit needs of the rural poor, the Government appointed a working group on rural credit, the Narasimhan Committee in July 1975. Based on its recommendations, Regional Rural Banks (RRB) emerged in 1975. These banks were meant to take banking to the rural masses, particularly in areas without banking facilities, make available cheaper institutional credit to the weaker sections of society, mobilise rural savings and channelise them for other productive activities in rural areas and bring down the cost of providing credit in rural areas. The number of RRBs increased dramatically over a period of time. At the end of the fiscal year of 2002-03, there were 196 RRBs spread with a network of 14,350 branches, accounting for 44.5 per cent of the total rural network of all scheduled commercial banks (including RRBs).

The bulk of the loans from RRBs have been given to priority sectors, which accounted for over 70 per cent of the total. Agriculture alone took up 46 per cent of the priority sector advances. RRBs have also taken a lead role in the financing of Self Help Groups (SHG's) mostly comprising women leading to their economic and social empowerment. Cooperative banks were formed to promote the rural credit. Cooperative banks and RRBs differ in their ownership and management. Cooperative banks are state-government run banks while RRBs are managed by the sponsor bank with an equity stake of 35%. The Central Government and State Government hold 50% & 15% equity stake in RRBs.

Since independence, the RBI has taken a number of measures to augment the flow of rural credit.

Since independence, the RBI has taken a number of measures to augment the flow of rural credit. It has a unique system of extending General Line of Credit-I for seasonal agricultural operations and General Line of Credit-II for the handloom sector out of the created money. The RBI has also been issuing directives for a long time now regarding 'social and development banking' like imposing a cap on the interest rates and sectoral allocation of credit and expansion of rural branches. The RBI has also made it mandatory for commercial banks to lend 40% of their advances to the 'priority sector'. The Service Area Approach was introduced by the Government in 1989, which imparted development orientation to agricultural lending. Other major innovations in the field of rural credit delivery in the 1990s were the successful introduction and implementation of Kisan Credit Cards (KCCs) and the extension of micro-finance in the form of Self-Help Group (SHG).

Challenges For Rural and Agricultural Credit

Agriculture is a matter of livelihood and food security, with nearly 60 per cent of the population depending on it. At the same time, to withstand the global competition, enhanced productivity and sustainability of the agriculture sector has become imperative. In addition, the majority of the country's population, more so marginal and disadvantaged sections of society, stay in villages. Hence, the role of banks in the enhancement of agriculture productivity, expansion of rural credit and poverty eradication assumes high priority.

