Rural Credit Policy in India: Mutilated or Missing?

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Rural India has witnessed many programmes introduced by the Government and Reserve Bank of India aiming at displacing the ubiquitous village moneylender during the last hundred years. The perception of the policy makers was based on the assumption that replacing the money lender by institutional credit would solve the rural credit problems. Cooperative credit was conceived as a panacea for rural maladies to begin with. However, it could not succeed in meeting the rural credit needs despite government patronage. The land mark report of All India Rural Credit Survey, diagnosing the deep rooted maladies, prescribed the urgency of inducting a strong commercial bank to operate in the rural sector. State Bank of India was ushered in in 1951 with a mandate for opening rural branches. Later, nationalising 14 banks in 1969, the Government of India directed them to go to the villages. Since then rural banking has become a great hurdle race, because the directive was not merely about barefoot banking, but to run into unfamiliar terrain to establish their flag posts. The players were untrained and mostly unwilling to participate in the marathon. Their captains were equally unprepared. Only the umpire was stubborn and unrelenting. He brought more players into the race, changed the rules of the game many times. At some stage it appeared as if he himself had lost interest in the race. But the race continues, proceeding in different directions.

The road map of Financial Sector Reforms has totally bypassed rural banking. Short of putting up the **No Entry** board, it has displayed visibly the **Go Slow** boards. Deceleration of the rural branch expansion programme was the direct result. The process of liberalisation, privatisation and globalisation was construed as the adoption of only remunerative banking business. Neglect of the rural banking segment became quite visible, as the new generation banks were exempted from opening the mandatory rural branches. While directed credit was disliked by the authors of the financial sector reforms, directives for doubling farm credit within a short period were issued and modalities were prescribed. The bare foot bankers, reconciled now, continue to walk amidst the debris of some of the populist programmes, scattered around them. *Ad hocism* continues to be the base for most of the operational guidelines pertaining to rural credit policy, issued by the regulator.

A critical review of the various aspects of rural credit policy as operationalised since bank nationalisation would reveal the absence of a long term perspective. It is a sad commentary on our rural credit management that the organised credit agencies could not displace village money lender nor diminish his role of as a source of rural credit. According to the All India Debt and Investment Survey 2002, his share in the debt of rural households has gone up from 17.5 percent in 1991 to 29.6 percent in 2002. More disheartening is the decline in the share of commercial banks during the same period; from 33.7 percent to 24.5 percent. No serious attempts have been made to consolidate the banking system so as to develop a strong alternative to the moneylender. New banks - regional and local - are introduced in great hurry. The regional rural banks have somehow survived, passing through periods of admiration, approbation and finally recouping from the edge of annihilation. Local area banks, which made more noise before they actually appeared on the scene, make an insignificant existence, hardly visible. Cooperative credit sector has its own woes and worries. Private sector banks' indifference to rural banking is quite open, as hardly 6 percent of their business originates from the rural sector. Public sector banks have little choice, while a new set of financial agencies are entering the rural credit market, unregulated and un-checked (Thingalaya 2006). The growing number of farmers committing suicide is a sad reminder partly of the insensitivity of the organized financial system.

The scope of this paper is confined to a critical review of the four components of rural credit policy: rural branch expansion, innovation in credit supply, improvements in

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the credit delivery mechanism and interest rate regulation. An alternative rural banking structure is suggested, carrying further from the partial consolidation of *gramin* banks, which has been accomplished recently. Commercial banks should concentrate on their core competences, by hiving off the rural banking business into a subsidiary, to become globally competitive banks. And rural India certainly needs specialised credit agencies responding to its growing credit needs in the context of globalisation.

Pressurised Branch Expansion: Need for Rationalisation

Expansion of rural branches was rightly conceived as a strategy for augmenting rural credit by the regulator. Banks in the private sector were concentrating in urban areas for obvious reasons. Immediately after bank nationalisation, the task adopted was to goad the banks to go rural. After pursuing this goal relentlessly in the 70s and 80s, there was a total change in emphasis since the 90s, when the new generation banks came into being. The latest trend is the emergence of branchless banking, with the tacit support of the regulator.

Public sector banks were under great pressure in the 70s to open rural branches in the districts allotted to them under the Lead Bank Scheme. In many cases, in the lead districts, the designated lead banks were having no presence or very little exposure. But they initiated the survey of the districts, identifying unbanked areas for branch opening. The branch licensing policy of the Reserve Bank of India was modulated to compel banks to open four rural branches in order to get licences for opening one urban or metropolitan branch. In December 1969, there were only 1443 branches operating in rural areas, constituting 17 percent of the total branch net work. Their number increased to 24,577 during the next 15 years thanks to the prodding. Perhaps, but for the regimentation of branch expansion, banks would not have opened rural branches in such large numbers[1].

