A Study on Indian Rural Banking Industry - Issues and Challenges

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Abstract

Rural banking in India started since the establishment of banking sector in India. Rural Banks in those days mainly focused upon the agro sector. Rural India contributes a major chunk to the economy every year. Today, commercial banks and Regional Rural Banks in India are touching every corner of the country and are extending a helping hand in the growth process of the rural sector in the country. To give this sector a stronghold on finance and to enable economic independence, rural banks have special offerings that extend credit facilities to small farmers, agricultural labors and cottage industry entrepreneurs.

This paper entitled 'RURAL BANKING' throws light on the following aspects:

- Rural Banking – an introduction
- Objectives of rural banking
- Banks functioning for the development of rural areas
- Sources of rural finance
- Role of Co-operative banks and rural credit
- Role of Commercial banks and rural credit
- Role of Regional rural banks and rural credit
- Role of RBI in rural credit
- Marketing of mutual fund units-RRBs
- Conclusion

1. Introduction

Rural banking in India started since the establishment of banking sector in India and banking sector in India was set up on April, 1935. In those days, rural banks basically focused upon the agriculture sector of India because a great percentage of Indian population is engaged in agricultural activities. Today, commercial banks and Regional rural banks in India are touching every corner of the country are extending a helping hand in the growth process of the rural sector in the country. To give this sector a stronghold on finance and to enable economic independence, rural banks have special offerings that extend credit facilities to small farmers, agricultural labors and cottage industry entrepreneurs.

Rural banking is the process of conducting banking transactions out in the country where bank branches are too far away to be of use. Rural banking is popular for very small towns and farmers who live far away from areas of larger population and cannot make the drive to these locations whenever they need to use banking services. Typically, an agent of the bank will visit these rural locations and offer to make transactions in an official capacity.

2. Types of Services

- Rural banking attempts to offer all the basic banking services that people living in rural areas need. Cash deposits are one of the most common services, since these occur on a regular basis and must often be done in person. Loan and loan repayment services are also offered for those who cannot make their payments in any other way.

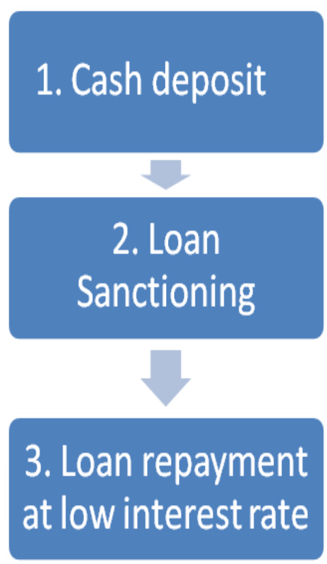

Fig: 1. Types of Services

3. Objectives of Rural Banks

1. To provide cheap and liberal credit facilities to small and marginal farmers, agriculture labourers, artisans, small entrepreneurs and other weaker sections.
2. To save the rural poor from the moneylenders
3. To act as a catalyst element and thereby accelerate the economic growth in the particular region.
4. To cultivate the banking habits among the rural people and mobilize savings for the economic development of rural areas.
5. To increase employment opportunities by encouraging trade and commerce in rural areas.

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6. To encourage entrepreneurship in rural areas.
7. To cater to the needs of the backward areas which are not covered by the other efforts of the Government?
8. To develop underdeveloped regions and thereby strive to remove economic disparity between regions.

Solar cell is a p-n junction fabricated in a thin wafer or

4. Banks: Functioning for the Development of Rural Areas

In India, most of the rural areas were financially excluded means no saving, no insurance, no asset, no bank account, no affordable credit, no access to money device etc. Now the question arises who were financially excluded?

1. Poor
2. Disabled
3. Socially under privileged
4. Old as well as children
5. Women
6. Uneducated
7. Farmers and labors

And just to help these above categories and person, rural banks are playing a vital role by introducing the concept of financial inclusion which means first understand the needs of the rural people and then support them in the best way at an affordable cost.