Despite decades of efforts and experimentation in banking, the organised fi-

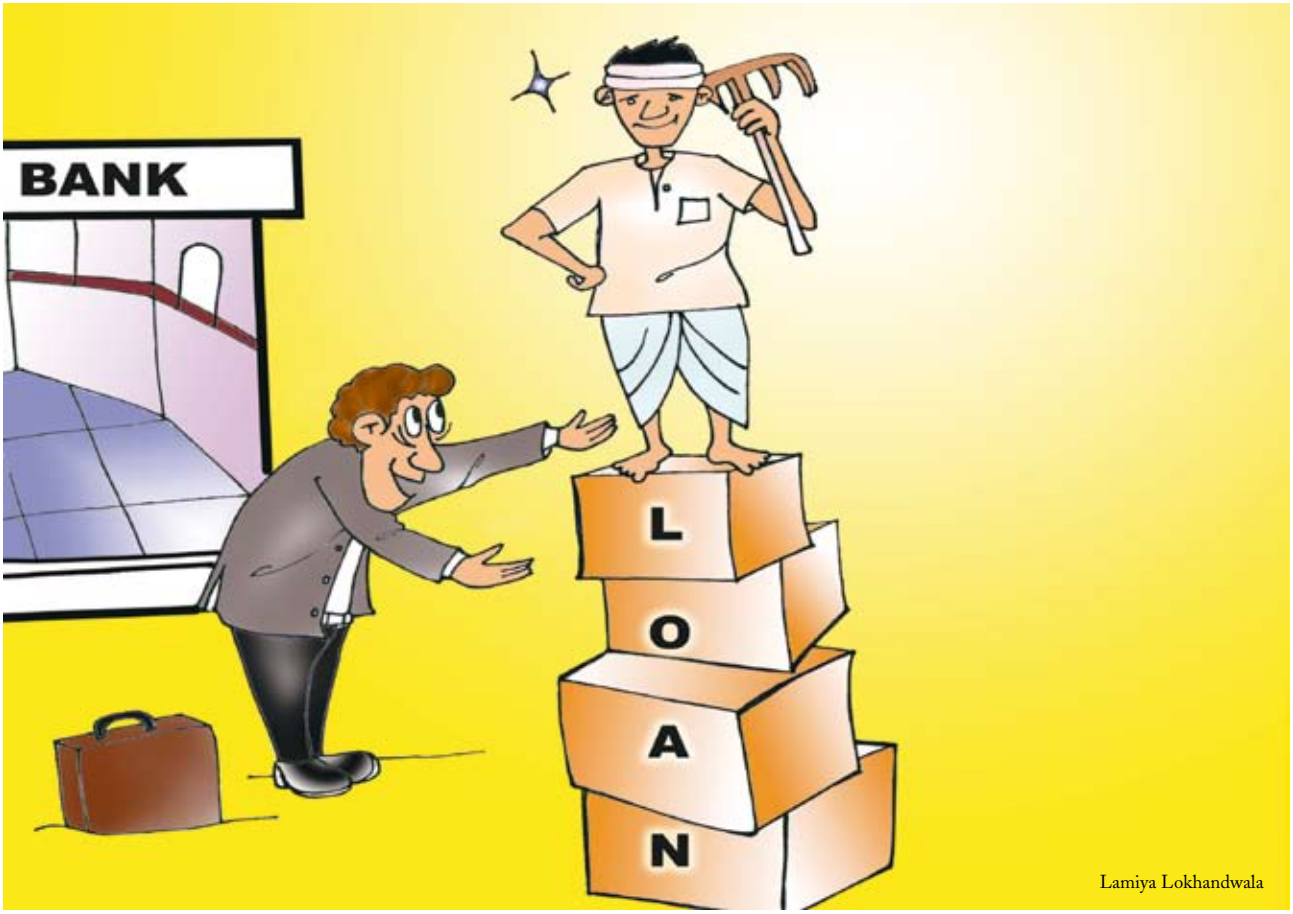
nancial sector is still not able to meet the credit gap in the rural sector. The lower levels of per capita income, lack of infrastructure in the rural areas, focus in the urban sector and lack of proper connectivity were the main hindrances for banks to venture into rural areas. Directed lending, cumbersome procedures, delay in sanctioning loans and lack of statutory backing for recoveries were other major impediments to the growth of banking in the rural sector.

The focus in the past has always been to make available cheaper credit. When banks are forced to lend cheap, there has been a tendency for a scramble for credit by the non-target group of beneficiaries. While interest rates of scheduled banks for advances over Rs. 2 lakh is completely deregulated, loans up to Rs. 2 lakh are subject to maximum of prime lending rate (PLR). In the process of recovering the opportunity lost on income, the banks used to charge a high rate of interest for loans above 2 lakhs. This led to acceleration in the process of willful defaulting. This has really damaged the credit culture and structure in the rural sector resulting in shutting down of non-viable outlets of rural branches of commercial banks, co-operative banks and RRBs in last few years.