With the introduction of financial sector reforms, the scene of activities shifted from rural branches to urban branches since the 90s. Liberalisation of branch licensing policy did not insist upon the new generation banks to open rural branches. They were permitted to operate in metropolitan centres without the hassles of rural banking. They started competing with each other in making their presence felt by opening branches in strategic locations in cities and metropolitan centres. During the last 16 years, the total number of branches opened by them is 2497. Out of them 130 branches - less than 5 percent - are located in rural areas as on March 2007. These banks were reluctant even to extend their activities to less developed states for a long time.

The tangible result of the branch expansion programme was the dramatic change in the branch distribution pattern of the commercial banks. The share of rural branches has increased from 17 percent in 1969 to 42 percent in 2007. However, their share in total banking business remains disproportionately low. Though the rural retail outlets constitute 42 per cent of the branch net work, they have single digit shares in both deposit mobilised and credit lent by banks. In deposit mobilisation their share is 9 percent and in credit deployment it is not more than 8 percent. On the other end are the metropolitan branches, which are less in number but have a lion's share in banking business. These 11,789 branches, forming 16 percent of the total branch network, mobilise 56 percent of the total bank deposits. Over 65 percent of the total credit is lent through them. The concentration of banking business of this magnitude in the metropolitan centres in a large country like ours, certainly calls for a reduction in the regional inequalities. What is more intriguing is the fact that inequalities are more pronounced in terms of the volume of banking business than in terms of the availability of banking outlets.

The composition of rural-urban branches varies among banks, may be due to historical reasons influencing their concentration in some states. The share of rural branches in the public sector banks varies from 19.6 percent in the case of Corporation Bank to the highest share of 46.5 percent in the case of Allahabad Bank. For the private sector banks of the older generation, the range is from 5 percent for Catholic Syrian Bank Ltd to 43 percent for Jammu & Kashmir Bank Ltd. The details are given in Annexure 1. It is often not readily recognized that the size of rural branch network would become a speed- breaker in the process of merger and acquisitions of public sector banks

(Thingalaya 2004). Size and efficiency do not necessarily go together in the banking sector in India, as is evident from the performance of many banks, big and small.

New Trends in Branch Expansion:

Banks have travelled a long way from their traditional banking environment. The computer-savvy new generation banks have changed the concept of branches as business channels. Brick and mortar branches are substituted by computerised click branches. For improving the accessibility to customers, their reliance is not on the traditional branches. E-banking is being popularised and out-sourcing of agents is increasingly being
used for reaching out the a growing number of customers. The latest trend is to go for cost effective branchless banking.

Installation of ATMs, specially those located off-site, is the beginning of branchless banking Initially, these gadgets housed in small kiosks, were used as cash dispensing machines, accessible 24 hours throughout the year. Cost of installation and its maintenance being very high, banks were slow in investing in them. But when the foreign banks started installing them in many of the metropolitan centres, domestic banks could not remain comfortable without the new facility. Foreign banks, having the experience of managing ATMs for quite some time, were installing them in cities, where they did not have branches. For them ATMs were substitutes for regular branches, as the licences for the latter were not readily available, because of the reciprocal arrangements in vogue. The new generation banks copied them and started installing more ATMs than opening branches. A majority of their ATMs are on off-site locations.

Slowly, ATMs are entering the rural areas also. Biometric-enabled ATMs are being considered for installation in rural areas by some of the banks. Gramin banks are also in the process of adopting this mode of expansion. The new trend in expanding the service channels is the branchless banking system shaping up, with the assistance of software companies. A local resident in a selected village is made as the business correspondent for a small commission, working at his / her home with a small gadget installed by the bank. Accepting deposits and loan instalments, withdrawal of deposits and disbursement of loans sanctioned at the base branch are the functions handled throughout the day using the smart cards. This is a cost-effective process, which can be adopted as a channel for reaching out to rural households residing away from the existing rural branches (Thingalaya 2007a).

According to a recent press report there is a proposal to dispense with the branch licensing policy by the Reserve Bank of India (2008).While the inevitability of developing branchless banking as a model for rural business expansion is beyond doubt, there is a need for rationalisation of the existing rural branch network. The necessity of opening new rural branches cannot be ruled out, considering the regional inequalities in their dispersion. Lead Banks have to identify unbanked centres in the backward districts to complement the process of development of branchless banking in their vicinity. Rural branch expansion cannot be stopped in the name of globalised banking. If the world is becoming a global village, village banks should be designed to respond to the changing needs. A more pragmatic stand has to be taken in this case, by making a fresh survey of the pattern of dispersion of rural branches. ***The branch expansion policy has to be region-specific, not a common format for all banks.***

There is also the problem of the ***stray rural branches*** of some banks operating in isolation in some states since long. For some compulsions or pressures from the State Level Bankers Committees or the District Consultative Committees, many banks have opened single rural branch in some districts and states[2]. Relocation of such branches has to be done to for preventing their stagnation.