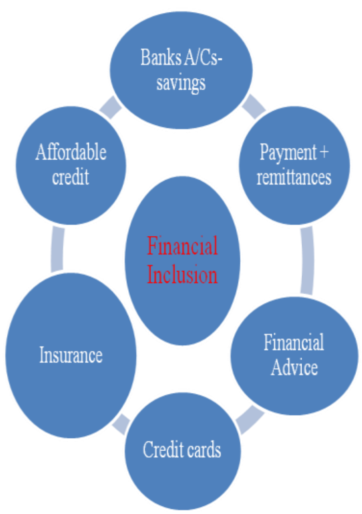

Fig: 2. Financial Inclusion

4.1 Sources of Rural Finance

Two credit sources available to the farmers are Institutional and private.

1. Institutional sources consist of the co-operative and commercial banks including RRBs (Regional Rural Bank)
2. Private sources include money lenders, traders, commission agents and landlords

Depending on the requirement and purpose, the funds needed by the Indian farmers can be divided into 3 parts:-

1. Short term loans- 12 to 15 Months
2. Medium term loans- 3 to 5 years
3. Long term loans- 15 to 20 years

4.2 Institutional sources of finance

At present three agencies supply institutional finance to the farmers. They are:-

- Co-Operatives
- Commercial Banks
- RRBs (Regional Rural Banks)

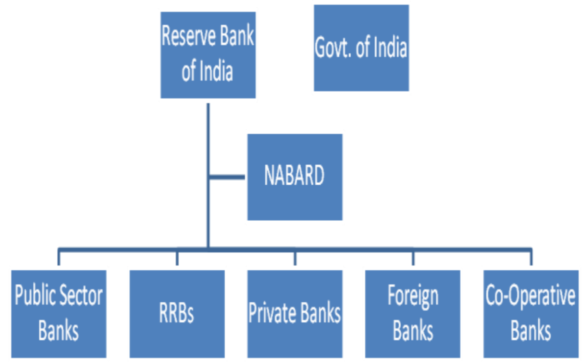

Fig: 3. Bank Network for Rural Credit

5. Role of Co-operative Banks and Rural Credit

The Co-operative bank has a history of almost 100 years. The Co-operative banks are an important constituent of the Indian Financial System, judging by the role assigned to them, the expectations they are supposed to fulfill, their number, and the number of offices they operate.

Their role in rural financing continues to be important even today, and their business in the urban areas also has increased phenomenally in recent years mainly due to the sharp increase in the number of primary co-operative banks.

Co-operative Banks in India are registered under the Co-operative Societies Act. The RBI also regulates the cooperative bank. They are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

Co-Operative Banks in India Finance Rural Areas Under

- Farming
- Cattle
- Milk
- Hatchery
- Personal finance

Institutional Arrangements for Rural Credit (Co-operatives)

- Short Term Co-operatives
- Long Term Co-operatives

Short Term Co-operatives

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District Central Co-operative Banks

|

State Co-operative Banks

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Primary Agriculture Credit Co-operative Societies

|

Branches

Long Term Cooperatives
|
State Agriculture & Rural Development Banks
|
Primary Agriculture & Rural Development Banks
|
Branches

5.1 Primary Agricultural Credit Societies (PACSs)

An agricultural credit society can be started with 10 or more persons normally belonging to a village or a group of villages. The value of each share is generally nominal so as to enable even the poorest farmer to become a member. The members have unlimited liability, that is each member is fully responsible for the entire loss of the society, in the event of failure. Loans are given for short periods, normally for the harvest season, for carrying on agricultural operation, and the rate of interest is fixed. There are now over 92,000 primary agricultural credit societies in the country with a membership of over 100 million.

The primary agricultural credit society was expected to attract deposits from among the well –to-do members and non-members of the village and thus promote thrift and self-help. It should give loans and advances to needy members mainly out of these deposits.