Role of Government/RBI in Meeting the Challenges

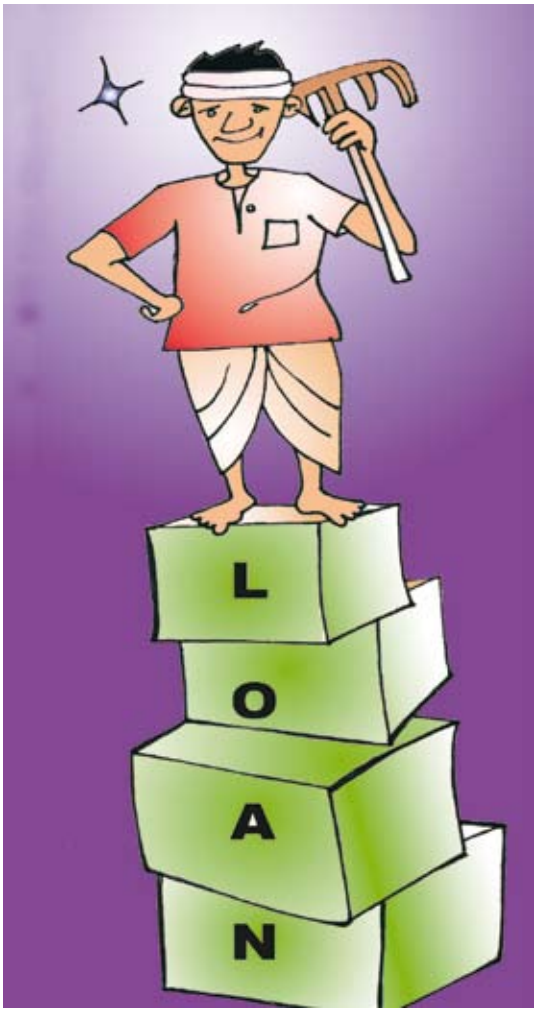
The number of reports on the rural credit delivery system matches the population of co-operative credit institutions, is a common saying in banking circles. As the agriculture sector becomes more commercial, there would be a greater need for credit. Banks need to change their strategy towards agriculture lending, from 'directed' credit to the one that is business opportunity-led. A substantial jump in the credit flow to agriculture is envisaged in the Tenth Plan at Rs.7,36,570 crore, which is more than three times of what was achieved during the Ninth Plan. The contribution by commercial banks is projected at Rs.3,81,652 crore. In order to achieve this target, the Government has directed banks to double the flow of farm credit from the level achieved as on 31.03.2004 in the next three years. In this context, the Government/RBI needs to take a number of initiatives:

Revitalising RRBs: Although, RRBs have established themselves as a strong alternative mechanism for rural credit delivery, their potential and relevance is rather neglected in the current scenario. The issue of capital infusion of



Lamiya Lokhandwala

RRBs assumes critical importance to enlarge the scope of RRB operations. RRBs need to be provided with adequate capital support to enable them to have a net capital adequacy ratio (CAR) of 5 per cent. The share of sponsoring institutions in the capital structure of RRBs also needs to be enlarged to make them majority shareholders. By acquiring the majority shareholding in RRB, the sponsor banks/institutions can convert them into vibrant and professional subsidiaries and area-specific special business units (SBU). In the long run, they may merge all their agricultural and rural activities under the umbrella of these SBU. The government should further amalgamate regional rural banks (RRBs) with the sponsor banks to increase the reach of PSBs in rural areas. With the merger of RRBs with sponsor banks, the latter will get a wide branch network in rural areas.



In the long term, however, a single independent owner of all RRBs with exclusive focus on rural and micro-credit, would be a great step towards channelising resources for the purpose for which RRBs were established.

Increasing the scope of NABARD: NABARD has evolved over the past two decades into a strong and rural-sensitive developmental institution with a complete understanding of the complexities of the agricultural and rural sectors. NABARD should thus become an apex development bank in the rural and agricultural sectors with direct equity participation in RRBs along with sponsoring institutions. With presence on the boards of all RRBs and co-operatives, NABARD is fully equipped to emerge as a strong player in the rural credit system. NABARD's promotion of self-help group (SHGs) movements reflects its immense capability in capacity building and nurturing the rural credit delivery system.

Minimum CD Ratio: In order to obviate the regional or urban/rural imbalances, the minimum benchmark CD ratio provided (for example 55%) should be envisaged in all districts of the country. That will assist broad-based and equitable credit expansion thereby contributing enhanced economic activity. The reason urban India is reflecting enhanced economic activity post-reforms is the availability and expansion of credit for housing and consumption purposes.

Reducing cost of rural credit: A different dispensation under CRR and SLR would help in making available more resources for rural credit deployment. The rate of interest paid on CRR balances held by these rural institutions might also be marginally (100 basis points) above what is paid to commercial banks. Similarly, the Central Government and all State governments need to park their rural developmental funds with RRB to ensure cheaper flow of demand deposits. Regulation with respect to banking has been designed for delivery in urban India and distribution required more manpower to be deployed in rural areas. All rural financial institutions need special dispensation suited to their local potential and challenges.