Gramin Banks: An Innovation, Incomplete

An institutional innovation made in the field of rural credit is the formation of regional rural banks - gramin banks. Though they were thrust upon the rural banking scenario in 1975 by the Government of India driven by its impatience about the slow progress made by banks

in rural areas, the new credit agency raised some hopes about its comparative advantages. However, what was conceived as an experimental model to be tried in selected agro-economic zones initially, attracted the attention of most of the state governments. Between 1975 and 1987, as many as 196 gramin banks came into existence all over the country, excluding Goa, Puducherry, Sikkim and Andaman and Nicobar Islands.

The policy-makers' obsession with the propagation of gramin banks as low cost rural credit agencies, made them blind to the need for building up an integrated rural credit apparatus from the village level. With a mandate to provide credit to only the target groups, these banks were forced to operate in truncated rural economy, catering to only a section of the rural society. This has adversely affected their viability and growth. Smaller advances to the poorer people, at lower interest rates, operating in smaller premises (with a ceiling on rent) in backward villages, these banks were managed by people drawing lower salaries. Their lending operations were narrowly confined to the target groups - marginal farmers, landless labourers and village artisans. They were not permitted to lend to the borrowers from the non-target groups in their operational areas. Relaxations were made after much damage was done to the viability of the branches. This has led to what may be termed as the under-utilisation of the installed capacity of this rural credit agency (Thingalaya 2002).

The staff members of the gramin banks were not provided an exposure to the nuances of managing the credit proposals beyond those of pretty small advances. Expertise in handling medium size credit proposals emanating from the rural customers out side the target groups could not be built up during the last 25 years of the existence of these banks in the village set up. With limited exposure to the outside world and the selections being made locally, the staff was novices in banking. There was no promotion policy in place for the staff, when these banks started functioning.(Thingalaya 2008) Some banks headed by rural-minded persons could show some good results, while many others just existed in the rural sector.

There was lot of uncertainties about the continuation of these banks, when the financial sector reforms were implemented. However, some of elements of liberalisation in their operations introduced since then have improved their performance. Relaxation of the restricted lending, partial de-regulation of the interest rates and the introduction of a promotion policy for their staff have resulted in strengthening their bottom lines. Some of them have grown stronger than the old generation banks in the private sector, operating under comparable conditions in some states (Thingalaya 2005). In a comparative study of a gramin bank and an old private sector bank, both operating in Kerala, the profit per employee was found to be higher for the gramin bank.

After nearly three decades of existence, the policy makers realised the necessity of enlarging the operational areas of gramin banks, providing them more space to expand. Based on the recommendations of working groups, which have studied this aspect, they were allowed to extend their branch network to the neighbouring districts on a selective basis. Amalgamation of gramin banks sponsored by the same bank at state level was considered as necessary for their development. The process of amalgamation of gramin banks introduced recently, though incomplete, is a step in the right direction in revitalising the operational capabilities of these banks. Since September 2005 silently and effectively, 108 gramin banks have been amalgamated at the state level, reducing their number from 196 to 88. Gramin banks sponsored by the same bank in each state were merged to form bigger banks. Expansion of their operational areas is beneficial to them, as some of them were stagnating, by operating in single districts.

While the process of amalgamation is almost coming to an end, a new regional rural bank was set up in the union territory of Puducherry, which was not covered by RRBs so far. The new bank, Puduvai Bharathiar Grama Bank, sponsored by Indian Bank was inaugurated by Sri. Chidambaram, Union Finance Minister on June 1st 2008 at Puducherry.

The Relevance of Gramin Banks:

Gramin banks, despite the many problems faced by them, have built up a good customer base in the rural

sector. Over one-fifth of the bank borrowers in India are served by them. Nearly 45 percent of the rural branches of the banking sector are managed by them. Their share in rural deposits mobilised by the banking sector is 56 percent. Out of every rupee of rural credit lent by banks, 60 paise come from these banks (Thingalaya 2007). While the issues relating to their low capital base remain unsolved, most of them have wiped out their accumulated losses. The number of loss incurring banks has come down substantially after the amalgamation. They have also become bigger in size, measured in terms of branches and resources. There is a proposal to recapitalize those banks having negative net worth.