5.2 Central Co-operative Banks (CCBs)

The central co-operative banks are located at the district headquarters or some prominent town of the district. These banks have a few private individuals also who provide both finance and management. The central co-operative banks have three sources of funds,

- Their own share capital and reserves
- Deposits from the public and
- Loans from the state co-operative banks

Their main function is to lend to primary credit society apart from that, central cooperative banks have been undertaking normal commercial banking business also, such as attracting deposits from the general public and lending to the needy against proper securities. There are now 367 central co-operative banks.

5.3 State Co-operative Banks (SCBs)

The state Co-operative Banks, now 29 in number, they finance, co-ordinate and control the working of the central Co-operative Banks in each state. They serve as the link between the Reserve bank and the general money market on the one side and the central co-operative and primary societies on the other. They obtain their funds mainly from the general public by way of deposits, loans and advances from the Reserve Bank and they are own share capital and reserves.

6. Role of Commercial Banks and Rural Credit

The commercial banks at present provide short term crop loans account for nearly 45 to 47% of the total loans given and disbursed by the commercial banks. Term loans for varying periods are given for purchasing pump sets, tractors and other agricultural machinery, for construction of wells and tube well, for development of fruit and garden crops, for leveling and development of land, for purchase of ploughs, animals, etc. commercial banks also extend loans for allied activities viz., for dairying, poultry, piggery, bee keeping, fisheries and others. These loans come to 15 to 16%.

6.1 Commercial Banks and Small Farmers

The commercial banks identifying the small farmers through Small Farmers Development Agencies (SFDA) set up in various districts and group them into various categories for credit support so as to enable them to become bible cultivators. As regard small cultivators near urban areas and irrigation facilities, commercial banks can help them to go in for vegetable cultivation or combine it with small poultry farming and maintaining of one or two milk,cattle.

6.2 IRDP and Commercial Banks

Since October 1980, the Integrated Rural Development Programme (IRDP) has been extended to all the blocks in the country and the commercial banks have been asked by the government of India to finance IRDP. The lead banks have to prepare banking plans and allocate the responsibility of financing the identified beneficiaries among the participating banks. Commercial banks have been asked to finance all economically backward people identified by government agencies.

7. Regional Rural Banks And Rural Credit

The Narasimham committee on rural credit recommended the establishment of Regional Rural Banks (RRBs) on the ground that they would be much better suited than the commercial banks or co-operative banks in meeting the needs of rural areas. Accepting the recommendations of the Narasimham committee, the government passed the Regional Rural Banks Act, 1976. The main objective of RRBs is to provide credit and other facilities particularly to the small and marginal farmers, agricultural laborers, artisans and small entrepreneurs and develop agriculture, trade, commerce, industry and other productive activities in the rural areas.

The progress of RRBs in the initial stage was quite rapid. For instance, the Sixth Five-year plan (1980-85) had envisaged the setting up of 170 RRBs covering 270 districts by the end of march 1985.The target was exceeded. There are now 196 RRBs in 23 states of the country with 14,200 branches.

7.1 Structure of Regional Rural Bank

The establishment of the Regional Rural Banks (RRBs) was initiated in 1975 under the provisions of the ordinance promulgated on 26.9.1975 and thereafter Section 3(1) of the RRB Act, 1976. The issued capital of RRBs is shared by Central Government, sponsor bank and the State Government in the proportion of 50%, 35% and 15% respectively.

7.2 RRBs established with the explicit objective of

- Bridging the credit gap in rural areas
- Check the outflow of rural deposits to urban areas
- Reduce regional imbalances and increase rural employment generation

8. Role of RBI in Rural Credit

Since it was set up in 1934, RBI has been taking keen interest in expanding credit to the rural sector. After NABARD was set up as the apex bank for agriculture and rural development, RBI has been taking a series of steps for providing timely and adequate credit through NABARD.