Commodity Markets: The focus of the commodity exchanges has been confined to traditional future/derivative trading centres, and the farmers and actual commodity users are still not participating. Only traders and speculators are participating in it. Banks should be permitted to offer futures-based products to farmers in order to enable them to hedge against price or weather risk, etc. To mitigate the risk in the financing of agriculture, the Government should allow banks to operate on behalf of farmers and participate in commodity futures.

Allowing banks entry into commodity futures trading will not only boost liquidity and turnover volumes but will also provide them with a protective cover against default on agricultural loans. In the new arrangement, banks can lend to farmers or cooperatives and simultaneously encourage them to sell into futures contracts. This can help reduce the risk of farmers defaulting on their loans in the event of a fall in spot commodity prices or un-

expected weather conditions.

Crop Insurance: The Agriculture Insurance Company of India (AIC) should further spread crop insurance awareness level among the Indian farming community, which is abysmally low. The Union and State Governments should give time-bound subsidy on premiums of crop insurance to increase the coverage of the AIC.

Promoting Micro-finance/ Micro enterprise: Micro-finance refers to the provision of small-scale savings, credit, insurance, and any other financial services to those who cannot access them from formal financial institutions. Due to issues of risk and cost associated with servicing the larger numbers of small low capital input businesses, the formal sector lending to micro enterprises is low. Banks offer a variety of potential advantages for financing micro-enterprises like commercial outlook and relatively sophisticated skills. Apart from acting as a credit provider, the banks should act as agents of change by helping people in acquiring the basic knowledge of business, policy environment, etc.

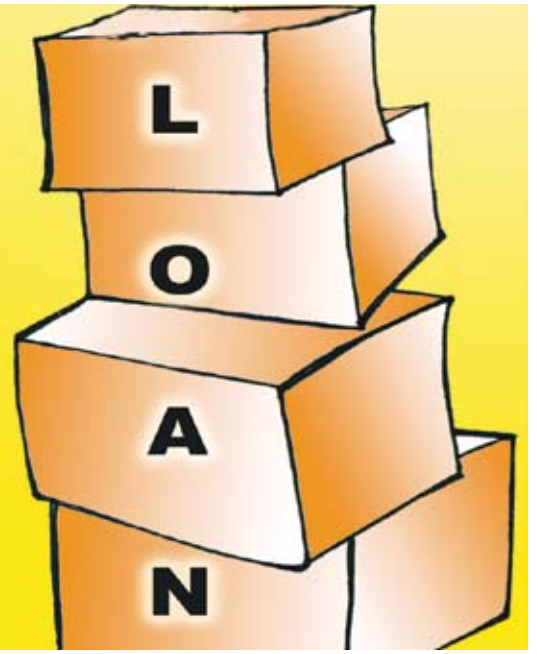
Well-defined investment policy: RBI/NABARD should also provide a well-defined investment policy for the above-mentioned institutions. This will help these institutions in better deployment of surplus funds. In comparison to PSB's and Private Sector banks these institutions can't afford to have statistically sophisticated models for investment and treasury management. In that regard they seek the guidance and assistance from the supervisor in this area.

Learning from other countries/Adopting new models: Banks also need to look at the models followed by banks in other countries. For example, Bangladesh Grameen Bank model and micro-finance experience of Philippines are quite well-known. Banking Correspondents in Brazil is another successful model where banks can create a network of "banking correspondents". These banking correspondents are small outlets, which provide basic banking services, example drug stores, petrol pump, small stores in the neighbourhood, etc. The widely spread post-offices network in the country can also be used to deliver banking services. Banks and regulators need to look at these models and their feasibility in the Indian scenario to bridge the banking divide.

Role of Chartered Accountants in Meeting the Challenges

Widening the reach: Of the 110 million farm households merely 36% have been covered by institutional credit, leaving a majority of them out of the scope of farm credit. Banks need to broaden their coverage so that the rural households can also reap the benefits of institutional credit. The Chartered Accountants can assist the banks and institutions in devising strategies to increase the reach of credit.

Risk-based pricing: Risk based pricing for rural and agricultural credits can expose minorities, low-income families and first-time creditors to higher interest costs and hence further keeping them economically vulnerable. Hence, there is a scope for Chartered Accountants who can assist Rural and Agro-Financing institutions in balancing principles of social justice and profit while assessing comprehensive risks of the borrower.