The whole spectrum of rural finance is changing very fast in the recent years. The entry of multinational insurance companies and mutual funds into the rural sector besides the spread of equity culture is changing the composition of rural savings. Micro finance institutions have entered the rural credit scene in a big way. Mega bucks are flowing into these new entrants, both from the domestic and foreign sources. At this juncture, it is desirable to emphasise the strategic role gramin banks can play in extending micro credit effectively and efficiently. The suitability of gramin banks can be observed from the following factors:

- ***Ready made rural base***: Gramin banks have a ready made rural base, designed for handling the credit delivery system conducive for small lending. Their branches numbering 14,773 are functioning for over two decades in many remote villages.
- ***Ready Access to low cost funds***: Gramin banks have been successful in mobilising rural savings at fairly lower costs. Savings bank deposits account for over 50 percent of the total deposits in many cases.
- ***Rapport with small borrowers***: Dealing with the small borrowers from the target groups, gramin banks have built up good rapport with the poorer sections of the rural sector.
- ***Lower operating costs***: Gramin banks, unlike the microfinance institutions can function with lower operating expenses and hence can afford to lend at reasonably lower rates of interest.
- ***Promotion of Self Help Groups:*** Gramin banks account for 33 percent of the SHGs promoted by the banking sector. They have also credit linked these SHGs.
- ***Selling other financial products***: Many gramin banks have already started selling other financial products like insurance and mutual fund schemes. The process of their transformation as microfinance institutions has already begun in a small way.

In view of these strategic advantages, gramin banks should emerge as the major player in the field of microfinance. They have credit linked 9.11 lakh SHGs and have lent a cumulative amount of Rs.5031 crore as on March 2007. In their credit portfolio, microfinance should form an integral part and not merely as one more column for reporting.

Agribusiness is attracting multinational companies to evince interest in rural development. Agricultural sector is expected to grow at a faster rate during the 11th Five Year Plan. Gramin banks cannot afford to remain like petty ration shops selling only a few items at regulated prices. They have to be re-designed to cater to the growing credit needs of the rural economy in its entirety. An efficient rural banking system, working like a rural financial infrastructure, can forge stronger links between rural India and the rest of the economy and provide an impetus to growth. One need not be apologetic to be rural-minded in seeking preferential treatment to agricultural credit by the central bank. Globalisation and Liberalisation do not necessarily mean the abandonment of preferential treatment to a crucial sector like the agricultural sector, as many developed countries continue to have special considerations to the agricultural credit needs (Satish 2007)

Credit Delivery Mechanism: Modifications Required

Having entered the rural sector, the public sector banks have made some attempts, though not very successfully, to modify their credit delivery mechanism in the rural setting. Small doses of credit and the low volume of business at the branch level have been the impediments in reducing the cost of credit delivery. A large number of agricultural graduates from agricultural universities all over the country were recruited and trained to function as specialist officers in rural branches. Lending programmes for various purposes were formulated and implemented in many of the branches.

For offering specialised services, bigger banks like State Bank of India opened Agricultural Development Branches in selected centres. Other banks imitated them to some extent. As the agricultural sector was passing through modernisation in floriculture and horticulture, banks started Hi-tech Agricultural branches in some urban centres. Many of these experiments did not succeed in enlarging farm credit to the desired extent. The cost of managing such branches, with some exceptions, was observed to be higher than the revenue generated. Dilution of the supervisory functions began as a result, posting the specialist officers only in some key branches. Their services were made available to a number of branches on specific days. Such experiments were made by almost all banks in the public sector.

The private sector banks of the old generation did not venture to make any such experiments in developing a rural credit delivery system, as their presence in the rural areas was very limited (See Annexure 1). Their exposure to agricultural credit was very low. In 1991, when the Government of India introduced the Agricultural Debt Relief Scheme, writing off the agricultural overdue advances of less than Rs.10,000, these private sector banks were denied the benefit of debt relief. It turned out to be a disincentive for them to take up rural business.

The new generation banks in the private sector have negligible exposure to rural credit. As they were not required to open rural branches in the beginning, they expanded their urban banking business using IT enabled services. Later on, when agribusiness started emerging as a lucrative investment destination, some of them stepped in along with the multinational companies eying on export business. A few rural branches also were added to their branch network. The biggest bank among them, ICICI Bank Ltd, obtained a small number of rural branches by the merger of Bank of Madurai Ltd and Sangli Bank Ltd. Axis Bank Ltd has recruited some agricultural graduates.

Lending through Self Help Groups:

As a result of the promotional efforts made by NABARD, India has the largest number of SHGs credit-linked by banking sector. Banks have accepted the inevitability of extending micro credit through SHGs as a cost-effective means of reaching out to the poor. Faced with the challenge of minimising the menace of non-performing assets, they are in search of lending avenues, where the probability of the emergence of NPA is very low. Though micro credit is not an attractive credit proposition, banks have been catering to the needs of the poorer sections of the society. They can ill afford to shut their doors to the rural customers, who would out-number their existing customers, if a proper atmosphere is created for them to do banking business. For reaching out to them, without sacrificing the financial viability norms, SHGs are found to be a reliable medium, where micro credit is involved. While the identification of credit needs and rationalization of the same is done by the groups themselves, peer pressure works as the collateral substitute for ensuring loan recovery. Procedural simplicity, assured repayments, availability of refinancing facilities and a sense of fulfillment of social obligation collectively make SHG-lending a good business strategy as well as business model for retail banking.