Scheduled commercial banks excluding foreign banks have been forced to supplement NABARDs efforts-through the stipulation that 40percent of net bank credit should go to the priority sector, out of which at least 18 percent of net bank credit should flow to agriculture. Besides, it is mandatory that any shortfall in fulfilling the 40 percent target or the 18 percent sub-target would have to go to the corpus Rural Infrastructure Development Fund(RIDF).RBI has also taken steps in recent years to strengthen institutional mechanisms such as recapitalization of Regional Rural Banks (RRBs) and setting up of local area banks(LABs).

8.1 Micro-Finance

Micro-finance is a novel approach to "banking with poor" as they attempt to combine lower transaction costs and high degree of repayments. The major thrust of these micro-finance initiatives is through the setting up of Self Help Groups (SHGs), Non-Governmental organizations (NGOs), Credit Unions etc.

8.2 Kisan (Farmers') Credit Card

Another notable development in recent years is the introduction of Kisan Credit Cards (KCC) in 1998-99.The purpose of the Kisan Credit Cards (KCC) scheme is to facilities short term credit to farmers. The scheme has gained popularity and its implementation has been taken up by 27 commercial banks, 187 RRBs and 334 Central cooperative banks.

8.3 Agricultural Insurance

As Agricultural is highly susceptible to risks such as drought, flood, pests etc. It is necessary to protect the farmers from natural calamities and ensure their credit eligibility from the next season. Towards this purpose, the Government of India introduced a comprehensive crop insurance scheme throughout the country in 1985 covering major cereal crops, oilseeds and pulses. Among commercial crops, seven crops viz., sugarcane potato, cotton, ginger, onion, turmeric and chilies are presently covered.

9. Marketing Of Mutual Fund Units – RRBS

With a view to expanding the scope of business of RRBs and considering that marketing of Mutual Fund (MF) units provides a profitable avenue for banks, it has been decided by RBI on 17th May 2006 to allow Regional Rural Banks (RRBs) to undertake marketing of units of Mutual Funds, as agents.

Accordingly, RRBs may, with approval of their Board of Directors, enter into agreements with Mutual Funds for marketing their units subject to the following terms and conditions:

- The bank should only act as an agent of the customers, forwarding applications of the investors for purchase / sale of MF units to the Mutual Fund / Registrar Transfer Agents.
- The purchase of MF units should be at the risk of customers and without the bank guaranteeing any assured return.
- The bank should not acquire such units of Mutual Fund from the secondary market.
- The bank should not buy back units of Mutual Funds from their customers.
- The bank holding custody of MF units on behalf of their customers should ensure that its own investment and investments belonging to their customers are kept distinct from each other.
- Retailing of units of Mutual Funds may be confined to some select branches of the bank to ensure better control.
- The bank should comply with the extant KYC/ AML guidelines in respect of the applicants.
- The RRBs should put in place adequate and effective control mechanisms in consultation with their sponsor banks.

10. Conclusion

RRBs' performance in respect of some important indicators was certainly better than that of commercial banks or even cooperatives. RRBs have also performed better in terms of providing loans to small and retail traders and petty non-farm rural activities. In recent years, they have taken a leading role in financing Self-Help Groups (SHGs) and other micro-credit institutions and linking such groups with the formal credit sector.

RRBs should really be strengthened and provided with more resources with which they can undertake more of these important activities. And most certainly they should be kept apart from a profit-oriented corporate motivation that would reduce their capacity to provide much needed financial services to the rural areas, including to agriculture. Ideally, the best use of the resources raised by RRBs through deposits would be through extensive cross-subsidisation. This, in turn, really requires an apex body that would cover and oversee all the RRBs, something like a National Rural Bank of India (NRBI).

The number of rural branches should be increased rather than reduced; they should be encouraged to develop more sophisticated methods of credit delivery to meet the changing needs of farming; and most of all, there should be greater coordination between district planning authorities, panchayati raj institutions and the banks operating in rural areas. Only then will the RRBs fulfill the promise that is so essential for rural development.

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