New product innovation & development for the agriculture/rural sector: Chartered Accountants should focus on developing new products suited to agricultural and rural requirements for better fund mobilisation and credit disbursement. They should look at more non-food crops and also offer more flexibility in repayment schedules in order to bring rural credit to the mainstream. Owing to their reach, banks are in a better position to cross-sell other products like crop insurance in the rural sector too. This will help alleviate the farmers in times of distress. A wider network of specialised ATMs suited to rural needs may make the spread of rural banking easier. For example, as part of its rural initiative, some banks are developing a low cost ATM to cater to the needs of villages in India. Products like Kisan Credit Cards (KCC), which address the needs of farmers and cultivators, have been very successful. Similar products should be designed to provide banking services to artisans, agricultural labour, and household entrepreneurs. Chartered Accountants should not limit their thinking only to design-

ing the products for micro-credit. A lot of innovation needs to be done for designing micro-savings products also.

Target SME: Small and Medium Enterprises (SMEs) have an important role to play, which is evident from their contribution to GDP, employment generation and export earnings, etc. The Third Census of SSI Sector conducted by the Government of India reveals that the SSI sector (registered and unregistered units) comprised 1,05,21,190 units in 2001-02. About 55.0 per cent of these units were located in rural India. So, a strong focus of the banks on rural credit will have a positive impact in strengthening the SME sector. Chartered Accountants can play a crucial role both in the development, management and formation of SME's.

Reduce cost: The overhead cost of operations for banks in Rural India will be more because of low business per employee and the large number of small clients. However, mechanisation and centralisation of accounting, cheaper office premises, engagement of external agents for recovery of loans and marketing of products will make up for the other drawbacks. Cross-selling of products can also help banks to reduce the cost. For example, the cost to serve a customer who takes a loan is as high as 25 per cent. Chartered Accountants can assist the banks in selling health insurance, weather insurance and other financial products to the same customer, which will substantially reduce the cost to serve the customer to 7-8 per cent.

Chartered Accountants can play a crucial role both in the formation, coordination, management and support of MFIs.

Know your customer norms: If banks can offer housing and car loans through simple procedures in urban markets, it is unreasonable to have complicated procedures in the rural sector. Simplification of loan procedures and credit accessibility will attract quality and high net worth borrowers. Chartered Accountants can assist both the borrowers and lenders in fulfilling the desired Know Your Customer norms.

Training requirements: Chartered Accountants can assist the banks in improving the skills of the farm-lending managers for better assessment and disbursement of credit. They can also help in sensitising people engaged in agriculture and allied activities, regarding usage of credit.

Micro-finance institutions: Commercial banks are now allowed to appoint MFIs as "banking correspondents". Banks can now delegate some of their routine banking functions to the MFIs. This can help them extend their coverage at far lower costs than would be possible with their own networks. The MFIs too will gain as they will get to handle a variety of sophisticated financial products and earn a fee income. The Self Help Groups-bank linkage has several benefits like lower transaction costs, negligible NPAs and generation of goodwill among the rural populace. Chartered Accountants can play a crucial role both in the formation, co-ordination, management and support of MFIs.

Conclusion

To achieve the ambitious average GDP growth of 8 per cent per annum target set in the Tenth Plan, it is important to revitalise and revamp not only the agricultural sector but also rural financial institutions. The directed lending norms that require commercial banks to allocate 40 per cent of their lending to the `priority sector' have not generated the intended results, since most of the banks get around this requirement by subscribing to other eligible instruments. Large farmers and agri-businesses seem to be able to obtain financial services from modern financial institutions but small and marginal farmers continue to depend, largely, on indigenous money-lenders.

Banks, Government and Chartered Accountants need to re-evaluate their pre-conceived notions about the commercial opportunities in serving the rural and agricultural sector. Banks can achieve commercial success and helps in societal improvement if it conceives the products and services keeping these segments in mind. Banks must also strengthen their credit delivery systems for Rural India. Today, finance and banking systems are very strong. It is time to focus on people at the bottom of the pyramid and align all sections with the systems that have been put in place. We can also conclude that there are a lot of untouched and unexplored areas for fulfilling social and professional commitments. There are tremendous opportunities for Chartered Accountants to excel in the agriculture and rural sectors and it all depends on how best one capitalises these. ❐