There are 25.05 lakh SHGs operating in India credit linked by banks and gramin banks, excluding those of cooperative banks. The banks have lent to them cumulatively Rs.16,488 crore as on March 2007. Among the SHGs, which have been in existence for longer periods, fatigue has set in as could be seen in the migration of members, duplication of membership and some of them becoming dormant. Though the Reserve Bank of India gets an assessment of their operations made occasionally, not much is known about their irregularities. One of the problems observed in a field study is the growing number of SHGs in some villages sponsored by different agencies leading to poaching of members. Politicalisation of SHGs also is slowly emerging as an undesirable issue. How long the SHGs should remain promoting micro credit disbursement? Can they ever hope to graduate into promoting micro-enterprises? This aspect needs the attention of policy makers.

Interest Rates: De-regulation and Beyond

From the beginning interest rates in the rural banking sector were meticulously regulated. There was a wide interest rate structure prescribed by the Reserve Bank of India both purpose-wise and size-wise for different lending operations. The rates were differentiated in favour

of smaller advances. Interest rates were different for lendings with and without refinance facility available.

The Differential Rate of Interest scheme introduced in 1972 was one the earliest experiments in micro credit. Banks were directed to lend at least 0.5 percent of their total advances to the poor at an interest rate of 4 percent. Later this limit was raised to one percent. The interest rate was fixed 2 percent lower than the then prevailing Bank Rate of 6 percent. The ceiling on advances under this scheme was fixed at Rs.6500. The beneficiaries were the poor from both rural and urban areas. It was stipulated that 66 percent of the total advances should be made to the eligible borrowers in the rural and semi-urban branches. Though this scheme has been in operation for over three decades, the flow of credit under it is unbelievably low. According to the latest data, there are 2.60 lakh borrowing accounts; the amount lent is Rs.634.46 crore accounting for 0.06 percent of the total credit as on March 2007. In the Union Budget of 2007-08, the scope of the scheme was widened raising the ceiling on loan from Rs.6,500 to Rs.15,000 and for housing from Rs.5000 to Rs.20,000. The interest rate however remains unchanged at 4 percent. Some increase in the disbursement is likely to take place as a result. DRI scheme has been a failure despite the fact that there was neither the funds constraint nor the dearth of the eligible poor.

With the implementation of the financial sector reforms, the interest rates are totally deregulated in the Indian banking sector. The wide range of the interest structure was reduced considerably. In the process, agricultural advances have lost the advantage of having softer interest rates. An anomaly that has crept in is the rate interest for purchasing power tiller has become costlier than that for purchasing a car. With the de-linking of the priority sectors and softer interest rate structure, rural borrowers have lost the preferential treatment, which they were getting earlier.

Micro finance and Mega bucks:

Many micro finance institutions (mFIs) have appeared on the scene, extending micro credit at very high interest rates. The major operational difference between the banks and mFIs is the rates of interest charged to the ultimate borrowers. While the Regulator has largely deregulated the interest rate structure, banks are not free to fix the interest rates on the loans given to SHGs. The mFIs, however, do not come under the purview of the Regulator at present. Though the Government of India is planning to bring out an act to regulate the functioning of mFIs, there appears to be strong reluctance on the part of the authors of the proposed act to prescribe a cap on interest rates. While the moneylender, crude in his dealings, is despised and disliked universally, the sophisticated mFIs are treated as the saviors of the poor. The Regulator's stand of non-interference in interest rate regulation would have very adverse impact on the poor borrowers in the area of micro credit.

Considering the insatiable demand for rural credit, the micro finance institutions perceive in micro credit, a lucrative business proposition, provided they are allowed to have a free hand. The monetary *pundits*, who were supporting the interest regimentation during the pre-financial sector reform period, now strongly plead for the interest rates to be decided by the market forces. The risk perception of mFIs' rural lending is very high; their cost of funds and management is quite high. Therefore, they should be allowed to charge the market-determined interest rate, it is argued. That the interest rate charged by mFI is lower than that charged by moneylender is not a sufficient justification for charging rates much higher than that charged by banks. The rude manner in which some of them have stepped up their recovery rate has created undue hardships to the debt-ridden poor farmers (Thingalaya 2006)

The Regulator cannot afford to be a silent spectator, when the poor borrowers are exploited by the mFIs. Secondly, the mFIs should voluntarily adopt a social audit to assess whether the interest rates charged by them are justified. While viability and reasonable margin of profit are fundamental prerequisites for financial institutions, encashing on the misery of the helpless borrowers has to be avoided. It may be noted that there are mFIs, whose interest rates are not higher than 12 percent. And they are viable and have strong bottom lines. The secret of their success is a very lean administrative set up, where the executive remuneration is not luxurious.

An Alternative Rural Banking Structure:

Commercial banks, it must be admitted, are the unwilling horses in the rural banking race. They have

been pushed into the turf and no doubt, they have run some distance. Rural business, as explained earlier, constitutes a very small percentage of their total business. Accordingly, the contribution of the rural branches to their total revenue may be very small. Manning the rural branches still continues for them to be a problem in staff deployment. Staff rotation being a common feature of the transfer policy, bank employees have to complete a stint in a rural branch in their service. Even the specialist officers in the areas like foreign exchange and computer also have to undergo this inconvenience at least once in their service.

The basic premise of the Narasimham Committee's approach to rural credit was, "The structure of rural credit will have to combine the local character of the RRBs and the resources, skills and organizational and managerial abilities of the commercial banks" (Thingalaya 2000). Taking a clue from this approach, an alternative rural credit structure is proposed. The proposition is: ***The total withdrawal of commercial banks from the rural areas, passing on their rural business to the gramin banks sponsored by them in each state. Banks not having gramin banks in the state, may hive off their rural business to any of the gramin banks operating in the state, based on logistics. Private sector banks, because of their insignificant rural presence, may have the option to continue or hive off the branches.*** Only two rural credit agencies - gramin banks and cooperative banks – may be able to function as the most suitable credit agencies in rural India from a long term perceptive.

This type of functional specialisation may be conducive for the development of both commercial banks and the rural credit agencies in the long run. It is not often recognized that the problem of Indian banking sector is more a problem of ***too many small branches handling too little business***. This can be observed from the details given in Annexure 3. The problem of handling very small volume of business distributed over large number of small branches has strong financial implications, adding to the cost of supervision and depressing the bottom line. ***About 42 percent of the branches - an over- whelmingly large number of them being in rural areas - handle only 3 percent of the total credit lent by the banking sector.*** The big banks have to review their core competence and avoid dissipating their energies in handling tiny credit in nondescript villages scattered across the country. There are others, who are capable of handling this business more efficiently without huge overheads. Commercial banks can sharpen their competitive skills to compete with the foreign banks, which are expected to make an inroad into Indian banking after March 2009. State Bank of India, the biggest bank in India has a network of 9567 branches, of which 3825 are rural branches. Compared to this, ICICI Bank, the new generation bank having been in existence for less than two decades has only 714 branches, whose rural component is only 75 branches. The younger bank, with its aggressive banking strategies is competing to become the number one bank. For the 150 year-old omnipresent bank, its rural branches are likely to be the speed-breakers in its race to maintain its position. ICICI Bank's net profit in FY 2008 was Rs.4158 crore, the second highest (next to State Bank's Rs.6729 crore), far ahead of all other bigger banks in India. One distinguishing feature of its operations is the very limited exposure of ICICI Bank to rural business, unlike the older banks. Exempting the public sector banks from handling rural business, therefore, would enable them to specialise in urban-oriented business more comfortably. Their area of operation would begin from the semi-urban areas to metropolitan centres all over the country.

Assets and liabilities of the ***rural branches*** of the public sector banks along with the staff could be merged with the gramin banks sponsored by them in the state. Since gramin banks have already been amalgamated at the state level, the addition of more rural branches would widen their rural reach. Their area of operation would be extended from the selected districts to the entire state. The problem of the stray branches, mentioned earlier, could be solved by their assimilation with the gramin banks. As the staff members of the "joining rural branches" have the experiences of handling different types of credit proposals, the process of

diversifying the credit pattern would be easily initiated. Staff assimilation should not pose a major problem as most of them come from the same language zones. With this change, the New Rural banks should be able to function like commercial banks, specialising in rural business.

The new generation banks of the private sector may be too glad to get rid of their rural business, given a choice. Excepting ICICIC Bank, other banks have less than 5 percent of their branches in rural business.

Supportive Actions Needed:

The over-simplified model of New Rural Banks suggested above requires many supportive actions to make it workable. The acceptance by the organized unions is needed for its smooth transformation. Unions may not oppose it totally, because after the amalgamation there cannot be any difference in the staff benefits like the pension scheme etc between the RRB staff and the bank staff. Unions, in fact, have been pleading for this uniformity since long.

The current pattern of capital ownership need not be changed, while recapitalisation may be necessary in many cases. The Reserve Bank of India has stipulated that the gramin banks have to disclose their capital adequacy ratios in their annual balance sheets from March 2008. Therefore, for securing the stipulated minimum capital adequacy ratio, additional capital may be infused wherever required. Since the sponsor banks and the New Rural Banks would not be competing with each other in future, because of functional specialisation, there is hardly any scope for conflict of interests. The umbilical chord therefore need not be cut. Parental guidance can be provided by the sponsor bank, treating the New Rural bank as an adult.

The new banks have to be treated as autonomous institutions, with their boards empowered to take all decisions. Professionalisation of the boards is imperative. Boards should have experts in rural development, agricultural scientists, chartered accountants, economists and retired bank executives, leaving no room for politicians of any hue.

NABARD, which has played a key role in rejuvenating the gramin banks, should be the sole controlling authority along with the sponsoring bank. The New Rural banks should not be made answerable to many masters, as is being done now. The Regional Rural Bank Act 1976 may have to be suitably amended wherever required.

The human resources of these banks have to be carefully nurtured and oriented to take up the task professionally. Recruitments should be broad-based to have specialists in agricultural science as well as in banking and finance. Well-defined career path for them should be adopted, the absence of which has been a regrettable deficiency so far. The senior executives have to be groomed from within the banks within a reasonable period. The New Rural banks' credit portfolio should accommodate any type of bankable credit proposal emanating from their operational area, in conformity with the prudential norms. Non-fund based business should find place in their business plans. Due importance has to be accorded to the generation of fee-based income by cross selling financial products.

There has to be a total transformation from its current image of a brick and mortar bank to a computer-savvy bank. Its future branch expansion should be of the branchless model, relying on the rural business correspondents using the simple electronic gadgets. A beginning in this direction has already been made by a few of the gramin banks. This has to be done on a greater scale for reducing the unit cost. Entering into collaborative efforts with the multi-national companies engaged in agri-business, like the e-choupal project of ITC Ltd should not be difficult for them. That will pave the way for their involvement in modern farming and thereby contributing to rural development.

Foot notes

1 For facilitating the brisk branch expansion process, the regulator had also streamlined the licensing procedure in the 70s. After the identification of unbanked rural centres by the lead banks, special meetings of bankers were held under the aegis of the Department of Banking Operations and Development at the state level. An officer from the regional offices of DBOD would also participate in the meeting, where the identified centres would be allotted to banks interested in opening their branches. Once the allocations are made, licences would be granted by the Reserve Bank without delay. Within a short time frame, banks were then expected to open the branches. I remember the experiences of attending one such meeting in Hyderabad, for the allotment of unbanked centres in Andhra Pradesh. In the prolonged meeting held in the crowded board room of State Bank of Hyderabad, there were about a dozen identified centres in Nellore district, which remained un-allotted. Unhappy with the task remaining incomplete, the senior executive from the central office literally shouted at the chairman of Pinakini Gramin Bank for not volunteering to opt for these centres. Meeting concluded with these centres being allotted to the gramin bank. Branches were opened by the bank in due course. It may also be added to the credit of public sector banks that hardly any rural branch was closed; some of them were relocated to better locations in the 90s.

2 There are 113 such rural branches in various states, as indicated in Annexure 2. It may be added that this data relate to 2002, the latest available data published by the Reserve Bank. To cite an example, Vijaya Bank has one rural branch each in Nagaland, Arunachala Pradesh and Manipur or Corporation Bank having single rural branch in Haryana and Gujarat. As administratively it is very difficult to supervise such isolated branches, they are likely to languish without making any tangible contribution to rural banking business. Being aware of this anomaly, the Reserve Bank had advised banks to swap such branches with the lead bank. However, little progress appears to have been made in this direction.

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Annexure 1.

Share of Rural Branches in the Total Branch Network:

Bank	Rural Branches (number)	Total Branches (number)	Share of Rural Branches (% age).
Nationalised Banks			
1. Punjab National Bank	1855	4178	44.4
2 Central Bank of India	1324	3324	39.8
3. Bank of India	1217	2845	42.8
4 Bank of Baroda	1090	2845	38.3
5.Allahabad Bank	947	2135	44.4
6 UCO Bank	755	1945	38.8
7 Union Bank of India	748	2324	32.2
8 .Canara Bank	723	2690	26.9
9 Syndicate Bank	647	2188	29.6
10. United Bank of India	613	1399	43.8
11 Bank of Maharashtra	515	1365	37.7
12 Indian Overseas Bank	535	1879	28.5
13 India Bank	458	1524	30.1
14.Dena Bank	348	1071	32.5
15 Punjab& Sind Bank	283	839	33.7
16.Vijaya .Bank	254	1053	24.1
17.Oriental Bank of Commerce	266	1344	19.8
18 Corporation Bank	180	964	18.7
19. IDBI Bank	53	500	10.6
State Bank Group			
1.State Bank of India	4015	10183	39.4
2.State Bank of Bikaner& Jaipur	288	847	34.0
3.State Bank of Hyderabad	257	992	25.9
4. State Bank of Patiala	259	802	32.3
5. State Bank of Mysore	207	650	31.8
6. State Bank of Saurashtra	135	459	29.4
7. State Bank of Indore	116	459	25.3
8.State Bank of Travancore	51	713	7.2
Private Sector Old Gen. Banks			
1.Jammu &Kashmir Bank Ltd	213	480	44.4
2.Bank of Rajasthan Ltd	99	458	21.6
3.Karnataka Bank Ltd	88	436	20.2
4.ING Vysya Bank Ltd	78	398	19.6
5.South Indian Bank Ltd	66	489	13.5
6.Tamilnad Mercantile Bank Ltd	49	201	24.4
7.Federal Bank Ltd	40	601	6.7
8.Lakshmi Vilas Bank Ltd	33	236	14.0
9.City Union Bank Ltd	31	182	17.0
10.Karur Vysya Bank Ltd	30	274	10.9
11.Ratnakar Bank Ltd	24	79	30.4
12.Dhanlakshmi Bank Ltd	21	181	11.6
13.Catholic Syrian Bank Ltd	17	346	4.9
14.Nainital Bank Ltd	19	87	21.8
Private Sector: New Gen Banks			
1.ICICI Bank Ltd	131	1249	10.5
2.HDFC Bank Ltd	31	745	4.2
3.Axis Bank Ltd	15	626	2.4
4. Kotak Mahindra Bank Ltd	11	180	6.1

Source: Report on Trend and Progress of Banking in India 2007-08, Reserve Bank of India

Annexure 2.

Stray Rural Branches in Different States

States	***Banks having Insignificant Rural Presence***
Andhra Pradesh	Allahabad Bank 4; Dena Bank 1
Arunachala Pradesh	UCO Bank 1:United Bank of India 1; Vijaya Bank 1
Assam	Bank of India 4; Canara Bank 4; Syndicate Bank 1
Bihar	nil
Chhattisgarh	Bank of India 3; Indian Bank 2
Goa	St. Bank of Mysore 1;Indian Bank 1; UCO Bank 1
Gujarat	Allahabad Bank 1;OBC 1; Corp. Bank 1
Haryana	Corp Bank 1; Dena 2; Indian Bank 3.
Himachal Pradesh	nil
Jammu & Kashmir	CBI 2; OBC 2; Union Bank of India 1.
Jharkhand	Indian Bank 1; Dena 2; Syndicate 3.
Karnataka	Indian Bank 4; Allahabad Bank 1; UCO Bank 4.
Kerala	OBC 1; PNB 1; BOB 3.
Madhya Pradesh	Indian Bank 1; OBC 1; IOB 1.
Maharashtra	St .Bank of Indore 1; Vijaya Bank 3.
Manipur	PNB 1; BOB 2; Vijaya Bank 1..
Meghalaya	Indian Bank 1; United Bank of India 1; BOB 2.
Mizoram	nil
Nagaland	Allahabad Bank 2; Vijaya Bank 1.
Orissa	nil
Puducherry	UCO Bank 3; State Bank of India 3.
Punjab	nil
Rajastan	Dena Bank 1; IOB 2; Vijaya Bank 2.
Sikkim	UCO Bank 1; United Bank of India 3.
Tamil Nadu	Dena Bank 1; St. BH 1; Allahabad Bank 2.
Tripura	Central Bank of India 1; UCO Bank 1.
Uttar Pradesh	State Bank of Patiala 3.
Uttarakhand	BOI 1; IOB 4; Allahabad Bank 3.
West Bengal	Andhra Bank 1; PSB 1; Vijaya Bank 2.

Source: Complied from **Branch Banking Statistics, March 2002, Reserve Bank of India, 2003, Mumbai**

Annexure 3.

Retail Outlets handling too little Business: June 2008

Branch Size *(measured by credit)*	**Branches** *(number)*	**Deposits** *(Rs. crore)*	**Credit** *(Rs.crore)*
Up to Rs.1 crore	6,389 (8.4)	1,00,740 (3.1)	2,367 (0.1)
Rs.1 crore to Rs5 crore	25,669 (33.8)	2,87,775 (9.7)	73,857 (.3.0)
Rs5 crore to Rs.10 crore	170,37 (22.4)	3,83,713 (11.7)	1,22,455 (5.0)
Total	**49,095** **(64.6)**	**7,72,208** **(24.5)**	**1.98,679** **(8.1)**

(Figures in bracket indicate the percentage share in the total)

Source: Compiled from Banking Statistics- Quarterly Handout, June 2008 Reserve Bank of India, 2008, Mumbai.